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Key Implications of SEC's Climate-Related Disclosure Rules for Public Companies

Final Rules Reflect Significant Changes from Proposal but Still Require Extensive Disclosures that Will Meaningfully Increase Cost, Compliance Challenges and Liability Exposure

Related Webinar hosted on March 13, 2024

SUMMARY

On March 6, 2024, the Securities and Exchange Commission ("SEC") in a 3-to-2 vote[1] adopted its landmark climate-related disclosure rules (the "Final Rules"), which will significantly expand the climate-related information that U.S. public companies and foreign private issuers (other than Canadian issuers reporting on Form 40-F) will be required to disclose in their periodic reports and registration statements.[2] Our March 7, 2024 publication provided a high level summary of the Final Rules. This memorandum provides additional analysis of the Final Rules and their implications for public companies.

The Final Rules were adopted to provide investors "more complete and decision-useful information about the impacts of climate-related risks on registrants".[3] After receiving a record 24,000 comment letters on its March 2022 proposed rulemaking (the "Proposed Rules"),[4] the SEC narrowed the Proposed Rules. Notably, the SEC qualified many disclosure requirements by materiality (including disclosures of Scope 1 and 2 greenhouse gas ("GHG") emissions), eliminated the proposed Scope 3 emissions reporting requirements, and narrowed the proposed financial statement disclosures.

Nevertheless, the Final Rules still prescribe expansive climate-related disclosures that will meaningfully increase the cost, compliance challenges and liability exposure associated with public reporting. Key implications of the Final Rules for public companies include:

- ***Relatively short initial compliance timeline:*** The earliest compliance date is in 2026 with respect to fiscal years beginning in 2025 (for large accelerated filers, with tiered compliance dates for others). In the first year of compliance, companies will be required to present most of the narrative disclosures, which are modeled on the Task Force on Climate-Related Financial Disclosure ("TCFD") framework, as well as most of the financial statement disclosures. This will be the first time most companies include TCFD-style disclosures in an SEC filing, rather than a sustainability report. In addition, the new financial statement disclosures will be subject to audit and within scope of internal controls over financial reporting. As a result, companies will need to assess their compliance approach and readiness, including necessary controls and procedures to capture, prepare and validate the required new disclosures on a timely basis. In-scope companies will need to prepare data collection processes and implement associated controls now.
- ***Interpretive challenges:*** Key requirements of the Final Rules—such as the need to assess the materiality of Scope 1 and 2 emissions and the disaggregated financial impact of severe weather events and "other natural conditions"—will create significant interpretive challenges for companies, as well as for their attestation providers and auditors.
- ***Implications of overlapping requirements in other jurisdictions:*** The SEC declined to permit companies to comply with other jurisdictions' climate-related disclosure rules in lieu of the Final Rules. For many companies, a key challenge of initial compliance will be preparing to report under both the Final Rules and disclosure standards that differ from the Final Rules, including international, federal and state requirements (for example, in the EU or California), and any standards adopted to meet the expectations of key investors, customers and other stakeholders.
- ***Expanded liability exposure, limited safe harbor:*** The SEC acknowledged that the Final Rules will expose public companies to increased litigation risks.[5] Although the Final Rules provide a safe harbor covering certain forward-looking information, there is no safe harbor for statements of historical fact, including those prepared using evolving methodologies or third-party data.
- ***Legal challenges amplify uncertainty:*** Petitions challenging the Final Rules have already been filed, along with at least one stay motion requesting that the Fifth Circuit grant emergency relief by March 16, 2024[6] and more are expected. However, given the short compliance timeline and potentially significant readiness efforts required, in-scope companies (and large accelerated filers in particular) do not have the luxury of waiting for a final judicial ruling.

On March 13, 2024, Sullivan & Cromwell hosted a webinar (view here) discussing the Final Rules, as well as key takeaways to facilitate compliance with the Final Rules.

OVERVIEW OF THE FINAL RULES

The Final Rules will require companies to make additional disclosures both in narrative form in their periodic reports and registration statements (new subpart 1500 of Regulation S-K) and in the notes to their audited financial statements (new Article 14 of Regulation S-X). The new financial statement disclosures under Regulation S-X will be subject to audit by a company's independent auditor and within scope of internal control over financial reporting, and all disclosures will be subject to the company's disclosure controls and procedures and Sarbanes-Oxley officer certifications.

Regulation S-K

The new requirements in Regulation S-K, which establishes the disclosure requirements for companies' periodic reports and registration statements, include:

- ***Governance*** (Item 1501) – disclosure regarding board oversight of climate-related risks and management's role in assessing and managing material climate-related risks;
- ***Strategy*** (Item 1502) – disclosure of material climate-related risks, their material impacts and whether and how such impacts are considered as part of a company's strategy, including, if used, transition plans, scenario analysis and internal carbon price;
- ***Risk management*** (Item 1503) – disclosure of processes used to identify, assess and manage material climate-related risks;
- ***Targets and goals*** (Item 1504) – disclosure of climate-related targets and goals with material effect on a company's business, results of operations or financial condition (which must be updated annually to describe actions taken during the year to achieve such targets and goals);
- ***GHG emissions metrics*** (Item 1505) – disclosure of Scope 1 and 2 emissions to the extent such emissions are material (required only for large accelerated filers and accelerated filers); and
- ***Attestation of Scope 1 and 2 emissions disclosure*** (Item 1506) – requirement to obtain an attestation report covering GHG emissions disclosures.

In addition, Item 1507 specifies that companies will benefit from a safe harbor covering forward-looking information (but not historical facts) related to transition plans, scenario analysis, internal carbon price and targets and goals.

Regulation S-X

New Article 14 of Regulation S-X, which establishes disclosure and presentation requirements for companies' financial statements, includes the following disclosures, among others, in the notes to audited financial statements:

- ***Expenditure metrics*** (Rule 14-02(c)) – disclosure of aggregated expenditures expensed as incurred and losses, excluding recoveries, as a result of severe weather events and other natural conditions (collectively, "SWEs"), subject to a 1% disclosure threshold (measured against the absolute value of pre-tax income or loss) and a *de minimis* disclosure threshold ($100,000);
- ***Capitalized costs and charges*** (Rule 14-02(d)) – disclosure of aggregated capitalized costs and charges incurred, excluding recoveries, as a result of SWEs, subject to a 1% disclosure threshold (measured against the absolute value of stockholders' equity or deficit) and a *de minimis* disclosure threshold ($500,000); and
- ***Carbon offsets and RECs*** (Rule 14-02(e)) – with respect to carbon offsets and renewable energy credits or certificates ("RECs") that are used as a material component of a company's plans to achieve any climate-related targets or goals disclosed under the Final Rules, disclosure of the aggregate amount of carbon offsets and RECs expensed, the aggregate amount of capitalized carbon offsets and RECs recognized, and the aggregate amount of losses incurred on the capitalized carbon credits and RECs.

SUMMARY OF NEW REGULATION S-K REQUIREMENTS

A. Governance (Item 1501)

Item 1501 will require companies to disclose their board of directors' oversight of climate-related risks, as well as management's role in assessing and managing material climate-related risks.

Board of directors. Item 1501(a), which will require companies to describe the board of directors' oversight of climate-related risks, specifies that companies should (i) disclose the identification of any board committee or subcommittee responsible for the oversight of climate-related risks and (ii) describe any processes by which the board or such committee or subcommittee is informed about such risks. Companies must also describe whether and how the board oversees progress towards any climate-related target or goal required to be disclosed pursuant to Item 1504 or a transition plan required to be disclosed pursuant to Item 1502(e)(1). The SEC removed certain of the proposed governance-related disclosures in response to comments, recognizing that most boards do not oversee climate-related risks at a granular level. Notably, the SEC eliminated proposed requirements that would have singled out individual directors, including identification of the director(s) overseeing climate-related risks and board "climate experts".

