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Client Alert

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A Closer Look: Key Components of the SEC's Long-Awaited Final Rules on Climate Disclosure and Where to Go from Here

The Final Rules adopted by the U.S. Securities and Exchange Commission enhancing and standardizing climate-related disclosures and their impact.

In brief

On March 6, 2024, the U.S. Securities and Exchange Commission (the "**SEC**" or the "**Commission**") adopted final rules (the "**Final Rules**") that enhance and standardize the disclosure of climate-related information in registration statements and Exchange Act reports. The Final Rules were scaled back after years of significant feedback from registrants and other stakeholders, with the Commission receiving more than 24,000 comment letters in response to the initial rule proposal (the "**Proposed Rules**") in March 2022 (see our firm's key takeaways regarding the Proposed Rules and their impact here and here).

Below we discuss, among others: (i) the key takeaways and requirements for climate disclosures under the Final Rules, (ii) the key differences between the Proposed Rules and Final Rules, (iii) the expected compliance dates for disclosures under the Final Rules, and (iv) some practical considerations for companies that are subject to multiple climate disclosure regimes and regulations such as the new California and European Union climate reporting requirements.

Contents

1. Summary of Required Disclosures Under the Final Rules

The Final Rules impose significant disclosure requirements on registrants, including:

- Disclosure of climate-related risks that have or may have a material impact on the registrant, the actual or potential impact of such risks, and whether the registrant has undertaken any activities to mitigate or adapt to any material climate-related risks;
- Processes the registrant has for identifying, assessing and managing climate-related risks, including whether the registrant has adopted a transition plan or uses scenario analysis to manage climate-related risks, the role the registrant's board of directors and management play in such processes, and whether and how such processes are built into the registrant's overall risk management system;
- Disclosure of climate-related targets or goals the registrant may have that would materially impact the registrant, and the financial impact of such goals;
- For large accelerated filers ("**LAFs**") and accelerated filers ("**AFs**") only, disclosure of Scope 1 and Scope 2 GHG emissions, subject to a materiality threshold, and attestation reports on such emissions according to phased-in compliance dates; and
- Financial statement disclosures regarding capitalized costs, expenditures expensed, charges, and losses incurred related to climate events, carbon offsets, renewable energy credits or certificates if such aggregate amounts exceed a 1% threshold of the total line item for the relevant fiscal year, and, if the estimates or assumptions used by a registrant to produce its financial statements were materially impacted by climate-related events, a description of how the financial statements were affected.

2. Final Rules vs. Proposed Rules: Key Differences

The SEC's Proposed Rules sparked intense feedback from registrants and other stakeholders. As a result, the Final Rules scaled back the Proposed Rules in several key ways. Specifically, the Final Rules:

- Eliminated the proposed requirement to provide Scope 3 GHG emissions (i.e., indirect emissions that occur across the value chain).
- Limited material Scope 1 and Scope 2 GHG emissions disclosure to LAFs and AFs, with longer phased-in compliance dates giving registrants more time to prepare for such disclosure and any related attestation report requirements.
- Provided LAFs and AFs with more flexibility in determining the organizational boundary for their material Scope 1 (i.e., direct emissions) and Scope 2 GHG emissions (i.e., indirect emissions from the use of purchased energy).
- Eliminated "financial impact metrics" that would have required line-by-line disclosure of climate-related financial impacts, including changes to revenue due to disruptions in business, instead limiting disclosure to financial statement effects (expenditures, costs, charges and losses) when they exceed certain 1% thresholds.
- Extended the Private Securities Litigation Reform Act ("**PSLRA**") safe harbor for forward-looking statements to all disclosure (other than a historical fact) provided pursuant to a registrant's transition plan, scenario analysis, internal carbon pricing, and climate-related targets and goals, even for registrants that would not qualify for the PSLRA (such as blank check companies and IPO registrants) but did not extend the safe harbor to Scope 1 and Scope 2 emission disclosures.
- Exempted smaller reporting companies ("**SRCs**"), emerging growth companies ("**EGCs**"), and nonaccelerated filers ("**NAFs**") from the requirement to disclose Scope 1 and Scope 2 GHG emissions and related assurance requirements.
- Eliminated the requirement that registrants disclose the climate expertise of board members.
- Give registrants flexibility to choose where in their filings they want to position certain climate-related disclosures.
- Eliminated the requirement to disclose in a registrant's interim report on Form 10-Q or Form 6-K material changes to the climate-related disclosures previously provided in a registration statement or annual report.

