Harvard Law School Forum on Corporate Governance

# SEC Adopts Climate Disclosure Rules

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**Editor's note:** Archie Fallon and Robert B. Stebbins are Partners, and William L. Thomas is Counsel at Willkie Farr & Gallagher LLP. This post is based on a Willkie memorandum by Mr. Fallon, Mr. Stebbins, Mr. Thomas, Adam S. Aderton, A. Kristina Littman, and William J. Stellmach. Related research from the Program on Corporate Governance includes The Illusory Promise of Stakeholder Governance (discussed on the Forum here) and Will Corporations Deliver Value to All Stakeholders? (discussed on the Forum here) both by Lucian A. Bebchuk and Roberto Tallarita; Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy – A Reply to Professor Rock (discussed on the Forum here) by Leo E. Strine, Jr.; and Stakeholder Capitalism in the Time of COVID (discussed on the Forum here) by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita.

On March 6, 2024, the Securities and Exchange Commission (the "SEC" or the "Commission") voted 3 to 2 to adopt rules requiring registrants to provide additional climate-related information in their registration statements and annual reports, including in their financial statements.

The rules are effective in 60 days after publication in the Federal Register and largely track the rules proposed by the Commission in March 2022, which we summarized in this Client Alert.[1]

The final rules differ from the 2022 proposal, however, in several meaningful ways. Most significantly, the adopted rules do not require companies to disclose Scope 3 emissions. Further still, large companies will only be required to disclose Scope 1 and Scope 2 emissions if material, and smaller registrants are exempted from the rules entirely. Notably, registrants will be required to disclose actual expenses attributable to severe weather events or other natural conditions—as opposed to identifying climate-related risks on each financial statement line item.

## The Rule

The rules are modeled in large part on the recommendations of the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol. At a high level, the rules require:

- a description of any climate-related risks that have materially impacted or are reasonably likely to have a material impact on the registrant;

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[1] *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors (Mar. 22, 2022) (the "Proposing Release").

- disclosure regarding a registrant's activities, if any, to mitigate or adapt to a material climate-related risk or use of transition plans, scenario analysis or internal carbon prices to manage a material climate-related risk;
- disclosure about any oversight by the registrant's board of directors of climate-related risks and any role by management in assessing and managing material climate-related risks;
- a description of any processes the registrant uses to assess or manage material climate-related risks;
- disclosure of Scope 1 and Scope 2 emissions on a phased-in basis for some registrants, if material; and
- disclosure of the effects of severe weather events and other natural conditions including costs and losses on the registrant's financial statements.

**Significant Changes in the Final Rules**.

*Scope 3 Disclosures*

The most significant change between the March 2022 Proposing Release and the final release concerns Scope 3 emissions. Scope 3 emissions are indirect greenhouse gas ("GHG") emissions which occur in the upstream and downstream activities of a registrant's value chain. The proposed rules would have required registrants to disclose these emissions if material.

This element of the Proposing Release, however, met with fierce pushback from many commenters. As the Commission noted, some commenters "asserted that the Commission lacks the authority to require disclosures of information that may come largely from non-public companies in registrants' value chain" and others questioned "the reliability of the metric" as well as "costs and burdens," especially those on smaller suppliers. Transparency stakeholders have already expressed concern over this change in the rules, and will likely continue to advocate for such disclosure in the future.

*Scopes 1 and 2 Disclosures*

The final release also lessens the burdens on registrants related to disclosure of Scopes 1 and 2 emissions. Scope 1 emissions are direct GHG emissions from operations that are owned or controlled by the registrant. Scope 2 emissions are indirect GHG emissions from the generation of purchased electricity, steam, heat, or cooling that are consumed by operations owned or controlled by the registrant.

Under the Proposing Release, a registrant would have been required to disclose its total Scope 1 emissions and its total Scope 2 emissions (regardless of materiality) after calculating them from all

sources that are included in the registrant's organizational and operational boundaries. Commenters to the rules noted that disclosure, even when a registrant has deemed the information material, "may not result in decision-useful information for investors." Still others noted that the registrants producing approximately 80% of GHGs in the United States already report their emissions to the U.S. Environmental Protection Agency. The Commission recognized "commenters' concerns about the potentially high cost of compliance."

