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SUMMARY OF AND CONSIDERATIONS REGARDING THE SEC'S PROPOSED RULES ON CLIMATE CHANGE DISCLOSURE

To Our Clients and Friends:

This client alert provides an overview of, and our current perspectives on, the SEC's recently proposed rules that would establish a new climate change reporting framework for U.S. public companies and foreign private issuers as well as practical recommendations on what companies should be doing now.

I. Overview

On March 21, 2022, the Securities and Exchange Commission (the "SEC" or "Commission") proposed rules for climate change disclosure requirements for both U.S. public companies and foreign private issuers. The SEC posted a 500+ page Proposing Release (the "Proposing Release") and issued a Press Release and a Fact Sheet summarizing notable provisions.

These disclosure requirements are mostly prescriptive rather than principles-based, and in many respects are derived from the Taskforce on Climate-related Financial Disclosures ("TCFD") reporting framework and the Greenhouse Gas Protocol. The requirements would apply to annual reports on Forms 10-K and 20-F, with material changes to be reported quarterly on Form 10-Q. These requirements would also apply to IPO, spin-off and merger registration statements. Rather than creating a new stand-alone reporting form, as some corporate commenters had urged, the Commission has proposed amending Regulation S-K and Regulation S-X to create a climate change reporting framework within existing Securities Act and Exchange Act forms.

The proposed climate change reporting framework is extensive and detailed. For example, the text of the proposed Regulation S-K climate change reporting requirements comprise approximately 50% more words than the part of Regulation S-K requiring large public companies to describe their Business. In most cases where the proposed rules call for disclosure, the level of specificity and detail called for is virtually unprecedented in the SEC's public company reporting rules.

Given the breadth and specificity of the proposed climate change reporting framework, compliance costs are expected to be significant. It is difficult to reasonably estimate the incremental costs of compliance given the absence of precedent for such disclosures. The Commission estimates that annual direct costs to comply with the proposed rules (including both internal and external resources) would range from $490,000 (smaller reporting companies) to

$640,000 (non-smaller reporting companies) in the first year and $420,000 to $530,000 in subsequent years.[1] In terms of the additional workload that would be necessary to prepare an annual report on Form 10-K, the Commission estimates this would be approximately 3,400 to 4,400 hours in the first year and 2,900 to 3,700 hours in years 2-6.[2] While these estimates appear to include the incremental costs associated with the third-party attestation requirements, these estimates assume that companies already have the necessary internal personnel to support compliance and do not include transaction costs associated with hiring additional personnel or of implementing new processes, controls and procedures to satisfy the extensive reporting obligations.

The proposed rules would phase in over time, based on a company's filer status.

II. Background

The SEC's rule proposal comes amidst a backdrop of increasing focus on climate change by the investment community in recent years and follows on the heels of several initiatives and announcements throughout 2021 that signaled the Commission's growing resolve to take action on the topic of climate change disclosure. The Commission had been mostly silent on these disclosure issues since its issuance of principles-based climate change disclosure guidance in 2010.[3]

- ***Request for public comment.*** In March 2021, in an effort to determine how and whether the Commission should further regulate the disclosure of this information, the Commission's then-Acting Chair, Allison Herren Lee, requested public input regarding the need for climate change disclosure requirements.[4] This solicitation generated 600 unique responses from a wide range of individuals, organizations, and institutions.[5] Proponents of additional climate-related disclosure supported their position with arguments that "climate change poses significant financial risks to registrants and investors," and that "current disclosure practice[s have] not produced consistent, comparable, reliable information for investors and their advisors."[6] Advocates opposed to additional climate-related disclosure argued that the existing principles-based disclosure framework under the securities laws, including the 2010 Climate Change Guidance, adequately provided for disclosure of climate-related risk when material.

- ***ESG Task Force.*** Also in March 2021, the SEC established a Climate and Environmental, Social, and Governance Task Force (the "ESG Task Force") within the Commission's Division of Enforcement. The initial focus of this task force was to "identify any material gaps or misstatements in issuers' disclosure of climate risks under existing [Commission]

1 *See* the Proposing Release, p. 386.
2 *See* the Proposing Release, p. 450.
3 *See* Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (Feb. 2, 2010) (the "2010 Climate Change Guidance"), https://www.sec.gov/rules/interp/2010/33-9106.pdf.
4 *See* Acting Chair Allison Herren Lee, "Public Input Welcomed on Climate Change Disclosures" (Mar. 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.
5 *See* the Proposing Release, p. 19.
6 *Id.*, pp. 19-20

rules."[7] We are not yet aware of any publicly announced climate-related enforcement actions initiated by the ESG Task Force.

- ***Announced rulemaking priorities.*** In May 2021, shortly after his confirmation, SEC Chair Gary Gensler announced that information about climate risk "is one of my top priorities and will be an early focus during my tenure at the SEC."[8] In June of that year, climate change disclosure rulemaking appeared on the SEC's Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions ("Reg-Flex Agenda").[9]

- ***Wave of climate change comment letters.*** In the Summer and Fall of 2021, the Commission's Division of Corporation Finance issued comment letters to dozens of companies on their fiscal 2020 Form 10-Ks relating exclusively to climate change disclosure issues. The comments, which were issued by a variety of the Division's industry review groups, appeared to be based on the 2010 Climate Change Guidance.[10] In contrast, between 2010 and 2020, the SEC issued relatively few climate change-related comments.[11]

Chair Gensler had intended to propose climate change rules by the end of 2021, but the timing was reportedly delayed due to ongoing internal debate at the Commission on the scope of the proposed rules and continued refinement of the rule proposal.[12]

III. Summary of Proposed Reg. S-K Amendments

A. Overview

The proposed climate change disclosure requirements would amend Regulation S-K to require a new, separately captioned "Climate-Related Disclosure" section in applicable SEC filings, which would cover a range of climate-related information. In order to avoid duplicative disclosure, companies would have the flexibility to incorporate by reference into the new section relevant information included elsewhere in the document (*e.g.*, Risk Factors, MD&A), subject to compliance with the SEC's general rules on incorporation by reference.[13] The proposed

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7 *See* SEC Announces Enforcement Task Force Focused on Climate and ESG Issues, Press Release 2021-42 (Mar. 4, 2021), https://www.sec.gov/news/press-release/2021-42.

