April 1, 2024

SEC Adopts Final Rules for Climate-Related Disclosures as Controversy and Challenges Loom

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On March 6, 2024, the Securities and Exchange Commission ("SEC") issued an adopting release (Release Nos. 33-11275 and 34-99678), entitled *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (the "Adopting Release"), which finalized new disclosure rules ("Final Rules") that will require domestic and foreign companies to provide certain climate-related information in their registration statements and annual reports filed with the SEC, with some limited exceptions. Under the new Final Rules, a company will need to disclose, among other things, (i) climate-related risks that have materially impacted, or are reasonably likely to have a material impact on, its business, strategy, results of operations, or financial condition, (ii) the governance and management of such risks, and (iii) certain information concerning the effects of severe weather events and other natural conditions on the company. The Final Rules reflect some significant modifications to the rules that the SEC had originally proposed in 2022 and represent, in certain respects, a scaled-back version of those proposed rules.

This client alert includes: (a) a list of some key takeaways from the Final Rules, (b) a detailed summary of the new disclosure requirements under the Final Rules, and (c) next steps for companies to consider in order to prepare for implementation of the Final Rules (if the Final Rules survive ongoing court challenges).

Key Takeaways

While there is a lot of information contained in the Final Rules, we highlight, in particular, the following key takeaways:

1. **No required Scope 3 greenhouse gas emissions disclosures for any companies:** Under the Final Rules, companies will not be required to disclose Scope 3 greenhouse gas ("GHG") emissions.

2. **Material Scope 1 and Scope 2 GHG emissions disclosures (and related attestation) will be required in future years for large accelerated filers and most accelerated filers:** A large accelerated filer ("LAF") and an accelerated filer ("AF") not classified as a smaller reporting company ("SRC") or emerging growth company ("EGC") will be required to disclose Scope 1 and Scope 2 GHG emissions, if material, beginning with (1) its annual report that covers its fiscal year that begins in 2026, in the case of an LAF, and (2) its annual report that covers its fiscal year that begins in 2028, in the case of an AF. An LAF will be required to provide an attestation report in its annual report that covers its fiscal year that begins in 2029, and an AF not classified as an SRC or EGC will be required to provide an attestation report in its annual report that covers its fiscal year that begins in 2031. Similar timing requirements apply with respect to registration statements.

3. **Disclosures focus on climate-related risks and governance, management, and risk management processes:** Under new Items 1500-1506 of Reg. S-K, a company will potentially be required to provide disclosure regarding its climate-related risks, how its board and management govern and oversee those risks, and information regarding its risk management processes.

4. **Materiality decisions will inform or trigger a significant number of climate disclosures, and liability safe harbors exist for certain forward-looking disclosures:** The SEC included materiality qualifiers in many of the new disclosure requirements. In addition, the SEC expressly allowed for forward-looking disclosure liability safe harbors for certain climate-related disclosures, as discussed below.

5. **Financial statement disclosures focus on costs, expenses, and charges related to climate-related events and risks, with de minimis and bright line thresholds:** Under new Article 14 of Reg. S-X, companies will be required to make certain financial statement disclosures regarding certain costs, expenses, and charges related to climate related events and risks, which is disaggregated from currently required financial disclosures. However, such disclosures are subject to thresholds based on the income and assets of the company and are also subject to de minimis thresholds.

6. **The obligations of companies to ultimately comply with the new rules could be impacted by the outcome of litigation related to the rules:** Multiple plaintiffs representing a variety of interests have filed lawsuits seeking to vacate all or a portion of the Final Rules. Additional plaintiffs could file additional lawsuits challenging the Final Rules. The outcome of any of these challenges could potentially impact companies' reporting obligations under the rules.

It is also notable that the Final Rules allow companies some flexibility with respect to the placement of their climate-related disclosures, other than disclosures required to be in their financial statements. From our assessment of the rules, it appears that, while a company may create a "Climate-Related Disclosure" section in an applicable filing (for example, in new Part II, Item 6 of Form 10-K) to address the requirements of the new rules, a company may also choose to weave the applicable climate-related disclosures into other sections of a given report or registration statement. However, the SEC made clear that, unlike other Part III information contained in Form 10-K, companies may not incorporate by reference climate disclosures from their proxy statements into their Form 10-K filings pursuant to General Instruction G.3 of Form 10-K.

Detailed Summary of Disclosure Obligations Under the Final Rules

A. <u>Disclosure of Climate Related Risks</u>.

Under the Final Rules, new Item 1502(a) of Reg. S-K requires companies to describe any climate-related risks that have materially impacted, or are reasonably likely to have a material impact on, the company, including on the company's strategy, results of operations, or financial condition. In the March 6, 2024 Open Meeting during which the SEC adopted the rules, the Commissioners emphasized that materiality should be the guiding principle in such disclosure, which was reiterated in the Final Rules.

Unpacking some of the core definitions to this disclosure obligation, the SEC stated that climate-related risks include both "physical risks" and "transition risks." Physical risks include acute (event-driven) risks that impact a company's business and can be classified to include, among other risks, short-term "natural disasters" such as floods, wildfires, hurricanes, and tornados. Physical risks also include "chronic risks," which are longer-term in nature and share characteristics with climate change. Chronic risks may include higher (or lower) temperatures, rising water levels, drought, and further effects on land and sea environments as a result of such conditions. Transition risks, on the other hand, are defined as 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. Transition risks thus relate to how a company reacts to climate-related risks. To assist companies in identifying these risks, the SEC provided a non-exclusive list of transition risks, which cover situations where increased costs or decreased sales/profits flow from climate-related changes to market behavior, consumer preferences (or behavior), or the company's behavior.

