

The SEC's climate-related disclosure rules: a scaled back milestone

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On March 6, 2024, the Securities and Exchange Commission (the "SEC") voted to adopt its Climate-Related Disclosure Rule¹ (the "Final Rule"), by a vote of 3-2.

Finalized almost two years after the initial proposed rule² (the "Proposed Rule") garnered over 24,000 comment letters from issuers, shareholders, interest groups and others — significantly more than any other past piece of SEC rulemaking — the Final Rule marks the first federal sustainability disclosure requirement in the U.S. and requires issuers to provide information on Scope 1 and Scope 2 greenhouse gas emissions ("GHG emissions"), severe weather-related financial statement disclosures and climate-related governance, risks and targets disclosures.

Notably, the Final Rule includes several significant deviations from the Proposed Rule, including:

- The requirement to provide GHG emissions data will only apply to registrants that are accelerated filers ("AFs") or large accelerated filers ("LAFs");
- No issuer will be required to provide Scope 3 GHG emissions data, and Scope 1 and 2 GHG emissions data is required by AFs and LAFs only if material;
- Issuers will not be required to disclose the financial impacts of severe weather events and transition activities on each line item in the consolidated financial statements;
- Disclosure of board and management oversight required by the Final Rule is streamlined, and issuers will not need to disclose the climate expertise of their board members;
- Most disclosure requirements in the Final Rule are subject to a materiality threshold.

On the whole, the Final Rule represents a win for detractors of the Proposed Rule given its significantly scaled-back requirements.

Below, we discuss the requirements of the Final Rule, offer a comparison to other climate disclosure requirements in force, summarize potential (and already-filed) legal arguments challenging the Final Rule's enforceability and provide next steps for consideration.

GHG emissions metrics

The Final Rule requires Scope 1 (*i.e.*, direct emissions from company-owned or -controlled sources) and/or Scope 2 (*i.e.*, indirect emissions from the generation of purchased energy, such as electricity) GHG emissions disclosures, if material, by LAFs and AFs that are not smaller reporting companies ("SRCs") or emerging growth companies ("EGCs"). The disclosure is required on a phased-in basis as presented in the table on page 5 below and notably excludes Scope 3 emissions and GHG emissions intensity figures entirely.

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The requirement to disclose material Scope 3 emissions (*i.e.*, all indirect emissions that occur both upstream and downstream in the value chain of the reporting company) was one of the most controversial aspects of the Proposed Rule due to the anticipated calculation costs and challenges associated with the current reliability and robustness of data associated with those calculations.

In determining whether Scope 1 and 2 emissions are material, the SEC noted in its adopting release for the Final Rule (the "Adopting Release") that traditional notions of materiality are intended to apply — a sentiment reiterated throughout the release.

The Adopting Release goes on to provide two examples: (i) where the registrant is subject to transition risk by virtue of its GHG emissions that is likely to materially impact its business in the short or long term and (ii) where the registrant has targets, goals or a transition plan that otherwise requires disclosure under the rules.

Under the Final Rule, material Scope 1 and 2 emissions must be reported for the registrant's most recently completed fiscal year, and for the historical fiscal year(s) included in the consolidated

financial statements included in the filing, if previously reported.³ Limited assurance must be provided on a phased-in basis for Scope 1 and Scope 2 emissions by both LAFs and AFs, but only LAFs will be required to provide reasonable assurance.

Additionally, registrants must describe the organizational and operational boundaries used when calculating Scope 1 and/or Scope 2 emissions, including the method used to determine such boundaries, whether the organizational boundaries materially differ from the scope of entities and operations included in the registrant's consolidated financial statements, and the method used to determine boundaries in that scenario.

Though the Scope 1 and/or Scope 2 emissions disclosure is required to be included in the registrant's Form 10-K (or 20-F) filing, the Final Rule provides that it may be incorporated by reference from the registrant's Form 10-Q for the second fiscal quarter in the fiscal year immediately following the year to which the GHG emissions disclosure relates.

Strategy and risk disclosure

The Final Rule, in part modeled on the Task Force on Climate-Related Financial Disclosures, requires detailed disclosure of climate-related risks that have materially impacted or are reasonably likely to have a material impact on registrants' strategy, results of operations or financial condition.

