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SEC Proposes Long-Awaited Climate-Related Disclosure Rules

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On March 21, 2022, the Securities and Exchange Commission (the "Commission") proposed its long-anticipated climate-related disclosure rules that would require public companies to make disclosures of greenhouse gas ("GHG") emissions and climate-related risks that are reasonably likely to have a material impact on their business, results of operations or financial condition in their registration statements and annual reports. Public companies currently disclose varying degrees of climate-related information utilizing disclosure frameworks developed by standard-setters, investor demands and other groups. In response to climate-related attention and investor focus, the Commission has proposed *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (the "Proposed Rules"), which would require public companies to provide disclosures on a "common set of qualitative and quantitative climate-related disclosure topics in their filings" to provide "consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments."

In an effort to standardize the methodologies companies apply in disclosing climate-related information, the Proposed Rules incorporate certain concepts and vocabulary of the climate-related reporting framework established by the Task Force on Climate-Related Financial Disclosures ("TCFD") and the accounting and reporting standards for GHG emissions in accordance with the Greenhouse Gas Protocol ("GHG Protocol"). Under the Proposed Rules, public companies would be required to disclose emissions that occur from the sources owned or controlled by the company (Scope 1) and emissions resulting from the generation of electricity (or other sources of power) purchased and consumed by the company (Scope 2) and, in certain circumstances, all other indirect emissions in the company's value chain, upstream and downstream (Scope 3). The Proposed Rules would require companies to disclose Scope 1 and Scope 2 emissions for their most recently completed fiscal year (along with GHG emissions for the historical fiscal years included in consolidated financial statements), together with a description of the methodologies, significant inputs and significant assumptions used to calculate such emissions. Given that public companies and investors have gravitated towards the TCFD framework and the GHG Protocol, the Commission sought to incorporate many of their concepts and vocabulary into the Proposed Rules to mitigate the compliance burden for companies and reduce the burdens encountered by investors in analyzing and comparing disclosures.

The Commission has proposed to add (1) a new Subpart 1500 to Regulation S-K that would require a company to disclose certain climate-related information and GHG emissions metrics that could help investors assess the climate-related risks and (2) a new Article 14 to Regulation S-X that would require certain climate-related financial statement metrics and related disclosure to be included in a note to a company's audited financial statements. The new Subpart 1500 and Article 14 would require five general categories of disclosure:

- Climate-related risks and impacts on the registrant's business, strategy and outlook;
- Governance of climate-related risks and relevant risk management processes;
- GHG emissions metrics;
    - Scope 1 and Scope 2 emissions, separately disclosed, in absolute terms, irrespective of materiality:

        - disaggregated by constituent greenhouse gases and in the aggregate; and
        - in terms of intensity by reference to revenue and production unit;
    - Scope 3 emissions and intensity, if material, or if the company has set a reduction target or goal that includes Scope 3 emissions;
- Climate-related financial statement metrics and related footnote disclosures in the registrant's audited financial statements; and
- Climate-related targets and goals, and transition plan, if any.

The Proposed Rules would require accelerated filers and large accelerated filers to include an attestation report with respect to Scope 1 and Scope 2 emissions disclosures. During the transition period, companies would be required to obtain an attestation report at a "limited assurance" level. Following the transition period, the attestation report must be provided at the "reasonable assurance" level, the same assurance level required with respect to the audited financial statements.

Notably, there are certain accommodations provided under the Proposed Rules. First, there is a scaled phase-in schedule for the disclosure requirements based on filer status and scope of emissions, with Scope 1 and Scope 2 first. Second, with respect to reporting of Scope 3 emissions, the Proposed Rules include an additional year of phase-in period, a "good faith" safe harbor from liability and a general exemption for smaller reporting companies. Nonetheless, if the Proposed Rules become final in their current form, many companies will face increased compliance costs (e.g., attestation reports), heightened potential liability exposure and meaningful changes in oversight.

Public Comments must be delivered to the Commission on or before the later of thirty days after the date of publication in the Federal Register and May 20, 2022.

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QUESTIONS & ANSWERS

What is the goal of the Commission with respect to the proposed climate change disclosures?

