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Climate-related Disclosures and Targets Proposed for U.S. Federal Government Contractors – An Overview

On November 10, the Federal Supplier Climate Risks and Resilience Rule was proposed. This Rule would amend the Federal Acquisition Regulation to require large federal government contractors to disclose their greenhouse gas emissions and climate-related financial risks and set science-based emissions reduction targets. The proposed Rule is intended to address GHG emissions and protect the federal government's supply chains from climate-related financial risks. The proposal is in furtherance of the Biden Administration's goal to achieve net-zero emissions procurement by 2050. For public companies, there is overlap between the proposed Rule and the Securities and Exchange Commission's proposed climate risk disclosure rules; although, in some respects, the proposed Rule goes further. The proposed Rule and its similarities and differences to the rules proposed by the SEC are discussed in this Alert.

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Overview of the Proposed Rule

The Rule would amend the Federal Acquisition Regulation. The FAR is the primary regulation used by federal executive agencies in procuring goods and services with appropriated funds. The Rule is being proposed in furtherance of Executive Order 14030. That May 30, 2021 E.O. directs the Federal Acquisition Regulatory Council, in coordination with the Council on Environmental Quality and the heads of relevant agencies, to consider an amendment to the FAR to ensure that major federal suppliers disclose their GHG emissions and climate-related financial risks and set science-based targets to reduce their GHG emissions.

Covered Contractors

The Rule would apply to two categories of federal contractors: significant contractors and major contractors. The commentary to the proposed Rule indicates that the Rule would cover approximately 86% of the federal government's annual spend and supply chain GHG impacts.

A contractor would be considered a "**significant contractor**" if it received between \$7.5 million and \$50 million in federal contract obligations in the prior federal fiscal year. According to data available in the Federal Procurement Data System, there were approximately 4,413 entities in this group for fiscal year 2021.

A contractor would be considered a "**major contractor**" if it received more than \$50 million in federal contract obligations in the prior federal fiscal year. According to data available in the Federal Procurement Data System, there were approximately 1,353 entities that exceeded this threshold for fiscal year 2021.

Several categories of federal government contractors would not be required to comply with the Rule, including the following (among others):

- Higher education institutions;
- Nonprofit research entities;
- State or local governments; and

- Entities deriving 80% or more of their annual revenue from federal management and operating contracts that are subject to agency annual site sustainability reporting requirements. An M&O contract is an agreement under which the federal government contracts for the operation, maintenance or support of a government-owned or government-controlled research, development, special production or testing establishment wholly or principally devoted to one or more major programs of the contracting federal agency.

The Rule also allows for exemptions and waivers in other limited circumstances.

Compliance Requirements

The proposed Rule contains three principal compliance requirements: (1) completion of a GHG emissions inventory; (2) annual climate disclosures; and (3) setting science-based targets for GHG emissions reduction. The applicable requirements would depend on whether the contractor is a significant contractor or major contractor, as further discussed below.

If a subject contractor is considered a small business for the North American Industry Classification System (NAICS) code it has identified as its primary NAICS code, it would not be subject to some of the compliance requirements, also as discussed below. According to the commentary to the Rule, in fiscal year 2021, approximately 2,835 (64%) significant contractors and 389 major contractors (29%) were small businesses.

The requirements of the Rule generally would be required to be met as a condition to a contract award. A noncompliant contractor would be presumed to be “nonresponsible” for purposes of the FAR, unless the contracting officer determines that (1) noncompliance resulted from circumstances properly beyond the prospective contractor’s control, (2) the prospective contractor has provided sufficient documentation that demonstrates substantial efforts to comply and (3) the prospective contractor has made a public commitment to comply as soon as possible on a publicly accessible website (within one year).

Greenhouse Gas Emissions Inventory

A significant or major contractor (itself or through its immediate owner or highest-level owner) would be required to complete within its current or previous fiscal year an inventory of annual Scope 1 and Scope 2 GHG emissions. The inventory would be required to cover a continuous period of 12 months, ending not more than 12 months before the inventory is completed. This requirement would apply starting one year after publication of the final Rule.

In conducting the GHG emissions inventory, the contractor would be required to follow the GHG Protocol Corporate Accounting and Reporting Standard. Contractors would be permitted to calculate emissions using the calculation tool of their choice, as long as it is aligned with the GHG Protocol.

As defined in the proposed Rule and consistent with the GHG Protocol:

- “**Greenhouse Gas**” would include carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluoro carbons, nitrogen trifluoride and sulfur hexafluoride.
- “**Scope 1 emissions**” would include direct GHG emissions from sources that are owned or controlled by the reporting entity.
- “**Scope 2 emissions**” would include indirect GHG emissions associated with the generation of electricity, heating and cooling or steam when these are purchased or acquired for the reporting entity’s own consumption but occur at sources owned or controlled by another entity.