8 *See* Gensler Says Climate Disclosure Rules Among "Top Priorities," Law360 (May 13, 2021), https://www.law360.com/articles/1384626.

9 *See* SEC Announces Annual Regulatory Agenda, Press Release 2021-99 (June 11, 2021), https://www.sec.gov/news/press-release/2021-99.

10 *See* SEC Staff Scrutiny of Climate Change Disclosures Has Arrived: What to Expect and How to Respond, Gibson, Dunn & Crutcher (Sep. 19, 2021), https://www.securitiesregulationmonitor.com/Lists/Posts/Post.aspx?ID=446. *See* also Sample Letter to Companies Regarding Climate Change Disclosures, (Last Modified Sept. 22, 2021), https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.

11 Based on Gibson Dunn's review of the Intelligize database for the relevant time period.

12 *See* SEC Bogs Down on Climate Rule, Handing White House Fresh Setback, Robert Schmidt and Benjamin Bain, Bloomberg Green (Feb. 8, 2022), https://www.bloomberg.com/news/articles/2022-02-08/sec-bogs-down-on-climate-rule-saddling-biden-team-with-new-woe.

13 *See* the Proposing Release, p. 54.

disclosure requirements, which would be housed in new subpart 1500 of Regulation S-K and are discussed in more detail in the following sections, include:

- ***Risks.*** How any climate-related risks have had or are reasonably likely to have material impacts on a company's business or consolidated financial statements.

- ***Impact on the company.*** How any climate-related risks have affected or are reasonably likely to affect a company's strategy, business model and outlook.

- ***Risk management/oversight process.*** Processes for identifying, assessing and managing climate-related risks, as well as board governance of climate-related risks and relevant risk management processes.

- ***GHG emissions.*** Greenhouse gas ("GHG") emissions metrics, which would include:

    - Scope 1 and Scope 2, which, for accelerated and large accelerated filers only, would be subject to assurance by an independent GHG emissions attestation provider.

    - For certain filers, Scope 3, but only if material or if the company has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.

- ***Targets/goals.*** Information regarding climate-related targets, goals, and transition plans, if any.

B. Climate-Related Risks

Proposed Item 1502 of Reg. S-K would require companies to describe "climate-related risks reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term." The detailed disclosures would include:

- ***Categorization of each risk*** as either a "physical risk" (*i.e.*, related to the physical impacts of climate change, such as hurricanes, wildfires, floods) or "transition risk" (*i.e.*, related to the transition to a lower-carbon economy).

- ***For physical risks,*** the nature of the risk, including whether it is acute (*i.e.*, short-term or event-driven) or chronic (*i.e.*, related to longer-term weather patterns); the location (by ZIP code or, for regions without ZIP codes, a similar subnational postal zone or geographic location) and nature of the properties/operations subject to the risk; and, to the extent the risk concerns flooding or drought conditions, additional information about the size/amount and location of assets.

- ***For transition risks,*** the nature of the risk, including whether it relates to regulatory, technological, market (including changing consumer, business counterparty, and investor preferences), liability, reputational or other transition-related factors, and how those factors impact the company.

A couple of aspects of the proposed rules would impact how companies assess the potential materiality of climate-related risks. First, companies would be required to consider various time horizons (short-, medium- and long-term). The proposed rules would provide flexibility for companies to determine how they define these time horizons, but companies would be required to disclose this determination as well as information about how such determination ties to the expected useful life of assets and climate-related planning processes and goals. Second, based on the proposed rules' definition of "climate-related risks," companies would need to consider not only the direct impacts of climate change on their financial statements and business, but also the indirect impacts on their "value chains" (*i.e.*, upstream and downstream activities related to the company's operations). This would encompass supply chain activities as well as product distribution and end use.

While the prescriptive requirements are largely focused on climate-related risks, the proposed rules make clear that companies also are permitted, but not required, to provide corresponding information about climate-related opportunities.

C. Climate-Related Impacts on Strategy, Business Model & Outlook

Proposed Item 1502 of Reg. S-K would also require companies to describe "the actual and potential impacts of any [identified] climate-related risks … on the registrant's strategy, business model, and outlook." The detailed disclosures would include:

- ***Nature of the impact,*** including on business operations (by type and location), products or services, value chain, activities to mitigate or adapt to climate-related risks, R&D expenditures and any other "significant changes or impacts."

- ***Time horizon for each impact,*** *i.e.*, short-, medium- or long-term.

- ***How each impact is integrated into the company's business model and outlook,*** including with respect to strategy planning, financial planning, capital allocation and resources used for risk mitigation.

- ***How identified climate change metrics and targets are integrated into the business model and strategy,*** including the role of any carbon offsets or renewable energy credits or certificates ("RECs") that the company utilizes.

- ***Financial statement impact,*** including whether and how identified climate-related risks have affected or are reasonably likely to affect the financial statements and considering any climate-related metrics required to be disclosed in the financials under the proposed rules (as discussed below).

