

INSIGHTS

## The SEC's Proposed Rules on Climate-Related Disclosures – What to Do Now: A Guide for In-House Counsel Facing the Proposed Rules

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The U.S. Securities and Exchange Commission's recently [proposed rules](#) governing climate-related disclosures, if adopted as proposed, would represent a sea change to the existing public-company disclosure regime. The rules would require that public companies include the following, among other disclosures, in reports and registration statements filed with the SEC:

- disclosure of greenhouse gas (GHG) emissions data covering Scope 1 and Scope 2 emissions for all companies and Scope 3 emissions for companies<sup>1</sup> (other than those that qualify as “smaller reporting companies”) for which Scope 3 emissions are material or that have set emissions reduction targets that include Scope 3 emissions, with third-party attestation being required for Scope 1 and Scope 2 data for companies that qualify as “large accelerated filers” or “accelerated filers”;
- extensive and detailed disclosures regarding climate-related risks, including physical risks and transition-related risks, to a company's financial statements, business operations or value chain (*i.e.*, upstream and downstream activities of third parties related to the company's operations);
- disclosure in the notes to audited financial statements of quantitative and qualitative information regarding financial impacts of climate-related risk, including disaggregated quantitative information with respect to impacts of physical risks or transition activities on specific financial statement line items if the impact is 1% or more of the line item;
- extensive and detailed disclosures regarding climate-related governance, strategy and risk management; and
- to the extent relevant to a particular company, disclosures regarding the company's transition plan, climate-related targets or goals, use of scenario analyses or other analytical tools in evaluating climate-related risk and use of an internal carbon price.

For many companies, the rules would require enterprise-wide changes to how the company collects, assesses and reports climate-related data and other information, as well as changes to their governance structures and systems of controls. Changes may be driven both by the need to comply with the disclosure requirements and by a company's view of how its disclosures will be received by investors or the public generally.

The tasks of understanding the implications of the proposed rules for a particular company and preparing for eventually complying with the rules are monumental, and, unfortunately, public companies currently find themselves in the difficult position of possibly needing to act with some urgency in order to be prepared to comply with rules of uncertain substance on an uncertain timeline. At this point, the proposed rules are just that – proposed and not final. The period for public comment on the proposed rules will run until May 20 at the earliest and could be extended by the SEC, and public comments are likely to reflect the controversial nature of the proposed rules and strong opinions by both supporters and detractors. After the comment period, whether and when the SEC releases final rules, and the extent to which any final rules largely follow or reflect significant changes from the proposed rules, will remain to be seen. Like the proposed rules, any final rules should provide for phase-in periods for compliance. Further, any final rules are almost certain to face legal challenges that could delay implementation of the rules even if such challenges ultimately are unsuccessful. It is therefore very difficult to predict when companies will need to comply with new rules and precisely what information they will be required to disclose under new rules.

Despite that uncertainty, it appears very likely that the SEC will adopt final climate-related disclosure rules in the not-too-distant future and that those rules will include in some form most, if not all, of the big buckets of disclosure requirements reflected in the proposed rules. Because of the significant effort and degree of organizational change that compliance with the rules likely will require, companies may not be able to wait until final rules are released to begin assessing the impacts of the proposed rules on their organizations. And, if the SEC were to adopt final rules later this year in the proposed form, companies that are large accelerated filers with a calendar fiscal year would be required to include information for 2023, including Scope 1 and 2 emissions data, in their annual reports filed in early 2024, meaning that they would need to have the systems in place to track and record the relevant information by the end of this year.

Assessing the potential impact of the proposed rules on a company and preparing the company for eventually complying with the rules will require participation from many different parts of the organization, but we expect that, at many companies, the task of setting the company on a course to do those things will fall on the general counsel and other in-house counsel with responsibility for relevant substantive areas. With that in mind, we have prepared the following guide for in-house counsel with respect to near-term actions their companies should be taking or should consider taking, depending on their circumstances. Bracewell will expand on a number of the topics noted below in future alerts, webinars or other similar communications.

**1. Engage senior management, the board of directors and relevant board committees and begin assessing governance, oversight and management of climate-related risks.**

In-house counsel likely will be hearing from their CEOs and board members, if they haven't already, asking what the proposed rules mean for their company. In any case, in-house counsel should ensure that top-level management and board members understand the potential challenges and changes their companies may face with the proposed rules and encourage the level of board and senior management oversight and engagement that is appropriate for their situation. The proposed rules would require companies to provide detailed disclosures concerning their boards' oversight of climate-related risks and management's role in assessing and managing those risks. Although many companies already have robust board oversight of ESG matters and include related disclosures in their SEC filings, the proposed rules are far more granular in dictating the type of information that would need to be disclosed.