Under the final release, a registrant is only required to disclose Scope 1 and 2 emissions if the registrant is a so-called "large accelerated filer" or "accelerated filer" (and is not a smaller reporting company or an emerging growth company) *and* such emissions are material. Expect companies' materiality determinations to be a subject of litigation and investigation, as well as ongoing stakeholder scrutiny.

These requirements will be phased in over the next three years. Large accelerated filers will have a one-year transition period before they are expected to comply. Accelerated filers (other than smaller reporting companies or emerging growth companies) will have an additional two years after that to become compliant.[2]

*Line-by-Line Disclosures*

The Proposing Release required registrants to determine the impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on each financial statement line item. Within each category, impacts would be required to be disclosed on an aggregated, line-by-line basis for all negative impacts and, separately, on an aggregated, line-by-line basis for all positive impacts. However, for purposes of determining whether the disclosure threshold has been met, a registrant would be required to aggregate the value of the positive and negative impacts on a line-by-line basis.

These proposed requirements were controversial. Commenters to the rules asserted that meeting these requirements would not be feasible. They noted that companies do not track climate-related impacts by financial statement line item, and that they do not have processes in place to do so given their current accounting systems. Complying with these requirements, they argued, would be burdensome, costly, and require companies to create new accounting systems, processes, and controls. Still others questioned how useful this line-by-line reporting would be to investors, given the difficulty in comparing the data across registrants, and whether it was even possible to accurately estimate the potential of future severe weather events on each line item.

[2] Limited third-party assurance is required for large accelerated filers in the fiscal year beginning 2029 and for accelerated filers in the fiscal year beginning 2031. Reasonable third-party assurance is required for large accelerated filers in the fiscal year beginning 2033; it is not required for accelerated filers.

The final rules do not adopt the financial metrics as originally proposed. Instead, the Commission adopted rules narrowing the scope of required disclosures, which disclosures are focused on actual expenses attributable to severe weather events or other natural conditions.

*Board Expertise*

The proposed rules would require disclosure of (i) any board members or board committees responsible for the oversight of climate-related risks, (ii) whether any board member has expertise in climate-related risks, (iii) the processes and frequency by which the board discusses these risks, (iv) how the board considers these risks as part of its business strategy, risk management and financial oversight, and (v) how the board sets climate-related targets or goals and oversees progress against those targets or goals.

The final rules, however, drop the requirements that registrants disclose the specific board members responsible for climate change oversight, provide information about whether board members have climate expertise, and disclose information about whether and how the board sets climate-related goals. The Commission made this change in part in response to comments expressing the view that placing undue focus on board members' expertise on climate issues could limit the registrants' flexibility to fill board seats and disagreeing with the elevation of climate risk over other issues that may be relevant to the company.

*Other Changes*

Additionally, and among others, the final rules:

- qualify the requirements to provide certain climate-related disclosures based on materiality; and
- eliminate the proposed requirement to disclose material changes to climate-related disclosures in Form 10-Qs or Form 6-Ks.

**Dissents.**

As expected, Commissioners Hester M. Pierce and Mark T. Uyeda dissented from issuance of the rules.

Commissioner Pierce's dissenting statement identified the rules' "fundamental flaw" as their "insistence that climate issues deserve special treatment and disproportionate space in Commission disclosures and managers' and directors' brain space." Commissioner Pierce believes that the Commission's pre-existing disclosure regime properly focused on climate risk and decried that the release "replaces our current principles-based regime," focused on materiality, "with dozens of pages of prescriptive climate-related regulations." References to materiality in the rules are "decorat[ions]…materiality ribbons" that the rules "embrace[] … in name only." Commissioner

Pierce also noted that the Commission "lack[s] the expertise to oversee these special interest disclosures, and only a mandate from Congress should put us in the business of facilitating the disclosure of information not clearly related to financial returns."[3]

Commissioner Uyeda decried the rules as "climate regulation promulgated under the Commission's seal" and "the culmination of efforts by various interests to hijack and use the federal securities laws for their climate-related goals." He expressed concern that there is now a roadmap for special interests to abuse the Commission to achieve their own personal political goals. And Commissioner Uyeda echoed Commissioner Pierce's concerns about Congressional authorization, explicitly stating his belief that the Commission's actions fail under the Supreme Court's Major Questions Doctrine. (See below.)

Further, given the significant changes to the rules in the nearly two years since they were proposed, both Commissioners suggest that the Commission has violated the Administrative Procedure Act by failing to re-propose the rules. Pointing to the decision to drop Scope 3 disclosures, Commissioner Uyeda stated that the "Commission has essentially admitted that the proposal did not get it right" and that regular order would involve an opportunity for an additional round of review and comment.