- ***Business strategy resilience in light of potential changes in climate-related risks,*** on both a qualitative and quantitative basis and including any analytical tools used by the company to assess the impact of climate-related risks and support resiliency. Companies that use scenario analysis (*i.e.*, a process for identifying and assessing a potential range of outcomes under various possible future climate scenarios, such as global surface temperature rise of 2 degrees Celsius above pre-industrial levels) would be required to disclose the specific scenarios considered along with parameters, assumptions, analytical choices and projected financial impacts under each scenario.

In addition to the above, for companies that have set an internal price on carbon (*i.e.*, an estimate of the cost of carbon emissions for planning purposes), the proposed rules would require detailed disclosure about the price per unit and total price used, how the total price is estimated to change over time, calculation methodology, rationale for selecting the price used, and how the company uses that information to evaluate and manage climate-related risks. If the company uses more than one internal carbon price (*i.e.*, for planning under various scenarios), then it would be required to provide disclosures for each price.

D. Climate-Related Risk Oversight & Management

Proposed Item 1501 of Reg. S-K would require companies to describe "the [board's] oversight of climate-related risks" and "management's role in assessing and managing climate-related risks." The detailed disclosures would include:

- ***With respect to the board's role,*** who, if any, on the board is responsible for climate risk oversight (*e.g.*, full board, board committee, certain directors), whether any directors have "expertise in climate-related risks" (including supporting information to fully describe the nature of the expertise), the process by which the board is informed about climate risks and frequency of discussion, integration of climate risks into the strategy/risk/financial oversight processes, and the board's establishment of and monitoring of climate-related targets or goals.

- ***With respect to management's role,*** to the extent applicable, who in management is responsible for climate risk assessment and management (*e.g.*, certain management positions or committees), relevant expertise of the position holders or committee members (including supporting information to fully describe the nature of the expertise), the process by which they are informed and monitor climate risks, and the frequency of reporting to the board/committee.

In addition, proposed Item 1503 of Reg. S-K would require companies to describe, if applicable, "any processes the registrant has for identifying, assessing, and managing climate-related risks." The detailed disclosures would include:

- ***Risk identification and assessment process,*** including determination of relative significance of climate risks versus other risks, consideration of existing or likely regulatory requirements or policies, consideration of shifts in customer or counterparty preferences, technological changes or changes in market prices, and determination of materiality of climate risks.

- ***Risk management process,*** specifically the decision-making process for mitigating, accepting or adapting to particular risks, including risk prioritization and mitigation of high-priority risks.

- ***How these processes are integrated into overall risk management,*** including whether and how climate-related risks are integrated into the registrant's overall risk management system or processes, and whether climate-focused board and management committees interact with the committees focused on overall risk management (if different).

Also, to the extent a company has adopted a transition plan as part of its climate risk management strategy, additional disclosures would be required. These disclosures would include, for example, a description of the plan, relevant metrics and targets used, annual updates about the transition plan (*e.g.*, actions taken to meet goals) and how the company plans to mitigate or adapt to identified physical and transition risks.

Notably, the Commission did not include specific requirements addressing compensation practices tying executive pay to climate-related targets and goals, taking the position that the Compensation Discussion & Analysis rules already provide a framework for this disclosure.[14]

E. GHG Emissions Reporting

Proposed Item 1504 of Reg. S-K would require companies to disclose Scope 1, Scope 2 and, in some cases, Scope 3 "GHG emissions … for [their] most recently completed fiscal year, and for the historical fiscal years included in [their] consolidated financial statements in the filing, to the extent such historical GHG emissions data is reasonably available," and Item 1505 of Reg. S-K would require certain companies to obtain external assurance of some of these disclosures.

The proposed rules define GHGs to include carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), nitrogen trifluoride (NF_3), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulfur hexafluoride (SF_6), consistent with the Kyoto Protocol, the UN Framework Convention on Climate Change, the U.S. Energy Information Administration, and the U.S. Environmental Protection Agency. The proposed rules share basic concepts and vocabulary from the Greenhouse Gas Protocol, which is a widely accepted accounting and reporting standard for GHG emissions, in order to attempt to reduce the compliance burden on companies and promote comparability of reported data.[15] However, the SEC rules would require reporting to exclude the effects of offsets and RECs, and companies would not be required to follow the standards and guidance provided by the Greenhouse Gas Protocol in reporting their GHG emissions.

The proposed rules generally would require companies to provide GHG emissions data with respect to each year for which financial statements are included in the filing. For example, for a non-smaller reporting company, this would mean three years of GHG emissions data in an annual report on Form 10-K. Although data for the most recent fiscal year would always be required to be reported, the proposed rules contain an exception for prior years to the extent the data is not "reasonably available." The proposing release explains that a company would be able to omit data for such years to the extent it "has not previously presented such metric for such fiscal year and the historical information necessary to calculate or estimate such metric is not reasonably available … without unreasonable effort or expense."[16] As a result, we expect that companies that did not previously collect such data would be able to avail themselves of this exception on a scope-by-scope basis to "phase in" to full compliance (*i.e.*, for a large accelerated

[14] *See* the Proposing Release, p. 102.
[15] *See* the Proposing Release, p. 154.
[16] *See* the Proposing Release, p. 192.

filer, providing one year of data for the first year of compliance, two years of data for the next year, and three years of data beginning in the third year of compliance).

The proposed rules also include a limited safe harbor from liability for Scope 3 disclosures, providing that such disclosures will not be deemed fraudulent, "unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." However, the proposed safe harbor does little beyond defining the standard necessary to establish scienter for fraud-based claims, and provides only limited protection in the context of Securities Act liability standards provided it is shown that the company was not negligent.