For climate-related risks that have materially impacted or are reasonably likely to have a material impact on a company, the company must disclose whether the risk is a physical or transition risk and disclose information necessary to allow investors to understand the nature of the risk presented, and the extent of the company's exposure to the risk. The SEC again provided a non-exclusive list of disclosures to help guide companies in complying with such disclosure obligations. With respect to physical risks, a company should consider disclosing whether such risk is an acute or chronic risk, and the geographic location and nature of the properties, processes, or operations subject to the physical risk. In a change from the proposed rules, the SEC will not require ZIP code data with respect to physical properties impacted by physical climate risks. Concerning transition risks, a company should consider disclosing whether the risk relates to regulatory, technological, market (including changing stakeholder preferences), or other transition-related factors, and how those factors impact the company. While the SEC removed the references to "liability and reputational factors" from the list of examples of transition risks in the Final Rules, it clarified that "transition-related factors" can include material impacts to a company's liability and reputation. Furthermore, the SEC noted in the Adopting Release, as part of the non-exclusive factors that may implicate transition risks, that companies with significant operations in jurisdictions that have made GHG emissions reduction commitments should consider whether they may be exposed to material transition risks related to the implementation of such commitments.

When implementing the disclosure of climate-related risks that have materially impacted or are reasonably likely to have a material impact on the company, a company must provide a timeframe as to whether a risk is reasonably likely to occur in the short-term (i.e., the next 12 months), and, separately, whether such risk is reasonably likely to occur in the long-term (i.e., beyond the next 12 months). The SEC adopted this 12-month dividing line to align with similar disclosures required in a company's management discussion and analysis ("MD&A"), of financial condition and results of operations, although companies are not prohibited from providing more granular detail about the timing of climate-related risks.

Notably, for companies that are focused on climate-related opportunities, the SEC neither prohibits nor mandates disclosure of such opportunities. Instead, the SEC will treat such disclosure as it would any other voluntary disclosure.

B. Disclosure of Material Impacts.

After a company has identified climate-related risks, new Item 1502(b) of Reg. S-K requires that the company disclose actual and potential material impacts of such climate risks on the company's strategy, business model, and outlook. In adopting Item 1502(b) of Reg. S-K, the SEC reasoned in the Adopting Release that the disclosure of such material impacts is critical for investors to understand how the company's business has changed (or will change) to address those climate risk impacts, management's response to such impacts, and the strength of the company's strategy as related to climate-related factors.

Following a similar theme to the disclosure mandated under Item 1502(a) of Reg. S-K, the information a company must provide concerning the impact of climate-related risks is qualified by materiality, and the SEC has included a non-exclusive list of categories of potential material impacts. This list includes, but is not limited to, material impacts on the company's business operations, products, or services; business counterparties (including counterparties to material contracts under Item 601 of Reg. S-K); efforts to mitigate and address climate-related risks; and research and development expenditures. Notably, with regard to business counterparties, a company is only required to disclose information that is known or is reasonably available pursuant to it in accordance with Rule 409 of the Securities Act and Rule 12b-21 of the Exchange Act. The SEC noted in the Adopting Release that if no impacts are material, then no disclosure is required.

In addition, new Item 1502(c) of Reg. S-K requires that a company discuss the extent to which these material climate-related impacts are considered as part of the company's strategy, financial planning, and capital allocation. More specifically, the company must describe, to the extent applicable, whether material impacts of climate related risk have been integrated into the company's business model or strategy (including any resources allocated to mitigate climate-related risks), and the relationship of the company's business model or strategy to climate-related targets (targets under Item 1504 of Reg. S-K and transition plans are discussed in more detail below).

The SEC observed in the Adopting Release that Item 1502(c) disclosure can, but is not required to, include both current and forward-looking information. Furthermore, the SEC clarified in the Adopting Release that if a company has not yet articulated a business model or does not believe that its business model is or will be materially impacted by climate-related risks, it need not provide the business model disclosure under Item 1502(c).

With respect to the financial effects of climate-related risks, new Item 1502(d) of Reg. S-K obligates companies to disclose, in narrative form, how their climate-related risks identified under Item 1502(a) of Reg. S-K have had a material effect, or are reasonably likely to have a material effect on, the company's consolidated financial statements, including a quantitative and qualitative description of material expenditures and impacts on financial estimates that, in management's assessment, directly result from the company's efforts to address certain climate-related risks. It is important to note that the company may present the requisite description of material expenditures in tabular or narrative form, and that the SEC has provided a phase-in period for compliance with the quantitative and qualitative description called for under Item 1502(d)(2) of Reg. S-K. Additionally, the SEC suggested in the Adopting Release that the disclosure related to financial impacts should generally resemble a company's MD&A disclosure, rather than a company's financial statement disclosure.

1. *Transition Plan Disclosure.* If a company has adopted a "transition plan" to manage material transition risks facing the company, the company must describe that plan. Under Item 1500 of Reg. S-K, a transition plan is defined as "a [company's] strategy and implementation plan to reduce climate-related risks, which may include a plan to reduce its own GHG emissions in line with its own commitments or commitments of jurisdictions within which it has significant operations." The SEC noted in the Adopting Release that, while the adoption or implementation of such transition plans is not mandatory (and if a company does not adopt a transition plan, then no disclosure is required), companies choosing to adopt transition plans should disclose information concerning the plans so that investors can assess how well a company is managing its climate-related risks, as well as how the company's strategy regarding climate targets and goals could potentially impact the company's business, results of operations, or financial condition.

