FENWICK

Fenwick Alert

March 18, 2024

The SEC Adopts Final Climate-Related Disclosure Rules

Dave Bell, Ran Ben-Tzur, Julia Forbess, Aman Singh, Per Chilstrom, Michael Pilo, Ron Llewellyn, and Emily Sacks-Wilner

What You Need to Know

- On March 6, 2024, the SEC adopted landmark disclosure rules (Final Rules) mandating extensive climate-related disclosure in companies' annual reports and registration statements.
- While the Final Rules eliminate the requirement to disclose Scope 3 emissions from indirect sources and make numerous other changes from the proposed rules, the overall compliance burden for reporting companies will increase, in some cases very significantly. Even companies that ultimately reach the conclusion that many aspects of the disclosure are not required because they are not material will need to expend significant resources and effort in reaching that conclusion.
- With the European Union, the State of California and other jurisdictions and private organizations adopting and releasing climate-reporting regulations and guidelines, companies will face a patchwork of overlapping climate-related regulations that they will need to prepare for in the coming years.
- Following the announcement of the Final Rules, a strong wave of opposition surfaced from various Republican-led states and attorneys general, as well as private litigants such as the U.S. Chamber of Commerce and the Sierra Club, challenging the rules on both sides of the spectrum. In addition, the Fifth Circuit has temporary stayed the Final Rules. The resolution timeline, as well as the ultimate outcome of these challenges, is currently uncertain.
- Companies should begin the process of allocating resources and identifying consultants and advisers that can aid them in carbon accounting and related analyses, reporting climate data and establishing systems and controls for the collection, reporting and assurance of climate data.

On March 6, 2024, the SEC adopted final rules (Final Rules) requiring extensive climate-related disclosures in companies' annual reports and registration statements. The new rules are set forth in Release No. 33-11275. The climate disclosure rules were proposed in March 2022 and drew considerable attention, with the SEC receiving approximately 24,000 comment letters from a variety of stakeholders (including Fenwick). Many of the comment letters from reporting companies and their advisors expressed concern around the extremely detailed, prescriptive and burdensome nature of certain provisions in the proposed rules.

The Final Rules include a new set of disclosure requirements in Regulation S-K and a new section of Regulation S-X mandating the addition of certain quantitative and qualitative climate-related disclosures in audited financial statements. While maintaining the basic disclosure structure contained in the proposed rules, the Final Rules have been extensively revised in terms of the details of the required disclosure. The most significant changes between the proposed rules released in 2022 and the Final Rules include:

- Eliminating the proposed Scope 3 greenhouse gas (GHG) emissions disclosure requirement;
- Adding a materiality qualifier to the obligation to report Scope 1 and Scope 2 GHG emissions, and exempting emerging growth companies (EGCs) and smaller reporting companies (SRCs) from the requirement to report such emissions;
- Adding other materiality qualifiers throughout the rules and paring back some of the most prescriptive disclosure requirements, including the proposed requirement to describe board members' climate expertise;
- Removing some of the most detailed financial statement footnote disclosure requirements and adding thresholds that should result in fewer instances of required disclosure than had been proposed; and
- The express application of the forward-looking statement safe harbor to a number of the new disclosure requirements.

The revisions from the proposed rules will be welcomed by reporting companies. Nonetheless, the new rules are some of the most extensive additions to public company reporting requirements in decades. Per the SEC's estimates of compliance costs, which have been substantially below the costs actually incurred for new disclosure in the case of other new disclosures, the cost for a reporting company to comply with the Final Rules will likely be hundreds of thousands of dollars per year. For example, the SEC estimates that the average cost for providing the new disclosures under Regulation S-K related to governance, impacts of climate-related risks on strategy, business model, and outlook, and risk management will be $327,000 in the first year and $183,000 annually in subsequent years.

The new disclosure will be required in annual reports on Form 10-K for domestic public reporting companies, subject to permitted forward incorporation by reference of annual GHG emissions disclosures (where required), and will also be required in registration statements on Form S-1 and Form S-4. This will include registration statements filed by private companies seeking to go public. The disclosure requirements will also apply to annual reports and registration statements on Form 20-F, Form F-1 and Form F-4 filed by foreign private issuers.