3. Phased-In Approach to Compliance Date

The Final Rules include a phased approach to the compliance date requirements based on filer type and information to be disclosed.[1] For registrants with a calendar fiscal year-end, the mandatory compliance dates are as follows:

Compliance Dates under the Final Rules[2] For Registrants With Calendar Fiscal Year-End Reporting[3]						
Registrant Type	**Disclosure and Financial Statement Effects Audit**		**GHG Emissions/Assurance**			**Electronic Tagging[4]**
	All Reg. S-K and S-X disclosures, other than as noted in this table	**Item 1502(d)(2), Item 1502(e)(2), and Item 1504(c)(2)**	**Item 1505 (Scopes 1 and 2 GHG emissions)**	**Item 1506 – Limited Assurance**	**Item 1506 – Reasonable Assurance**	**Item 1508 - Inline XBRL tagging for subpart 1500[5]**
LAFs	2025	2026	2026	2029	2033	2026
AFs (other than SRCs and EGCs)	2026	2027	2028	2031	N/A	2026
SRCs, EGCs, and NAFs	2027	2028	N/A	N/A	N/A	2027

4. Registrants Subject to Climate-Related Disclosure Rules and Affected Forms

The Final Rules adopt amendments to Regulation S-K (adding new subpart 1500) and Regulation S-X (adding a new Article 14) and require all registrants,[6] including domestic filers and Foreign Private Issuers, to present climate change impact disclosures in their annual Exchange Act reports and registration statements;[7] provided, however, the new disclosures will not apply to private companies that are parties to business combination transactions (as defined by Securities Act Rule 165(f)) involving an offering registered on Forms S-4 or F-4, which would include a private company target in a de-SPAC transaction. Additionally, all registrants are allowed to delay reporting of their annual Scope 1 and/or Scope 2 GHG emissions disclosures until the date that their second quarter report on Form 10-Q is due by filing as of that date an amended 10-K including such information (or by incorporating by reference into their annual report such disclosure from their Form 10-Q filed for the second quarter of the previous year), in the

[1] *See* The SEC, The Enhancement and Standardization of Climate-Related Disclosures for Investors (2024), Release Nos. 33-11275; 34-99678; File No. S7-10-22, https://www.sec.gov/files/rules/final/2024/33-11275.pdf (the "**Final Rules**"), section II.O.3.

[2] See The SEC, Fact Sheet, The Enhancement and Standardization of Climate-Related Disclosures: Final Rules, (2024), https://www.sec.gov/files/33-11275-fact-sheet.pdf.

[3] All non-calendar year-end registrants will be required to provide disclosure under the Final Rules for the fiscal year beginning in the years shown in the table above.

[4] The Final Rules require registrants to tag climate-related disclosures, including block text tagging and detail tagging of narrative and quantitative disclosures provided pursuant to subpart 1500 of Regulation S-K and Article 14 of Regulation S-X, in Inline eXtensible Business Reporting Language ("**Inline XBRL**") in accordance with 17 CFR 232.405 (Rule 405 of Regulation S-T) and the EDGAR Filer Manual (17 CFR 229.1508).

[5] Financial statement disclosures under Article 14 will be required to be tagged in accordance with existing rules pertaining to the tagging of financial statements. *See* Rule 405(b)(1)(i) of Regulation S-T.

[6] This includes large accelerated filers, accelerated filers, smaller reporting companies, emerging growth companies, nonaccelerated filers and foreign private issuers.

[7] This includes reports on Form 10, Form 10-Q, Form 10-K and Form 20-F under the Exchange Act, as well as registration statements on Form S-1 or F-1, Form S-3 or Form F-3, Form S-4 or F-4, or S-11, as applicable, under the Securities Act.

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case of a domestic registrant, or until 225 days after the fiscal year end by filing as of that date an amended Form 20-F including such information, in the case of a Foreign Private Issuer.

Climate-related disclosures under new subpart 1500 of Regulation S-K must be provided in either a separate climate-related disclosure section within a registrant's Exchange Act report or registration statement, or other appropriate sections within the filing, such as the description of business, management's discussion and analysis of financial condition and results of operations, the risk factors, or the management and corporate governance sections. Disclosures required under new Article 14 of Regulation S-X must be provided in any filing where audited financial statements are required (disclosures are not required for filings containing only interim statements that are reviewed).

