April 12, 2022

Ten Thoughts on the SEC's Proposed Climate Disclosure Rules

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Last month, the Securities and Exchange Commission proposed long-awaited rules that would mandate enhanced climate-related disclosures by public companies. In this Alert, we provide an overview of this significant, and controversial, rulemaking proposal. We also provide our views on where the rules fit into governance, compliance and disclosure more broadly.

A Bit of Background and the Broader Context

Enhanced environmental disclosure has been a topic of discussion within the SEC since the 1970s. More recently, with the January 2021 change-over in administration and the resulting shift in rulemaking philosophy, climate disclosure has been an area of increasing SEC focus. Among other actions, during February 2021, shortly after taking office, then-Acting Chair Allison Herren Lee issued a statement directing the SEC's Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings.

In March 2021, the SEC launched a public consultation requesting input from investors, registrants and other market participants about whether current disclosures adequately inform investors about climate change. Approximately 600 unique comment letters were submitted to the SEC by leading issuers, institutional investors, trade associations, NGOs and others (Ropes & Gray advised several clients on their comment letters). Many of the more significant letters are cited in the SEC's Proposing Release for the new climate disclosure rules.

In September 2021, the SEC's Division of Corporation Finance published a sample comment letter related to climate change disclosures, which is discussed in our earlier Alert here. The sample comment letter followed the views expressed in the interpretive release on climate change disclosure published by the SEC in 2010, discussed in our earlier article here. The 2010 Interpretative Release and 2021 sample comment letter both focused on ways in which the SEC's existing principles-based disclosure requirements elicit climate-related information.

In its filing reviews, the SEC also has been increasingly, albeit selectively, focused on climate disclosures. In 2021, the SEC issued comments relating to climate disclosures to more than 40 registrants.

Alignment with Third-Party Frameworks

The proposed rules are in part based on (but not identical to) the frameworks published by the Task Force on Climate-related Financial Disclosures and the Greenhouse Gas Protocol.

The objective of the TCFD framework is to encourage companies to evaluate and disclose, as part of their financial filing preparation and reporting processes, the material climate-related risks and opportunities pertinent to their business activities. This is intended to help investors and other financial market participants, such as lenders and insurance underwriters, to assess and price climate-related risks and opportunities. The TCFD's high level recommendations for all sectors consist of eleven recommended disclosure topics grouped into four elements: (1) governance; (2) strategy; (3) risk management; and (4) metrics and targets. The TCFD recommendations also include supplemental guidance for the financial sector (banks, insurance companies, asset owners and asset managers) and non-financial groups (energy, transportation, materials and buildings and agriculture, food and forest products), including suggested metrics. The TCFD is a voluntary framework. However, it is being incorporated to varying degrees into national legislation and/or securities exchange requirements in several jurisdictions, including, among others, Canada, Hong Kong, Japan, New Zealand, Singapore, Switzerland and the United Kingdom. Even without the force of law, TCFD reporting has increased

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significantly over the last few years, although most companies only publish disclosures aligned with a subset of the TCFD recommendations.

The Greenhouse Gas Protocol consists of global standardized frameworks to measure and manage greenhouse gas (GHG) emissions from operations, value chains and mitigation actions. The GHG Protocol Corporate Accounting and Reporting Standard provides requirements and guidance for companies and other organizations preparing a corporate-level GHG emissions inventory. The standard covers the accounting and reporting of seven greenhouse gases covered by the Kyoto Protocol: carbon dioxide; methane; nitrous oxide; hydrofluorocarbons; perfluorocarbons; sulphur hexafluoride; and nitrogen trifluoride. All seven of these GHG emissions come within the scope of the SEC's proposed rules.

The standard was designed with the following objectives in mind:

- to help companies prepare a GHG inventory that represents a true and fair account of their emissions, through the use of standardized approaches and principles;
- to simplify and reduce the costs of compiling a GHG inventory;
- to provide business with information that can be used to build an effective strategy to manage and reduce GHG emissions; and
- to increase consistency and transparency in GHG accounting and reporting among various companies and GHG programs.

To complement the standard, a number of cross-sector and sector-specific calculation tools are available. These tools provide step-by-step guidance and electronic worksheets to help users calculate GHG emissions from specific sources or industries.