A summary of the Final Rules can be found below. Although the SEC's modifications have made the Final Rules less prescriptive than the proposed rules and many provisions will be subject to a materiality qualifier, compliance with the Final Rules will be challenging for many companies. Accordingly, we first provide key takeaways that companies should keep top of mind as they read through the Final Rules, followed by a description of the new disclosure requirements and financial statement disclosures and related considerations.

KEY TAKEAWAYS

While the first compliance date for large accelerated filers is in 2025, companies will need to take action soon to be prepared for these extensive compliance requirements. Below are some of the issues that companies will need to consider at the outset.

- Companies that are already reporting on climate risk voluntarily or that are subject to state or foreign disclosure requirements should be able to leverage the systems, controls and procedures that they have developed to enable such reporting. However, because the disclosures required by the Final Rules will be provided in SEC filings, companies will need to ensure that they have effective disclosure controls and procedures (DCPs) for climate reporting, and effective internal controls over financial reporting (ICFRs) for the new climate information included in their financial statements. In addition, while there is some overlap between these other climate regulations and the Final Rules, there are still enough differences that companies' internal processes and disclosure controls will need to account for the variances between the regulations.

- For EGCs, SRCs and others that have not yet considered or reported on climate-related risks, they should consider building a cross-functional working group and establishing climate risk assessment processes. Although many of the various disclosure requirements have a materiality qualifier, companies will still need to have enough information around these climate-related topics to make a judgment on whether they are in fact material and therefore require disclosure.

- Companies will have to ensure that they have adequate governance structures in place to properly oversee and report on climate risk, taking into account the evolving expectations of important stakeholders. Companies should consider formalizing or enhancing their existing procedures and reporting and oversight structures as part of their preparation to comply with Item 1501 of Regulation S-K.

- For companies that have established targets or goals to reduce their carbon or GHG emissions, they should consider whether such targets or goals have materially affected or are reasonably likely to materially affect their business, results of operations or financial condition, in which case they will need to provide more granular details surrounding such goals, even if the goal has not been publicly announced, including the means by which progress against goals will be tracked and how they intend to meet their goals. Companies may wish to reconsider, revise or withdraw such targets or goals, balancing business purposes of the goal against the burden and impact of the required disclosures.

- Companies that already disclose their Scope 1 and Scope 2 emissions data outside of SEC filings and consider such data immaterial will need to consider whether to disclose prophylactically such figures in their SEC filings despite their immateriality, or at a minimum, be prepared for an SEC comment querying why the emissions data was published in a voluntary report but not in the annual report or registration statement. Larger companies will also need to assess whether Scope 1 and Scope 2 emissions are material to their business and may need to expend significant resources to make such determination.

- Many companies will have to procure internal and external resources to meet the disclosure requirements under the Final Rules. Companies may need to train or hire staff or engage outside consultants or advisers just to determine whether climate-related risks are reasonably likely to have a material impact on their strategy, results of operations, or financial condition. To the extent they have not done so already, companies should begin the process of allocating resources and identifying consultants and advisers that can aid them in carbon accounting and related analyses, reporting climate data and establishing systems and controls for the collection, verification and reporting of climate data. If applicable, a company may also need to engage an attestation provider that meets the requirements of Item 1506 of Regulation S-K, which should be different from the service provider that assists the company with the analysis and reporting of its Scope 1 and Scope 2 emissions.

NEW DISCLOSURE REQUIREMENTS

The Final Rules add a new subpart 1500 to Regulation S-K, containing nine items. Item 1500 defines terms used in the new disclosure requirements and the ensuing eight items address specific aspects of climate-related disclosure (which are often overlapping).

The Final Rules leverage and refer to the disclosure framework of the Task Force on Climate-Related Financial Disclosures (TCFD), which has developed a climate-related reporting framework, and the Greenhouse Gas Protocol (GHG Protocol), a leading accounting and reporting standard for GHG emissions.