The following table provides an overview of the detailed GHG emissions reporting requirements contained in the proposed rules, comparing applicable requirements for Scopes 1, 2 and 3:

	Scope 1	**Scope 2**	**Scope 3**
How this is defined	Direct emissions from operations owned or controlled by company (*i.e.*, consolidated or accounted for as an equity method investment)	Indirect emissions from generation of purchased or acquired energy consumed by operations owned or controlled by company	All other indirect emissions not otherwise included in Scope 2 that occur in upstream and downstream activities of a company's value chain
Who must report	All companies	Same as Scope 1	All companies (other than smaller reporting companies), but only if (a) material to the company, or (b) the company has set[17] a GHG emissions target that includes Scope 3
What must be reported: absolute GHG emissions	➢ Aggregate amount in terms of metric tons of CO_2e* ➢ Breakdown by constituent GHGs* **Excluding impact of purchased or generated offsets*	Same as Scope 1	Same as Scope 1* plus breakdown by any significant categories of Scope 3 emissions **May choose to present as a range if company discloses reasons for doing so and underlying assumptions*
What must be reported: GHG intensity	Sum of Scopes 1+2 emissions in terms of metric tons of: ➢ CO_2e[18] per unit of total revenue (using company's reporting currency), and ➢ CO_2e per unit of production relevant to company's industry (disclosing basis for unit used)* **Special rules apply for companies with no revenue or unit of production for a fiscal year or when voluntarily disclosing additional GHG intensity measures*		Same as Scopes 1+2, but must be calculated and presented separately

[17] The proposed rules are not as clear on what it means to "set" a target, but we believe it makes sense to interpret this as meaning the company has publicly disclosed a target that includes Scope 3 emissions.

[18] CO_2e refers to carbon dioxide equivalents and is a common unit of measurement that indicates global warming potential of each greenhouse gas. *See* the Proposing Release, p. 474.

	Scope 1	Scope 2	Scope 3
What must be reported: description of methodology	➢ Approach to categorizing emissions, including organizational & operational boundaries[19] (which must be consistent with financial reporting & as between Scopes 1/2/3) ➢ Reasonable estimates & material data gaps ➢ Calculation approach, including third-party data ➢ Material year-over-year changes in methodology	Same as Scope 1	Same as Scope 1 plus: ➢ Categories of included upstream and downstream activities ➢ Data sources used to calculate, including whether verified by company or third party ➢ Any significant overlap in categories producing Scope 3 emissions and how accounted for
Time period covered	Most recent fiscal year plus, if reasonably available, other years covered by financial statements in filing* **If full-year data not reasonably available for most recent year, can use actual data for Q1-Q3 plus reasonable estimate for Q4, but must promptly disclose any material difference between Q4 estimates and actuals*	Same as Scope 1	Same as Scope 1
Subject to attestation requirements	Yes, for large accelerated filers and accelerated filers, subject to a stepped phase-in from limited assurance to reasonable assurance	Same as Scope 1	No
Subject to liability safe harbor	No	No	Yes, not deemed to be fraudulent unless it is shown that the disclosure was made without a reasonable basis or not in good faith

A key question for large accelerated filers and accelerated filers that have not yet set GHG emissions targets that encompass Scope 3 emissions will be whether such emissions are material to the company and, therefore, required to be disclosed. According to the Commission, Scope 3 emissions disclosure would be subject to a materiality qualifier in order to balance the “relative difficulty” for companies to collect this data and in acknowledgment of the fact that the impact of Scope 3 emissions can vary significantly across industries and companies.[20] The Commission stated that this determination is based on traditional notions of materiality and that disclosure would be required “if there is a substantial likelihood that a reasonable investor would consider

[19] Organizational boundaries refer to entities owned or controlled by the company, whereas operational boundaries define the direct and indirect emissions associated with the business. *See* the Proposing Release, p. 193.

[20] *See* the Proposing Release, p. 169.

[Scope 3 emissions] important when making an investment or voting decision."[21] The Commission added that this inherently is a company-specific determination that depends, in part, on a company's industry and whether Scope 3 emissions represent a significant portion of a company's total GHG emissions footprint.[22] Although the proposed rules would not explicitly require a company to disclose its basis for determining that Scope 3 emissions are not material, the proposing release notes that "it may be useful to investors to understand the basis for that determination."[23] Moreover, the recent wave of SEC comment letters on climate change disclosures shows the Staff's willingness to probe companies' materiality determinations in this area.

F. Attestation of GHG Emissions

As noted above, proposed Item 1505 of Reg. S-K would require large accelerated filers and accelerated filers to obtain an attestation report from a GHG emissions attestation provider covering disclosure of Scope 1 and Scope 2 emissions. The detailed disclosures would include:

- ***Requirements for selecting a GHG emissions attestation provider,*** including that the person or firm is an expert in GHG emissions by virtue of having "significant experience," and is "independent" from the company and its affiliates during the "attestation and professional engagement period" (as such terms are defined in the proposed rules), and the company would be required to disclose whether the attestation provider has a license to provide assurance (identifying any such licensing or accreditation body), is subject to any oversight inspection program (identifying any such program), and is subject to record-keeping requirements with respect to the engagement (identifying any such requirements and their duration).

- ***Form and content requirements for the report,*** including that the report contain information about its subject matter, evaluation time period, measurement criteria and attestation standard used (which must be publicly available at no cost and established by a group that has followed due process procedures), level of assurance provided, nature of engagement, description of the work performed if it is a limited assurance engagement, relative responsibilities of the company versus the attestation provider, independence of the attestation provider, any inherent limitations in the evaluation and conclusion of the attestation provider, among other technical form requirements.