5. In-Depth Summary of Final Climate Disclosure Requirements Under Regulation S-K

Description of Climate-Related Risks (Item 1502(a))

Item 1502(a) requires registrants to describe the climate-related risks that have materially impacted or are reasonably likely to materially impact the registrant, including on its strategy, results of operations and financial condition. Note that this item focuses on a description of the risk, whereas Items 1502(b) and (d)(1), discussed further below, focus on describing the material impacts these risks have or are reasonably likely to have on the registrant.

- **Climate-Related Risks**: Item 1500 defines climate-related risks as actual or potential negative impacts of climate-related conditions and events on a registrant's business, results of operations, or financial condition, and includes both physical risks (which can be acute or chronic risks), as well as transition risks (including negative impacts due to regulatory, technological, or market changes):
  - <u>Physical Risks</u>: Item 1500 defines a physical risk as a risk related to the physical impacts of the climate, and registrants must categorize each physical risk according to whether it is acute or chronic. An acute physical risk is "event-driven," and would include "shorter-term severe weather events, such as hurricanes, floods, tornadoes, and wildfires, among other events." A chronic physical risk relates to "longer-term climate events, such as sustained higher temperatures, sea level rise, and drought, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water." In describing any physical risk, registrants must state the geographic location, nature of the properties, processes, or operations that are subject to the physical risk;
  - <u>Transition Risks</u>: Item 1500 defines a transition risk as the actual or potential negative impact on a registrant that is "attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks." In describing any transition risk, registrants must also specify the nature of the transition risk (whether it relates to regulatory, technological, market (e.g., changing consumer, business counterparty, and investor preferences)), or other transition-related factors, and how those factors impact the registrant. The Final Rules included a non-exhaustive list of examples that would be captured under the definition of transition risk:
    - increased costs due to changes in regulation or policy,
    - reduced demand for products or services (such as carbon-intensive products),
    - devaluation of assets,
    - liability for, and costs of, climate-related litigation,
    - competitive pressures due to changes in technology or consumer preference, and
    - reputational impact (including stemming from registrant's customers or business counterparties) that could trigger changes to the behavior of the market, consumers or registrants.
- **Value Chain Risks and Impacts**: The definition of transition risk is extremely broad and captures a litany of climate-related risks effecting the registrant's business, and broadly includes risks related to a registrant's upstream and downstream value chain activities. Although material value chain risks may need to be disclosed under Item 1502(a), note that the Final Rules pared back the requirement to disclose material impacts to a registrant under 1502(b), discussed below, from "parties in [a registrant's] value chain" and limited the required impact disclosure to "suppliers, purchasers, or counterparties to material contracts to the extent known or reasonably known." Thus, while broad value chain risks may need to be disclosed under Item

1502(a), registrants can narrow their material impact disclosure under Item 1502(b) to a more limited group and to the extent such impact is known or reasonably known.

- **Time Horizon***:* Climate-related risk disclosure must describe the time frame in which each material climate-related risks is reasonably likely to manifest either in terms of short-term (*i.e.*, the next 12 months) or long-term (*i.e.*, beyond 12 months) risks. However, registrants may break down their risk description into more detailed components and discuss medium-term risks.
- **GHG Emissions Reduction Jurisdictions***:* The Final Rules require material risks related to GHG reduction targets and other significant climate-change regulations to be disclosed as a transition risk. Thus, registrants with operations in a jurisdiction with GHG emissions reduction targets or other significant climate-change regulations to carefully consider to what extent complying with those targets or regulations will constitute a material transition risk.
- **Materiality***:* Registrants are only required to disclose climate-related risks to the extent they have materially impacted or are reasonably likely to materially impact the registrant. The Final Rules note that registrants should apply traditional notions of materiality under federal securities law. The guiding principle for determining materiality is whether "there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available."[8]
- **Voluntary Disclosure of Climate-Related Opportunities***:* The Proposed Rules defined "climate-related opportunities" to mean the actual or potential positive impacts of climate-related conditions and events on a registrant, and the Final Rules state that such disclosure is voluntary.

Disclosure of Impacts of Climate-Related Risks on Strategy, Business Model, and Outlook (Items 1502(b), (c), and (d))

Items 1502(b), (c), and (d) require a description of the actual and potential material impacts that the climate-related risks disclosed under Item 1502(a), discussed above, have on a registrant.