Covered Registrants; Compliance Dates

The rules would apply to SEC registrants broadly, other than registered investment companies, asset-backed issuers and Canadian issuers that are MJDS filers. Accordingly, the rules would apply to other foreign private issuers, even if they are subject to a home country reporting regime that requires climate disclosures, although the SEC asks for feedback on this portion of the rules in the Proposing Release.

The initial compliance date would vary based on filer size. Compliance would be keyed off of the number of fiscal years following the effective date of the rules. Assuming the rules are adopted in December 2022 (which we expect the SEC to push hard to achieve) and a registrant has a fiscal year ending December 31, the first compliance period for large accelerated filers would be the first fiscal year after the effective date of the rules, or fiscal 2023. The first compliance period for accelerated and non-accelerated filers would be the following year, or fiscal 2024. Compliance would be required by smaller reporting companies the year after that, or fiscal 2025.

However, compliance with Scope 3 greenhouse gas emissions and associated intensity metrics disclosure requirements – both of which are discussed later in this Alert – would not be required until the second fiscal year for which a registrant is required to comply with the rules. Smaller reporting companies would be exempted from the Scope 3 disclosure requirements.

To the extent third-party attestation is required, that would not begin for large accelerated filers and accelerated filers until the second fiscal year for which they are subject to the rules. Non-accelerated filers and smaller reporting

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companies would not be subject to the attestation requirements. Attestation is discussed in further detail later in this Alert.

Applicable Filings

Disclosures would apply to both Securities Act registration statements and Exchange Act periodic reports. More specifically, the disclosures called for by the rules would be required to be included in registration statements on Forms 10, S-1, S-11, S-4, F-1 and F-4 and primarily in periodic reports on Forms 10-K and 20-F.

Disclosures under the rules would be treated as "filed" rather than "furnished." Accordingly, they would be subject to potential liability under Section 18 of the Exchange Act or Section 11 of the Securities Act, as applicable.

A 100,000 Foot Look at the Disclosure Requirements

In contrast to the current principles-based approach to climate disclosure, the proposed rules take a different tack, requiring specific and detailed disclosures relating to climate matters. Key components of the proposed rules include the following:

- Oversight and management of climate risk.
- Impacts of climate-related risks on the business, financials, strategy, business model and outlook over the short, medium and long terms.
- Processes for identifying, assessing and managing climate-related risks.
- Historical GHG emissions data (Scopes 1 and 2, and in many cases Scope 3), with third-party assurance.
- Climate-related targets and goals, if set.
- Financial statement disclosure on the financial impacts of physical and transition risks.

Key elements of the proposed rules are summarized in subsequent sections of this Alert.

Climate-related Opportunities

Disclosure regarding climate-related opportunities would largely be optional under the rules. The Proposing Release indicates this is to allay any anti-competitive concerns that might arise from a requirement to disclose a particular business opportunity. However, disclosure of climate-related opportunities may nevertheless be required under the existing principles-based disclosure framework. For example, in the 2010 Interpretative Release, the SEC noted that a registrant's plans to reposition itself to take advantage of potential opportunities may be required by Item 101(a)(1) of Regulation S-K.

GHG Emissions Metrics

The rules would require registrants to disclose Scope 1 and Scope 2 emissions for the same periods for which information is presented in their audited financial statements, unless for prior historical periods the data is not reasonably available. For purposes of the calculation, registrants would use the sources included in their organizational and operational boundaries. In a deviation from the GHG Protocol for some companies, these boundaries would follow the same principles used when determining whether entities should be consolidated or proportionally consolidated for financial statement purposes.

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Scope 3 emissions would be required to be disclosed if material to the registrant or the registrant has set reduction targets or goals that include Scope 3 emissions. As earlier noted, the Scope 3 disclosure requirement would phase in one year after Scopes 1 and 2 disclosures are required and would not apply to smaller reporting companies.