The Final Rule requires registrants to describe board oversight of, and management's role in respect of, climate-related risk.

While the Proposed Rule put the burden on registrants to define relevant short-, medium- and long-term time horizons for these risks, the Final Rule simply requires registrants to disclose whether the identified climate-related risks are likely to manifest in the short term, meaning the next 12 months, or in the long term, covering any time after 12 months.

Among other requirements, the Final Rule requires registrants to disclose:

- Whether the risk is a physical or transition risk.
- The actual and potential material impacts on the registrant's **business strategy, financial planning and capital allocation** of any climate-related risks.
- Information about the **material expenditures** incurred and material impacts on financial estimates and assumptions.

In addition, the Final Rule requires disclosure regarding the use of (1) transition plans, (2) scenario analysis and (3) internal carbon pricing, each to the extent applicable to the registrant.

Financial statement metrics

The Final Rule requires registrants to provide disclosure relating to:

- (1) *Capitalized costs, expenditures expensed, charges and losses*: quantitative disclosure of the aggregate amount of capitalized costs, expenditures expensed, charges and losses incurred, excluding recoveries, during the fiscal year as a result of severe weather events and other natural conditions (subject to applicable 1% and *de minimis* thresholds, disclosed in a note to the financial statements);
- (2) *Carbon offsets and RECs*: quantitative disclosure of the capitalized costs, expenditures expensed and losses incurred associated with carbon offsets and RECs, if they have been used as a material component of the registrant's plan to achieve climate-related targets or goals, disclosed in a note to the financial statements;
- (3) *Financial estimates and assumptions*: where financial estimates and assumptions a registrant uses to produce financial statements are materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or disclosed climate-related targets or transition plans, qualitative disclosure on how the development of estimates/assumptions was impacted, disclosed in a note to the financial statements; and
- (4) Certain contextual information, including the aggregate amount of any recoveries recognized during the fiscal year as a result of severe weather events and other natural conditions for which capitalized costs, expenditures expensed, charges or losses have been disclosed.

Governance and oversight

The Final Rule requires registrants to describe board oversight of, and management's role in respect of, climate-related risk.

With respect to the board oversight of these risks, the Final Rule requires registrants to disclose:

- Any board committee or subcommittee responsible for climate-related risk, if applicable;
- The processes by which the board or relevant committee or subcommittee is informed about climate-related risks, if applicable; and
- Whether and how the board oversees progress against a disclosed transition plan, climate-related target or goal, if any.

The SEC noted in the Adopting Release that the Final Rule is not intended to shift governance behaviors and that disclosure in this section is not required for registrants that do not have responsive information. Given the requirement that a registrant "describe the board of directors' oversight of climate-related risks," arguably a registrant whose board does not oversee those risks would need to state as such.

Other disclosures

Targets and goals: Registrants must disclose any climate-related targets or goals that have materially affected or is reasonably likely to materially affect the registrant’s business, results of operations or financial condition. Disclosure should include a description of the scope of activities and emissions, units of measurement, defined time horizon of meeting targets, relevant baselines, interim targets and a description of how the registrant intends to meet its stated goals.

Risk management: Disclose any processes in place for identifying, assessing and managing material climate-related risks and how such processes are integrated into the registrant’s overall risk management system.

Use of carbon offsets and renewable energy certificates: If they are a material component of a company’s emissions reduction strategy, disclose the amount of carbon reduction represented by such offsets/RECs, the nature and source of the offsets/RECs, a description and location of the underlying projects and any registries or other authentication methods.

Safe harbor

The Final Rule includes an important new section extending a safe harbor from private liability for forward-looking statements to cover disclosures relating to transition plans, scenario analysis, use of internal carbon price and climate-related targets and goals. Statements of historical fact are not covered by the safe harbor.

Disclosure obligation timeline

The below chart reflects the disclosure obligation timeline for in-scope entities, reported as of fiscal year beginnings.