- **Strategy, Business Model and Outlook***:* Item 1502(b) requires a description of the actual and potential material impacts that climate-related risks have or are reasonably likely to have on a registrant's strategy, business model, and outlook. This includes, but is not limited to, material impacts on (i) business operations, including the type and location of operations, (ii) products or services, (iii) suppliers, purchasers, or counterparties to material contracts to the extent known or reasonably available, (iv) activities to mitigate or adapt to climate-related risks (such as adoption of new technologies or processes), and (v) research and development expenditures. Note that the scope of impact (iii) above was narrowed in the Final Rules from "suppliers and other parties in [a registrant's] value chain."
- **Business, Results of Operation, and Financial Condition***:* Item 1502(d)(1) requires a description of the actual and potential material impacts that climate-related risks have or are reasonably likely to have on a registrant's business, results of operations, or financial condition. This would include descriptions of the material impacts to a registrant's financial statements.
- **Strategy, Financial Planning, Capital Allocation***:* Item 1502(c) requires a description of whether and how a registrant considers any material impacts discussed under Item 1502(b) as part of its strategy, financial planning, and capital allocation. This includes, (i) whether the identified impacts have been integrated into the registrant's business model or strategy (such as whether and how resources are being used to mitigate climate-related risks), and (ii) how any targets, goals, or transition plans disclosed under Item 1504 (discussed below) relate to its business model or strategy. These requirements would include disclosing the registrant's use of carbon offsets or renewable energy credits or certificates ("**RECs**") if they constitute a material component of the registrant's plan to achieve its climate-related targets or goals. Disclosure of forward-looking information, climate-related metrics (such as renewable energy usage and water consumption), or financial information in response to Item 1502(c) is voluntary.

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[8] *See* Final Rules at 105.

- **Activities to Mitigate or Adapt**: Item 1502(d)(2) requires quantitative and qualitative descriptions of the material expenditures incurred, and material impacts on financial estimates and assumptions, that, in management's assessment, directly result from activities to mitigate or adapt to the climate-related risks disclosed under Item 1502(b).

Transition Plan Disclosure (Item 1502(e))

Item 1502(e) requires disclosure of a registrant's transition plan to manage a material transition risk.

- **What is a Transition Plan?** Item 1500 defines a transition plan as "a registrant's strategy and implementation plan to reduce climate-related risks, which may include a plan to reduce its GHG emissions in line with its own commitments or commitments of jurisdictions within which it has significant operations." Item 1502(e) requires:
    - Transition Plan Disclosure*:* Item 1502(e)(1) requires any plans for managing or mitigating material transition risks to be disclosed. This includes describing the actions, strategies, steps or initiatives the registrant is undertaking or planning to address these risks during the year under the plan.
    - Quantitative and Qualitative Disclosures: Item 1502(e)(2)[9] requires quantitative and qualitative disclosures of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the transition plan. These expenditures should be considered from both an individual and an aggregate perspective. Registrants have the flexibility to explain qualitatively (as opposed to purely quantitatively) the nature of a material expenditure or material impact on their financial estimates or assumptions and how they directly resulted from the disclosed actions taken under the plan.

A registrant is not required to adopt a transition plan. If no plan exists, no disclosure is required.

Disclosure of Scenario Analysis, if Used (Item 1502(f))

Item 1502(f) requires registrants to disclose any scenario analysis, if used, in assessing climate-related risks:

- **Identification of Scenario Analysis***:* Item 1500 defines a scenario analysis as the "process for identifying and assessing a potential range of outcomes of various possible future climate scenarios, and how climate-related risks may impact a registrant's business strategy, results of operations, or financial condition over time." Registrants are not required to conduct a scenario analysis or any specific risk management model. However, if any such analysis or model is used, it must be disclosed.
- **Scenario Outcomes and Implications***:* If a scenario analysis is used and a material impact is identified, then each scenario must be described. Disclosure should include a brief description of the parameters, assumptions and analytical choices used, and the expected material impacts on the registrant under each such scenario. Although Item 1502(f) provides registrants flexibility to determine the appropriate mix of qualitative and quantitative disclosures, the SEC noted that it expects disclosure under Item 1502(f) will become more quantitative over the years.

Disclosure of a Maintained Internal Carbon Price (Item 1502(g))

Item 1502(g) requires disclosure of a maintained internal carbon price. It aims to provide insight into how registrants use internal carbon pricing mechanisms as part of their strategies for addressing climate-related risks and opportunities.