- ***Phase-in of attestation requirements,*** under which filings with respect to the (1) first fiscal year after the compliance date would not require attestation, (2) second and third fiscal years after the compliance date would require, at a minimum, attestation at a "limited assurance"

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21 *Id.*

22 *See* the Proposing Release, pp. 169-173 (highlighting several industry dynamics that might lead a company to conclude that Scope 3 emissions are material).

23 *See* the Proposing Release, p. 174.

level, and (3) all years beginning with the fourth fiscal year after the compliance date would require attestation at a "reasonable assurance" level.[24]

- ***Voluntary attestation or verification*** would be permitted during the first fiscal year after the compliance date, but various disclosure requirements would apply, such as providing the identity of the attestation/verification provider and information about its independence, description of the standards used, level and scope of the attestation/verification provided, and a brief description of the results. Companies who voluntarily comply after the first fiscal year after the compliance date would be required to follow the full attestation requirements in the proposed rules.

The proposed rules would not require that the GHG emissions attestation provider be an independent, registered public accounting firm.[25] However, given the extensive qualification and disclosure requirements that would apply to the provider, as well as the expert liability that the provider would be subject to under the Securities Act of 1933 (the "Securities Act"),[26] we believe that many large public companies would engage their existing outside audit firm to provide these attestation services.[27] In this regard, registration statements that include an attestation report would be required to include as an exhibit a consent from the GHG emissions attestation provider, and, as a result, such provider would have a role in the diligence and comfort letter process for securities offerings.

G. Targets, Goals & Transition Plans

Proposed Item 1506 of Reg. S-K would require detailed disclosures if a company has "set any targets or goals related to the reduction of GHG emissions, or any other climate-related target or goal (*e.g.*, regarding energy usage, water usage, conservation or ecosystem restoration, or revenues from low-carbon products) such as actual or anticipated regulatory requirements, market constraints, or other goals established by a climate-related treaty, law, regulation, policy, or organization." The detailed disclosures would include:

- ***Scope and calculation of the target,*** including scope of activities and emissions included in the target, unit of measurement and whether absolute or intensity-based, time horizon for achievement (including whether it is consistent with an external standard), and baseline against which progress is measured (including a requirement to use a consistent base year for multiple targets).

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[24] "Reasonable assurance" is the same level of assurance as a company's financial statements in Form 10-K. It is an affirmative assurance that the GHG emissions disclosure is measured in accordance with the attestation provider's standards. "Limited assurance" is a form of negative assurance and commonly referred to as "review," and it is the same level of assurance provided to a company's financial statements in a Form 10-Q.

[25] *See* the Proposing Release, p. 47.

[26] *See* the Proposing Release, pp. 252-253.

[27] The Commission affirmed that fees paid to the outside auditor for GHG emissions attestation services would be considered "audit-related fees" for proxy disclosure purposes. *See* the Proposing Release, p. 252.

- ***Progress achievement,*** including how the company intends to meet the target, any interim targets set by the company, and annual updates on progress achieved towards the target (including quantitative data and actions taken).

- ***Any use of carbon offsets or RECs,*** including the amount of carbon reduction represented by the offsets or amount of generated renewable energy from the RECs, description and location of the underlying projects, and information about the source, cost and authentication of the offsets or RECs.

IV. Summary of Proposed Reg. S-X Amendments

A. Overview

The proposed rules would amend Regulation S-X to require certain climate-related financial statement metrics and related disclosures in a separate footnote to companies' annual audited financial statements. Specifically, the proposed disclosure requirements, which would be housed in new Article 14 of Regulation S-X, would require disclosure of three types of information: (1) financial impact metrics, (2) expenditure/cost metrics, and (3) financial estimates and assumptions.

As this information would be included in the financial statements, it would come within the scope of an independent, registered public accounting firm's audit of the financials as well as a company's internal control over financial reporting and related CEO and CFO certifications.

These disclosures, which are discussed in more detail below, would not be required to be included in filings that do not include audited financial statements (*e.g.*, quarterly reports on Form 10-Q).

B. Generally Applicable Requirements

Proposed Rules 14-01 and 14-02 of Reg. S-X contain several requirements that would apply with respect to all of the climate-related financial metrics discussed below. The detailed disclosures would include:

- ***Disclosure thresholds.*** A particular metric would need to be disclosed if the absolute value of all climate-related impacts or expenditures/costs, as applicable, with respect to a corresponding financial statement line item represents at least 1% of that line item.

- ***Calculation methodology.*** The calculation of reported metrics must use financial information that is consistent with the scope of the rest of the financial statements and apply the same accounting principles utilized for the rest of the financial statements.

- ***Contextual information.*** For each reported metric, contextual information must be provided as to how it was derived, including significant inputs and assumptions, policy decisions (if applicable) and the impact of any climate-related risks identified pursuant to the new Regulation S-K requirements.

C. Financial Impact Metrics

Proposed Rule 14-02(c) and (d) of Reg. S-X would require companies to disclose, subject to the 1% line-item threshold, the financial impacts of severe weather events, other natural conditions and transition activities on any relevant line items in the company's financial statements. The detailed disclosures would include:

- ***Presentation requirements,*** including that disclosure be presented, at a minimum, on an aggregated, line-by-line basis for all negative impacts and, separately, positive impacts.

- ***Scope of severe weather events and other natural conditions,*** including flooding, drought, wildfires, extreme temperatures and sea level rise, with potential impacts, including, for example, revenue and cost changes from business disruptions, asset impairment charges, changes in loss contingencies or reserves, and changes in total expected insured losses.