Management. Item 1501(b) will require companies to disclose management's role in assessing and managing material climate-related risks.[7] Under Item 1501(b), companies will need to:

- identify any management positions or committees responsible for assessing and managing climate-related risks and the relevant expertise of such persons in such detail as necessary to fully describe the nature of the expertise;
- describe the process by which such persons or committees assess and manage climate-related risks; and
- address whether such persons or committees report information about climate-related risks to the board, a committee or subcommittee of the board.

The SEC noted that the required disclosure of management's relevant expertise may include, for example, prior work experience in climate-related matters, any relevant degrees or certifications, any knowledge, skills or other background in climate-related matters. This instruction on "relevant expertise" is nearly identical to the corresponding language in the SEC's recently adopted cybersecurity rules.

B. Strategy (Item 1502)

Item 1502 will require companies to describe their material climate-related risks and the actual and potential material impacts of these risks on their strategy, business model and outlook, including any material impacts on their mitigation or adaptation activities (e.g., the use, if any, of transition plans, scenario analysis or internal carbon price).

Definition of "climate-related risks". The SEC defines "climate-related risks" as "the actual or potential negative impacts of climate-related conditions and events on a registrant's business, results of operations or financial condition", including physical risks and transition risks.[8] Consistent with the elimination of the proposed Scope 3 emissions reporting requirements, the Final Rules will not require disclosure of climate-related risks involving a company's value chain, except where such a risk has materially impacted, or is reasonably likely to materially impact, the company's business, results of operations or financial condition.[9]

Material climate-related risks. Under Item 1502(a), a company will be required to describe any climate-related risks that have materially impacted, or are reasonably likely to have a material impact,[10] on the company, including on its strategy, results of operations or financial condition.[11] In describing these material climate-related risks, a company must include the following disclosures:

- ***Time horizon.*** A description of whether the material climate-related risks are reasonably likely to manifest in the short term (i.e., within the next 12 months) or in the long term (i.e., beyond the next 12 months). Unlike the Proposed Rules, which would have required a company to describe any material climate-related risks that may manifest over the short, medium and long term as defined by the company, the Final Rules adopt a temporal standard that is generally consistent with disclosure obligations under Item 303 (in the Management's Discussion and Analysis of Financial Condition and Operation Results ("MD&A")) related to a company's ability to generate and obtain cash to meet its cash requirements in the short term and the long term.[12] However, a company will not be precluded from breaking down its material climate-related risks reasonably likely to manifest beyond the next 12 months into components that may include more medium- and long-term risks in line with TCFD and legal requirements in other jurisdictions.[13]
- ***Risk type and exposure.*** A description of whether the risk is a physical or transition[14] risk, providing information necessary to understand the nature of the risk presented and the extent of the company's exposure to the risk.
  - ***Physical risks*.** A description of whether a material physical risk may be categorized as an acute or chronic risk,[15] and the geographic location and nature of the properties, processes or operations subject to such physical risk. Unlike the Proposed Rules, the Final Rules give companies flexibility to determine, based on their particular facts and circumstances, the granularity of any location disclosures and the particular physical risk metrics included in their physical risk disclosures.[16]
  - ***Transition risks*.** A description of whether the material transition risk relates to regulatory, technological, market (including changing customer, business counterparty and investor preferences) or other transition-related factors, and how those factors impact the company.

Material impacts on strategy, business model and outlook. Item 1502(b) will require a company to describe the actual or potential material impacts of any material climate-related risks identified pursuant to Item 1502(a) on the company's strategy, business model and outlook, including any material impacts on (i) business 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) R&D expenditures. The potential categories of material impacts listed in Item 1502(b) are non-exclusive and, in a departure from the Proposed Rules, exclude material impacts on of suppliers and other parties in a company's Scope 3 value chain.

Item 1502(c) will require a company to discuss whether and how it considers any material impacts described in response to Item 1502(b) as part of its strategy, financial planning and capital allocation, including (i) whether any such impacts have been integrated into the company's business model or strategy and (ii) how any of the climate-related targets referenced in Item 1504 or in a transition plan referenced in Item 1502(e) relate to the company's business model or strategy.

Item 1502(d) will require a company to (i) discuss how any climate-related risks identified pursuant to Item 1502(a) have materially impacted, or are reasonably likely to materially impact, the company's business, results of operations or financial condition and (ii) 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 to mitigate or adapt to climate-related risks disclosed pursuant to Item 1502(b) (subject to an additional phase-in period as described in "Scope, Presentation and Timing" below).[17]

Transition plan. The Final Rules will not require a company to adopt a transition plan to mitigate, adapt to or reduce climate-related risks.[18] However, under Item 1502(e)(1), if a company has adopted such a plan to manage a material transition risk, the Final Rules will require disclosure of the plan and annual updates that describe any actions taken during the year under the plan, including how those actions have impacted the company's business, results of operations or financial condition. Disclosure of a transition plan will be required even if the plan itself is not material and even if the plan has not been formally approved by the company's board of directors, so long as the plan was adopted to manage a material transition risk.[19]

Item 1502(e)(2) will require a company to include quantitative and qualitative disclosures of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the disclosed transition plan (subject to an additional phase-in period as described in "Scope, Presentation and Timing" below). The SEC explained that when considering which expenditures are material, a company should consider whether a series of individually immaterial expenditures could be the result of the same action or related actions under the plan, and whether those expenditures could be material in the aggregate.[20]

Scenario analysis. Although the Final Rules will not require a company to use scenario analysis, under Item 1502(f), if (i) a company uses "scenario analysis"[21] to assess the impact of climate-related risks on its business, results of operations or financial condition and (ii) based on results of such scenario analysis, the company determines that a climate-related risk is reasonably likely to have a material impact on its business, results of operations or financial condition, the company must describe each such scenario. The disclosure must briefly describe the parameters, assumptions and analytical choices used, as well as the expected material impacts, including financial impacts, on the company under such scenario.

The Final Rules will not require the use of any specific climate scenarios or climate scenario models.[22] Recognizing that scenario analysis practices are still evolving, the SEC noted that the Final Rules will provide companies with flexibility to determine the mix of qualitative and quantitative disclosures that best fit their circumstances. However, the SEC also noted that while a company's scenario analysis disclosure may be qualitative in the early stages of the company's use of scenario analysis, it expects the disclosure to become more quantitative as the company's use of scenario analysis becomes more sophisticated.[23]

Internal carbon price. Under Item 1502(g)(1), if a company's use of an "internal carbon price"—i.e., an estimated cost of carbon emissions used internally within an organization[24]—is material to how it evaluates and manages a climate-related risk identified pursuant to Item 1502(a), the Final Rules will require the company to disclose, in units of the company's reporting currency, (i) the price per metric ton of CO_2e and (ii) the total price, including how it is estimated to change over the short term (i.e., within the next 12 months) and the long term (i.e., beyond the next 12 months), as applicable. If more than one internal carbon price is used, the company must also provide such disclosures for each internal carbon price and disclose its reasons for using different prices.

Item 1502(g)(3) will also require the company to briefly describe any material difference between the scope of entities and operations involved in the use of an internal carbon price and the organizational boundaries used for GHG emissions reporting.

Climate-related opportunities. In a departure from the Proposed Rules, the Final Rules omit references to climate-related opportunities.[25] Although disclosure of climate-related opportunities is not required, the SEC noted that companies may nonetheless elect to include disclosure regarding any material climate-related opportunities it is pursuing or is reasonably likely to pursue in addition to the required disclosure regarding material climate-related risks. Similarly, companies may, but will not be required under Item 1501 to, disclose governance processes involving climate-related opportunities.