The GHG Protocol's Corporate Accounting and Reporting Standards provide methods for reporting the seven principal GHGs covered by the Kyoto Protocol utilizing the GHG Protocol's concept of "scopes" of emissions. Scope 1 emissions are GHG emissions generated directly by a company and sources owned or controlled by it, and Scope 2 emissions are those generated indirectly, primarily through the purchase and consumption of electricity and other forms of energy.

Governance Structure

Under Regulation S-K Item 1501, if a company's board or management oversees climate-related risks, the company must provide information regarding its governance structure for climate-related risks, including the role of the board and management. With respect to the board of directors, companies must describe the board's oversight of climate-related risks and identify any board committee or subcommittee responsible for the oversight of climate-related risks. Further, companies must disclose the processes by which the board or such committee or subcommittee is informed about such risks. If a company has adopted a transition plan or climate-related target or goal required to be disclosed under subpart 1500, it must describe whether and how the board of directors oversees progress against the target or goal or transition plan.

Similarly, companies must disclose management's role in assessing and managing material climate-related risks, specifically including the following non-exclusive list of disclosure items:

- Whether and which management positions or committees are responsible for assessing and managing climate-related risks and the relevant expertise of such position holders or committee members;

- The processes by which such positions or committees assess and manage climate-related risks; and

- Whether such positions or committees report information about such risks to the board of directors or a committee or subcommittee of the board of directors.

Disclosure of Climate-Related Risks

Regulation S-K Item 1502(a) requires companies to describe climate-related risks that are reasonably likely to have (or have had) a material impact on their strategy, results of operations, or financial condition. This description must delineate whether such risks are reasonably likely to manifest in the short term (up to 12 months) and separately in the long term (beyond 12 months) and whether any disclosed risk is a *physical risk* or *transition risk*. In layman's terms, physical risks include both (1) acute risks that are event-driven, such as hurricanes and wildfires, and (2) chronic risks that relate to longer-term weather patterns, such as rising sea levels and drought. Transition risks are risks arising from a potential transition to a lower carbon economy.1

- For *physical risks*, disclosure is required of whether the risk is acute or chronic, and the location and nature of the properties, processes or operations subject to such risk.

- For *transition risks*, disclosure is required as to whether the risk relates to regulatory, technological, market, or other transition-related factors, and how those factors impact the company. A company with significant operations in a jurisdiction that has made a GHG emissions reduction commitment must consider whether it may be exposed to a material transition risk related to the implementation of the commitment.

Disclosure of Material Impacts

Regulation S-K Item 1502(b) requires companies to describe the actual and potential material impacts of any climate-related risk identified under Item 1502(a) on their strategy, business model, and outlook, including, as applicable, any material impacts on the following non-exclusive list of items:

- Business operations, including the types and locations of operations;

- Products or services;

- Suppliers, purchasers, or counterparties to material contracts, to the extent known or reasonably available;

- Activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes; and

- Expenditure for research and development.

Regulation S-K Item 1502(c) requires companies to discuss whether and how they consider any such impacts as part of their strategy, financial planning, and capital allocation, including whether and how resources are being used to mitigate climate-related risks, and how any of the targets or transition plans required to be disclosed under subpart 1500 relate to their business model or strategy.

Regulation S-K Item 1502(d) requires that companies discuss how any climate-related risks that have been disclosed have materially impacted or are reasonably likely to materially impact their business, results of operations, or financial condition, and describe quantitatively and qualitatively the material expenditures incurred and material impacts on financial estimates and assumptions that directly result from activities undertaken to mitigate or adapt to climate-related risks.

Per Regulation S-K Item 1502(e), if a company has adopted a transition plan to manage a material transition risk, it must describe the plan and then must update its disclosure annually to describe any actions taken during the respective year under the plan, including how such actions have impacted its business, results of operations, or financial condition. This description must include quantitative and qualitative disclosure of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the transition plan.

Per Regulation S-K Item 1502(f), if a company uses scenario analysis (a newly defined term) to assess the impact of climate-related risks on its business, results of operations, or financial condition, and if, based on the results of such analysis, it determines that a climate-related risk is reasonably likely to have a material impact on its business, results of operations, or financial condition, it must describe each such scenario, including a brief description of the parameters, assumptions, and analytical choices used, as well as the expected material impacts, including financial impacts, on it under each such scenario.