The foregoing emissions data would be required to be reported through the System for Award Management, which is a federal government website that serves as a central registration point for government contractors. According to the proposal, approximately 31% of major contractors and 10% of significant contractors already report disclosing their GHG emissions through SAM.

Annual Climate Disclosures

A major contractor (itself or through its immediate owner or highest-level owner) that is not a small business also would be required to complete a more extensive annual climate disclosure within their current or previous fiscal year.

The annual climate disclosure would be required to align with the recommendations of the Task Force on Climate-related Financial Disclosures. The TCFD has published climate-related financial disclosure recommendations designed to help companies provide better information to support informed capital allocation. The disclosure recommendations are structured around four thematic areas – governance, strategy, risk management and metrics and targets – and supported by 11 recommended disclosures that build out the framework with information to help investors and others understand how reporting organizations think about and assess climate-related risks and opportunities.

As noted in the commentary to the proposed Rule, among other things, these disclosures would include:

- A GHG inventory of not only Scope 1 and Scope 2 emissions, but also relevant Scope 3 emissions.

Consistent with the GHG Protocol, the proposed Rule defines “**Scope 3 emissions**” to include GHG emissions, other than Scope 2 emissions, that are a consequence of the operations of the reporting entity but occur at sources other than those owned or controlled by the entity.

- The entity’s climate risk assessment process and any risks identified.

To comply with this disclosure requirement, a major contractor (itself or through its immediate owner or highest-level owner) would be required to complete within its current or previous fiscal year those portions of the CDP Climate Change Questionnaire that align with the TCFD framework, as identified by CDP. CDP, formerly known as the Carbon Disclosure Project, is a not-for-profit that runs a global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts.

CDP’s Online Response System opens annually in early spring (in approximately April) and closes in early summer (in approximately July). Major contractors would not be required to complete other portions of the questionnaire for purposes of the Rule, although CDP would presumably take a failure to do so into account in its scoring. The annual disclosure would be required to be available on a publicly accessible website, including either the contractor’s own website or the CDP website.

Major contractors would be required to complete an annual climate disclosure starting two years after publication of the final Rule. This extended phase-in period is intended to provide major contractors additional time to calculate Scope 3 emissions and conduct a climate risk assessment.

Science-based Targets

A major contractor (itself or through its immediate owner or highest-level owner) that is not a small business also would be required to develop science-based targets and have the targets validated by the Science Based Targets initiative. A science-based target is a target for reducing GHG emissions that is in line with reductions that the latest climate science deems necessary to meet the goals of the Paris Agreement to limit global warming to well below 2° C above pre-

industrial levels and pursue efforts to limit warming to 1.5° C. The SBTi is a partnership between CDP, the United Nations Global Compact, World Resources Institute and the World Wide Fund for Nature.

This requirement would apply beginning two years after publication of the final Rule. Targets would be required to be validated by SBTi within the previous five calendar years and would be required to be available on a publicly accessible website.

Alignment with the SEC's Proposed Climate Risk Disclosure Rules

On March 21, the SEC published proposed rules that would require SEC registrants to disclose a significant amount of information relating to climate-related financial risks. The proposed SEC climate risk disclosure rules are described in detail in our earlier Alert [here](#).

Many significant and major contractors are SEC registrants. As such, they would be required to comply with at least some of the same requirements contemplated by the proposed Rule. In particular, the final SEC rules are expected to require disclosure of Scope 1 and Scope 2 GHG emissions, as well as information regarding the management and assessment of climate risk. Like the proposed Rule, the SEC rules are based on the Greenhouse Gas Protocol and the TCFD framework.

However, as proposed, the Rule would differ from the SEC rules in the following significant respects:

- The Rule may require a contractor to disclose Scope 3 emissions that are not otherwise required to be disclosed pursuant to the SEC rules.
- The SEC rules would not require a registrant to set emissions reduction targets (science-based or otherwise); although, if set, related disclosures would be required.
- Under the Rule, TCFD-related disclosures would be determined by the requirements of the CDP Climate Change Questionnaire. The presentation and substance of TCFD-related disclosures required pursuant to the Rule may therefore differ from what a contractor includes in its SEC reports. Those differences may increase with the passage of time due to changes made to the CDP questionnaire.

Next Steps in the Rulemaking Process

The proposed Rule is still in the comment period. Comments may be submitted until January 13, 2023.

Given the fierce controversy surrounding mandatory climate reporting (and initiatives and requirements to manage GHG emissions more generally), we expect the proposal to draw a significant number of comments. In this regard, as a point of reference, see our Alert [here](#) analyzing comments submitted pursuant to the SEC's proposed climate risk disclosure rules.

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