   The transition plan disclosure requirements contained in the Final Rules reduce the prescriptive disclosure approach included in the proposed rules (i.e., listing specific risks and factors that must be disclosed), and purport to provide greater flexibility to companies by allowing them to simply disclose the facts and circumstances related to their particular material transition risks. In a further welcome development, such transition plan disclosure is subject to a "forward-looking statement" safe harbor as discussed below.

   Further, Item 1501(e)(1) of Reg. S-K requires a company to update, for each fiscal year, the transition plan disclosure contained in its annual report to show any actions taken under the transition plan during the previous year, and the impact of those actions on the company's business, results of operations, or financial condition. In another modification from the proposed rules, under new Item 1502(e)(1) of Reg. S-K, the SEC will require, as part of a company's updating of such disclosure, that the company disclose, quantitatively and qualitatively, material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the disclosed actions taken under its transition plan. While this provision mirrors to some extent the financial-related disclosure required under Item 1502(d) of Reg. S-K described above, Item 1502(e) of Reg. S-K calls only for disclosure of material impacts that directly result from actions taken under a transition plan, and companies need not repeat disclosure if there is overlap between Items 1502(d) and 1502(e) of Reg. S-K. Disclosure under Item 1502(e) has the same phase-in period as the financial-related disclosure under Item 1502(d) discussed below.

2. *Scenario Analysis Disclosure.* Under new Item 1501(f) of Reg. S-K, if a company uses a scenario analysis to assess the impact of climate-related risks on the company's business, results of operations, or financial condition and such scenario analysis indicates that a climate-related risk is reasonably likely to have a material impact on the company, the company 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 the [company]" under each scenario. It is worth noting that companies are not required to conduct a scenario analysis, and scenario analysis disclosure is only required if it indicates that there is a material impact to the company. Furthermore, like the transition plan disclosure noted above, the scenario analysis disclosure is subject to a safe harbor discussed below.

With respect to the form of such scenario analysis disclosure, the SEC indicated that it anticipates that, because scenario analyses are still evolving from a practical standpoint, a company's disclosure may initially be qualitative. However, as a company's use of scenario analyses becomes more sophisticated, the SEC indicated that it expects that such disclosure should become more qualitative. Qualitative disclosure would be particularly necessary when describing, under each scenario, any expected material financial impacts on a company's business strategy, which must be disclosed under Item 1501(e) of Reg. S-K in connection with the scenario analysis description.

3. *Internal Carbon Pricing Disclosure.* Under Item 1500 of Reg. S-K, an internal carbon price is the estimated cost of carbon emissions used internally within an organization. Under new Item 1502(g) of Reg. S-K, a company that uses internal carbon pricing that is material to how it evaluates and manages a climate-related risk identified pursuant to Item 1502(a) of Reg. S-K must disclose (1) the price per metric ton of "carbon dioxide equivalent" ("CO2e") and (2) the total price, including how the total price is estimated to change over the time periods associated with the identified climate-related risk (both in the company's reporting currency). If a company uses more than one internal carbon price, it must provide the information for each internal carbon price and explain the reasons for using different prices per new Item 1502(g)(2) of Reg. S-K. Moreover, new Item 1502(g)(3) of Reg. S-K requires that if the scope of entities and operations involved in the use of an internal carbon price is materially different from the organizational boundaries used for the purpose of calculating a registrant's GHG emissions pursuant to Item 1505 of Reg. S-K, the company must briefly describe this difference.

   The SEC noted in the Adopting Release that the Final Rules contain a materiality qualifier that was not included in the proposed rule. Whereas the proposed rule would have required internal carbon pricing disclosure whenever a company maintains an internal carbon price, the Final Rules require such disclosure only when the use of internal carbon pricing is material to how a company evaluates and manages a climate-related risk. The Final Rules also do not adopt the proposed requirement to describe how a company uses an internal carbon price to evaluate and manage climate-related risks. Like the transition risks and scenario analysis discussed above, the use of carbon price is also subject to a safe harbor discussed below.

C. <u>Governance and Risk Management Disclosure</u>.

1. *Disclosure of Board and Management Oversight.* Under new Items 1501(a) and 1501(b) of Reg. S-K, a company must disclose information concerning its board's and management's respective oversight of climate-related risks. The SEC noted in the Adopting Release that these rules requiring disclosure of board and management oversight were each modified in response to input from commenters who felt that the proposed rules were overly burdensome and intended to transform the governance practices of companies. The SEC streamlined these disclosure obligations in the Final Rules by removing the more prescriptive elements included in the proposed rules.

   With respect to board oversight under new Item 1501(a) of Reg. S-K, a company must (i) describe its board of directors' oversight of climate-related risks, (ii) identify any committee or subcommittee responsible for overseeing climate-related risks, and (iii) describe the process pursuant to which the board, committee, or subcommittee is informed of those risks. In addition, a company is obligated to describe "whether and how the board of directors oversees progress against disclosed climate-related targets, goals, or transition plans," which ties the board oversight disclosure requirements to specific targets and goals already disclosed by the company. The SEC reasoned in the Adopting Release that disclosure of the board's oversight processes will allow investors to more clearly understand such processes and, as a result, make informed investment decisions. The SEC noted in the Adopting Release that the oversight disclosures are not required for companies that do not exercise board oversight of such climate-related risks and that companies are not required to disclose the frequency of climate-related risk discussions by the board or any applicable committee.