Under Regulation S-K Item 1502(g), if a company's use of an internal carbon price is material to how it evaluates and manages an identified climate-related risk, it is required to disclose in units of its reporting currency: (i) the price per metric ton of CO_2e, and (ii) the total price, including how the total price is estimated to change over the time short- and long-term, as applicable. If a company uses more than one internal carbon price to evaluate and manage a material climate-related risk, it must provide the disclosures for each internal carbon price and disclose its reasons for using different prices. If the scope of entities and operations involved in the use of any such internal carbon price is materially different from the organizational boundaries used for the purpose of calculating the company's GHG emissions pursuant to Regulation S-K Item 1505, the company must briefly describe this difference.

Risk Management

Regulation S-K Item 1503 requires companies to describe any processes established for identifying, assessing and managing material climate-related risks. In providing such disclosure, companies should address, as applicable, the following non-exclusive list of disclosure items regarding how they:

- Identify whether they have incurred or are reasonably likely to incur a material physical or transition risk;
- Decide whether to mitigate, accept, or adapt to the particular risk; and
- Prioritize whether to address the climate-related risk.

A company managing a material climate-related risk must disclose whether and how any processes it has described under this item have been integrated into its overall risk management system or processes.

Targets and Goals

Regulation S-K Item 1504 requires that companies disclose any climate-related target or goal they have adopted, whether or not publicly announced, if any such target or goal has materially affected or is reasonably likely to materially affect their business, results of operation, or financial condition. In providing this disclosure, companies must provide any information or explanation necessary to an understanding of the material impact or reasonably likely material impact of the target or goal, including, as applicable, but not limited to, 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;
- If the company has established a baseline for the target or goal, the defined baseline time period, 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.

Companies must disclose any progress made toward meeting any identified target or goal and how any such progress has been achieved, and they must update this disclosure each fiscal year by describing the actions taken during the year. This disclosure must include 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 the actions taken to make progress toward meeting the target or goal. Companies are further required to include quantitative and qualitative disclosures 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.A company will not have to provide this disclosure regarding the impact of such expenditures until the fiscal year that immediately follows the year of its initial compliance with Item 1504.

If carbon offsets or renewable energy credits (RECs) have been used as a material component of a company's plan to achieve climate-related targets or goals, the company must separately disclose 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.

GHG Emissions Disclosure

Regulation S-K Item 1505 requires large accelerated filers and accelerated filers to disclose their Scope 1 emissions and/or Scope 2 emissions, *if such emissions are material* (emphasis added), for the most recently completed fiscal year and, to the extent previously disclosed in an SEC filing, for the historical fiscal year(s) included in the consolidated financial statements in the filing. For any such GHG emissions, large accelerated filers and accelerated filers must disclose their Scope 1 emissions and/or Scope 2 emissions separately, each expressed in the aggregate, in terms of CO_2e. In addition, if any constituent gas of the disclosed emissions is individually material, disclosure is required of such constituent gas disaggregated from the other gases. Large accelerated filers and accelerated filers must disclose these Scope 1 emissions and/or Scope 2 emissions in gross terms by excluding the impact of any purchased or generated offsets.

As noted above, SRCs and EGCs as well as non-accelerated filers are exempt from the disclosure requirements of Item 1505.

Companies subject to Item 1505 are required to describe the methodology, significant inputs, and significant assumptions used to calculate the reported GHG emissions. This description must include: (i) the organizational boundaries used when calculating the disclosed GHG emissions, including the method used to determine those boundaries; (ii) a brief discussion of the operational boundaries used, including the approach to categorization of emissions and emissions sources; and (iii) a brief description of the protocol or standard used to report the GHG emissions, including the calculation approach, the type and source of any emission factors used, and any calculation tools used to calculate the GHG emissions. Companies are allowed to use reasonable estimates when disclosing GHG emissions as long as they describe the underlying assumptions and the reasons for using the estimates.