- **What is an internal carbon price?** Item 1500 defines internal carbon price as "the estimated cost of carbon emissions used internally within an organization." Commentors to the Final Rules noted that internal carbon pricing is often used as a planning tool to identify and manage climate-related risks, drive energy efficiencies and reduce costs, plan for a potential carbon tax, and guide investment decisions.
- **Carbon Price Disclosure***:* Item 1502(g) requires disclosure of an internal carbon price if use of such price is material to how a registrant evaluates or manages a climate-related risk disclosed under Item 1502(a) (discussed above), then the registrant must disclosure (in terms of the reporting currency) (i) the price per metric ton of CO^2e and (ii) the total internal carbon price,

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[9] Registrants will not be required to comply with Item 1502(e)(2) (and Item 1502(d)(2)) until the fiscal year immediately following the first fiscal year of its initial compliance date for the subpart 1500 rules based on its filer status. As a discussed, Item 1502(d)(2) will require a registrant to describe quantitatively and qualitatively the material expenditures incurred and material impacts on financial estimates and assumptions that, in management's assessment, directly result from activities to mitigate or adapt to climate-related risks disclosed pursuant to Item 1502(b)(4).

as well as how such prices are estimated to change over the short and long terms. If more than one internal carbon price is used, each internal carbon price must be disclosed, as well as the reasons for using different prices.

- **Scope of Entities**: Item 1502(g)(3) requires a description of any material difference between the scope of entities and operations involved in the use of an internal carbon price under 1502(g), and the organizational boundaries used for Scope 1 and/or Scope 2 GHG emissions reporting under Item 1505 (see below).

A registrant is not required to use internal carbon pricing. If internal carbon pricing is not used, no disclosure is required.

Governance Disclosure (Item 1501(a) and (b))

Items 1501(a) and 1501(b) require information on the board of directors' oversight of climate-related risks, as well as management's role in assessing and managing those risks:

- **Disclosure of Board Oversight**: Item 1501(a) requires a registrant to describe (i) if any board committee or subcommittee is responsible for the oversight of climate-related risks,[10] (ii) whether and how the board oversees climate-related risks, including the processes, structures, and mechanisms in place for such oversight and (iii) how (and if) the board oversees progress of the registrant against any climate-related target or goal or transition plan (if disclosed).

- **Disclosure of Management Oversight**: Item 1501(b) requires a registrant to describe management's role in assessing and managing material climate-related risks, including (i) identification of any management positions or committees responsible for assessing and managing climate-related risks and the relevant expertise of such persons in enough detail to fully describe the nature of the expertise, (ii) the process of how management assesses and manages climate-related risks, and (iii) if, and how, management reports information about climate-related risks to the board or any related subcommittees.

Risk Management Disclosure (Item 1503)

Item 1503 requires a description of a registrant's climate-related risk management processes to identify, assess and manage climate-related risks, and how these practices are integrated into the registrant's overall risk management framework. In describing such processes, a registrant should address:

- **Risk Identification**: whether it has incurred or is likely to incur a material (physical or transition) climate-related risk and how it decides whether to mitigate, accept, or adapt to the risk.

- **Prioritization**: how it prioritizes addressing the climate-related risk.

- **Processes for Material Risks**: how the processes disclosed have been integrated into the registrant's risk management systems.

If no material climate-related risk has been identified, then climate-related risk management disclosure under Item 1503 is not required.[11]

Targets and Goals Disclosure (Item 1504)

Item 1504 requires disclosure of a registrant's climate-related targets and goals. It aims to give investors an understanding of the registrant's efforts, strategies and progress towards addressing climate-related risks and opportunities through measurable targets and goals aligned with sustainable business practices.

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[10] Notably, the SEC eliminated proposed requirements that would have singled out individual directors, including identification of the directors overseeing climate-related risks and board members considered climate experts. The SEC revised the final rule in response to comments to make the disclosure requirement less prescriptive, giving registrants additional flexibility to determine how much detail to provide about the board's oversight of climate-related risk.

[11] The Proposed Rules included more prescriptive disclosure requirements that would have required a registrant to describe certain additional processes related to how it identifies, assesses and determines the materiality of climate-related risks, including how a registrant considers external factors such as regulatory requirements or policies, customer or counterparty preferences, technological changes and changes in market prices. The SEC also removed the proposed requirement to disclose how a registrant determines the relative significance of climate-related risks compared to other risks and how it mitigates any high priority risks.