C. Risk Management (Item 1503)

Under Item 1503(a), companies will be required to describe any processes in place for identifying, assessing and managing material climate-related risks. Item 1503(a) includes a non-exclusive list of disclosure items that a company should address, including how the company:

- identifies whether it has incurred or is reasonably likely to incur a material physical or transition risk;
- decides whether to mitigate, accept or adapt to the particular risk; and
- prioritizes whether to address the climate-related risk.

In addition, if a company is managing a material climate-related risk, Item 1503(b) will require disclosure of whether and how any processes to identify, assess and manage such material climate-related risk are integrated into the company's overall risk management system or processes.

The Final Rules meaningfully streamlined the proposed risk management disclosures in response to comments that such disclosures were overly prescriptive. The Final Rules include a materiality qualifier—in other words, if a company has not identified a material climate-related risk, no risk management disclosure will be required.[26] Further, in an effort to provide flexibility for companies to tailor disclosure of material climate-related risks and risk management practices to their own particular facts and circumstances, Item 1502(a) includes the above non-exclusive list of disclosure items, but specifies that they should be included only if applicable to a company. In contrast, the Proposed Rules included more prescriptive disclosure requirements that would have required a company to describe, as applicable, certain additional processes related to how it identifies, assesses and determines the materiality of climate-related risks, including how a company considers external factors such as regulatory requirements or policies, customer or counterparty preferences, technological changes and changes in market prices.[27] Importantly, the SEC also removed the proposed requirement to disclose how a company determines the relative significance of climate-related risks compared to other risks and how it mitigates any "high priority risks".[28]

D. Targets and Goals (Item 1504)

Targets and goals and annual progress update. Item 1504(a) will require a company to disclose any climate-related target or goal if such target or goal has materially affected, or is reasonably likely to materially affect, the company's business, results of operations or financial condition. Item 1504(b) will further require that, in providing the disclosure pursuant to Item 1504(a), a company must also provide any additional information or explanation necessary to understand the material impact or reasonably likely material impact of the target or goal, including, as applicable, a description of:

- the scope of activities included in the target;
- the unit of measurement;
- the defined time horizon by which the target is intended to be achieved, and whether the time horizon is based on one or more goals established by a climate-related treaty, law, regulation, policy or organization;
- the baseline time period (if established) and the means by which progress will be tracked; and
- a qualitative description of how the company intends to meet its climate-related targets or goals.

Item 1504(c) will require a company to disclose any progress made toward meeting the climate-related target or goal and how any such progress was achieved. Companies will need to update this disclosure each fiscal year by describing the actions taken during the year to achieve its targets or goals. Specifically, the Final Rules will require:

- a discussion of any material impacts to the company's business, results of operations or financial condition as a direct result of the target or goal or actions taken to make progress toward meeting the target or goal; and

- quantitative and qualitative disclosure of any material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or the actions taken to make progress toward meeting the target or goal (subject to an additional phase-in period as described in "Scope, Presentation and Timing" below).[29]

A company may provide the required disclosure on climate-related targets and goals as part of its disclosure in response to Item 1502 or Item 1503.[30]

The above disclosure requirements are not limited to material targets or goals that have been publicly announced or formally adopted by a company's board of directors or CEO.[31] Moreover, a climate-related target or goal may include both GHG emissions and non-GHG emissions targets and goals, and may include interim targets and goals.[32] Given the broad scope of the disclosure requirements under Item 1504, a company may need to disclose Scope 3 emissions metrics on an annually updated basis if it has a Scope 3 emissions reduction target that has materially affected, or is reasonably likely to materially affect, its business, results of operations or financial condition.

Use of carbon offsets or RECs. Item 1504(d) will require a separate disclosure regarding carbon offsets or RECs if they have been used as a material component of a company's plan to achieve climate-related targets or goals. The disclosure should include:

- the amount of carbon avoidance, reduction or removal represented by the offsets or the amount of generated renewable energy represented by the RECs;
- the nature and source of the offsets or RECs;
- a description and location of the underlying projects;
- any registries or other authentication of the offsets or RECs; and
- the cost of the offsets or RECs.

E. GHG Emissions Metrics (Item 1505)

In a substantial change from the Proposed Rules, companies will not be required to disclose their Scope 3 (indirect value chain) emissions. The SEC eliminated the proposed Scope 3 disclosure requirement in response to the many commenters who highlighted it as one of the most onerous aspects of the Proposed Rules due to the potentially high cost of compliance and the current lack of availability and reliability of the underlying data.[33]

However, the Final Rules do require disclosure of material Scope 1 emissions (direct GHG emissions from owned or controlled operations) and Scope 2 emissions (indirect emissions from purchased or acquired electricity, steam, heat or cooling consumed by owned or controlled operations). The SEC noted that such information "can be necessary to inform an investor's understanding of the overall impact of transition risk and related targets and goals on a company's business, results of operations, financial condition, and prospects".[34] To balance the perceived value of such information with reporting burdens, the Final Rules (i) qualify the Scope 1 and 2 emissions disclosure obligation by materiality, (ii) extend phase-in periods, (iii) limit the historical periods required to be presented and (iv) exempt smaller reporting companies and emerging growth companies.

Reporting of material Scope 1 and 2 emissions. Under the Final Rules, only large accelerated filers and accelerated filers will be required to disclose Scope 1 and 2 emissions, and only if such emissions are material to the company. The Proposed Rules would have required all public companies (including the now-exempted smaller reporting companies and emerging growth companies) to disclose Scope 1 and 2 emissions regardless of their materiality.

Materiality determination. The Final Rules do not specify how companies should determine the materiality of Scope 1 and 2 emissions metrics. In the Adopting Release, the SEC stated that companies should apply "traditional notions of materiality", using the guiding principle of whether a reasonable investor would (i) consider the disclosure of the company's Scope 1 and/or 2 emissions important when making an investment or voting decision or (ii) view omission of the disclosure as having significantly altered the total mix of information made available.[35] The SEC also outlined non-exhaustive factors that may indicate a company's Scope 1 and/or 2 emissions metrics are material, including if:

- such disclosures are necessary to allow investors to understand whether those emissions are significant enough to subject the company to material transition risks (but noted that the fact a company is exposed to a material transition risk does not necessarily result in its Scope 1 and/or 2 emissions being material[36]);
- a company 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 because such emissions are currently or are reasonably likely to be subject to additional regulatory burdens through increased taxes or financial penalties; and
- their calculation and disclosure are necessary to enable investors to understand whether the company has made progress toward achieving a target or goal or a transition plan required to be disclosed under the Final Rules.

Historical periods. Any required GHG emissions disclosure must be presented for the most recently completed reporting year and any historical years included in the company's consolidated financial statements to the extent such emissions were previously disclosed in an SEC filing. In other words, if a company has not previously disclosed GHG emissions in an SEC filing for a particular historical fiscal year, it will not be required to estimate and report those emissions for that period.[37] The Proposed Rules would have required GHG emissions metrics to be presented for all historical periods included in the company's consolidated financial statements, if reasonably available.

Presentation. For any GHG emissions required to be disclosed, companies must disclose Scope 1 and 2 emissions separately (each expressed in the aggregate) in terms of CO_2e, as well as Scope 1 and 2 emissions in gross terms by excluding the impact of any purchased or generated offsets.

Reporting of material constituent gases. A company will be required to make a disaggregated disclosure with respect to a constituent greenhouse gas only if the constituent gas is individually material.

This represents a departure from the Proposed Rules, which would have required the disclosure of GHG emissions disaggregated by each of the seven constituent gases,[38] to address commenters' concern that the proposed approach would impose additional burdens and costs on companies without necessarily resulting in material information for investors.[39]

The Final Rules do not specify how companies should determine the materiality of individual gases. However, the Adopting Release noted that if a company has included a particular constituent gas in a GHG emissions reduction target that is disclosed pursuant to Item 1504(a), such constituent gas may be material. In particular, this guidance suggests that companies with methane reduction targets may be required to disclose such emissions on a disaggregated basis.