In the Proposing Release, the SEC indicates that, consistent with its definition of "material" and Supreme Court precedent, Scope 3 emissions would be required to be disclosed if there is a substantial likelihood that a reasonable investor would consider Scope 3 emissions important when making an investment or voting decision. The SEC further states that, when assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions. Although the SEC indicated it is not proposing a quantitative threshold for determining materiality (and that a quantitative threshold alone would not suffice for determining whether Scope 3 emissions are material), it goes on to note that some companies rely on, or support reliance on, a quantitative threshold such as 40% when assessing the materiality of Scope 3 emissions. The Proposing Release also suggests, although the rules would not mandate, that registrants that determine that Scope 3 emissions, or categories of Scope 3 emissions, are not material should explain the basis for that determination.

GHG emissions data for each Scope presented would be required to be presented disaggregated by each constituent GHG and in the aggregate. Each Scope would be required to be separately disclosed. The impact of purchased or generated offsets would be required to be excluded. If Scope 3 emissions are disclosed, the registrant would be required to indicate the categories of upstream and/or downstream activities included in the calculation and, for each significant category, the emissions would be required to be separately broken out.

Additionally, registrants would be required to disclose GHG intensity per unit of total revenue and per unit of production for the sum of Scope 1 and Scope 2 emissions and, if Scope 3 emissions are disclosed, separately for Scope 3.

Registrants would be required to disclose the methodology, significant inputs and significant assumptions used to calculate GHG emissions, including any material gaps in the data and material changes to the methodology or assumptions from the prior fiscal year. Third-party data sources used for calculating GHG emissions would also need to be disclosed, as well as the process the registrant undertook to obtain and assess the data.

Estimates could be used, provided that the underlying assumptions and reasons for using estimates are disclosed. When disclosing GHG emissions for the most recently completed fiscal year, if actual reported data is not reasonably available, a registrant would be permitted to use a reasonable estimate of its GHG emissions for its fourth fiscal quarter (together with actual, determined GHG emissions data for the first three fiscal quarters), so long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter.

Scope 3 Safe Harbor

Scope 3 disclosures would benefit from a safe harbor from liability that would deem those disclosures to not be fraudulent statements unless made or reaffirmed without a reasonable basis or disclosed other than in good faith. The rules would not include a safe harbor for Scope 1 and Scope 2 disclosures, or other disclosures required by the rules.

Other than the foregoing Scope 3 disclosure safe harbor, the rules would not include any new safe harbors. Instead, in several places in the Proposing Release, the SEC notes the availability of the Private Securities Litigation Reform Act safe harbor for forward-looking statements. In order to rely on that safe harbor, the relevant forward-looking statement must be accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement. The PSLRA safe harbor does not apply to disclosures in initial public offerings or tender offers or to disclosure made by certain "bad actors" (among other exclusions).

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Attestation Requirements

Scope 1 and Scope 2 emissions disclosures by accelerated filers and large accelerated filers would require third-party attestation, following a phase-in period. Because the assurance requirements would be limited to accelerated filers and large accelerated filers, a new registrant would not be subject to these requirements until it has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for at least twelve months and has filed one annual report pursuant to the Exchange Act. Therefore, the assurance requirement would not apply to IPO issuers.

As earlier noted, the third-party attestation requirements would not kick in until the second fiscal year for which a registrant is subject to the rules. If the rules are adopted in 2022, this means that attestation would be required for large accelerated filers beginning with fiscal 2024 and for accelerated filers beginning with fiscal 2025. Non-accelerated filers and smaller reporting companies would not be subject to the attestation requirements.

Initially, for the first two years, limited (negative) assurance would be required. After the first two years, attestation would be required to be at a reasonable assurance level. Attestation would not be required to cover the effectiveness of controls around GHG reporting.

Attestation would not be required for Scope 3 emissions disclosure. However, if voluntarily obtained, it would be required to satisfy the same standards as attestation relating to Scope 1 and Scope 2 emissions disclosures.

The attestation report would need to be provided by an independent firm qualified to do so. It would not need to be a PCAOB-registered accounting firm.

Disclosures Regarding Targets, Strategy, Risk Management and Governance

Targets and Goals

Climate-related targets or goals set by a registrant would need to be disclosed. The rules would require a description of (1) the scope of activities and emissions included in the target, (2) the unit of measurement, including whether the target is absolute or intensity based, (3) the time horizon and (4) the baseline against which progress is tracked, with a consistent base year set if there are multiple targets. The rules would also require a description of any interim targets set by the registrant.