A company must also disclose, under new Item 1501(b) of Reg. S-K, management's role in assessing and managing *material* climate-related risks. As with other disclosure requirements discussed above, the Final Rules include a non-exclusive list of disclosure items related to management's risk assessment role, including: (a) the roles of management-level personnel or committees responsible for managing climate-related risk (and a full description of their expertise), (b) such management personnel or committees' process for managing climate-related risks, and (c) whether such management personnel or committee reports information concerning such risks to the board or a committee or subcommittee of the board. The SEC noted in the Adopting Release that the oversight disclosures are not required for companies that do not exercise management oversight of such climate-related risks.

2. *Risk Management Disclosure.* In addition to disclosure of board and management assessment of climate-related risks, under new Item 1503 of Reg. S-K, a company must describe any process it has for identifying, assessing, and managing material climate-related risks. As with board and management oversight of climate-related risks, the SEC considers this information critical to allowing investors to make informed investment and voting decisions, and the Final Rules reflect the SEC's belief, stated in the Adopting Release, that this requirement will improve the consistency, comparability, and reliability of disclosures regarding climate-related risk management. Further, in complying with the risk-management disclosure obligation a company should, as applicable, describe how it identifies whether the company has incurred or is reasonably likely to incur a material, physical, or transition risk. The company should also address, as applicable, how the company decides whether to mitigate, accept, or adapt to a particular risk, and how the company prioritizes whether to address a climate-related risk. In addition, if a company is in fact managing a material climate-related risk, the company must describe whether and how its disclosed risk-management practices have been integrated into the company's overall risk management system. The SEC emphasized in the Adopting Release that disclosure is only required for material climate risks.

D. Targets and Goals Disclosure.

Under new Item 1504(a) of Reg. S-K, a company must disclose any climate-related target or goal that has materially affected or is reasonably likely to materially affect its business, results of operations, or financial condition. The requirement applies regardless of whether the target or goal is internal or publicly announced as well as the particular issue the target or goal addresses. The SEC noted in the Adopting Release that goals or targets which are unlikely to materially affect the company do not need to be disclosed, but a goal that materially affects the company should be disclosed even if it is non-public. New Item 1504(b) of Reg. S-K contains a non-exhaustive list of information that the company may disclose for such target or goal, including:

- 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 are not required to disclose any interim targets. However, a company must disclose/update in each fiscal year any progress toward meeting the target or goal and how such progress has been achieved under new Item 1504(c) of Reg. S-K. The disclosure must also 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, including quantitative and qualitative disclosure of any material expenditures and impacts on financial estimates and assumptions thereto.

Under new Item 1504(d) of Reg. S-K, companies must also disclose information related to their use of carbon offset or renewable energy credits ("RECs") if such use is a material component of a company's plan to achieve climate-related targets or goals. Specifically, a company must disclose:

- The amount of carbon avoidance, reduction, or removal represented by the offsets or the amount of 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.

To the extent that carbon offsets or RECs are not a material aspect of a company's plan to achieve climate-related targets or goals, then no disclosure is required under Item 1504(d) of Reg. S-K.

E. GHG Emissions Disclosure.

Some of the most controversial aspects of the SEC's originally proposed rules related to disclosures of GHG emissions. In a change from the proposed rules, under the Final Rules only certain companies need to disclose their Scope 1 and 2 emissions, and Scope 3 emissions are not required to be disclosed by any company. Specifically, pursuant to Item 1505(a)(i) of Reg. S-K, disclosure of Scope 1 and 2 emissions is required if (1) either or both categories of GHG emissions are material and (2) the company is either (x) an LAF or (y) an AF that is not classified as an SRC or an EGC. The SEC indicated that it specifically exempted smaller reporting companies and emerging growth companies from the Scope 1 and Scope 2 emissions disclosure requirements due to the associated compliance burden on such smaller entities. Similar to the determination of materiality for climate-related risks, traditional notions of materiality under federal securities law apply for purposes of GHG emissions disclosure. Notably, the

SEC recognized that the Scope 1 and Scope 2 emissions disclosures are separate disclosures, meaning if Scope 1 is material and Scope 2 is not, then only Scope 1 needs to be disclosed.

In a change from the proposed rules, the Final Rules do not require disclosure of a company's GHG emissions disaggregated by each constituent GHG, but only the aggregate emissions in terms of CO2e. However, under Item 1505(a)(2)(i) of Reg. S-K, if any constituent GHG (i.e., methane) is individually material, the company must disclose disaggregated information for such constituent gas. Further, the Scope 1 and/or Scope 2 emissions disclosure must reflect the gross amount excluding the impact of any purchased or generated offsets. The SEC indicated that it elected to require companies to disclose a gross number to allow investors to understand the total GHG profile of a company.

In new Item 1505(a)(2)(i) of Reg. S-K, a company with material GHG emissions must describe the methodology, significant inputs, and significant assumptions used to calculate the disclosed GHG emissions. Similar to the requirement under Item 1502(g) of Reg. S-K, if the organizational boundaries materially differ from the scope of entities and operations included in the company's consolidated financial statements, the company must provide a brief explanation of this difference between such boundaries and the financial statements.