Calculation methodology. The Final Rules do not prescribe a particular methodology for calculating GHG emissions, but instead will require companies to describe the methodology, significant inputs, and significant assumptions used to calculate any GHG emissions required to be disclosed pursuant to Item 1505. The Final Rules also permit companies to determine their organizational boundary for GHG emissions disclosure purposes (rather than requiring alignment with financial reporting boundaries as proposed). Companies will be required to (i) describe the organizational boundaries used, including the method used to determine those boundaries and (ii) briefly explain if the organizational boundaries materially differ from the scope of entities and operations included in the company's consolidated financial statements. The Final Rules will also require companies to provide a brief discussion of the operational boundaries used, including the approach to categorization of emissions and emissions sources. Companies may use reasonable estimates when disclosing GHG emissions, as long as they also describe the underlying assumptions and reasons for using the estimates.

Delayed basis reporting. Unlike the Proposed Rules, the Final Rules will not require GHG emissions disclosed pursuant to Item 1505 to be included in the annual report. Instead, the disclosure can be forward incorporated from a later SEC filing as described in "Scope, Presentation and Timing" below. [40]

F. Attestation of Scope 1 and 2 Emissions Disclosure (Item 1506)

For companies that are required to disclose Scope 1 and/or 2 emissions under Item 1505, Item 1506 will require the filing of an attestation report covering such disclosure, which must be included in the filing that contains the GHG emissions disclosure covered by the report.

Level of assurance. The Final Rules extended the proposed phase-in periods for attestation in response to commenters' concerns about the potential cost of obtaining assurance, the potential shortage in the current supply of assurance providers and the continually evolving state of assurance standards and methodologies.[41] For both large accelerated filers and accelerated filers, beginning the third fiscal year after the initial compliance date for reporting GHG emissions under Item 1505, the attestation engagement covering disclosed Scope 1 and/or 2 emissions will need to be at least at a limited assurance level. Recognizing that obtaining reasonable assurance will be more costly,[42] the Final Rules will only require large accelerated filers to scale up to reasonable assurance (which will begin the seventh fiscal year after the initial compliance date for reporting GHG emissions under Item 1505).

The SEC declined to define limited assurance and reasonable assurance in the GHG emissions attestation context because "this terminology is generally well understood and should be defined by assurance standard setters and not by the Commission".[43] Furthermore, the SEC stated that it expects the description of the work performed as a basis for the assurance provider's conclusion to be included in any assurance report issued pursuant to the final rules, which should facilitate investors' understanding of the nature of the limited or reasonable assurance engagement.

Attestation standard. The Final Rules do not prescribe the use of any particular attestation standard, but require the standard used to be (i) publicly available at no cost or widely used for GHG emissions assurance and (ii) established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment.

Voluntary assurance prior to mandatory compliance date. If a company that is required to provide GHG emissions disclosure obtains voluntary assurance prior to being required to do so under Item 1506, it will need to include a description of such assurance (including the attestation provider and standards used, the level and scope of assurance, and the results of the assurance) in the relevant filing.[44]

Attestation report requirements. The Final Rules eliminate proposed provisions prescribing the minimum details that must be included in attestation reports, simply providing that the form and content of the attestation report must follow the requirements set forth by the attestation standard used by the GHG emissions attestation provider. Even though those proposed provisions have been removed, they have already impacted industry practices and are likely to continue to do so.

GHG emissions attestation provider. The GHG emissions attestation report will need to be prepared and signed by a GHG emissions attestation provider that has "significant experience"[45] in measuring, analyzing, reporting or attesting to GHG emissions, and meets the prescribed independence standards.

Additional disclosure. Large accelerated filers and accelerated filers must disclose whether the GHG emissions attestation provider is subject to any oversight inspection program and, if so, which program, and whether the GHG emissions attestation engagement is included within the scope of authority of such oversight inspection program. The Final Rules added a requirement to disclose whether any GHG emissions attestation provider engaged during the covered year resigned, declined to stand for reappointment or was dismissed and, if so, to disclose related details.

G. Safe Harbor (Item 1507)

Item 1507 specifies that the statutory safe harbor for forward-looking statements under the Private Securities Litigation Reform Act ("PSLRA") will cover "all information […] except for historical facts" related to transition plans, internal carbon price and scenario analysis (disclosed under Item 1502) and climate-related targets and goals (disclosed under Item 1504). The existing PSLRA safe harbor for forward-looking statements under the Securities Act of 1933 (the "Securities Act") and Securities Exchange Act of 1934 ("Exchange Act") will also cover other aspects of the new Regulation S-K disclosures to the extent that such disclosures meet the statutory definition of forward-looking statements. However, the existing safe harbor does not apply to forward-looking statements included in a company's consolidated financial statements. The SEC also declined to extend a safe harbor to Scope 1 and 2 emissions disclosures.[46]

The SEC adopted Item 1507 to provide a presumption that the covered disclosure items should benefit to the full extent permitted under the PSLRA safe harbor. Responding to comments that the covered disclosure items will likely elicit disclosures of mixed fact and forward-looking statements, the SEC indicated that the information falling outside of the safe harbor will be limited to those consisting "solely of historical fact".[47] The text of the Final Rules sets forth non-exclusive examples of disclosures that would constitute historical facts, including terms related to carbon offsets or RECs or statements about material expenditures actually incurred. The extent of the additional protection offered by Item 1507 is not clear, however. The proposing release noted that, without a specific safe harbor, forward-looking statements related to the impacts of climate-related targets and goals, scenario analysis, internal carbon price and transition plans would have been covered by the existing PSLRA safe harbor.

The Final Rules also extend the Item 1507 safe harbor to certain categories of transactions that are generally excluded from the PSLRA safe harbor (including IPOs).

To benefit from the Item 1507 safe harbor and the existing PSLRA safe harbor, companies will need to carefully review the new climate-related disclosures to ensure that forward-looking statements are clearly presented as such, and include well-drafted and tailored cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statements.

SUMMARY OF NEW REGULATION S-X REQUIREMENTS

Among the more controversial aspects of the Proposed Rules was the requirement that companies evaluate financial statement impacts on a line-item-by-line-item basis in the notes to their audited financial statements. The SEC received extensive comments regarding the difficulty companies would face in implementing the proposed requirements and the costly and burdensome adjustments companies would need to make to their controls, procedures and accounting records. In response to these comments, the SEC significantly narrowed the scope of financial statement disclosures in the Final Rules.

Nevertheless, the Final Rules prescribe potentially significant financial statement disclosures that will need to be supported by robust internal controls over financial reporting, which will be costly and time-consuming to implement and test on a timely basis.