- Item 1504(a) requires disclosure of any climate-related target or goal if such target or goal has materially affected, or is reasonably likely to materially affect, the registrant's business.
- Item 1504(b) requires disclosure of any material impacts (or reasonably likely material impacts) on a registrant's target or goal. This includes a description of (i) the scope of activities included in the target, (ii) the unit of measurement, including whether the target is absolute or intensity based (absolute targets aim to reduce GHG emissions by a set amount; an intensity target sets a registrant's emissions target relative to an economic or operational variable, allowing the registrant to set emissions reduction targets while accounting for economic growth),[12] (iii) the time by which the target is intended to be achieved, and whether such time horizon is based on one or more goals established by a climate-related treaty, law, regulation, policy or organization, (iv) if a baseline for the target or goal has been established, the time period for such baseline and how such progress will be tracked, and (v) a qualitative description about how the registrant intends to meet its climate-related targets or goals.
- Item 1504(c) requires disclosure of (i) the progress made toward meeting the climate-related target or goal and how such progress was achieved, and (ii) any material impacts (including quantitative and qualitative disclosures on material expenditures) to the registrant's business as a direct result of the target or goal, as well as the actions taken to make progress toward meeting the target or goal.
- Item 1504(d) provides that if carbon offsets or RECs were used and represent a material component of the plan to achieve climate-related targets or goals, the registrant must separately disclose (i) the amount of carbon avoidance, reduction or removal represented by the offsets or the amount of generated renewable energy represented by the RECs, (ii) the nature and source of the offsets or RECs, (iii) a description and location of the underlying projects, (iv) any registries or other authentication of the offsets or RECs and (v) the cost of purchasing the offsets or RECs.

A registrant is not required to implement climate-related targets and goals. If no climate-related targets or goals exist, no disclosure is required under Item 1504.

PSLRA Safe Harbor for Certain Climate-Related Disclosures (Item 1507)

Item 1507 provides a safe harbor provision for all disclosures (other than historic facts) required under Item 1502(e) (transition plans), Item 1502(f) (scenario analysis), Item 1502(g) (internal carbon pricing), and Item 1504 (targets and goals), providing that such disclosures will be considered a "forward-looking statement" for purposes of the PSLRA,[13] and also applies the PSLRA safe harbors to registrants that would otherwise not have the benefit of this safe harbor (such as registration statements for an IPO or by a blank check company). Notably, the safe harbor was not extended to Scope 1 and Scope 2 GHG emission disclosures under Item 1505.

6. GHG Emissions Disclosure (Item 1505)

The Final Rules implement Item 1505, which requires LAFs and AFs that are not EGCs or SRCs to disclose their material Scope 1 and Scope 2 GHG emissions.

- **What are Scope 1 and Scope 2 GHG emissions?**
  - The SEC noted in the Final Rules that Scope 1 and 2 GHG emissions are defined to give registrants the flexibility to choose between standards developed by the GHG Protocol, ISO 14064 and related ISO standards, as well as additional standards that are developed over time.[14]

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[12] Example of an absolute target: Registrant A has set a goal of reducing their GHG emissions by 20 percent by 2025. Example of an intensity-based target: Registrant B has set a goal of reducing their GHG emissions intensity per square foot of facility space by 20 percent by 2025.

[13] 15 U.S.C. §78u-4.

[14] *See* Final Rules, note 1011.

- Scope 1 GHG emissions are the "GHG emissions from operations owned or controlled by the registrant,"[15] and under the standards noted above, would include "emissions associated with fuel combustion, boilers, furnaces and vehicles."[16]
- Scope 2 GHG emissions are the "indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat or cooling that is consumed by operations owned or controlled by the registrant."[17]