Recognizing the time required to compile the annual GHG emissions metrics to be disclosed pursuant to this Item, the Final Rules provide that this information may be “forward” incorporated by reference into the annual report on Form 10-K from the company’s Form 10-Q for the second fiscal quarter in the fiscal year immediately following the year to which the GHG emissions metrics disclosure relates, or such information may be included in an amendment to the annual report on Form 10-K no later than the due date for such Form 10-Q. If the company is a foreign private issuer, such information may be disclosed 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 fiscal year to which the GHG emissions metrics disclosure relates (which corresponds approximately to the second quarter Form 10-Q filing deadline). If a company elects to take advantage of this deferral opportunity, it must include an express statement in its annual report indicating its intention to either incorporate by reference this information from a quarterly report on Form 10-Q or amend its annual report on Form 10-K or Form 20-F to provide this information by the due date. In the case of a registration statement filed under the Securities Act of 1933 or filed on Form 10 or Form 20-F under the Securities Exchange Act of 1934, any GHG emissions metrics required to be disclosed must be provided as of the most recently completed fiscal year that is at least 225 days prior to the date of effectiveness of the registration statement.

It remains to be seen how the implicit pressure imposed by Item 1505 will affect GHG emission disclosures, given the materiality qualifier. The adopting release states that, in fiscal years 2021 and 2022, approximately 20% of public companies provided some information regarding their Scope 1 and Scope 2 GHG emissions, often outside of their SEC filings. This information suggests that over 80% of public companies have not historically regarded their GHG emissions to be material to a reasonable investor’s investment or voting decisions. However, companies may still be required to expend significant resources in making such a non-materiality determination, particularly in light of the likely need to be able to justify non-disclosure in the event of SEC staff comment or enforcement inquiry.

GHG Emissions Attestation

Regulation S-K Item 1506 requires that large accelerated filers and accelerated filers making Scope 1 and/or Scope 2 emissions disclosure must provide an attestation report covering such disclosure in the relevant filing. This attestation requirement is subject to the following phase in periods:

> (i) for filings made by an accelerated filer beginning with the third fiscal year after the compliance date for Item 1505, the attestation engagement must, at a minimum, be at a limited assurance level and cover the Scope 1 and/or Scope 2 emissions disclosure; and
>
> (ii) for filings made by a large accelerated filer beginning with the third fiscal year after the compliance date for Item 1505, the attestation engagement must, at a minimum, be at a limited assurance level and cover the Scope 1 and/or Scope 2 emissions disclosure, and for filings made beginning with the seventh fiscal year after such compliance date, the attestation engagement must be at a reasonable assurance level.

Item 1506 contains an extensive list of requirements regarding the attestation report, the qualifications and independence of the attestation provider and disclosure of any disagreements the company has had with the attestation provider. The adopting release observes that it is extremely unlikely that a third party that has assisted a company in the development of its GHG reporting processes will satisfy the independence requirements. The adopting release further notes that a company's auditor could qualify to provide the attestation if the auditor provides these services. The Final Rules include an amendment of Rule 436 under the Securities Act of 1933 to provide that a report by an attestation provider covering Scope 1 and/or Scope 2 emissions at a limited assurance level will not be considered a part of the registration statement that is prepared or certified by an expert within the meaning of sections 7 and 11 of the Securities Act.

However, attestation reports at the reasonable assurance level will be regarded as "expertized" and will be subject to the consent filing and other reporting provisions of expertized information and be subject to section 11 liability. It remains to be seen what confirmation letters or other assurances underwriters may require from such experts as part of their due diligence process in connection with registration statements for securities offerings that include or incorporate by reference such an attestation report.

Safe Harbor

As noted above, per Item 1507, the safe harbors for forward-looking statements in section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934 apply to information provided pursuant to the new disclosure requirements for transition plans, scenario analysis, the use of internal carbon prices and targets and goals disclosed under Item 1504. The SEC made a special extension of the safe harbor for companies for which the safe harbor is otherwise not available, including, importantly, in connection with an initial public offering as well as in connection with an offering of securities by a blank check company, with respect to the business or operations of an issuer of penny stock, in connection with a rollup transaction, or in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program. Further, the safe harbor provided by this Item will apply to a company that, at the time that the statement is made, is not subject to the reporting requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934.