A. Financial Statement Disclosures on Severe Weather Events and Other Natural Conditions (SWEs) (Rule 14-02(a) through (d))

The Final Rules will require companies to disclose certain financial statement effects of SWEs, in a note to the company's audited consolidated financial statements. The SEC does not define the term "severe weather events" or "natural conditions", but provides examples such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures and sea level rise. The SEC noted that these examples are illustrative and not intended to create a presumption about whether disclosure is required for such events in every circumstance. Rather, companies will be required to make judgments as to what constitutes a disclosable SWE based on the company's particular facts and circumstances, taking into account, among other factors, the company's geographic location, historical experience and the financial impact to the company.[48]

Expenditure metrics and capitalized costs and charges. Under Rule 14-02(c) and (d), a company will be required to disclose:

- the aggregate amount of expenditures expensed as incurred and losses, excluding recoveries, incurred during the fiscal year as a result of SWEs (e.g., amounts expended to restore operations or to relocate assets or operations affected by the event) to the extent the amount equals or exceeds 1% of the absolute value of pre-tax income or loss for the relevant fiscal year, with a $100,000 *de minimis* exception;[49] and
- the aggregate amount of capitalized costs and charges, excluding recoveries, incurred during the fiscal year as a result of SWEs to the extent the absolute value of such amount equals or exceeds 1% of the absolute value of stockholder's equity or deficit at the end of the relevant fiscal year, with a $500,000 *de minimis* exception.[50]

With a more limited scope, Rule 14-02(c) and (d) represent a significant departure from the proposed "Financial Impact Metric" rule, which would have required much more granular disclosure of impacts of climate-related risks, including SWEs and transition activities, on individual financial statement line items and amounts incurred to reduce GHG emissions or otherwise mitigate exposure to transition risks.[51] Following feedback from commenters that the proposed rule was unworkable and would have been overly costly and burdensome to implement, the Final Rules focus on a "discrete set of actual expenses that registrants incur and can attribute to [SWEs]".[52]

The Final Rules retained a quantitative disclosure threshold for expenditures expensed as incurred and losses and capitalized costs and charges incurred as a result of SWEs. The SEC viewed a bright-line standard as a means to promote comparability and consistency among a company's filings over time as well as among different companies. However, a company that has a "break-even" amount of pre-tax income or loss will need to identify and disclose expenditures expensed as incurred and losses incurred that may be clearly immaterial in relation to its revenues, expenses and non-GAAP financial measures used by management and investors to measure operating performance.

Contextual information related to SWEs. Under Rule 14-02(a), if a company is required to disclose a financial statement effect as described above, it will also be required to provide contextual information about how the effect was derived, including a description of any 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 to calculate the specified disclosures. Under Rule 14-02(f), if a company is required to disclose expenditures expensed as incurred and losses or capitalized costs and charges as a result of SWEs pursuant to Rule 14-02(c) and (d) (described above), then it must separately disclose the aggregate amount of any recoveries recognized during the fiscal year as a result of the SWE for which expenditures expensed as incurred and losses or capitalized costs and charges have been disclosed. In addition, a company will be required to identify in its disclosure where such recoveries are presented in the income statement and balance sheet.[53]

B. Financial Statement Disclosures on Carbon Offsets and RECs (Rule 14-02(e))

Under Rule 14-02(e), if carbon offsets or RECs have been used as a material component of a company's plans to achieve climate-related targets or goals disclosed under the Final Rules, the company will be required to disclose (i) the aggregate amount of carbon offsets and RECs expensed, (ii) the aggregate amount of capitalized carbon offsets and RECs recognized, (iii) the aggregate amount of losses incurred on the capitalized carbon offsets and RECs during the relevant fiscal year and (iv) the beginning and ending balances of the capitalized carbon offsets and RECs for the fiscal year.[54] In addition, the company is required to separately identify where the expenditures expensed, capitalized costs, and losses are presented in the income statement and balance sheet. The Proposed Rules would have required disclosure of any use of carbon offsets or RECs as part of a company's plan to achieve climate-related targets or goals, regardless of materiality.[55]

C. Financial Estimates and Assumptions (Rule 14-02(h))

As part of the financial statement disclosures, companies will be required to provide qualitative disclosure of how the estimates and assumptions a company used to produce its consolidated financial statements were materially impacted by (i) exposure to risks and uncertainties associated with, or known impacts from, SWEs, (ii) any climate-related targets disclosed by the company or (iii) any transition plans disclosed by the company.

D. Attribution

In response to commenter concerns regarding companies' ability to isolate, attribute and quantify expenditures related to SWEs, the Final Rules prescribe an attribution principle. Under Rule 14-02(g), companies will be required to attribute a capitalized cost, expenditure expensed, charge, loss or recovery to a SWE and disclose the entire amount of the expenditure or recovery when the event or condition is "a significant contributing factor" in incurring the capitalized cost, expenditure expensed, charge, loss or recovery. The SEC recognized that U.S. GAAP does not define "significance", but noted that U.S. GAAP requires companies to apply the same concept in many areas.

E. Historical Periods

Under the Final Rules, companies will be required to provide disclosure for historical fiscal year(s) included in its consolidated financial statements on a prospective basis only. Under Rule 14-01(d), disclosure will be required for the company's most recently completed fiscal year, and to the extent previously disclosed or required to be disclosed, for historical fiscal year(s) for which audited consolidated financial statements are included in the filing. For example, in a large accelerated filer's first year of compliance, it will be required to provide disclosure only with respect to fiscal 2025. In its second year of compliance, it will be required to include disclosure with respect to fiscal 2025 and fiscal 2026. In contrast, the Proposed Rules would have required financial statement disclosures for all historical periods included in a company's consolidated financial statements, if reasonably available.

SCOPE, PRESENTATION AND TIMING

A. Scope

The new disclosure requirements apply to all domestic companies and foreign private issuers, even if the reporting company is already subject to similar disclosure requirements in another jurisdiction. Consistent with the Proposed Rules, the Final Rules exempt Canadian companies that qualify to use the Multijurisdictional Disclosure System and file annual reports on Form 40-F.

In a change from the Proposed Rules, the Final Rules will not extend to a private company that is a party to a business combination transaction registered on Form S-4 or Form F-4. However, IPO registrants must comply on the tiered timelines set forth below, without any exemption or additional phase-in.

B. Presentation

The Final Rules will require in-scope companies to make climate-related disclosures (on a "filed" basis) in their annual reports and registration statements filed with the SEC.

- ***Form 10-K filers:*** The Final Rules will require the information under the Final Rules (including the financial statement disclosures under Article 14 of Regulation S-X) to be included in companies' annual reports filed on Form 10-K. A company may provide the GHG emissions disclosures and attestation reports on a delayed basis, either in (i) its Form 10-Q for the second fiscal quarter in the fiscal year after the reporting year (indicating that such information is being incorporated by reference into its previously filed Form 10-K) or (ii) a Form 10-K amendment no later than the due date for such Form 10-Q. Companies wishing to take advantage of delayed reporting will need to include an express statement in their annual reports indicating their intention to do so.
- ***Form 20-F filers:*** Consistent with requirements for Form 10-K filers, the Final Rules will require the information under the Final Rules (including the financial statement disclosures under Article

14 of Regulation S-X) to be included in foreign private issuers' annual reports filed on Form 20-F. As discussed above, a foreign private issuer may provide the GHG emissions disclosures and attestation reports on a delayed basis in an amendment to its annual report on Form 20-F, which will be due no later than 225 days after the end of the reporting year. Companies wishing to take advantage of delayed reporting will need to include an express statement in their annual reports indicating their intention to do so.

- ***No quarterly update:*** In-scope companies will not have to disclose any material change to the climate-related disclosures provided in a registration statement or annual report in its Form 10-Q (or Form 6-K for a foreign private issuer).
- ***Registration statements:*** All information required to be disclosed under the Final Rules must be included in registration statements filed under the Securities Act and Exchange Act. If a company is filing a Securities Act or Exchange Act registration statement, subject to the applicable phase-in period, it must include GHG emissions disclosures and related attestation reports as of the most recently completed fiscal year that is at least 225 days prior to the date of effectiveness of the registration statement.[56] A company may incorporate by reference the information required by the new Regulation S-K requirements to the extent it is permitted to incorporate by reference the other information required by the applicable form and by the same means provided by such form.
- ***Location of disclosure:*** Companies must include the new Regulation S-K disclosures either in (i) a separate section of the relevant filing captioned "Climate-Related Disclosure" or (ii) another appropriate section of the filing, such as Risk Factors, Description of Business or MD&A. If a company takes the latter approach, the SEC suggested that the company should consider whether cross-referencing other disclosures in separately captioned sections would enhance the presentation of climate-related disclosures for investors.[57]
- ***iXBRL:*** Companies will be required to electronically tag both narrative and quantitative climate-related disclosures in Inline XBRL.[58]