The Commission wants public companies to provide consistent, comparable and reliable disclosures on material climate-related risks to provide investors with information to make informed investment or voting decisions in line with risk preferences. Given the voluntary nature of existing third-party climate disclosure frameworks and the various locations where public disclosures are made (e.g., sustainability reports, company websites and Commission filings), the Commission has proposed a uniform framework that would result in consistent disclosures of information and data with respect to actual or potential negative impacts of climate-related conditions and events, as well as climate-related opportunities, on a company's business operations, financial operations or value chains. In addition, the Commission stated that definitive disclosure requirements would both promote efficient valuation of securities and capital formation and foster competition as a result of more transparency and comparability.

What types of deficiencies has the Commission identified in existing disclosures?

After reviewing various studies of climate-related disclosures under different third-party frameworks, the Commission found considerable variation across companies and industries with respect to the depth and sufficiency of disclosures. At the same time, the Commission staff noted that significantly more extensive information is located in sustainability reports and on corporate websites than in Commission filings. In particular:

- Not all companies include information necessary to understand their climate change disclosures, such as methodologies, data sources, assumptions and other key parameters;
- The voluntary nature of climate change disclosures allows for inconsistencies across reporting periods, hindering comparability;
- Climate change disclosures that are separate from financial reporting make it difficult to determine whether the disclosures are consistent with the information located in financial statements; and
- Climate change disclosures that are provided outside of Commission filings may be inconsistent or unreliable and are not subject to the same liability standard as that in Commission filings.

Did the Commission adopt any particular framework for climate change disclosures?

The Commission has modeled its disclosure framework in part on the TCFD and in part on the GHG accounting and reporting standards set forth in the GHG Protocol, in effect standardizing company disclosures by creating a uniform methodology for disclosing climate-related information.

TCFD. The TCFD framework establishes eleven disclosure topics related to four core themes that provide a structure for the assessment, management and disclosure of climate-related financial risks: governance, strategy, risk management and metrics and targets. The Commission chose the TCFD framework because it has been widely adopted both in the United States and globally and the Commission determined that by aligning disclosures with the TCFD framework, the Commission could potentially facilitate higher levels of consistency and comparability of the disclosures. The Commission noted that public companies and investors have largely adopted the TCFD climate-related reporting framework and TCFD recommendations have been incorporated into other

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voluntary climate disclosure frameworks, such as the CDP (formerly the Carbon Disclosure Project), Global Reporting Initiative ("GRI"), Climate Disclosure Standards Board ("CDSB") and the Value Reporting Foundation (formed through a merger of the Sustainability Accounting Standards Board ("SASB")) frameworks.

GHG Protocol. The proposed disclosure rules on greenhouse gas emissions are based primarily on the GHG Protocol's Corporate Accounting and Reporting Standard. This standard provides methods to measure and report risk on seven greenhouse gases and introduces the concept of Scope 1, Scope 2 and Scope 3 emissions. The GHG Protocol has become the generally accepted standard for accounting and reporting GHG emissions and has been broadly incorporated into existing sustainability reporting frameworks, such as the TCFD, Value Reporting Foundation, GRI and CDP.

Can you provide an overview of the requirements in the Proposed Rules?

The Proposed Rules would require that climate-related disclosures be included in Commission filings as opposed to disclosures in sustainability reports or on corporate websites. In addition, the Proposed Rules would require:

- Climate-related disclosure in registration statements and annual reports in a separate, captioned item "Climate-Related Disclosure";
- Certain climate-related financial statement metrics and related disclosure in a footnote to the company's audited financial statements;
- Narrative and quantitative climate-related disclosures to be electronically tagged in Inline XBRL; and
- An attestation report covering Scope 1 and Scope 2 emissions as well as disclosures about the service provided (the attestation report would be required only with respect to accelerated filers and large accelerated filers).

Generally, the registrant may incorporate by reference disclosure from other parts of the registration statement or annual report (e.g., Risk Factors, MD&A, or the financial statements) into the Climate-Related Disclosure section.

Do the Proposed Rules contemplate different mandatory disclosures based on a company's industry?

No. However, each company will be required to assess climate-related risks based on its own unique facts and circumstances, and we would expect that the types of disclosures made by an oil and gas company would be considerably different than a software company's disclosures. Further, the fact that companies will only be required to disclose material Scope 3 emissions may result in disclosures that vary considerably among industries.