- **How does a registrant determine whether Scope 1 and Scope 2 GHG emissions are material?**
  - The Final Rules refer registrants to traditional concepts of materiality under federal securities laws in determining whether their Scope 1 or Scope 2 GHG emissions are material,[18] and note that the determination should not exclusively be based on the amount of omissions, but whether "a reasonable investor would consider the disclosure of … the registrant's Scope 1 emissions and/or its Scope 2 emissions, important when making an investment or voting decision or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available."[19]
  - The Final Rules provide several considerations for when Scope 1 and 2 disclosure may or may not be material, including when disclosure is necessary for investors to understand whether:
    - emissions are significant enough to subject the registrant to a transition risk that will or is reasonably likely to materially impact its business in the short- or long-term (including transition risk related to liability for complying with state or foreign law requirements to disclose GHGs, such as the CSRD or California's climate disclosure laws); or
    - the registrant has made progress toward achieving a target or goal or a transition plan that the registrant is required to disclose under the Final Rules.
  - The Final Rules note that the accommodations under Rule 12b-21 and Rule 409 are available if certain conditions are met, allowing a registrant to omit required Scope 1 and/or Scope 2 GHG emissions disclosure if that information is "unknown and not reasonably available."[20] It is unclear what, if any, Scope 1 and/or Scope 2 GHG emissions would qualify for these accommodations, but to the extent obtaining any unknown Scope 1 and/or Scope 2 GHG emissions data would "involve unreasonable effort or expense," registrants should consider whether these accommodations could apply.
- **Presentation***:* Item 1505 generally requires aggregated Scope 1 and Scope 2 GHG reporting according to CO^2e, disaggregated for material GHGs, and in gross figures:
  - <u>Aggregated Reporting</u>*:* Scope 1 and Scope 2 GHG emissions are required to be disclosed in the aggregate (note the Proposed Rules required disaggregated disclosure) and expressed in terms of CO^2e.[21]
  - <u>Disaggregated Material Component GHGs</u>*:* Disaggregated disclosure of an individual GHG is required if a registrant is required to disclose Scope 1 and Scope 2 GHG emissions and a component GHG in such disclosure is individually material. The Final Rules elaborate that disaggregated disclosure may be required if the registrant has identified a

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[15] *See* 17 CFR 229.1500.

[16] *See* World Business Council for Sustainable Development and World Resources Institute, *The Greenhouse Gas Protocol, A Corporate Accounting and Reporting Standard* REVISED EDITION, available at https://ghgprotocol.org/corporate-standard.

[17] *See* 17 CFR 229.1500.

[18] The guiding principle for this determination is whether a reasonable investor would consider the disclosure of an item of information, in this case, the registrant's Scope 1 emissions and/or its Scope 2 emissions, important when making an investment or voting decision or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available.

[19] *See* Final Rules at 246.

[20] *See* 17 CFR 240.12b-21; 17 CFR § 230.409.

[21] The price in units of the registrant's reporting currency per metric ton of carbon dioxide equivalent.

particular GHG in its reduction target under Item 1504(a) of Regulation S-K, and may also be required to help investors understand transition risk to the extent that foreign governments and states treat individual GHGs differently.

- Gross Figures*:* GHGs are required to be presented in gross terms, excluding the impact of purchased or generated offsets.

- **Methodology, Significant Inputs and Assumptions***:* Item 1505 requires registrants to disclose the methodology, significant inputs, and significant assumptions used to calculate the registrant's disclosed GHG emissions, including:
  - Organizational Boundaries: The registrant's "organizational boundaries" that "determined the operations owned or controlled" for purposes of calculating its Scope 1 and Scope 2 GHG emissions. The entities within a registrant's organizational boundary do not need to match those described in its financial statements. The registrant must describe any differences compared to the organization as described in its financial statements, as well as the method used to determine its boundary, such as the method for determining control of an entity.
  - Operational Boundaries: The registrant must disclose the operational boundaries, including sources and categorizations, to provide investors an understanding of how the registrant determined the sources and categories of emissions included in its calculations for Scope 1 and Scope 2 emissions.
  - Protocol, Standard and Calculation: In contrast to the Proposed Rules that required more detailed disclosure, Item 1505 promulgated under the Final Rules requires only a brief description of:
    - the protocol or standard used to report the GHG emissions,
    - the approach to calculation (whether GHG emissions metrics were calculated according to the GHG Protocol's Corporate Accounting and Reporting Standard, an EPA regulation, or applicable ISO standard, as well as whether the registrant used for its Scope 2 disclosure a location-based method or market-based method),
    - qualitative disclosure of the type and source of any emission factors used (the SEC noted this would include the EPA's emission factors for stationary and/or mobile combustion of fuel types), and
    - any calculation tools used to calculate the GHG emissions.
- **Reasonable Estimates**: If reasonable estimates are used, the assumptions and reasons for using such estimates must be described.
- **Timeline and Historical Periods**: If required to disclose Scope 1 and/or Scope 2 emissions, a registrant must do so for its most recently completed fiscal year and for the historical fiscal year(s) covered by the financial statements included in such filing, but for such historical period, only to the extent such Scope 1 and/or 2 emissions were previously disclosed. This means that after the phase-in compliance dates, for a LAF disclosing GHG emissions for 2026 or an AF disclosing GHG emissions for 2028, historical GHG disclosures would not be required prior to 2026 and 2028, respectively, because GHG emission disclosure for those prior periods were not disclosed.
- **Extended Timing for Annual Disclosure***:* In recognition that registrants may have difficulty disclosing GHG emissions by the time their Form 10-K is due, GHG emission disclosure under Item 1505 may be incorporated by reference from a registrant's second quarter report on Form 10-Q from the prior fiscal year or may be included in an amended annual report on Form 10-K no later than the due date for a registrant's second quarter report on Form 10-Q, giving registrants additional time to finalize their GHG emissions disclosure under Item 1505. Foreign Private Issuers may include their GHG emissions disclosure in an amendment to their annual report on Form 20-F no later than 225 days after their fiscal year end.