- ***Scope of covered transition activities,*** including efforts to reduce GHG emissions or mitigate exposure to transition risks, with potential impacts, including, for example, revenue and cost changes from new emissions pricing or regulations, cash flow changes from changes in upstream costs, changes in asset carrying amounts due to reduction in useful life, and changes to interest expense due to climate-linked bonds with variable interest rates based on achievement of climate targets.

D. Expenditure/Cost Metrics

Proposed Rule 14-02(e) and (f) of Reg. S-X would require companies to disclose, subject to the 1% threshold, expenditures and capitalized costs to mitigate the risks of severe weather events or other natural conditions and expenditures related to transition activities. The detailed disclosures would include:

- ***Presentation requirements,*** including that disclosure be presented on an aggregated basis for expenditures expensed and, separately, capitalized costs incurred.

- ***Scope of covered severe weather events and other natural conditions,*** including flooding, drought, wildfires, extreme temperatures and sea level rise (same as for financial impact metrics), with potential expenses/costs related to, for example, increasing business resilience, retiring or shortening the useful life of assets, relocating at-risk assets or operations, and otherwise reducing the future impact of severe weather events and other natural conditions on the business.

- ***Scope of covered transition activities,*** including efforts to reduce GHG emissions or mitigate exposure to transition risks (same as for financial impact metrics), with potential expenses/costs related to, for example, R&D for new technologies, purchase of assets, infrastructure or products to reduce GHG emissions, increase energy efficiency, offset emissions (*e.g.*, energy credit purchases) or improve resource efficiency, and progress towards meeting disclosed climate-related targets or commitments.

E. Financial Estimates & Assumptions

Proposed Rule 14-02(g) and (h) of Reg. S-X would require companies to disclose whether estimates and assumptions underlying the amounts reported in the financial statements were impacted by risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions, the transition to a lower-carbon economy and any disclosed climate-related targets. To the extent there was an impact, qualitative disclosure would be required as to how the development of any such estimate or assumption was impacted.

F. Time Period Covered

Proposed Rule 14-01 of Reg. S-X would require the financial statement disclosures discussed above to be provided for a company's most recently completed fiscal year and for each historical fiscal year included in the financial statements in the filing. As an example, a company that includes balance sheets as of the end of its two most recent fiscal years and three years of income and cash flow statements would be required to disclose two years of climate-related metrics that correspond to balance sheet line items and three years of climate-related metrics that correspond to income or cash flow statement line items.

Unlike the Reg. S-K disclosure requirements for GHG emissions, the Reg. S-X disclosure proposals do not contain an exemption for information that is not reasonably available with respect to historical periods.

V. OTHER SIGNIFICANT ASPECTS OF THE PROPOSED RULES

A. Applicability

The proposed rules would apply to companies with reporting obligations under the Securities Exchange Act of 1934 (the "Exchange Act") pursuant to Section 13(a) or Section 15(d) and companies filing a registration statement under the Securities Act or Exchange Act. As a result, the proposed rules would apply to both U.S. public companies and foreign private issuers.

Once the rules are completely phased in (as discussed below), there generally would not be any filer-status-based exemptions from complying with the proposed rules. There would be limited exceptions for Scope 3 emissions disclosure (smaller reporting companies would be exempt) and GHG emissions attestation requirements (non-accelerated filers would be exempt). However, in contrast to some of the other SEC rules adopted in recent years, there would be no exemption for emerging growth companies.

The new disclosures would apply broadly to periodic filings as well as registration statements, including U.S. companies' Forms S-1, S-3, S-4, S-11, 10, 10-Q and 10-K and foreign companies' Forms F-1, F-3, F-4, 6-K and 20-F.[28] Although these forms generally would require the full panoply of disclosures in the proposed rules, quarterly reports on Form 10-Q would be

[28] *See* the Proposing Release, p. 285-286.

required to disclose only material changes to the Regulation S-K-based climate change disclosures included in a company's Form 10-K.

B. Liability Implications

The proposed rules would treat all climate-related disclosures as "filed" rather than "furnished" (other than those included in a foreign private issuer's Form 6-K, which generally are "furnished"). This means that, in addition to general anti-fraud liability under Rule 10b-5 under the Exchange Act, such disclosures would be subject to incremental liability under Section 18 of the Exchange Act and, to the extent such disclosures are included or incorporated by reference into Securities Act Registration Statements, subject to liability under Sections 11 and 12 of the Securities Act. Importantly, claims under Section 11 of the Securities Act and Section 18 of the Exchange Act do not require a plaintiff to prove scienter or negligence, in contrast to claims under Rule 10b-5. As discussed above, there would be a limited safe-harbor from liability for Scope 3 emissions disclosures.

C. Safe Harbor for Forward-Looking Information

The proposed rules make clear that, to the extent that any of the climate-related disclosures are forward-looking (*e.g.*, climate-related goals, emission reduction targets, transition plans, scenario analysis), they would be subject to the general safe-harbor protections under the Private Securities Litigation Reform Act ("PSLRA"), assuming that all of the required conditions under the PSLRA are met.[29] However, the PSLRA safe harbor would not be available for climate-related disclosures contained in the financial statement notes or in the context of initial public offerings. Also, compliance with the PSLRA safe harbor does not limit the Commission's ability to bring enforcement actions.