PROPOSED DISCLOSURE REQUIREMENTS

Below is a brief summary of the proposed disclosure requirements.

What are the general categories of climate-related disclosures that would be required?

- Material climate-related impacts on the company's strategy, business model and outlook;
- GHG emissions metrics;

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- Climate-related targets and goals, if any;
- Disaggregated climate-related financial statement metrics including the financial impact metrics, expenditure metrics and financial estimates and assumptions;
- Climate-related risk management; and
- Governance of climate-related risks.

What types of climate-related risks would a company be required to disclose in connection with climate-related risk management?

The Proposed Rules include definitions of several terms, including "climate-related risks", "physical risks", and "transition risks".

- Climate-related risks, comprised of physical risks and transition risks, include the actual and potential negative impacts of climate-related conditions and events on a company's consolidated financial statements, business operations or value chains, as a whole:
  - Physical risks include both acute and chronic risks to a company's business operations or the operations of those with whom it does business, including:
    - acute risks, such as those arising from severe weather events, hurricanes, tornadoes and heatwaves; and
    - chronic risks, generally longer-term in nature, such as drought, sustained high temperatures and decreased availability of fresh water; and
  - Transition risks include changes resulting from a potential transition to lower carbon, including risks around regulatory changes, climate-related litigation, changes in customer preferences and reputational impact.

Companies would also be required to describe any processes for identifying, assessing and managing climate-related risks, including whether the company has a "transition plan" or strategy and implementation plan to reduce climate-related risks. An example of a transition plan is a plan to reduce GHG emissions in line with a quantitative commitment.

What governance disclosures would be required?

The Proposed Rules would require the disclosure of certain information with respect to board of director oversight of climate-related risks and management's role in assessing and managing those risks. Specifically, the Proposed Rules would require the disclosure of:

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Board

- Board members or board committees responsible for the oversight of climate-related risks, including a description of such board members' expertise in climate-related risks;
- The processes for informing the board members of climate-related risks and the frequency of board or committee discussions of climate-related risks;
- Whether and how the board or board committee considers climate-related risks as part of the company's business strategy, risk management and financial oversight; and
- Whether and how the board establishes climate-related targets or goals and how the board monitors the progress of those targets or goals.

Management

- If management positions or committees are responsible for assessing and managing climate-related risks, detailed descriptions of the relevant expertise of such individuals;
- The processes and procedures by which information regarding climate-related risks is assessed and delivered to management; and
- The extent and frequency with which management or committees report to the board or board committee on climate-related risks.

What types of disclosures would be required with respect to the impact of climate-related risks?

Companies would be required to disclose the impacts of climate-related risks on:

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

In particular, if a company uses carbon offsets or renewable energy credits or certificates ("RECs"), the Proposed Rules would require the disclosure of the role that these items play in the company's climate-related business strategy. The Proposed Rules include a definition for RECs. Companies would also be required to disclose an internal carbon price if used.

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What types of disclosures on GHG emissions would be required?

Companies would be required to disclose information on GHG emissions for their most recently completed fiscal year and for the historical fiscal years included in the consolidated financial statements in the relevant Commission filing, to the extent reasonably available, as summarized below:

- For all registrants, Scope 1 and Scope 2 emissions are required. For registrants other than smaller reporting companies, Scope 3 emissions are required for the fiscal year if those emissions are material or if the registrant has established a GHG emissions reduction target or goal that includes its Scope 3 emissions;
    - The total Scope 1 emissions must be disclosed separately from the total Scope 2 emissions after calculating each scope from all sources that are included in the company's organizational boundaries (boundaries that determine the operations owned or controlled by the company for the purpose of calculating its GHG emissions) and operational boundaries (boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by the company);
    - For each of the Scopes 1, 2 and 3 (if required) emissions, the aggregate emissions must be disclosed, as well as the emissions disaggregated by type of constituent greenhouse gas (carbon dioxide, methane, nitrous oxide, nitrogen trifluoride, hydrofluorocarbons, perfluorocarbons and sulfur hexafluoride); and
    - GHG emissions would be disclosed in gross terms, excluding any use of purchased or generated offsets;
- GHG emissions would be expressed in terms of carbon dioxide equivalent ("CO2e");
- GHG intensity for each of the Scopes 1, 2 and 3 (if required) must be disclosed in terms of metric tons of CO2e per unit of total revenue and per unit of production for the fiscal year; and
- A description of the methodologies, significant inputs and significant assumptions used to calculate GHG emissions metrics.