Registrants would also need to describe how they intend to meet climate-related targets and goals. As part of this requirement, they would be required to provide specified information regarding carbon offsets or renewable energy credits (RECs) that are part of the registrant's plan.

Registrants also would be required to disclose relevant data to indicate whether the registrant is making progress toward meeting the target or goal and how such progress has been achieved. Each year, the registrant would be required to update this disclosure by describing the actions taken during the year to achieve its targets or goals.

Strategy, Business Model and Outlook

The rules would require detailed disclosure of climate-related risks and how they may impact a registrant. Specifically, the rules would require a description of climate-related risks reasonably likely to have a material impact on the registrant, including on the registrant's business or consolidated financial statements, which may manifest over the short, medium and long terms.

Among other things, registrants would be required to disclose how they define their short-, medium- and long-term time horizons and indicate whether risks are physical or transition risks. For physical risks, registrants would be required to

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indicate, among other things, the nature of the risk and the location (including zip code or similar geographic identifier) and nature of the properties, processes or operations subject to the risk. For transition risks, disclosure regarding the nature of the risk and how relevant transition-related factors impact the registrant would be required.

Registrants would need to also describe the actual and potential impacts of their physical and transition risks on their strategy, business model and outlook and whether and how any such impacts are considered as part of the registrant's business strategy, financial planning and capital allocation, including both current and forward-looking disclosures that facilitate an understanding of whether the implications of the identified risks have been integrated into the registrant's business model or strategy. The registrant would also need to include a discussion of how any resources are being used to mitigate climate-related risks, the role that carbon offsets or RECs play in the strategy (if applicable) and financial statement impacts.

The rule would also require granular disclosure of certain metrics and tools if they are used by a registrant. If the registrant maintains an internal carbon price, it would be required to disclose that price, the boundaries for measurement, the rationale for selecting the price and how the registrant uses it to evaluate and manage climate-related risks. Scenario analysis and other analytical tools used by the registrant to assess the impact of climate-related risks would also need to be disclosed, together with the scenarios considered and related parameters, assumptions and analytical choices and the projected principal financial impacts on the registrant's business strategy under each scenario.

Risk Management

In addition to requiring disclosure of climate-related risks, the rules would require disclosure of a registrant's processes for identifying, assessing and managing those risks.

The rules would include a number of specific items that registrants would be required to discuss, if applicable, when describing their processes for identifying, assessing and managing climate-related risks, including how the registrant:

- determines the relative significance of climate-related risks compared to other risks;
- considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks;
- considers shifts in customer or counterparty preferences, technological changes or changes in market prices in assessing potential transition risks;
- determines the materiality of climate-related risks;
- decides whether to mitigate, accept or adapt to a particular risk;
- prioritizes whether to address climate-related risks; and
- determines how to mitigate any high priority risks.

Registrants would be required to disclose whether and how any such processes are integrated into the registrant's overall risk management system or processes.

Registrants also would need to describe any transition plan adopted as part of their climate-related risk management strategy, including how the registrant plans to mitigate or adapt to climate risks and the relevant metrics and targets used

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to identify and manage physical and transition risks. The disclosure would need to be updated annually to describe the actions taken during the preceding fiscal year to achieve the transition plan's targets or goals.

Governance

The rules would require registrants to describe how their board of directors oversees and management assesses and manages climate-related risks.

Registrants would be required to disclose if any member of the board has expertise in climate-related risks. That follows the approach taken in the SEC's recent proposal on cybersecurity disclosure, which would similarly require registrants to disclose if any member of the board of directors has relevant subject matter expertise. However, unlike the recent cybersecurity proposal and the existing disclosure requirements regarding audit committee financial experts, the Proposing Release and proposed rules do not state that being identified as having climate-related expertise would not result in a director being deemed to be an "expert" for purposes of Section 11 of the Securities Act, impose duties or liabilities on that director or relieve other directors of any of their obligations.

Additionally, registrants would be required to identify which directors or board committees are responsible for the oversight of climate-related risks, the processes by which board members are informed about and the frequency of board-level discussions regarding climate-related risks and whether and how the board considers climate-related risks as part of its business strategy, risk management and financial oversight. Whether and how the board sets climate-related targets or goals and oversees their progress, including the establishment of any interim targets or goals, would also be required to be disclosed.