C. Initial Compliance Timeline

The SEC adopted tiered compliance dates for the Final Rules as follows:[59]

Filer Type	Disclosure and Financial Statement Effects Audit		GHG Emissions / Assurance			Electronic Tagging
	All Requirements (Except As Otherwise Specified)	*Material Expenditures and Impacts on Financial Estimates* [60]	*Scope 1 and 2 Metrics*	*Limited Assurance*	*Reasonable Assurance*	*Inline XBRL Tagging for Subpart 1500*[61]
Large Accelerated Filer	Fiscal Year* 2025	Fiscal Year* 2026	Fiscal Year* 2026	Fiscal Year* 2029	Fiscal Year* 2033	Fiscal Year* 2026
Accelerated Filer	Fiscal Year* 2026	Fiscal Year* 2027	Fiscal Year* 2028	Fiscal Year* 2031	N/A	Fiscal Year* 2026
Smaller Reporting Company, Emerging Growth Company and Non-Accelerated Filer	Fiscal Year* 2027	Fiscal Year* 2028	N/A	N/A	N/A	Fiscal Year* 2027

** In the above table, "Fiscal Year" refers to any fiscal year beginning in the specified calendar year.*

KEY IMPLICATIONS

1. In light of the relatively short initial compliance timeline, in-scope companies should prepare now.

Companies will need to stand ready to comply with the rules in advance of the applicable initial compliance date. For companies that do not have robust climate reporting processes already in place, it could take substantial effort and resources to build up the infrastructure needed to ensure compliance readiness. Even a company that already publishes TCFD-aligned climate disclosures in its sustainability reports may need to expend significant additional efforts to subject such disclosures to the rigor required for disclosures in SEC filings, including to comply with disclosure controls and procedures and support Sarbanes-Oxley officer certifications. In addition, the new financial statement disclosures will be subject to audit and will be within the scope of internal controls over financial reporting. Therefore, it is crucial for companies to promptly review their data collection and control infrastructure, assess the controls and procedures currently in place to capture, prepare and validate the information required under the Final Rules, and to adopt and implement new controls and procedures prior to initial reporting. For example, for large accelerated filers, a SWE occurring in January 2025 may trigger disclosure under the Final Rules, and such filers will need to ensure that they have established and tested processes (including those discussed below) in advance for identifying a SWE and tracking the related financial impacts.

2. Interpretive challenges under the Final Rules, such as the determination of materiality and disaggregated financial impact of SWEs, will increase reporting complexity.

Key elements of the Final Rules pose interpretive challenges that may require changes to current practices:

Materiality of GHG emissions metrics. Assessing the materiality of GHG emissions metrics could pose particularly significant interpretive challenges. The SEC stated that the materiality of GHG emissions metrics should be assessed under the Supreme Court's standard in *TSC Industries, Inc.* v. *Northway, Inc.*, and intimates such an assessment could require companies to conduct qualitative and quantitative assessments with respect to their Scope 1 and 2 emissions.[62] As a result, companies may need to track and monitor their Scope 1 and 2 emissions in order to evaluate materiality, even in situations where a company ultimately determines that the disclosures are not required. The SEC further acknowledged that, for some companies, the cost of making a materiality determination could be significant, especially if the company is not already tracking this information for internal purposes.[63]

Adding to the challenges, a standardized approach to determining materiality in the GHG emissions context has not emerged. Today, many companies use a "comply-or-explain" approach when deciding which GHG emissions metrics they disclose under voluntary frameworks such as TCFD. In the absence of a standardized approach, different stakeholders within a company, as well as its attestation and other external service providers, may need to expend meaningful coordination efforts to align on materiality determinations. While the Adopting Release lists a range of factors that may indicate Scope 1 and/or 2 emissions are material to a company, such factors are non-exhaustive, and stakeholders may take differing views on how to apply such factors. Companies should also be mindful that the SEC may not defer to companies' materiality determinations with respect to climate-related disclosures, as evidenced by the SEC staff's comment letters on this topic between 2021 and 2024. Therefore, in making this determination, companies should consider coordinating across their organization, including their board, management and their risk, legal, finance, technology, sustainability and accounting functions.

Other materiality determinations and related implications. The Final Rules call on companies to make materiality determinations in many other contexts, such as in connection with material climate-related risks and their material impacts, which may differ from disclosure determinations made as part of voluntary climate reporting under TCFD or another standard. Any perceived discrepancy between the information contained in an SEC filing and those in other public disclosures (including prior SEC filings and voluntary reports) could invite questions from the SEC, shareholders, potential litigants and other stakeholders. For example, if a company determines that certain climate-related information included in its voluntary sustainability report is immaterial and therefore omits such information from its annual report or registration statement, the SEC could question the company's materiality determination, as it has done in its recent comment letters. As another example, if a company discloses a material chronic risk under the Final Rules but did not disclose such risk in prior SEC filings, stakeholders may question the omission of such disclosure in prior years.[64]

Companies should also be aware that their materiality determinations can potentially trigger additional disclosure requirements under the Final Rules. For example, once a company identifies a climate-related risk as material, any transition plans adopted to manage the impact of such material risk must also be disclosed. As discussed in "Targets and Goals", if a company determines that a GHG emissions reduction target or goal is material, the company may also need to report and annually update the underlying Scope 1, 2 and/or 3 emissions metrics to satisfy its disclosure obligations, even if the GHG emissions metrics are not otherwise required to be disclosed. In other words, if a company discloses a net zero goal covering Scope 1 and/or 2 emissions but does not report GHG emissions metrics under Item 1505, such decision could attract questions from the SEC and other stakeholders.

Determining disaggregated financial Impact of SWEs. The Final Rules link financial statement disclosure requirements to "severe weather events" and "other natural conditions" without defining such terms. This will require companies to make their own determinations as to which SWEs trigger disclosure, and they will need to substantiate these determinations as part of the audit process. In addition, companies will need to disaggregate the financial impacts of SWEs, which imposes further interpretive challenges since it can often be difficult to determine whether a financial impact results from a SWE or other surrounding circumstances. Making these interpretations in a principled manner that is consistent with robust internal controls over financial reporting will require significant time and effort from the company and its auditors. Interpretive issues should be addressed well in advance of the initial compliance date and with sufficient time to conduct required testing.

3. In assessing initial compliance readiness, companies must consider the implications of climate-related disclosure requirements in other jurisdictions, such as the EU and California.

For many companies, the Final Rules will constitute only one of several disclosure frameworks under which they must report climate-related information. U.S. public companies and foreign private issuers subject to multiple climate-related disclosure requirements will need to consider the overlap and discrepancies between the information requirements in each relevant jurisdiction, requirements with respect to reporting timelines, formats and attestation, each jurisdiction's approach to materiality and the standards of liability applicable to disclosures provided. In designing a climate-related disclosure plan that is responsive to all relevant requirements, a threshold question is whether to use a single climate disclosure report that complies with multiple standards, or to prepare separate reports that differ in scope and content.

No substituted compliance or recognition of non-U.S. disclosure rules. The SEC's rejection[65] of substitute compliance will most immediately affect companies subject to the EU's Corporate Sustainability Reporting Directive ("CSRD") and those that report in jurisdictions expected to adopt disclosure requirements aligned with the standards developed by the International Sustainability Standards Board ("ISSB"), such as the United Kingdom, Australia, Canada, China, Japan, New Zealand and Singapore. The SEC noted that it "may consider such accommodations in the future", depending on how international climate reporting practices develop and the SEC's experience with disclosures made under its rules,[66] but provided no timeline for revisiting the matter. ***State-level requirements.*** In the U.S., state lawmakers have enacted or proposed climate-related disclosure requirements with explicitly extraterritorial coverage. For example, California's expansive climate-related disclosure laws will require TCFD-aligned disclosure of climate-related financial risk and Scope 1, 2 and 3 emissions reporting for all U.S. companies (both public and private) that "do business" in California and meet a specified total annual revenue threshold. As drafted, the California law requirements are not qualified by materiality. While it is clear that California's climate-related disclosure laws would intersect with those in the Final Rules, it is not yet clear how they will interoperate. The California laws require implementing regulations that have not yet been developed and are facing pending litigation. Similar laws have also been proposed in other states, including New York and Illinois.