For any company required to disclose Scope 1 and/or Scope 2 emissions, the applicable reporting time period under new Item 1505(a)(2)(i) of Reg. S-K is the most recently completed fiscal year, and, to the extent previously disclosed in an SEC filing, for the historical fiscal years included in the consolidated financial statements included in the filing. Furthermore, the SEC provided a more generous timeline for reporting the Scope 1 and Scope 2 emissions. For any fiscal year, such Scope 1 and Scope 2 disclosures may be incorporated by reference 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. This allows a company approximately 220 days from the end of the company's fiscal year to make such disclosures. For Item 1505 disclosures in a Securities Act or Exchange Act registration statement, the Final Rules require that the GHG emissions metrics 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.

F. **GHG Emissions Disclosure Attestation**.

LAFs and AFs (including foreign private issuers) required to provide Scope 1 and/or Scope 2 emissions disclosure under Item 1505 of Reg. S-K will eventually be required to include an attestation report covering such disclosure in the relevant filing pursuant to new Item 1506 of Reg. S-K. Such attestation report will be required to be prepared by an attestation provider at a designed assurance level. For both LAFs and AFs, "limited assurance" for the Scope 1 and/or Scope 2 emissions will be required beginning the third fiscal year after their respective first compliance date for the Item 1505 GHG emissions reporting. Specifically, Scope 1 and Scope 2 disclosure compliance for an LAF will be required beginning with its annual report that covers its fiscal year that begins in 2026, and compliance for an AF not classified as an SRC or EGC will be required beginning with its annual report that covers its fiscal year that begins in 2028. As a result, an LAF will be required to provide limited assurance in its annual report that covers its fiscal year that begins in 2029, and an AF not classified as an SRC or EGC will be required to provide limited assurance in its annual report that covers its fiscal year that begins in 2031. In addition, an LAF will be required to provide "reasonable assurance" in its annual report that covers its fiscal year that begins in 2033. AFs will not be required to provide reasonable assurance—limited assurance will only be required as noted above. For each of these fiscal years, the report in question will be due after the conclusion of the applicable fiscal year. The SEC did not in the Adopting Release, and does not, provide any definition of "limited assurance" and "reasonable assurance," finding that such terms are generally well understood and should be defined by assurance-standard setters, not by the SEC.

Under new Item 1506(a)(2) of Reg. S-K, attestation standards used for purposes of the requirement under Item 1506 must be (1) publicly available at no cost or widely used for GHG emissions assurance and (2) established by a body or group that has followed due process procedures. New Item 1506(c) of Reg. S-K requires that the form and content of the attestation report must comply with the requirements set forth by the attestation standard used by the attestation provider.

Item 1506 of Reg. S-K does not impose specific experience requirements for the attestation provider (such as the number of years of experience) but instead adopts a "principles-based" approach, requiring that the attestation provider be (1) an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting, or attesting to GHG emissions; and (2) independent with respect to the company, and any of its affiliates, for whom it is providing the attestation report. Independence is a facts and circumstances test.

New Item 1506(e) of Reg. S-K contains additional disclosure requirements for companies that obtain voluntary assurance about any GHG emissions disclosure. In particular:

- In the case of any company that is required to provide Scope 1 and/or Scope 2 emissions disclosure (e.g., an LAF or an AF that is not classified as an SRC or an EGC), if that company obtains voluntary assurance over any GHG emissions disclosure <u>prior</u> to the start of the assurance requirement, then that company must disclose the following:

    - Identification of the service provider of such assurance;
    - Description of the assurance standard used;
    - Description of the level and scope of assurance services provided;
    - Brief description of the results of the assurance services;
    - Whether the service provider has any material business relationships with, or has provided any material professional services to, the company; and
    - Whether the service provider is subject to any oversight inspection program, and if so, which program(s) and whether the assurance services cover GHG emissions included within the scope of authority of such oversight inspection program.

- In the case of any company that is <u>not</u> required to provide Scope 1 and/or Scope 2 emissions disclosure, if that company nonetheless obtains any voluntary assurance over any voluntary GHG emissions disclosure, then that company must also comply with the above disclosure requirements.

- In the case of any company that is required to provide Scope 1 and/or Scope 2 emissions disclosure (e.g., an LAF or an AF that is not classified as an SRC or an EGC), if that company obtains, <u>after</u> the start of the assurance requirement, voluntary assurance over any GHG emissions disclosures that are not required to be assured (e.g., voluntary Scope 3 disclosures), then such voluntary assurance must follow the same requirements applicable to that company's mandatory assurance (and must use the same attestation standard as the required assurance over its Scope 1 and/or Scope 2 emissions disclosure).

G. <u>Safe Harbor for Climate-Related Disclosures</u>.

New Item 1507 of Reg. S-K provides a safe harbor for disclosures made pursuant to Item 1502(e) (concerning transition plans), Item 1502(f) (concerning scenario analysis), Item 1502(g) (concerning internal carbon pricing), and Item 1504 (concerning climate-related targets and goals). Disclosures made by a company in response to the foregoing disclosure obligations will be considered "forward-looking statements" under the Private Securities Litigation Reform Act of 1995, as amended ("PSLRA").

To the extent disclosures are made in response to the above listed Items (or any other subpart 1500 provision of Reg. S-K) and contain one or more of the following statements, they will fall within the PSLRA safe harbor for forward-looking statements: (i) projections of revenues, income (or income loss), earnings (or earnings loss) per share, capital expenditures, capital structure, or other financial items; (ii) plans and objectives of management for future operations, including as related to products or services of the company; (iii) future economic performance, including in discussion and analysis of financial condition by management pursuant to SEC rules; (iv) any statement of the assumptions underlying the statements described in (i)-(iii); and (v) projections or estimates of items specified by SEC rules or regulations.