When should Scope 3 emissions be considered material?

Companies should first consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions. The Commission did not propose a bright line test but noted that some companies use a 40% threshold. However, even if Scope 3 emissions do not make up a significant portion of overall GHG emissions, companies should consider whether Scope 3 emissions, even in relatively small amounts, are material when there is a substantial likelihood that a reasonable investor would consider it important. For example, the Proposed Rules note that investors can use an automobile manufacturer's Scope 3 emissions with respect to automobiles sold to assess whether the company is taking steps to mitigate or adapt to the risks posed by a transition to lower emission vehicles.

Notably, the Commission acknowledged that determination and disclosure of Scope 3 emissions will likely present challenges for companies and, in response, proposed the following accommodations:

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- A safe harbor for Scope 3 emissions disclosures from certain forms of liability;
- An exemption for smaller reporting companies; and
- A delayed compliance date for Scope 3 emissions disclosures.

The Commission also noted that the Securities Act Rule 409 and the Exchange Act Rule 12b-21, which provide accommodations for information that is unknown and not reasonably available, would be available for the proposed Scope 3 emissions disclosures.

What kind of attestation report is required for climate-related disclosures?

The Proposed Rules would require accelerated filers and large accelerated filers (including foreign private issuers) to include an attestation report providing:

- Limited assurance for Scope 1 and Scope 2 emissions disclosures that will scale up to reasonable assurance after a specified transition period;
- Minimum qualifications and independence requirements for the attestation service provider; and
- Minimum requirements for the accompanying attestation report.

"Limited assurance" would require that the service provider express a conclusion about whether it is aware of any material modifications that should be made to the subject matter in order for it to be fairly stated or in accordance with the relevant criteria (expressed in the form of a negative assurance). For "reasonable assurance," which is the same level as that provided in an audit of a company's financial statements, the service provider must express an opinion on whether the subject matter is in accordance with the relevant criteria in all material respects—providing positive assurance that the subject matter is free from material misstatement.

The Commission determined that by proposing minimum standards for the attestation, the Proposed Rules would improve the accuracy and consistency of reporting GHG emissions and provide investors with an enhanced level of reliability with respect to such disclosures. While many companies have already engaged third parties to provide some type of assurance or verification on climate-related disclosures, if adopted in the final rules, we expect this requirement to be controversial for many.

What type of disclosure would be required for climate-related targets and goals?

If a company has set any climate-related targets or goals, the Proposed Rules would require a description of the following:

- The scope of activities and emissions included in the target;
- The unit of measurement, including whether the target is absolute or intensity based;
- The defined time horizon by which the target is intended to be achieved and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy or organization;

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- The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
- Any interim targets set by the company; and
- How the company intends to meet its climate-related targets or goals.

What would public companies have to include in their audited financial statements on climate change?

The Proposed Rules would require certain metrics, including disaggregated climate-related impacts, on existing financial statement line items as well as a disclosure in a note to the audited financial statements. These metrics would be subject to audit by the company's independent registered public accounting firm and come within the scope of the company's internal control over financial reporting.

The required disclosure would fall into three categories:

- Financial impact metrics;
- Expenditure metrics; and
- Financial estimates and assumptions.

Financial impact metrics, with respect to specific line items in the financial statements, would require the disclosure of the impact of severe weather events and other natural conditions and transition activities as well as the impact from any climate-related risks identified by the company. The Proposed Rules include further details including determining whether the impacts would trigger the disclosure threshold requirements. Examples include changes to revenue or costs from disruptions to business operations or supply chains as well as changes to total expected insured losses due to flooding or wildfire patterns.

Expenditure metrics refer to the positive and negative impacts associated with climate-related events, transition activities and identified climate-related risks used in determining financial impact metrics. The Proposed Rules would require, among other disclosures, companies to separately disclose amounts of (i) expenditure expenses and (ii) capitalized costs incurred during the fiscal years presented. These disclosures would also be subject to specified thresholds.

The Proposed Rules would also require disclosure regarding whether the estimates and assumptions used to produce the financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events.