Requirements in other jurisdictions can influence the SEC's assessment of compliance with the Final Rules. The SEC indicated that it intends to observe developments in climate-related reporting requirements in other jurisdictions.[67] For example, the SEC stated in the Adopting Release that companies should consider whether GHG emission metrics may be material (and therefore required to be disclosed under the Final Rules) if a company discloses a material transition risk that has manifested as a result of a GHG reporting requirement in another jurisdiction that has made such company's emissions currently or reasonably likely to be subject to additional regulatory burdens through increased taxes or financial penalties.[68]

Companies may produce separate voluntary reports. Because the Final Rules omit or adjust certain elements of the TCFD framework, companies may choose to continue to publish more fulsome voluntary reports in response to expectations of shareholders, proxy advisors, customers, counterparties, sustainability disclosure and ranking organizations (such as CDP) and other key stakeholders, who may prefer climate reporting that more closely aligns with TCFD.[69] As discussed above, the SEC and other stakeholders may focus on perceived discrepancies between SEC filings and voluntary disclosures, and companies must carefully consider their statements made outside SEC filings in evaluating their approach to the Final Rules.

4. The Final Rules will increase companies' overall exposure to litigation and regulatory risks, but only provide a limited safe harbor.

By increasing the amount of climate-related disclosures required to be filed with the SEC, the Final Rules will increase public companies' exposure to liability. Given the limited safe harbor provided under the Final Rules and the current polarized environment, legal teams should be integrated early in the reporting process to mitigate potential legal risks.

Liability safe harbor excludes historical facts. Given the inherently uncertain nature of some of the climate-related disclosures that will be required, as well as evolving science, standards, methodologies and industry practices, many commenters requested that the SEC provide robust safe harbors covering both forward-looking and certain historical information provided under the new climate-related disclosure requirements. The SEC opted to specify in Item 1507 that the PSLRA safe harbor covers required disclosures related to transition plans, scenario analysis, internal carbon price and targets and goals,[70] but explicitly stated that the safe harbor will not apply to matters of historical facts. The express exclusion for historical facts significantly limits the protection afforded under the safe harbor, as many of the inputs to these plans, analyses, prices, targets and goals will consist of a complex mix of factual and forward-looking information, making key aspects of the disclosures outside of the safe harbor provision. In addition, there is no liability safe harbor for Scope 1 and 2 GHG emissions or the new financial statement disclosures, where significant interpretive challenges exist as discussed above.

"Filed" not "furnished". The Final Rules will require the new disclosures to be filed in registration statements and in periodic reports that are automatically incorporated into registration statements. As a result, the climate-related disclosures filed under the Final Rules could be subject to heightened Securities Act liability.

Polarization of climate-related issues. The new disclosures may also increase companies' exposure to risks associated with action taken by regulators, other government officials, shareholders, customers, employees and other stakeholders, who may have diverging views and interests with respect to climate-related topics. In preparing the disclosures required under the Final Rules, companies should also consider the potential reactions of key stakeholders to such disclosures (including disclosures with respect to climate-related strategy, transition plans and targets and goals), which could have legal, reputational, operation and financial implications.

5. Legal challenges to the Final Rules amplify uncertainty for public companies.

The Final Rules have attracted immediate and intense scrutiny from a variety of stakeholders. Multiple petitions have been filed and more filings are anticipated. A preliminary ruling impacting the effectiveness of the Final Rules could be made in the coming months.

To date, petitions challenging the Final Rules include those filed by:

- 10 state attorneys general on March 6, 2024 in the Eleventh Circuit, arguing that the adoption of the Final Rules exceeded the SEC's statutory authority and is otherwise "arbitrary, capricious, an abuse of discretion and not in accordance with law";[71]
- Liberty Energy Inc. and Nomad Proppant Services LLC on March 6, 2024 in the Fifth Circuit along with an emergency stay motion and a request for a ruling on the stay by March 16, 2024;[72]
- a group of three state attorneys' general on March 7, 2024 in the Fifth Circuit, who described the Final Rules as "regulatory overreach seeking to advance the Biden Administration's climate-change agenda" in an accompanying statement;[73] and
- the Texas Alliance of Energy Producers and the Domestic Energy Producers Alliance in the Fifth Circuit on March 11, 2024, who issued an accompanying statement that "Congress did not authorize the SEC to demand that companies report environmental or any other controversial issues completely unrelated to finance".[74]

In addition, on March 6, 2024, the Sierra Club announced that it is "considering challenging the SEC's arbitrary removal of key provisions [including Scope 3 disclosure requirements] from the final rule, while also taking action to defend the SEC's authority to implement such a rule".[75] On the same day, the U.S. Chamber of Commerce issued a statement that it "will continue to use all the tools at [its] disposal, including litigation if necessary, to prevent government overreach and preserve a competitive capital market system".[76]

The uncertainty surrounding a potential judicial stay or *vacatur* of the Final Rules imposes additional challenges for companies subject to the Final Rules, including how to prioritize resources and allocate budgets. However, given the potentially significant amount of preparation required to become compliance-ready, companies may not have the luxury of waiting for a final judicial ruling, particularly large accelerated filers that will need to comply with respect to fiscal year 2025 and other companies that will require substantial enhancements to their climate reporting procedures to become compliance-ready.

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ENDNOTES

[1] SEC Chair Gary Gensler and Commissioners Caroline Crenshaw and Jaime Lizárraga voted in favor of the Final Rules, and Commissioners Hester Peirce and Mark Uyeda voted against.

[2] The Final Rules will become effective 60 days following their publication in the Federal Register.

[3] *See* SEC Release Nos. 33-11275; 34-99678; File No. S7-10-22 (March 6, 2024) (the "Adopting Release") at p. 12, *available at* https://www.sec.gov/files/rules/final/2024/33-11275.pdf.

[4] *See* the SEC's press release announcing the adoption of the Final Rules, *available at* https://www.sec.gov/news/press-release/2024-31.

[5] *See* the Adopting Release at pp. 596.

[6] *See* the Petition for Review filed by Liberty Energy Inc. and Nomad Proppant Services LLC in the Fifth Circuit, *available at* https://app.pacerpro.com/cases/18698083. For a more in-depth discussion of the lawsuits, please see "Key Implications".

[7] The SEC stated that, consistent with its "authority and its traditional role, the Commission is agnostic as to whether and how issuers manage climate-related risks so long as they appropriately inform investors of material risks". *See* the Adopting Release at p. 72.

[8] Item 1500 of Regulation S-K.

[9] *See* the Adopting Release at p. 91. The SEC had proposed including risks to a company's value chain within the definition of climate-related risks.

[10] The SEC explained that, when evaluating whether the impact of any climate-related risks are "reasonably likely" to occur, companies should follow the same standard used to assess MD&A disclosure regarding known trends, events and uncertainties. *See* the Adopting Release at p. 106 & n. 383. Under this standard, a company would have to disclose a known trend or uncertainty if it (i) is reasonably likely to occur and (ii) would be material to the company if it did occur. It is a lower threshold than "more likely than not" but a higher threshold than "remote".

[11] The Adopting Release acknowledges that the SEC's existing rules already generally require a company to disclose the effects of material risks, which would include climate-related risks. However, the SEC notes in the Adopting Release that many companies do not discuss climate-related risks in response to existing disclosure requirements, and that the SEC has added the new requirement to provide investors with access to information of climate-related material impacts and risks on a more "consistent and comparable basis." Adopting Release at pp. 115-16.