For purposes of this item, all information specified above as being eligible for the safe harbor is considered a forward-looking statement for purposes of the statutory safe harbors, except for historical facts, including, as non-exclusive examples, terms related to carbon offsets or RECs described pursuant to Item 1504.

Materiality

For purposes of the Regulation S-K disclosure requirements that are qualified by materiality, the adopting release notes that "materiality refers to the importance of information to investment and voting decisions about a particular company, not to the importance of the information to climate-related issues outside of those decisions." Further, the adopting release reiterates the materiality standard defined by the U.S. Supreme Court, i.e., that a matter is material if there is a substantial likelihood that a reasonable investor would consider it important to investment and voting decisions.

Disclosure Mechanics

While the SEC originally proposed that the information required under the new subpart 1500 of Regulation S-K be provided in a separate section of the company's registration statement or annual report captioned "Climate-Related Disclosure," it opted in the Final Rules to allow companies flexibility as to the placement of this information. New Item 6 of Part II of Form 10-K provides this flexibility as follows:

> Provide the disclosure required by subpart 1500 of Regulation S-K in a part of the annual report that is separately captioned as Climate-Related Disclosure. A registrant may include disclosure that is responsive to the topics specified in Items 1500 through 1507 of Regulation S-K in other parts of the annual report (e.g., Risk Factors, Business, or Management's Discussion and Analysis), in which case it should consider whether cross-referencing the other disclosures in the separately captioned section would enhance the presentation of the climate-related disclosures for investors.

Similar items have been added to the forms of registration statements under the Securities Act of 1933 and to Form 10 under the Securities Exchange Act (into which the climate information would likely be incorporated by reference).

Whether narrative or quantitative, a company will have to tag the required climate-related information using Inline XBRL.

The adopting release notes that companies may, at their election, add disclosure regarding any material climate-related opportunities that pertain to them. Any such disclosure would, of course, be subject to attendant liability considerations and to the potential requirement to explain the basis for any climate-related opportunities to the staff of the SEC in response to comments.

All disclosures made pursuant to the Final Rules will be filed, not furnished.

FINANCIAL STATEMENT DISCLOSURES

Under new Article 14 of Regulation S-X, companies must disclose quantitative and qualitative climate-related information in the notes to their audited financial statements. Article 14 consists of a brief Item 14-01, containing general information and definitions, and Item 14-02, containing the disclosure requirements. Disclosure must be provided under Article 14 for the most recently completed fiscal year, and to the extent previously disclosed or required to be disclosed, for the historical fiscal year(s) for which audited consolidated financial statements are included in the particular filing.

Quantitative Information

Companies must include in their audited financial statements: (i) the aggregate amount of expenditures expensed as incurred and losses, excluding recoveries, incurred during the fiscal year as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise (which we refer to in this alert as “severe weather expense disclosure”); and (ii) the aggregate amount of capitalized costs and charges, excluding recoveries, incurred during the fiscal year as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures (which we refer to in this alert as “severe weather cost disclosure”). Further, if carbon offsets or RECs have been used as a material component of the company’s plans to achieve its disclosed climate-related targets or goals, the company must disclose 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 offsets and RECs, during the fiscal year. In addition, it must disclose the beginning and ending balances of the capitalized carbon offsets and RECs for the fiscal year.

The adopting release provides certain examples of this disclosure. With respect to severe weather expense disclosure, a company may be required to disclose the amount of expense or loss, as applicable, to restore operations, relocate assets or operations affected by the event or other natural condition, retire affected assets, repair affected assets, recognize impairment loss on affected assets, or otherwise respond to the effect that severe weather events and other natural conditions had on business operations. Any such disclosure must separately identify where the expenditures expensed as incurred and losses are presented in the income statement. With respect to severe weather cost disclosure, a company may be required to disclose the amount of capitalized costs or charges, as applicable, to restore operations, retire affected assets, replace or repair affected assets, recognize an impairment charge for affected assets, or otherwise respond to the effect that severe weather events and other natural conditions had on business operations. Any such disclosure must separately identify where the capitalized costs and charges are presented in the balance sheet.