In addition, registrants would be required to describe management's role in assessing and managing climate-related risks. That disclosure would need to address whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, the identity of the positions or committees and the relevant expertise of the position holders or committee members, the processes by which the positions or committees are informed about and monitor climate-related risks and whether and how frequently such positions or committees report to the board or a board committee on climate-related risks.

Financial Statement Requirements

The rules would amend Regulation S-X to require inclusion of a note to the audited financial statements disclosing among other things the financial impacts of physical conditions and transition activities. As part of a registrant's financial statements, these metrics would be subject to audit by an independent registered public accounting firm and would come within the scope of the registrant's internal control over financial reporting. Selected elements of this aspect of the rules are described below.

The registrant would be required to disclose the impact on relevant financial statement line items of severe weather events and other natural conditions (such as flooding, drought, wildfires, extreme temperatures and sea level rise). The registrant also would be required to disclose the impact of transition activities (including any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks) on each impacted line item. At a minimum, impacts would be required to be presented on an aggregated line-by-line basis, separately for negative and positive impacts. The note would also be required to separately indicate the aggregate amount of expenses and capitalized costs incurred to mitigate the risks of severe weather events and other natural conditions and to reduce GHG emissions or otherwise mitigate exposure to transition risks.

Inclusion of the foregoing information would be subject to quantitative thresholds. Disclosure of the financial impact on a line item would not be required if the sum of the absolute values of all impacts on the line item is less than 1% of the

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line item. Disclosure of the aggregate amount of expenses and/or capitalized costs would not be required if the amount incurred is less than 1% of the total expensed or capitalized costs incurred.

Disclosures would be required for the registrant's most recently completed fiscal year, and for the historical fiscal year(s) included in the consolidated financial statements in the filing. A registrant that is required to include balance sheets as of the end of its two most recent fiscal years and income statements and cash flow statements as of the end of its three most recent fiscal years would be required to disclose two years of the climate-related metrics that correspond to balance sheet line items and three years of climate-related metrics that correspond to income statement or cash flow statement line items. For fiscal years preceding the then-current reporting year, the registrant would be able to rely on Rule 409 or Rule 12b-21, to the extent the information is not reasonably available and would require unreasonable effort or expense to obtain.

The note also would be required to include contextual information describing how each specified metric was derived, including a description of significant inputs and assumptions used, and, if applicable, policy decisions made by the registrant to calculate the specified metrics.

Additionally, registrants would be required to include (if applicable) a qualitative description of how the development of the estimates and assumptions used to produce the financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, (1) severe weather events and other natural conditions and (2) a potential transition to a lower-carbon economy or any climate-related targets disclosed by the registrant.

Ten Take-aways for Registrants

The Final Rules Are Likely to Differ from the Proposal, Perhaps Substantially

The rules are arguably the most significant new public company disclosure and compliance requirements in a generation. Compliance costs will be significant. The SEC will therefore receive a significant volume of comments from individual registrants and trade associations advocating for modifications to various aspects of the rules.

In addition, several members of Congress already have expressed their opposition. Congressman Joyce (R-Ohio) has introduced a resolution critical of the SEC's proposed approach to climate-related disclosure. Additionally, a number of members of Congress have publicly indicated they oppose the SEC's proposal, including Senator Manchin of West Virginia and 19 Republican senators. Senator Hagerty (R-TN), in addition to publicly opposing the proposed rules, has written to Chairman Gensler indicating that he will seek to review any final rules under the Congressional Review Act, although disapproval of the rules under the CRA is unlikely.