D. Inline XBRL Data Tagging Requirements

The proposed rules would require all of the required disclosures to be tagged in Inline XBRL, including block text tagging and detail tagging of both qualitative and quantitative disclosures. According to the proposing release, this Inline XBRL tagging requirement is intended to "enable automated extraction and analysis of climate-related disclosures, allowing investors and other market participants to more efficiently perform large-scale analysis and comparison of climate-related disclosures across companies and time periods."[30]

VI. COMMISSIONER REMARKS AND POTENTIAL CHALLENGES

The Commission voted on party lines, three-to-one, in support of the proposed rule amendments. Chair Gensler supported the proposed rules, indicating that the rules would provide investors with "consistent, comparable, and decision-useful information for making their investment decisions and would provide consistent and clear reporting obligations to issuers." He highlighted that the SEC has historically "stepped in when there's a significant need for

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[29] *See* the Proposing Release, pp. 70-71.
[30] *Id*. at 295.

disclosure of information relevant to investors' decisions." Subsequent to the open meeting at which the rule proposal was approved, in response to a letter sent to the Commission by 40 Congressional Republicans asking the SEC to "immediately table" the rule on grounds that it would be "extremely burdensome," Chair Gensler reiterated his view that the information sought by the proposed rules was "consistent with … concepts of decision-making and related materiality."[31]

Commissioner Lee also supported the proposed rules, hailing their introduction as a "watershed moment for investors and financial markets." In addition, Commissioner Lee noted that the majority of public comments received in last year's request for public comment favored enhanced climate disclosure and that the proposed rules are responsive to those requests. Similarly, Commissioner Crenshaw supported the proposed rules, noting that they would "empower investors to make more informed decisions."

Commissioner Peirce dissented and outlined several concerns she had regarding the proposed rules. In a dissent that may preview legal arguments that challengers would raise in litigation challenging the rule once finalized, Commissioner Peirce indicated that: (i) existing rules already cover material climate risks, (ii) the proposed rules would not apply a materiality threshold in some places (*e.g.*, Scope 1 and Scope 2 required disclosures) and would distort materiality in other places (*e.g.*, the Scope 3 disclosure requirements), (iii) the proposal would not lead to comparable, consistent, and reliable disclosures, (iv) the proposal exceeds the Commission's statutory limits of authority, (v) the proposed rules would be expensive for companies to implement, and (vi) the proposal would hurt investors, the economy and the reputation of the SEC. Notably, Commissioner Peirce's remarks also seemingly laid the framework for First Amendment challenges to the proposed rules based on limitations on compelled speech.

For the full text of the published statements of the Commissioners, please see the following links: Chair Gensler, Commissioner Peirce, Commissioner Lee and Commissioner Crenshaw.

VII. Effective Dates and Comment Period

The table below shows the phase-in schedule for the proposed rule requirements, assuming that final rules are adopted and effective by the end of 2022 (consistent with the proposing release's assumption). This illustrative schedule would apply to companies with a December 31 or later fiscal year-end.[32]

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31 *See* SEC Chief Doubles Down on Climate Plan Amid GOP Uproar, Law360 (Apr. 12, 2022), https://www.law360.com/securities/articles/1483445/sec-chief-doubles-down-on-climate-plan-amid-gop-uproar?nl_pk=a362658d-96a1-4200-b75b-8cd032e05259&utm_source=newsletter&utm_medium=email&utm_campaign=securities&utm_content=2022-04-13.

32 For companies with a fiscal year 2023 that commences before the adoption and effectiveness of the final rules, the proposing release makes clear that the time period for compliance would be one year later than illustrated above. *See* the Proposing Release, p. 225.

Disclosure Requirement	Large Accelerated Filers	Accelerated Filers	Non-Accelerated Filers	Smaller Reporting Companies
All disclosures other than Scope 3	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Same as for Accelerated Filers	Fiscal year 2025 (filed in 2026)
Scope 3 emissions disclosures	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Same as for Accelerated Filers	Exempt
Attestation for Scope 1 & Scope 2 emissions disclosures	Limited Assurance Fiscal year 2024 (filed in 2025) Reasonable Assurance Fiscal year 2026 (filed in 2027)	Limited Assurance Fiscal year 2025 (filed in 2026) Reasonable Assurance Fiscal year 2027 (filed in 2028)	Exempt	Same as for Accelerated Filers or Non-Accelerated Filers (as applicable)

The comment period ends on May 20, 2022, which is 60 days from when the SEC approved the rule proposal.

VIII. Key Takeaways and Action Items for Public Companies

In addition to their detailed and prescriptive approach to setting forth disclosure standards, several other aspects of the proposed rules are notable:

- ***Absence of materiality.*** The proposed disclosure standards largely eschew the use of a materiality standard; other than in the context of Form 10-Q updating, only the climate change risk disclosures, one of the two standards for requiring Scope 3 emissions disclosure, and certain details regarding emissions disclosures are predicated on materiality (and in the case of risk disclosures, the standard is "reasonably likely" to have a material impact). Notably, Chair Gensler stated that the definition of "materiality" applicable to the proposed rules is the one used under the U.S. securities laws, notwithstanding other "materiality" definitions used by various environmental, social and governance reporting frameworks,[33] suggesting that company disclosures in sustainability reports may encompass topics not required to be addressed under the proposed rules.

- ***Inner workings disclosure.*** The proposed rules would require companies to disclose detailed underlying methodologies regarding climate-change issues to a degree that has few precedents in the SEC's rules. For example, a company would not only have to disclose its GHG emissions, but would also have to provide a detailed description of its methodology, including significant inputs, calculation approach, and calculation tools. Thus, the rules

[33] *See* Chair Gary Gensler, "Statement on Proposed Mandatory Climate Risk Disclosures," Mar. 21, 2022, https://www.sec.gov/news/statement/gensler-climate-disclosure-20220321. Compare, for example, the Global Reporting Initiative, which uses an "impact materiality" standard based on whether information is important for reflecting an organization's economic, environmental and social impacts, or the European Union's Corporate Sustainability Reporting Directive, which uses a "double materiality" standard, based on both financial materiality and impact materiality concepts.

would provide insights into key internal aspects of this one facet of a company's business and operations to a greater degree than most other aspects of the company's operations, potentially resulting in disclosure of proprietary business strategies and competitively sensitive information.