In that regard, in-house counsel may be asked what changes, if any, should be made to board or committee composition and structure in light of the proposed new disclosure requirements. Among other matters, consideration should be given to whether the creation of a new ESG committee – or a purely climate-focused committee – is appropriate or whether responsibility reasonably can be shouldered by an existing committee, such as the audit committee.

**2. Establish organizational responsibility for assessing the implications of the proposed rules for your company.**

As noted above, this is a huge task that will require input from a multidisciplinary team, including legal, accounting, operations and possibly other personnel. Identifying the right team and setting clear responsibilities and timelines are critical near-term tasks.

**3. Understand the potential timeline for compliance with the proposed rules as it relates to your organization.**

As noted above, there is considerable uncertainty regarding, among other matters, whether final rules will require compliance on the timelines contemplated in the proposed rules, which would have the compliance requirements phased in over several years based on a company's status as a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. This [fact sheet](#) on the proposed rules published by the SEC provides helpful tables (on page 3) detailing the phase-in periods contemplated by the proposed rules for companies with a calendar fiscal year, assuming the proposed rules were adopted as final with an effective date in December 2022.

Despite the uncertainty, it is certainly possible that the SEC could adopt final rules later this year with compliance dates as contemplated by the proposed rules, and companies therefore would be ill-advised to assume that they will have a longer ramp-up period than they would under the proposed rules and the assumption of a December 2022 effective date.

**4. Understand the proposed rules and the disclosures they will require for your company based on its specific circumstances, including with regard to differences between what the company is**

**disclosing now and what would be required by the proposed rules.**

The proposed rules are highly prescriptive and are intended to produce consistent and comparable disclosures across the public-company spectrum. With limited exceptions (e.g., that smaller reporting companies would be exempted from the requirement to disclose Scope 3 emissions), all public companies will need to assess required disclosure under all provisions of the rules. That assessment, however, will need to be made in light of the company's specific circumstances, and there will be categories of required disclosures that are very relevant to some industries or companies but of no or limited relevance to other industries or companies. Additionally, many companies have been voluntarily disclosing information that is similar to some of the information that may be required to be provided under the proposed rules, but there may be gaps between or differences in required disclosures and a company's current practices.

As companies begin to digest the proposed rules, it will make sense for them to drill down on the specific types of disclosures they would need to make if the proposed rules were adopted as proposed. Questions that companies might ask themselves include the following:

- Will we need to disclose Scope 3 emissions data based on materiality or having set targets or goals including Scope 3 emissions?
- What, if anything, have we done with respect to the following topics such that disclosure regarding those topics would be required?
  - Adoption of a transition plan
  - Setting of climate-related goals or targets
  - Use of carbon offsets or renewable energy credits in setting goals or targets
  - Use of scenario analyses or other analytical tools in evaluating climate risk
  - Use of an internal carbon price
    - Note that, with respect to goals or targets, the proposed rules refer to a company's having "set" such goals or targets and not to its having publicly disclosed them. Similarly, with respect to all of these topics, it is not clear that the related disclosure would be triggered only by some level of formality or organizational scope in the adoption, setting or use of the applicable item. Companies therefore should assess the relevance of these topics broadly, including informal use or discussion within the organization.
- What information that we are not currently disclosing would the proposed rules require us to disclose?

- For information that we are currently disclosing, would the proposed rules require that information to be established, assembled or disclosed differently, or disclosed more expansively or granularly, from how we are doing it now? If so, how?
- Which required disclosures might be particularly challenging for our company, such that they might merit special or prioritized focus?

**5. Begin to evaluate existing systems and resources related to climate-related information and identify changes that will need to be made.**

Companies in some industries, such as energy or manufacturing, likely already have systems in place to collect much of the data called for by the proposed rules, and many public companies have been publishing voluntary disclosures in the form of ESG reports for years. However, smaller companies in such industries may not currently have the resources necessary to devote to compliance with the new rules. Likewise, companies in non-GHG intensive industries, such as financial services, previously may not have had the need, or a more limited need, for such systems. And even those companies that are experienced in collecting and disclosing climate-related data and other information likely would, under the proposed rules, need to expand their systems to cover a much broader universe of information and ensure that controls and procedures meet standards for disclosures in SEC-filed documents and are appropriate for enhanced scrutiny and potential liability that will come with including such disclosures in SEC-filed documents. Companies may need to invest significantly in new personnel with appropriate expertise and in new technology, and they will need to expand their disclosure controls and procedures and internal control over financial reporting to cover new sets of information that are wide-ranging, voluminous and highly detailed. Accordingly, public companies should begin to assess their existing capabilities and identify the changes they would need to make to comply with proposed rules to ensure that the changes can be effected in time to comply with new rules.