Undoubtedly, none of this is a surprise to the SEC. It knew going in that rulemaking in this area would be controversial. With that in mind, many commentators expect the final rules to soften some aspects of the proposal. Putting aside more philosophical questions around the SEC's authority to adopt the rules, the debate over rulemaking versus private ordering and the effect of the rules on capital formation, specific areas that will draw a significant number of comments will include, among others, (1) the phase-in periods for compliance; (2) the granularity of required GHG emissions disclosures; (3) Scope 3 emissions disclosure requirements, including the triggers; (4) the timing for filing GHG emissions disclosures; (5) required disclosures around board oversight and qualifications and management practices; (6) the extensive and prescriptive nature of the disclosures relating to strategy, business model, outlook and risk management, including relating to targets, goals and transition plans; (7) the extensive audited financial statement disclosure requirements and the low thresholds for quantitative disclosures; (8) the phase-in period for third-party assurance and the reasonable assurance requirement; (9) the lack of a broad-based safe-harbor from liability for historical GHG emissions data, which is often based on estimates, assumptions and methodologies that may be revised in the

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future; (10) the industry-agnostic approach taken by the rules; and (11) differences between the rules and voluntary frameworks and/or other non-SEC registrant compliance requirements.

Based on their public statements and reports in the press, it is widely believed the three Democratic Commissioners that voted in favor of releasing the proposed rules (Chair Gensler and Commissioners Lee and Crenshaw) had divergent views on some aspects of the Proposing Release and negotiated certain compromises prior to its release. The composition of the SEC will change before final rules are voted on. Commissioner Lee, a vocal advocate for robust climate-related disclosures, has announced she will be stepping down at the end of her term in June once her replacement is confirmed. The seat vacated by Commissioner Roisman, who left the SEC in January, may also be filled prior to a vote on the final rules. President Biden recently nominated Jaime Lizárraga, a Senior Advisor to Speaker of the House Nancy Pelosi, and Mark T. Uyeda, a career attorney with the SEC who is currently on detail to the U.S. Senate Committee on Banking, Housing, and Urban Affairs, where he serves as Securities Counsel on the Committee's Minority Staff. If confirmed, Mr. Lizárraga's views may be particularly impactful, as the final rules are highly likely to require the affirmative votes of all three Democratic Commissioners for adoption. As such, any divergence between Mr. Lizárraga's and Commissioner Lee's views may result in differences between the proposed and final rules.

The Final Rules Will Be Challenged in Court

It is a virtual certainty that there will be a court challenge to the final rules. Critics of the rules, including Commissioner Peirce in an extensive dissenting statement, have highlighted three objections to the proposed rules that are likely to form the basis for future litigation.

First, critics argue the SEC does not have authority to propose the rules. A group of Republican senators summarized that argument in a letter to Chair Gensler, stating that "The SEC is not tasked with environmental regulation, nor has Congress amended the SEC's regulatory authority to pursue the proposed climate disclosures." Second, critics argue the proposal violates First Amendment restrictions against compelled speech. This argument prevailed in the challenge to the Conflict Minerals Rule the SEC was required to adopt pursuant to the Dodd-Frank Act, resulting in parts of that rule being overturned, as discussed in our earlier Alert here. Finally, critics have argued the economic and cost-benefit analyses in the Proposing Release do not meet the requirements of the Administrative Procedure Act. That argument was successfully made in connection with the first iteration of the Resource Extraction Payments Disclosure Rule adopted by the SEC pursuant to Dodd-Frank, as discussed in our earlier Alert here.

It is premature to speculate on the challenges that will be brought, since that will to some extent depend on the final rules. It is even more premature to speculate on how litigation will play out. In some cases when rules have been challenged, the SEC has stayed their application pending resolution of the legal challenge. That is unlikely to happen here. Litigation concerning the Conflict Minerals Rule went on for four years, with registrants required to comply with the Rule while the litigation played out (in a bit of trivia, the final judgment in that case was entered by Judge Ketanji Brown Jackson). Ultimately, the rule was only partially scaled back, and companies will soon be making their ninth year of filings under the rule.

The Rules Are Not Just About Disclosure; They Will Drive Changes to Oversight and Management of Climate-Related Risks

Although the express purpose of the rules is to provide decision-useful information to investors to enable them to make informed judgments, many corporate social responsibility advocates view the rules as important for mitigating climate change. The rules will therefore be part of stakeholders' CSR toolkit for driving corporate practices. In CSR legislation, disclosure is intended as a catalyst for driving a race to the top in company practices. The power of disclosure-only CSR legislation to drive substantive change is illustrated by modern slavery legislation in California, the United Kingdom and Australia. Although detractors argue that these instruments have not done enough to address modern slavery, it is clear

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that, due to modern slavery disclosure requirements, many companies have over the last several years significantly enhanced their policies, procedures and practices to address this issue. Similarly, NGO and other pressures resulting from disclosures made pursuant to the SEC's Conflict Minerals Rule have led registrants to, in many cases, go well beyond the requirements of the Rule in furtherance of responsible minerals sourcing. Although framed as a disclosure requirement, SEC climate rules will have an even greater impact on company practices than these other regulations, including how registrants oversee, manage, assess and mitigate climate risk and the impacts of climate change, as well as the data they collect and how they assess and validate that data.