In addition, certain statements made by companies in connection with transactions that do not currently fall within the PSLRA safe harbor for forward-looking statements *will* be eligible for the Item 1507 safe harbor, including forward-looking statements made: (a) in connection with an offering by a blank-check company, (b) with respect to the business of a penny stock company, (c) in connection with a roll-up transaction, (d) in connection with an IPO, or (e) in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program. Note that, like the PSLRA safe harbor, the safe harbor provided under Item 1507 does not apply to statements consisting solely of historical facts, as such statements do not include the assumptions, judgments, and predictions regarding future events that would, from the SEC's perspective, require additional protection.

Further, the Item 1507 safe harbor is not available with respect to forward-looking statements included in the company's financial statements, or to statements that are incorporated by reference from the financial statements into the company's disclosures under subpart 1500 of Reg. S-K. The forward-looking statements must also be accompanied by a meaningful cautionary statement which identifies important factors that could cause actual results to differ materially from those in the forward-looking statements.

H. <u>Impact on Financial Statements</u>.

In addition to the Reg. S-K requirements discussed above, the SEC adopted new rules under Article 14 of Reg. S-X covering financial statement disclosures. The SEC focused on financial impacts of severe weather events and modified the Final Rules with a number of company-friendly provisions compared to the SEC's originally proposed rules.

1. *Income Statement and Balance Sheet Presentation for Severe Weather Events.* New Rule 14-02(b) and (c) of Reg. S-X requires companies to disclose in the financial statements the aggregate amount of expenditures expensed as incurred and losses and capitalized costs and charges, all excluding recoveries, incurred during the fiscal year as a result of severe weather events and other natural conditions. The SEC's examples include those conditions which resemble "acute events" under Item 1502 of Reg. S-K (discussed above) and certain other climate events, such as sea level rise. In a change from the proposed rules, the SEC determined that companies would not be required to disclose various climate mitigation activities, which were more difficult to determine and categorize in a company's financial statements. Instead, the SEC noted in the Adopting Release that the expenses and losses and capitalized costs and charges were already required to be contained in a company's financial statements under applicable accounting standards, so the new Rule 14-02(b) and (c) would simply be a disaggregation (and different presentation) of current accounting and disclosure requirements. As discussed below, there are attribution issues still unresolved under the Final Rules, but the financial information required to be disclosed should already be available for most companies.

   The SEC provided further examples of losses or expenses, or capitalized costs or charges that should be disclosed under Rule 14-02. For example, the SEC indicated that losses or expenses, or capitalized costs or charges that are incurred and that relate to assets which may be impaired or required to be repaired or be relocated due to a severe weather event, or other losses that the company experiences from the severe weather event, should be disclosed. Companies must separately identify where (1) the expenditures expensed as incurred and losses are presented in the income statement and (2) the capitalized costs or charges are presented in the balance sheet, in each case to allow investors to understand the overall financial impact of the severe weather events.

   To counterbalance the various expenses, losses, and capitalized costs or charges, new Rule 14-02(f) of Reg. S-X requires companies to state separately the aggregate amount of any recoveries recognized during the fiscal year as a result of severe weather events and other natural conditions for which any such capitalized costs, expenditures expensed, charges, or losses are disclosed. Such disclosure must separately identify where the expenditures expensed, capitalized costs, and losses are presented in the income statement and the balance sheet. The SEC believed that providing, on the one hand, the total costs, losses, and expenses, and on the other hand, the recoveries that mitigate such total costs, losses, and expenses, gives investors a better idea of the financial picture of the company with regard to severe weather events or other natural conditions.

   The SEC recognized that determining amounts for expenditures, losses, capitalized costs, or charges (or recoveries therefrom) could be difficult when multiple variables can impact such financial disclosures. To assist companies in determining whether disclosure is required, the SEC noted in the Adopting Release that if the severe weather event or natural condition is a significant contributing factor in incurring the capitalized cost, expenditure expensed, charge, loss, or recovery, then disclosure is required. Unfortunately, the SEC did not provide a definition for "significant contributing factor" in the Adopting Release and referred companies to accounting rules which used the term "significant" (without further definition). As a result, companies will need to potentially develop policies and use such policies in making judgment calls on whether an event is significant enough to trigger the financial statement disclosures discussed above.

2. *Disclosure Thresholds for Severe Weather Events.* A particularly controversial aspect of the SEC's originally proposed rules was the financial thresholds that would trigger reporting under Reg. S-X. The SEC, after considering comments, adopted a more company-friendly threshold with numerically based bright lines. Under new Rule 14-02(b) of Reg. S-X, a company will only be required to disclose:

    - Expenditures expensed as incurred and losses if the aggregate amount of such 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 (i.e., earnings before interest and taxes or EBIT) for the relevant fiscal year; and
    - Capitalized costs and charges recognized if the aggregate amount of the absolute value of capitalized costs and charges recognized equals or exceeds one percent of the absolute value of stockholders' equity or deficit, at the end of the relevant fiscal year.