Registrant Type	Disclosure and Financial Statement Compliance Dates		GHG Emissions/Assurance Compliance Dates		
	All Reg. S-K and S-X disclosures, other than as noted	Specified disclosures relating to material expenditures	Scopes 1 and 2 GHG Emissions Disclosure	Limited Assurance	Reasonable Assurance
Large accelerated filers	FYB 2025	FYB 2026	FYB 2026	FYB 2029	FYB 2033
Accelerated filers	FYB 2026	FYB 2027	FYB 2028	FYB 2031	N/A
Non-accelerated filers, smaller reporting companies, emerging growth companies	FYB 2027	FYB 2028	N/A	N/A	N/A

Legal challenges

With the heightened level of public scrutiny and interest around this rule, evidenced by the record-breaking number of comment letters the SEC received in response to the Proposed Rule, legal challenge was a certainty, notwithstanding the SEC’s protracted consultation with stakeholders prior to rule finalization and the significant changes made to its requirements.

Indeed, within just a few hours of its adoption, ten states filed a legal challenge in the 11th circuit arguing that the Final Rule exceeds the SEC’s statutory authority and is arbitrary, capricious and an abuse of discretion. The states’ request that the 11th circuit hold the Final Rule as unlawful and vacate the SEC’s action adopting the Final Rule.⁴ Other actual and threatened legal challenges have followed.

Next steps for issuers to consider

Though additional legal challenges are expected, issuers should prepare to comply with the Final Rule. SEC rules are typically not stayed during pending litigation, unless the SEC voluntarily postpones the effective date of the rule, or a federal court and/or the SEC grants a request to stay. Issuers are encouraged to engage with counsel and other third party-experts as necessary to implement a plan for compliance.

Although Chair Gensler noted in his remarks the challenge of compliance with differing climate disclosure laws, he also affirmed the SEC’s view of the importance of having U.S. standards to which U.S. issuers can point.

Therefore companies subject to these various regimes (e.g., CSRD and California climate disclosure laws) will need to track differing compliance dates and requirements (i.e., materiality standards;

whether Scope 3 disclosure is required; differing types of qualitative risk disclosure) and begin to prepare accordingly.

In light of the climate-related governance disclosures required under the Final Rule and recent SEC enforcement actions⁵ related to ESG governance, companies should thoroughly review and update, if necessary, climate-related processes, procedures and frameworks to ensure good governance practices with respect to oversight of climate risks.

Even if the Final Rule is successfully challenged, there is a strong likelihood that some form of governance disclosures may still stand as there is increasing federal attention, and investor demand, related to addressing climate-related risks.⁶ Further, aside from U.S. laws, registrants may be subject to global regulations that require disclosures that align with the TCFD Framework, calling for a thorough assessment of existing company climate-related governance.

Notes

¹ See The Enhancement and Standardization of Climate-Related Disclosures for Investors as well as Enhancement and Standardization of Climate-Related Disclosures Fact Sheet, <https://tinyurl.com/5ffc9br>.

² See The Proposed Enhancement and Standardization of Climate-Related Disclosures for Investors (<https://tinyurl.com/3sb69say>)

as well as Proposed Rule Enhancement and Standardization of Climate-Related Disclosures Fact Sheet, (<https://tinyurl.com/2vywf2c6>). For a brief overview of the Proposed Rule, see our client memo "SEC Proposed Long-Awaited Climate-Related Disclosure Rules," available here: <https://tinyurl.com/bdcwuyt9>.

³ Requirement will not apply to a registrant that has not previously disclosed its Scopes 1 and 2 emissions in a filing with the SEC for a particular historical fiscal year.

⁴ See Petition for Review filed in the 11th Circuit: <https://tinyurl.com/s9tvhafh>.

⁵ For more information on ESG-related enforcement actions, see our client memo "Tracking the SEC's Climate and ESG Task Force," available here: <https://tinyurl.com/uftpu3c6>.

⁶ Federal activity focusing on climate-related risks such as greenwashing and more, include: (i) the interagency guidance, Principles for Climate-Related Financial Risk Management for Large Financial Institutions (<https://tinyurl.com/2n2kjrku>), jointly issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (ii) the forthcoming update to the Green Guides by the Federal Trade Commission (<https://tinyurl.com/ysv3urte>) and (iii) Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts (<https://tinyurl.com/y94ed4yc>), issued by the Commodity Futures Trading Commission.

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