OTHER ITEMS IMPORTANT TO CONSIDER WITH RESPECT TO THE DISCLOSURE REQUIREMENTS

What liability would companies be subject to with respect to climate change disclosures?

Under the Proposed Rules, climate-related disclosures would be treated like other disclosures in SEC filings that are filed (not "furnished") with the Commission and therefore would be subject to the same liability. The Commission has proposed to treat the climate-related disclosures required under the Proposed Rules as "filed".

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As a result, such disclosures would subject the disclosing company to potential liability under Exchange Act Section 11 (if included in or incorporated by reference into a Securities Act registration statement) and Section 18. Notably, except for fraudulent statements, the Proposed Rules include a safe harbor for the disclosure of Scope 3 emissions from certain forms of liability under the federal securities laws. Under the safe harbor, disclosure of Scope 3 emissions would be deemed not to be a fraudulent statement unless it could be shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

The Proposed Rules would require the registrant to make certain forward-looking disclosures, regarding impacts on its business strategy, financial planning, and capital allocation. For example, a registrant may disclose how it intends to achieve its climate-related targets or a registrant may disclose internal carbon price, which would necessarily include assumptions about future events. Additionally, registrants may adopt a transition plan to mitigate or adapt to climate-related risks as a part of its risk management strategy, which requires judgements and predictions about the future. Statements about the registrant's climate-related targets or goals would not be construed as promises or guarantees. To the extent that information regarding a registrant's climate-related targets or goals would constitute a forward-looking statement, existing safe harbors under the Private Securities Litigation Reform Act (the "PSLRA") would apply. However, it is important to note that the safe harbors afforded by the PSLRA do not apply to all forward-looking statements, including those for initial public offerings, and forward-looking statements made in connection with initial public offerings. Additionally, the protections afforded under the PSLRA do not foreclose the Commission from bringing an enforcement action.

When would compliance be required if the Proposed Rules become final in their current form?

The Proposed Rules include a phase-in period for all companies, with the compliance date dependent on the company's filer status. Large accelerated filers have one year from the compliance date to disclose Scope 1 and Scope 2 emissions in annual reports. Accelerated filers and non-accelerated filers have two years from the compliance date to disclose emissions data and smaller reporting companies have three years to comply. Companies subject to the proposed Scope 3 disclosure requirements would have one additional year to make the disclosures. There is also a phase-in period for accelerated filers and large accelerated filers with respect to the assurance standard required in the attestation report. Assuming an effective date of the Proposed Rules in December 2022, set forth below are the phase-in periods for compliance with the disclosure requirements, as so proposed:

Filer Type	All Proposed Disclosures (including Scope 1 and 2 but excluding Scope 3)	Scope 3
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
Smaller Reporting Company	Fiscal Year 2025 (filed in 2026)	Exempted

The Proposed Rules provide that only large accelerated filers and accelerated filers are subject to an attestation requirement, covering Scope 1 and Scope 2 emissions. Smaller reporting companies are exempt from the attestation requirement. Assuming an effective date of the Proposed Rules in December 2022, set forth below are the phase-in periods for compliance with the minimum assurance level, as so proposed:

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Filer Type	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)
Smaller Reporting Company	Exempted	Exempted

What exemptions would smaller reporting companies have under the Proposed Rules?

The Proposed Rules exempt smaller reporting companies from the Scope 3 emissions disclosure requirement. In addition, smaller reporting companies that are also non-accelerated filers would be exempt from the attestation requirement covering Scope 1 and Scope 2 emissions. We expect the final rules will provide clarity as to whether a registrant who is both a smaller reporting company and an accelerated filer would be subject to the attestation requirement.

What should be included in any comments to the Proposed Rules?

The Commission has requested comment on all aspects of its economic analysis, alternative approaches to the Proposed Rules and the potential or associated costs and benefits (including empirical data, estimation methodologies and other information supporting the comment) with respect to the foregoing. To guide commentors, the Commission listed numerous questions in the “Request for Comment” section of the Proposed Rules for which it is seeking commentary, including with respect to the costs of disclosing Scope 1, Scope 2 and Scope 3 emissions and the costs of limited assurance and reasonable assurance for such disclosures.

The Proposed Rules can be found **here**.

For further information or if you would like assistance in providing comments to the Proposed Rules, please contact a member of the Haynes Boone Capital Markets and Securities Practice Group.

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