[12] *See* the Adopting Release at pp. 103-4.

[13] *See* the Adopting Release at p. 104.

[14] "Transition risk" is defined as "the actual or potential negative impacts on a company's business, results of operations, or financial condition attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks". Item 1500 of Regulation S-K.

[15] "Acute risks" mean "event-driven and may relate to shorter term severe weather events, such as hurricanes, floods, tornadoes, and wildfires, among other events", while "chronic risks" refer to risks that "relate to longer term weather patterns, such as sustained higher temperatures, sea level rise, and drought, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water". Item 1500 of Regulation S-K.

[16] *See* the Adopting Release at pp. 97-8.

[17] The SEC explained that the disclosure required under Item 1502(d)(2) is intended to provide investors with a financial metrics to assess the company's management of disclosed risk and the

ENDNOTES (CONTINUED)

financial impact of such activities. The SEC noted that by placing these requirements under Regulation S-K, companies will have the flexibility to explain qualitatively the nature of the expenditure and how management has determined that it is a direct result of the transition activities. These disclosures may be made in tabular or narrative form, according to how a company believes such information best fits within its overall climate risk disclosure. *See* the Adopting Release at pp. 121-4.

[18] A transition plan may include a company's plan to reduce its GHG emissions in line with its own commitments or commitments of jurisdictions within which it has significant operations. *See* Item 1500 of Regulation S-K.

[19] *See* the Adopting Release at pp. 139-40.

[20] *See* the Adopting Release at p. 137.

[21] Scenario analysis is defined as "a process for identifying and assessing a potential range of outcomes of various possible future climate scenarios, and how climate-related risks may impact a registrant's business strategy, results of operations, or financial condition over time". Item 1500 of Regulation S-K.

[22] *See* the Adopting Release at pp. 149-50.

[23] *See* the Adopting Release at p. 150.

[24] Item 1500 of Regulation S-K.

[25] *See* the Adopting Release at p. 100.

[26] *See* the Adopting Release at p. 194.

[27] *See* the Adopting Release at p. 184-85.

[28] *See* the Adopting Release at p. 196.

[29] *See* the Adopting Release pp. 215-216.

[30] Item 1504(a) of Regulation S-K.

[31] *See* the Adopting Release at p. 211.

[32] *See* the Adopting Release at pp. 211-12, 215.

[33] *See* the Adopting Release at p. 244.

[34] *See* the Adopting Release at p. 244.

[35] *See* the Adopting Release at p. 246.

[36] For example, a company could reasonably determine that it is exposed to a material transition risk for reasons other than its GHG emissions, such as a new law or regulation that restricts the sale of its products based on the technology it uses, not directly based on its emissions. *See* the Adopting Release at p. 247.

[37] *See* the Adopting Release at pp. 258-59.

[38] Constituent gases of GHG emissions include (i) carbon dioxide, (ii) methane, (iii) nitrous oxide, (iv) nitrogen trifluoride, (v) hydrofluorocarbons, (vi) perfluorocarbons and (vii) sulfur hexafluoride.

[39] *See* the Adopting Release at p. 249.

[40] The SEC provided for delayed reporting of GHG emission because companies may have difficulty measuring and reporting GHG emissions on the same timeline as an annual report. *See* the Adopting Release at p. 259. However, companies will likely need to have sufficiently complete GHG data by the time of the annual report in order to respond to other disclosure requirements,

ENDNOTES (CONTINUED)

such as the requirement to provide annual updates on progress towards any transition plans, targets or goals.

41 *See* the Adopting Release at pp. 287-88.

42 *See* the Adopting Release at p. 294.

43 *See* the Adopting Release at p. 298.

44 Voluntary assurance obtained after the first required fiscal year in addition to any required assurance must follow general attestation requirements and use the same attestation standard. *See* Item 1506 of Regulation S-K.

45 "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. *See* Item 1506 of Regulation S-K.

46 *See* the Adopting Release at p. 401. The Proposed Rule would have provided a modified fraud safe harbor for Scope 3 emissions disclosures.

47 *See* the Adopting Release at p. 400.

48 *See* the Adopting Release at pp. 485-486.

49 Rule 140-02(b)(1).

50 Rule 14-02(b)(2).

51 *See* the Adopting Release at p. 461.

52 *See* the Adopting Release at p. 447.

53 Rules 14-02(c), 14-02(d).

54 Rule 14-02(e).

55 The Adopting Release confirmed that disclosures made about carbon offsets and RECs, even if made as a part of a company's disclosure of its climate-related targets or goals, will not be subject to the safe harbor under the Final Rules. *See* the Adopting Release at 400.

56 *See* the Adopting Release at p. 34.

57 *See* the Adopting Release at p. 56.

58 *See* the Adopting Release at p. 720.

59 *See* the SEC's fact sheet on the Final Rules, *available at* https://www.sec.gov/files/33-11275-fact-sheet.pdf.

60 These provisions include Item 1502(d)(2) (material expenditures incurred and material impacts on financial estimates and assumptions from adaptive and mitigation activities), Item 1502(e)(2) (material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of a disclosed transition plan) and Item 1504(c)(2) (material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or the actions taken to make progress toward meeting the target or goal). These provisions do not include the financial statement disclosures under Article 14, which are subject to the applicable earlier compliance dates.

61 Financial statement disclosures under Article 14 will need to be tagged in accordance with existing rules pertaining to the tagging of financial statements. *See* Rule 405(b)(1)(i) of Regulation S-T.

62 *See* the Adopting Release at p. 247.

ENDNOTES (CONTINUED)

[63] *See* the Adopting Release at pp. 247-8.

[64] *See* note 11 above on the SEC statement in the Adopting Release that many companies do not discuss climate-related risks in response to existing disclosure requirements.

[65] *See* the Adopting Release at p. 568.

[66] *See* the Adopting Release at p. 805.

[67] *Id*.

[68] *See* the Adopting Release at pp. 246-47.

[69] For example, Glass Lewis's latest benchmark policy stated that it will assess whether companies have produced TCFD-aligned disclosures. *See* Glass Lewis, 2024 Benchmark Policy Guidelines at p. 8, *available at* https://www.glasslewis.com/wp-content/uploads/2023/11/2024-US-Benchmark-Policy-Guidelines-Glass-Lewis.pdf?hsCtaTracking=104cfc01-f8ff-4508-930b-b6f46137d7ab%7C3a769173-3e04-4693-9107-c57e17cca9f6*.*

[70] Item 1507 of Regulation S-K.

[71] *See* the Petition for Review filed by 10 state attorneys generals in the Eleventh Circuit, *available at* https://ago.wv.gov/Documents/SEC%20Climate%20Disclosure%20Petition%20for%20Review.pdf;.

[72] *See* the Petition for Review filed by Liberty Energy Inc. and Nomad Proppant Services LLC in the Fifth Circuit, *available at* https://app.pacerpro.com/cases/18698083.

[73] *See* the Petition for Review and accompanying statement from Louisiana Attorney General Liz Murrill, *available at* https://www.ag.state.la.us/Article/13199.

[74] *See* the Petition for Review and accompanying statement from the Texas Alliance of Energy Producers and the Domestic Energy Producers Alliance, *available at* https://pacificlegal.org/wp-content/uploads/2024/03/DEPA-v.-SEC-Petition-for-Review_final.pdf.

[75] *See* Sierra Club's statement (March 6, 2024), *available at* https://www.sierraclub.org/press-releases/2024/03/sec-climate-disclosure-rule-represents-important-progress-falls-short-key.

[76] *See* U.S. Chamber of Commerce's statement (March 6, 2024), *available at* https://www.uschamber.com/finance/corporate-governance/u-s-chamber-statement-on-the-sec-climate-disclosure-rule.

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