    The SEC noted that, because capitalized costs and charges could offset each other, using the absolute value of the costs and charges was appropriate to give investors a better idea of such costs and charges relative to the equity of the company. And to help smaller companies, the SEC adopted a de minimis threshold when no disclosure is required—even if the company exceeds the applicable 1% threshold discussed above. Specifically, if a company does not exceed $100,000 for expenditures expensed as incurred and losses in the income statement or $500,000 for capitalized costs and charges recognized on the balance sheet, then no disclosure is required for these events. The SEC acknowledged that the two threshold tests were independent of each other and in certain situations companies may exceed one threshold--but not the other threshold--and thus only provide partial disclosure in response to Rule 14-02(b).

3. *Carbon Credits and RECs.* As discussed above in connection with Item 1504 of Reg. S-K, the SEC focused on companies' usage of carbon credits and RECs in managing their climate programs. In addition to the requirements under Reg. S-K, the SEC indicated that it believes that investors would benefit from financial disclosures related to such carbon credits and RECs. New Rule 14-02(e)(1) of Reg. S-X requires that, for companies using carbon offsets or RECs as a material component of such 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. Such companies must also disclose the beginning and ending balances of the capitalized carbon offsets and RECs for the fiscal year to help investors understand the company's climate "balance sheet."

4. *Recognizing Uncertainty and Judgment in the Climate Disclosure Process.* The SEC acknowledged that the climate disclosures discussed above involve various uncertainties. New Rule 14-02(a) of Reg. S-X will require companies to disclose significant judgments made and other information that is important to an investor's understanding of the financial statement effect of the climate disclosures under Reg. S-X. Similar to other accounting policies disclosed in a company's financial statements, Rule 14-02(a) of Reg. S-X will require companies to provide context around their accounting presentations and provide information about how the company

determined their financial disclosures. For those companies that disclose carbon credits and RECs in managing their climate programs, Rule 14-02(e)(2) of Reg. S-X requires companies to state their accounting policy for carbon offsets and RECs. In a welcome development, the SEC provided that under Rule 14-01(c) of Reg. S-X, companies can calculate the financial statement effects of the climate rules using financial information that is consistent with the scope of the rest of the company's financial statements, and companies should apply the same set of accounting principles that a company is required to apply in preparation of the rest of its consolidated financial statements. Thus, for those companies reporting under GAAP, they need not deviate from GAAP or any other accounting policies adopted by the company in reporting the climate disclosures.

Under new Rule 14-02(h) of Reg. S-X, companies must disclose whether estimates and assumptions used to produce the financial statements were materially impacted by exposures to risks and uncertainties associated with, or known impacts from, severe weather or natural conditions or any climate-related targets or transition plans disclosed by the company. The SEC pointed out in the Adopting Release that this disclosure has a materiality standard, so if the financial statements were not materially impacted, then disclosure would not be required. In addition, if the company has adopted climate targets or transition plans (including any disclosed pursuant to Item 1502(e) of Reg. S-K), then the disclosures could also be tied to those climate targets or transition plans. For example, the SEC noted that if a company's transition plans or climate goals involved decommissioning of assets, providing disclosure as to the estimates used to compute depreciation expense as well as its measurement of asset retirement obligations should reflect alignment with the goal or commitment. If disclosure is required, then companies must provide a qualitative description of how the development of such estimates and assumptions were impacted by such events, conditions, targets, or transition plans.

It remains to be seen whether accounting firms will deem any disclosures to be "critical audit matters" due to their uncertainty. The SEC did not mandate reporting at the reportable segment or geographic level, but also did not explicitly mandate that such disaggregated disclosure would never be required.

5. *Historical Financial Statement Presentation*. Given that the climate rules are new standalone disclosures, the SEC considered whether previously completed financial periods should be modified to conform to the new presentations or whether the financial presentations should be required only on a prospective, or go-forward, basis. In new Rule 14-01(d) of Reg. S-X, the SEC chose the company-friendly prospective basis. Under Rule 14-01(d) of Reg. S-X, subject to the phase-in requirements discussed below, a company will be required to provide the new financial statement disclosures for the company's most recently completed fiscal year for which audited financial statements are included in the first filing to which the Final Rules apply. A company will not be required to provide disclosure for prior historical fiscal year(s) included in that first filing. For each subsequent fiscal year, the company will need to provide the applicable disclosure for an additional fiscal year until the required disclosure is provided for the entire period covered by the financial statements. Consequently, the disclosures will have a starting fiscal year and eventually cover each year of a filing.

6. *Financial Statement Presentation.* The climate disclosures under Reg. S-X will be required to be presented in the notes to the financial statements and therefore subject to audit by a company's independent registered public accounting firm and the company's internal control over financial reporting. In adopting the financial statement disclosures discussed above, the SEC reasoned that the information presented is a part of the overall books and records of the company and already included in the company's financial statements, albeit not necessarily in the current form. The SEC reiterated that Public Company Accounting Oversight Board ("PCAOB") standards would apply to the audit of any such information and that the climate disclosures would be within the scope of the audit when a company files financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

I. Companies Subject to Requirements and Affected Forms; Structured Data Requirement; Treatment under Securities Act and Exchange Act; Compliance Dates and Phase-In Periods.

1. *Companies Subject to the Final Rules and Affected Forms.* Companies must comply with the Reg. S-K and Reg. S-X disclosure requirements in their periodic reports under the Exchange Act and in registration statements under the Securities Act and under the Exchange Act, subject to certain exceptions. The SEC stated in the Adopting Release that the basis for mandating these disclosures in such a broad swath of periodic filings and registration statements is that disclosures in respect of climate-related risks (and related financial impacts) should receive the same treatment as other business and financial information, which is necessary in understanding a company's operating results, prospects, and financial condition.