Even with the Rules, Shareholder Demands for Greater Transparency and Action Will Continue

SEC rules will not end the call for more climate-related and other environmental disclosures. Investors will continue to seek climate-related and environmental disclosures that go beyond SEC disclosure requirements. In addition, even before the SEC's proposed rules phase in, some institutional investors will encourage registrants to voluntarily early adopt those standards in their SEC or voluntary sustainability disclosures.

Large institutional investors that invest globally seek globally comparable climate data. Therefore, International Sustainability Standards Board requirements relating to climate change will inform investor requests and expectations. On March 31, the ISSB published consultation drafts of both general sustainability and climate-related disclosure requirements. The climate standard is based on the TCFD framework, although it differs from that framework in many respects, including requiring many additional disclosures. To the extent ISSB standards go further than SEC climate disclosure requirements, expect many global institutional investors to seek additional voluntary disclosures from U.S. registrants that align with at least some additional elements of the ISSB standard.

Global institutional investor expectations also will be informed by the requirements of the European Union's Corporate Sustainability Reporting Directive. During April 2021, the European Commission adopted the CSRD, which would replace the current Non-Financial Reporting Directive and expand its scope. Among other things, subject companies would be required to assess sustainability risks and impacts associated with their business model and strategy, sustainability opportunities and compatibility with the Paris Agreement. Companies would be required to provide qualitative and quantitative sustainability information. New sustainability reporting standards would be developed by the European Financial Reporting Advisory Group. The proposed CSRD also would introduce an assurance obligation for reported sustainability information. Next steps are for the European Parliament and European Council to negotiate a final legislative text. In parallel, the EFRAG is working on a first set of draft sustainability reporting standards, which it aims to have proposed by mid-2022.

Furthermore, the focus of institutional investors is broader than just enhanced climate-related disclosure. Investors will continue to encourage companies to align their oversight and management practices with the TCFD framework and other best practices requests. Investors will also continue to encourage companies to align their business practices with investors' environmental sustainability objectives.

For all these reasons, one-on-one engagement, shareholder proposals and multi-stakeholder investor initiatives, such as Climate Action 100+, focused on climate will continue and are likely to increase due to both rising expectations and enhanced transparency.

For Now, the Primary Focus Should Be on TCFD and the GHG Protocol

Registrants should of course familiarize themselves with the rules, assess what enhancements to current voluntary disclosures and processes and procedures would be required to meet the requirements of the rules, start to develop an action plan for compliance and continue to monitor the rulemaking process. Given the uncertainty surrounding both the

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ultimate requirements and timing of the rules, most registrants are likely to conclude it is premature to start implementing compliance processes and procedures specifically designed to conform to the requirements of the rules.

However, registrants would be well-served to continue their journey integrating the TCFD framework and GHG Protocol standards into their oversight, management, processes and procedures and reporting. Doing so is aligned with both evolving market practices and institutional investor pressures. Furthermore, registrants will be well-positioned once final rules are adopted, given the likely general alignment of the final rules with both the TFCD framework and the GHG Protocol standards.

Don't Forget About Existing SEC Rules and Guidance

Once in effect, the rules will largely subsume the SEC's 2010 climate change guidance, discussed in our earlier article here. In the meantime, registrants should continue to consider the extent to which climate-related disclosures are appropriate in MD&A, risk factor, business and legal proceedings sections under existing principles-based requirements. As part of considering the interplay between current principles-based rules and climate risk, registrants should take into account the Division of Corporation Finance's sample comment letter relating to climate change disclosures (discussed in our earlier Alert here), as well as comments issued to comparable registrants.