**Takeaways.**

Even with the changes agreed to in the final rules, they will be met with strong opposition, including challenges premised on a number of administrative law doctrines. Most notably, courts may be skeptical that the Commission—a regulatory body focused on ensuring the efficient operation of markets—has the authority to implement such far-reaching rules that speak to environmental concerns, leaving the rules open to challenge under the Major Questions Doctrine. Indeed, the Commission's action seems like a textbook example of an "agenc[y] asserting highly consequential power beyond what Congress could reasonably be understood to have granted it." *West Virginia v. EPA*, 597 U.S. __ (2022). (Setting aside what will happen to so-called *Chevron* deference when the Supreme Court decides *Loper Bright Enterprs. v. Raimondo* later this term.)

Nevertheless, the outcome of judicial action is impossible to predict at this early stage, and any injunction may take some time to be instituted. It is also unclear which parts of the rules the courts may question. While challenges to the rules from some so-called "red states" have already begun,[4] one can also anticipate action by affected business interests, as well as by pro-

[3] Many firms subject to the regime will also be scrambling to staff up to meet their obligations. See Michael Cohn, "Financial execs need to staff up for SEC climate disclosures," Accounting Today, Nov. 2023, https://www.accountingtoday.com/news/financial-execs-need-to-staff-up-to-make-sec-climate-disclosures.

[4] A group of 10 states, led by West Virginia, filed a challenge to the rules on the day they were finalized.

transparency organizations frustrated by what they view as the watering down of the rules.[5] A key variable still to be determined is one of jurisdiction. A challenge handled by the U.S. Court of Appeals for the Fifth Circuit, for example, might net a sharply different result than one in the U.S. Court of Appeals for the Ninth Circuit. Ultimately, these strike us as questions that the Supreme Court will need to weigh in on. And that will take some time.

Further still, the SEC's rules are not the only regulations that a company must follow and are but a part of an emerging mosaic of mandatory climate disclosure requirements taking shape in the United States and around the globe. In October 2023, California adopted[6] a far-reaching set of climate-related financial disclosure requirements for companies that do business in California, which requirements include mandatory Scope 3 disclosures regardless of materiality.[7] The EU Corporate Sustainability Reporting Directive (CSRD), having entered into force in January 2023, is illustrative of similar trends abroad, as is Australia's "Treasury Laws Amendment Bill 2024: Climate-related financial disclosure," which would require large companies and financial institutions to report on climate risks and opportunities in their annual financial filings.[8]

Clients, therefore, must continue (or for late starters, begin) their efforts to prepare for compliance with these rules. In our March 2022 alert, we recommended that registrants begin:

setting up internal reporting systems, reviewing their risk management practices as to climate-related disclosures and climate risk assessment, reviewing disclosures in current public filings as per the proposed requirements, possibly hiring additional staff, reviewing board practices and the backgrounds of board members as per the disclosure requirements … and amending governance documents accordingly, briefing the board … [and] working with outside auditors in preparation for the new financial statement requirements, and beginning the process of obtaining an attestation provider.

That advice remains. Meanwhile, companies face increased litigation risk—from shareholders and opponents of climate-related disclosure regimes as well as pro-transparency stakeholders—with regard to their disclosures and related practices. We advise that registrants use forward-looking statement legends wherever appropriate, and carefully consider each disclosure required under the rules.

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[5] The Sierra Club, for instance, has stated that it is contemplating filing a suit challenging the rules. Some of the major stakeholders, however, will be pleased with the step and view it just the start of a long-term effort that will ultimately include Scope 3 emissions and other salient datapoints.

[6] Scope 1 and Scope 2 reports would initially be due in 2026 for calendar year 2025 and Scope 3 reports would initially be due in 2027 for calendar year 2026. But the California Climate Accountability Regime now faces possible delay in implementation due to both a lack of funding by Governor Newsom's recent budget plan and a federal lawsuit by a coalition of industry associations alleging violation of the First Amendment, Supremacy Clause, and other constitutional limitations.

[7] https://corpgov.law.harvard.edu/2023/11/25/californias-comprehensive-climate-accountability-regime-setting-an-aggressive-new-national-standard/.

[8] https://treasury.gov.au/sites/default/files/2024-01/c2024-466491-policy-state.pdf.