Additionally, the climate-related risk disclosures contemplated by the proposed rules may require that companies devote significant resources to expanding the process by which they identify and assess climate-related risk. Further, the need for companies to evaluate climate-related risks to upstream and downstream – value chain – activities, and potentially to disclose Scope 3 emissions associated with those activities, may pose significant challenges and likely will require many companies to develop new processes to address disclosure requirements that relate to matters that are largely outside of the company’s control and access. These are areas that companies may want to focus on in the near term.

**6. Evaluate needs and strategy for retaining third parties to assist with disclosures, including for attestation of GHG emissions data.**

As noted above, for large accelerated filers and accelerated filers, the proposed rules would require attestation regarding Scope 1 and Scope 2 GHG emissions data by an independent third party meeting certain minimum qualifications, which may be a public accounting firm if it meets the minimum qualifications but need not be an accounting firm. The market for providing

these attestation services is evolving and will continue to evolve as accounting firms and others develop their ability to provide these services. Some observers have raised concerns that the supply of emission-attestation services may not initially meet the demand for such services that the proposed rules would create. Companies may wish to begin thinking about their options for third-parties to handle the attestation, particularly large accelerated filers who could be subject to the attestation requirements as soon as in their 2024 annual reports filed in early 2025. Additionally, it is important for companies to have conversations around attestation ahead of their information gathering efforts to ensure that the disclosure information being developed and gathered will be sufficient for attestors to provide the required assurance.

In addition to attestation services, companies should consider their potential need for and access to other third-party advisors with the necessary expertise and experience, including attorneys, accountants/auditors and firms providing consulting and other services to assist companies with climate-related disclosures.

**7. Consider whether the disclosures contemplated by the proposed rules warrant any changes to your current, planned or contemplated climate-related activities, such as setting or disclosing of climate-related goals or targets.**

As noted above, the proposed rules contemplate detailed disclosures regarding several matters that may or may not be relevant to a particular company depending on things that the company may or may not have done in advance of the initial compliance date for the proposed rules. These include whether a company has:

- adopted a climate transition plan,
- set climate-related goals or targets,
- included Scope 3 emissions in its goals or targets,
- used carbon offsets or renewable energy credits in setting its goals or targets,
- used scenario analyses or other analytical tools in assessing climate-related risk, or
- used an internal carbon price.

Companies may wish to reassess their existing, planned or contemplated activities in these areas in view of the proposed rules. It may be the case that a company would want to modify its activities in one or more of these areas when viewed through the lens of what the company's disclosures regarding such activities would look like under the proposed rules. For example, if your company is planning to set or announce new GHG emissions goals, should the company modify the goals as they relate to Scope 3 emissions or otherwise before doing so, or would it be preferable for the company to delay any such setting or announcement of goals until there is clarity on the content of final rules?

## **8. Determine whether to submit comments on the proposed rules.**

The proposed rule release includes over 200 requests for comment. Comments are due by the later of 30 days after the date the proposing release is published in the Federal Register (which had not happened as of the date of this update) or May 20, 2022. (As noted above, it is possible that the comment period could be extended beyond that date, but, unless and until the SEC actually does that, parties desiring to submit comments should proceed with the expectation that they will need to submit them by the applicable current deadline.) Although the SEC will not agree with all comments received and may adopt final rules despite strong and widely-held opposing views reflected in the comments, the SEC and its staff will consider the comments received in adopting final rules and likely will make at least some changes to the proposed rules based on comments. If your company would like to have its voice heard on the proposed rules, you may consider doing so by submitting comments directly or through an industry association or similar group.

## **9. Monitor developments.**

As noted above, we are in the early stages of the process through which the proposed rules could, in their current form or with changes, become final rules with which public companies actually would need to comply. In-house lawyers should continue to monitor developments and advise others in their organizations of such developments as appropriate so that preparations for compliance with new climate-related disclosure rules can be adjusted as necessary.

## **10. Don't forget that climate-related disclosures may be required under existing SEC rules and interpretations.**

With the anticipation of a massive new disclosure regime for climate-related matters and preparation for compliance with that regime, it might be easy to overlook that fact the existing SEC rules and interpretations may require climate-related disclosures in SEC filings, and the SEC staff may issue comments on climate-related disclosures, or the absence thereof, in a company's SEC filings, as they did for a number of companies in the fall of 2021 with respect to the companies' 2020 annual reports on Form 10-K. Pending the adoption and implementation of final new rules, companies should continue to assess their disclosures in view of the SEC's [2010 guidance](#) on climate-related disclosures.

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1. Scope 1 emissions are direct GHG emissions from operations that are owned or controlled by a company. Scope 2 emissions are indirect GHG emissions from the generation of purchased or acquired energy that is consumed by a company's operations. Scope 3 emissions are all indirect GHG emissions not otherwise included in a company's Scope 2 emissions, which occur in the upstream and downstream activities of a company's value chain.