- ***Vague disclosure triggers based on company actions.*** In many cases, company actions can trigger disclosure under the proposed rules. For example, a company would have to provide Scope 3 emissions disclosure if the company "has set" a Scope 3 target or goal. Similarly, detailed disclosures would be required if a company "uses" a scenario analysis, "maintains" an internal carbon price, "has set" *any* climate-related target or goal, "has adopted" a transition plan. Moreover, once these disclosures are triggered, the proposed rules would prescribe detailed information that would have to be disclosed and would impose conditions on the disclosure that may differ from the company action that triggered the disclosure. For example, Scope 3 emissions disclosure would be required to be provided by constituent GHG, even if the target or goal that triggered the disclosure was not developed in that manner. Given the detailed reporting requirements that would be triggered by various company actions, the rules could disincentivize companies from taking such actions or from modifying or updating their planning around these types of actions and could lead to widely disparate disclosures among companies, largely without regard to the materiality of such actions or disclosures.

Although the rules have only been proposed and are subject to comment (which we believe will be significant) and any final rules could be challenged in court, it is not too early to start thinking about the potential implications of the proposed rules, if they are adopted as proposed, and assess what additional steps may be necessary to take in order to be well positioned to comply. The following planning suggestions should be tailored, as appropriate, to your company's particular industry and size.

- ***Participate in the rulemaking.*** Under the Administrative Procedure Act, the SEC is required to consider and reasonably respond to public comments. Accordingly, companies concerned about aspects of the proposed rules should consider participating in the rulemaking proceedings, either by submitting their own comments or by working in conjunction with a trade association. Among other things, comments may address the expected costs of compliance with the proposed rules (including quantitative data, where available); requirements in the proposed rules that are unclear, impractical or unduly burdensome; and possible alternatives to provisions of potential concern.

- ***Conduct a gap analysis against any existing disclosures.*** Companies should start by taking stock of their existing climate-related disclosures—including in their SEC filings and on their websites (*e.g.*, on an ESG webpage or stand-alone ESG report), as applicable—and assessing what additional disclosures would be needed to comply with the proposed climate-related risk disclosure framework. That will help focus and inform compliance and readiness efforts once final rules are issued.

- ***Assess sufficiency of internal and external climate change resources.*** Given their breadth and complexity, compliance with the proposed rules, if adopted, likely would require substantial internal and external resources. As a result, companies should begin to assess their internal resources' expertise and external service providers. In assessing resource sufficiency, consideration should also be given to the timing for preparing these disclosures, since most will need to be finalized early the following year in time for the annual report on Form 10-K. This is an already busy time for internal legal and financial reporting teams and, for those companies that voluntarily publish an ESG report, this timing likely represents an acceleration of when similar disclosures otherwise would have been prepared as ESG reports are often published later in the year. Companies should start gathering information necessary for budgeting and organizational planning purposes.

- ***Evaluate disclosure controls and internal controls.*** Given that the proposed new disclosures would be included in SEC filings, companies should assess their existing disclosure controls and procedures, as well as internal control over financial reporting as it relates to the proposed Regulation S-X rules, to identify any necessary enhancements to cover the new climate-related disclosures. As a general matter, in light of the potential disclosure liability that attaches to these disclosures generally (even those included on company websites),[34] it is important to have robust processes in place to collect and verify the underlying data and assumptions.

- ***Revisit climate-related risk oversight and management practices.*** As the proposed rules would require significant disclosure about climate-related risk oversight and management practices, companies should begin assessing their existing practices and considering whether any enhancements are warranted to how the board oversees climate-related risks (*e.g.*, whether at the full board level or a committee, frequency for monitoring, *etc.*) and how these risks are managed internally before such practices are subject to disclosure.

- ***Reassess board composition, focusing on climate change expertise.*** As the proposed rules would require disclosure about any climate change expertise on the board of directors, companies should start assessing relevant qualifications of existing board members to consider what the potential disclosure would look like and evaluate whether it is appropriate (or not) to make climate change expertise a recruitment focus area for future board refreshment opportunities.

- ***Conduct a detailed materiality assessment of climate-related risks on the business.*** As a significant portion of the new Regulation S-K qualitative disclosure requirements would include a materiality qualifier, companies, would be well served by conducting a more detailed materiality assessment of climate change risks and opportunities on their business than they have done in the past.

- ***Begin considering potential significance of Scope 3 emissions for your company.*** As a threshold question for whether Scope 3 emissions disclosure would be required is whether

34 For a discussion about potential disclosure and other liability associated with ESG disclosures, see ESG Legal Update: What Corporate Governance and ESG Professionals Need to Know, Gibson, Dunn & Crutcher (June 2020), https://www.gibsondunn.com/wp-content/uploads/2020/10/Ising-Meltzer-McPhee-Percopo-Assaf-Holmes-ESG-Legal-Update-What-Corporate-Governance-and-ESG-Professionals-Need-to-Know-Society-for-Corporate-Governance-06-2020.pdf.

they are material, companies should start to consider the potential significance of their Scope 3 emissions, including taking into account a company's value chain. As this likely will require reliance on third-party data to some extent, companies should begin identifying potential data sources, including both industry resources and partners in their value chains.

- ***Discuss implications with your outside auditor.*** Companies should start discussing with their outside auditors the implications of both (1) the proposed financial statement disclosure requirements on the firm's audit, and (2) the proposed disclosure requirements outside of the financial statements on the comfort letter process. Companies also should consider whether their outside auditors could be engaged to conduct the required GHG emissions attestation.

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