Companies must provide contextual information in their financial statements describing how each specified financial statement effect that has been disclosed was derived, including a description of significant inputs and assumptions used, significant judgments made, other information that is important to understand the financial statement effect and, if applicable, policy decisions made to calculate the specified disclosures. A company required to provide disclosure regarding carbon offsets or RECs, must state its accounting policy for carbon offsets and RECs as part of this contextual information. If a company is required to provide severe weather expense disclosure or severe weather cost disclosure, then as part of the contextual information, it must state separately for each such set of events 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 are disclosed. Any such disclosure must separately identify where the recoveries are presented in the income statement and the balance sheet.

For purposes of providing the above-described quantitative information, a capitalized cost, expenditure expensed, charge, loss, or recovery results from (our emphasis added) a severe weather event or other natural condition when the event or condition is a significant contributing factor (our emphasis added) in incurring the capitalized cost, expenditure expensed, charge, loss, or recovery. If an event or condition is a significant contributing factor in incurring a cost, expenditure, charge, loss, or recovery, then the entire amount of such cost, expenditure, charge, loss, or recovery must be included in the required quantitative disclosure.

Item 14-02 contains certain disclosure thresholds. Severe weather expense disclosure is required if the aggregate amount of expenditures expensed as incurred and losses equals or exceeds one percent of the absolute value of income or loss before income tax expense or benefit for the relevant fiscal year. Such disclosure is not required, however, if the aggregate amount of expenditures expensed as incurred and losses is less than $100,000 for the relevant fiscal year.

Severe weather cost disclosure is required if the aggregate amount of capitalized costs and charges incurred equals or exceeds one percent of the absolute value of stockholders' equity or deficit at the end of the relevant fiscal year. Such disclosure is not required, however, if the aggregate amount of the absolute value of capitalized costs and charges is less than $500,000 for the relevant fiscal year. The adopting release includes an example intended to illustrate the application of the disclosure thresholds (see page 492).

Qualitative Information

Companies must disclose whether the estimates and assumptions used to produce the consolidated financial statements were materially impacted by exposures to risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise, or any climate-related targets or transition plans that have been disclosed. If so, a qualitative description is required of how the development of such estimates and assumptions were impacted by such events, conditions, targets, or transition plans.

COMPLIANCE DATES

Given the complexity of some of these specific provisions, the SEC is implementing delayed and staggered compliance dates depending on the company's filer status. The following table in the adopting release summarizes the compliance dates, which apply for both annual reports and registration statements. Regarding registration statements, the SEC notes that compliance is required beginning in any registration statement that is required to include financial information for the full fiscal year indicated in the table below.

The Final Rules will become effective 60 days after publication in the Federal Register.

Compliance Dates under the Final Rules[1]						
Registrant Type	**Disclosure and Financial Statement Effects Audit**		**GHG Emissions/Assurance**			**Electronic Tagging**
	All Reg. S-K and S-X disclosures, other than as noted in this table	*Item 1502(d)(2), Item 1502(e)(2), and Item 1504(c)(2)*	*Item 1505 (Scopes 1 and 2 GHG emissions)*	*Item 1506 - Limited Assurance*	*Item 1506 - Reasonable Assurance*	*Item 1508 - Inline XBRL tagging for subpart 1500[2]*
LAFs	FYB 2025	FYB 2026	FYB 2026	FYB 2029	FYB 2033	FYB 2026
AFs (other than SRCs and EGCs)	FYB 2026	FYB 2027	FYB 2028	FYB 2031	N/A	FYB 2026
SRCs, EGCs, and NAFs	FYB 2027	FYB 2028	N/A	N/A	N/A	FYB 2027
	[1] As used in this chart, "FYB" refers to any fiscal year beginning in the calendar year listed. [2] Financial statement disclosures under Article 14 will be required to be tagged in accordance with existing rules pertaining to the tagging of financial statements. *See* Rule 405(b)(1)(i) of Regulation S-T.					