Even once the rules are adopted, registrants still will need to consider whether climate-related disclosures may be required by other SEC rules. For example, registrants still will need to consider the inclusion of climate-related risk factor disclosures. In addition, even though climate-related opportunities would largely be a voluntary disclosure topic under the rules, as earlier noted, the Proposing Release indicates that disclosure of climate-related opportunities may nevertheless be required under the existing principles-based disclosure framework.

The Search for Climate-Competent Directors Will Intensify

As previously discussed, the rules as proposed would require registrants to disclose if any member of the board has expertise in climate-related risks. If this requirement ultimately makes its way into the final rules, it will put pressure on many registrants to be able to indicate they have at least one director with this expertise. In addition, large institutional investors are increasing their focus on and expectations regarding the climate competency of boards.

Today, there are a limited number of individuals with the requisite subject matter expertise and that otherwise have the experience and background typically sought for public company board service. Even before the rules were proposed, many registrants were actively looking to add climate-related expertise to their board. If this disclosure requirement is part of the final rules, it is likely to drive an exponential increase in these searches.

Keep an Eye on State and Other Federal Initiatives

Although the focus is on climate rulemaking by the SEC, the states also bear watching. For example, a bill is under consideration in California that would require public companies with annual revenues in excess of $1,000,000,000 that do business in California to disclose Scope 1, Scope 2 and Scope 3 emissions, and to have that disclosure audited. A bill in New York that is specific to the fashion industry also has a climate-related component. That bill is discussed in our earlier Alert here. We would not be surprised to see additional climate-related disclosures proposed by some blue states if SEC climate-risk disclosure rules are perceived as falling short.

Furthermore, federal and state industry regulators will continue their focus on the substantive management of climate risk. For example, on March 30, the Federal Deposit Insurance Corporation published for comment draft principles for climate-related financial risk management for large financial institutions. Final guidance for domestic insurers on managing the financial risks from climate change was issued by the New York State Department of Financial Services

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during November 2021. Industry-focused prudential regulations will in many cases impose additional substantive requirements that directly or indirectly impact registrants.

Foreign CSR Regulations Also Will Add New Climate-Focused Requirements for U.S.-Based Companies

Over the next few years, many U.S.-based multinationals also will need to begin complying with foreign CSR legislation that to varying degrees seeks to address climate-related matters.

The United Kingdom adopted the Environment Act during November 2021. Among other things, that Act addresses deforestation and the use of forest risk commodities and derived products. The UK government is in the process of adopting secondary regulations in furtherance of the Environment Act. According to some studies, deforestation is responsible for approximately 15% of global carbon emissions. Deforestation is therefore inextricably linked to the debate over climate change and initiatives to address climate change. The Environment Act and proposed U.S. and EU legislative initiatives to address deforestation are discussed in our earlier Alert here.

Recently adopted and proposed mandatory human rights due diligence legislation in some jurisdictions also addresses climate where it intersects with human rights. For example, some of the environmental practices that come within the scope of the German Due Diligence in the Supply Chain Act (deforestation and water usage) may contribute to or be exacerbated by climate change. The German Act, which takes effect at the beginning of 2023, is discussed in our earlier Alerts here and here. The Corporate Sustainability Due Diligence Directive proposed by the European Commission in February 2022 also would, within its covered human rights, pick up adverse impacts that may contribute to or be magnified by climate change. In addition, as proposed in the Directive, directors of a large number of subject companies would be required to take into account the consequences of their decisions for sustainability matters, including, where applicable, climate change and environmental consequences, in the short-, medium- and long-term. In addition, a large number of subject companies would be required to adopt a plan to ensure their business model and strategy are compatible with the transition to a sustainable economy and with limiting global warming to 1.5°C in line with the Paris Agreement. The proposed EU Corporate Sustainability Due Diligence Directive is discussed in detail in our earlier Alert here.

Focus on Climate-Related Opportunities

As earlier noted, the SEC's proposal focuses largely on climate-related risks, rather than climate-related opportunities. Although not central to the proposed rules, climate risk is only part of the story. The TCFD framework explicitly takes climate-related opportunities into account. In any event, where appropriate, boards and management teams should be taking climate-related opportunities into account. In addition, many institutional investors are focused on climate-related opportunities in their engagements with companies. Furthermore, as earlier noted, climate-related opportunities may need to be disclosed under other, existing SEC rules.

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