   Companies must include the climate-related disclosures under the Final Rules in their Forms 10-K, in their registration statements on Form 10, Form S-1, and Form S-4 (except for private companies party to business combination transactions under Securities Act Rule 165(f) that involve a registered securities offering on Form S-4 and Form S-11. Foreign private issuers which file annual reports or registration statements on Form 20-F, or registration statements on Form F-1 or Form F-4 (except for private companies party to business combination transactions under Securities Act Rule 165(f) that involve a registered securities offering on Form F-4) must also comply with the rules. The new requirements will not apply to Canadian issuers which file annual reports or registration statements on Form 40-F. The Final Rules do not, however, apply to Forms S-8 and 11-K.

   In a notable change from the proposed rules, companies are not required to disclose in their quarterly reports material changes to climate-related disclosures previously provided in a registration statement or annual report. However, companies should consider how any climate-related events impact the interim financial statements and MD&A for purposes of Item 303 of Reg. S-K.

   SRCs and EGCs must comply with the Final Rules, with the exception of the obligation to disclose, as noted above, Scope 1 and Scope 2 emissions, and, as discussed below, SRCs and EGCs will have a longer phase-in period to comply with the rules as compared to other filers.

2. *Structured Data Requirement.* The structured data requirements included in the proposed rules were adopted by the SEC without modification. LAFs must comply with the structured data requirements under the Reg. S-K rules for all disclosures beginning one year after the company's initial compliance with the respective disclosure obligations under the Final Rules. Other filers must comply with tagging requirements upon compliance with subpart 1500 of Reg. S-K, and for specific provisions with an extended compliance date starting on or after the initial compliance date for LAFs, such filers must tag such information on the date of initial compliance.

3. *Treatment Under the Securities Act and Under the Exchange Act.* Because climate-related disclosures made pursuant to the Final Rules will be treated as filed (rather than furnished), such disclosures will be subject to potential liability under Section 18 of the Exchange Act, and to the extent such disclosures are included or otherwise incorporated by reference into a registration statement under the Securities Act, Section 11 of the Securities Act will apply. In this connection, the SEC reasoned in the Adopting Release that subjecting climate-related disclosures to the same liability as other critical information included in periodic reports and registration statements will likely ensure greater accuracy and consistent presentation of these types of climate-related disclosures. However, as discussed above, certain disclosures are subject to certain safe harbor provisions.

4. *Compliance Dates and Phase-In Periods.* As noted throughout this client alert, the start dates for compliance with the Final Rules are subject to phase-in periods depending on the filer status of a particular company. The new disclosure requirements will apply to LAFs earlier than they will apply to other categories of filers. These other categories of filers are being granted longer phase-in periods to develop systems, controls, and processes required to comply with the climate-related disclosure rules, as well as to anticipate higher costs which may be incurred as a result of compliance with the rules.

   The following chart summarizes compliance dates for climate-related disclosures in both registration statements and annual reports. With respect to annual reports, a company must comply with the rules beginning with its annual report covering the full fiscal year indicated in the chart. With respect to registration statements, a company must comply with the rules beginning with any registration statement that includes financial information for the full fiscal year indicated in the chart.

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.					

Next Steps for Companies to Consider

In light of these significant rule changes, companies should begin planning for these new disclosure requirements well in advance of their mandatory compliance dates. In connection with those planning efforts, companies could consider the following action items (among others):

- **Refresh internal risk assessment and oversight mechanisms to incorporate climate-related risks:** Companies could consider reviewing the types and examples of climate-related risks with internal stakeholders and external advisors to consider where current and future climate risks impact the company's overall business structure. Internal analysis of existing climate events and potential climate events will assist companies in their overall materiality analysis and/or any transition or other planning.

- **Evaluate current reporting and oversight of climate risks at the board or board committee level and revise charters or corporate governance documents as appropriate:** Companies could consider evaluating their current oversight structure regarding climate risks and modifying the structure to best incorporate appropriate risk structures or fine-tune existing risk structures in light of the Final Rules. Companies could also consider how climate risk oversight functions will be integrated into the board's overall risk oversight function.

- **Analyze management oversight of climate risks:** Companies could consider evaluating management's current oversight of climate risks and modifying their oversight functions and processes in light of the Final Rules.

- **Review disclosure controls and procedures for integration of climate disclosures:** Companies could consider reviewing their disclosure controls and procedures to assess and consider whether climate-related risks should be further integrated into their current frameworks. Internal disclosure committees could consider planning to ensure that the company progresses on an appropriate timeline in developing disclosure processes that will enable the company to fully comply with the new rules.

- **Discuss climate reporting and risk for development of any applicable accounting policies for climate matters and scope out financial disclosures relative to income statement and stockholders' equity:** Companies could consider developing climate reporting and accounting policies and scoping current climate disclosures for financial statement purposes, including examining the applicable threshold and de minimis exceptions.

- **Review current climate goals for materiality and timelines for implementation:** Companies could consider reviewing their current climate goals for their overall materiality, eventual implementation and timelines in light of the disclosure requirements.

- **Monitor litigation landscape and SEC responses:** Companies could consider monitoring existing legal challenges and future SEC responses to stay informed about the status and outcome of those challenges, and the effect any legal judgments in those matters may have on reporting obligations. In the past, the SEC has in some instances stayed the effectiveness of newly adopted rules while subject to litigation or in response to court challenges. It remains to be seen whether legal challenges to the new climate-related disclosure rules will lead to similar outcomes.

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