RELATIONSHIP TO OTHER ESG REGULATIONS

Other jurisdictions and organizations have adopted climate disclosure regulations of their own, which in many cases are broader than those in the Final Rules. For example, the European Union's Corporate Sustainability Reporting Directive is already in effect, and these standards require certain companies (including non-E.U. companies) to provide various sustainability disclosures in line with the European Sustainability Reporting Standards. These sustainability disclosures, which apply to U.S.-based (and other non-E.U.) companies that meet certain trigger thresholds, are much more comprehensive than the Final Rules, covering not just climate but also topics such as biodiversity, circular economy, and workers in the value chain. Separately, as we discussed in our prior alerts here and here, California adopted a trio of climate-related rules late last year, including SB 253, requiring certain large companies to disclose their Scope 1, 2 and 3 GHG emissions (Scope 3 GHG emissions are defined as all indirect GHG emissions not otherwise included in Scope 2), and SB 261, requiring certain large companies to provide a climate-related financial risk report. During the SEC's open meeting to consider the Final Rules, Commissioner Peirce asked whether the Final Rules would preempt California's disclosure laws, to which the SEC Staff noted that there is no express preemption. With respect to the question of implied preemption, the Staff seemed to expect that this will be determined by a court in the future.

Finally, there is a new voluntary sustainability disclosure standard – IFRS S1 and IFRS S2 published by the International Sustainability Standards Board – which is also built upon the TCFD recommendations and several other well-known disclosure organizations' frameworks and standards. While the ISSB's disclosure standards are voluntary, many jurisdictions are looking to adopt or at least closely align to the ISSB standards.

While there are some interoperability provisions built into some of these regulations (e.g., California's SB 253), the SEC has decided not to use these disclosure standards and instead adopted its own rules. In the adopting release, the SEC noted that disclosures required by these other laws will appear in non-SEC filings and will not be subject to the same level of liability, disclosure controls and other investor protections. In addition, the SEC emphasized that the Final Rules were adopted for a very specific purpose – for investors' needs for comparable, decision-useful information for investment and voting decisions. As a result, companies will continue to face a patchwork of overlapping climate-related regulations that they will need to prepare for in the coming years.

LEGAL CHALLENGES

Given the historic number of comments, both in favor and against, that the proposed climate rules received, it is not surprising that there have already been challenges to the Final Rules. On March 6, 2024, shortly after the SEC's climate rules were announced, ten Republican-led states filed a petition in the Eleventh U.S. Circuit Court of Appeals challenging the Final Rules. The petition seeks a review of the rules and claims that the SEC "exceeded its statutory authority and that the rules are arbitrary, capricious, an abuse of discretion and not in accordance with the law." On March 7, 2024, Republican attorneys general in Louisiana, Texas and Mississippi also challenged the Final Rules in the Fifth Circuit Court of Appeals, and on March 12, 2024, Republican attorneys general in Iowa, Missouri, and seven other states have challenged the Final Rules in the Eighth Circuit Court of Appeals, leading to a total of 22 states challenging the rules. The House Financial Services Committee's chairman also announced two hearings to review the impact of the Final Rules on the capital markets. Private litigants have also entered the fray, with energy companies such as Liberty Energy also filing its petition in the Fifth Circuit. Specifically, Liberty Energy requested a stay on the Final Rules, arguing that there would be "irreparable injury in the form of unrecoverable compliance costs and constitutional injuries," and on March 15, 2024, which the Fifth Circuit Court of Appeals promptly granted. The U.S. Chamber of Commerce, which successfully vacated the share repurchase rules, also recently filed its petition in the Fifth Circuit challenging the climate rules.

On the other side of the spectrum, the Sierra Club also brought a challenge to the Final Rules in the D.C. Circuit, noting that these rules did not go far enough. It is unclear what the ultimate outcome of these various legal challenges will be or the timing of their resolution.

About Fenwick: Fenwick is a leading law firm, purpose-built to guide visionary tech and life sciences companies and their investors through every stage of growth, from startups securing their first round of funding to leading publicly traded global enterprises. As one of Silicon Valley's original legal practices, today we have over 500 lawyers, patent agents, engineers and scientists serving clients from seven offices located in innovation hubs across the United States and China. Named 2023 Life Sciences Practice Group of the Year by *Law360,* we are consistently ranked a *Chambers* first-tier firm for delivering the deep experience and technical skill that help innovators at the forefront of their industries shatter boundaries and redefine what's possible. Visit www.fenwick.com to learn more.