Attestation Requirement (Item 1506(a)(1))

Item 1506(a)(1) requires LAFs and AFs to provide, in any relevant filing, an attestation report on their Scope 1 and/or Scope 2 emissions disclosure under Item 1505 at the assurance levels described below. EGCs and SRCs are not required to provide attestation reports.

- **Attestation Report Requirements***:* Item 1506(c) requires that an attestation report must follow the requirements set forth by the attestation standard (or standards) used by the GHG emissions attestation provider. Such standards must be (1) publicly available and widely used for GHG emissions assurance, and (2) established by a body that has followed due process procedures.

- **Level of Assurance and Compliance Dates**: LAFs are required to obtain limited assurance over their Scope 1 and/or Scope 2 emissions reported in 2029, and reasonable assurance on their GHG emissions disclosures for 2033, whereas AFs are only required to obtain limited assurance, and must do so on their GHG emissions disclosures for 2031. Limited assurance is equivalent to that provided on interim financial statements (referred to as "reviewed"), and reasonable assurance is equivalent to the standard provided on audited financial statements.
- **Attestation Provider**: Item 1506(b) sets forth the required standards of an attestation provider and is a person or firm that is (i) "an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting, or attesting to GHG emissions"[22] and (ii) is independent from the registrant or its affiliates.[23]
- **Attestation Engagement Details**: Item 1506(d) requires LAFs and AFs to include certain information about their attestation provider, including (i) details about whether the provider is subject to any oversight inspection program, and (ii) if another attestation provider was engaged for the relevant period and resigned or was dismissed. If there was such a departure during the relevant period, a registrant must disclose certain details about the departure, as well as whether there were any disagreements (interpreted broadly, and includes both resolved and unresolved differences in opinion, including certain oral opinions) and whether the former attestation provider is authorized to respond fully to inquiries from the new provider.

7. Effects of SEC Climate Disclosure Rules on Financial Statements

The Final Rules amended Regulation S-X to require registrants who are required to file disclosure under subpart 1500 of Regulation S-K, in a filing that requires audited financial statements, to disclose in a note to such financial statements certain financial statement effects related to capitalized costs, expenditures expensed, charges and losses incurred as a result of severe weather events and other natural conditions, and relevant expenses and costs related to carbon offsets and RECs.[24]

This disclosure is meant to capture quantitative information that can be found in the registrant's books and records underlying the registrant's financial statements, and will require the registrant to disclose where on its balance sheet these capitalized costs, expenditures expensed, charges, and losses are presented.

The SEC's Proposed Rules initially required financial statement disclosure falling into three categories of information to be presented in a note to the registrant's financial statements: Financial Impact Metrics, Expenditure Metrics, and Financial Estimates and Assumptions. After considering significant pushback from registrants and other stakeholders, the SEC significantly scaled back the financial statement disclosure requirements, including declining to adopt the Financial Impact Metrics in the Proposed Rules and modifying both the Expenditure Metrics and Financial Estimates and Assumptions.

Climate-Related Expenditures and Effects

The Final Rules update the originally proposed "Expenditures Metrics" as the following requirements to disclose expenditures expensed, losses, capitalized costs and charges associated with climate-related events, as well as certain expenditures, costs and losses related to carbon offsets and RECs. The expenditure disclosure under the Final Rules is intended to "focus[] on the disclosure of discrete expenditures," and was pared back from the Proposed Rules, which would have required disclosure of expenditures to "mitigate the risks from severe weather events and other natural conditions." The Final Rules attempted to address concerns that, among others, such disclosure would have required "forecasting and determining … expectations about future severe-weather events" when making expenditure decisions.

[22] "Significant experience" is defined in Item 1506(b)(1) as having "sufficient capabilities and experience necessary to (1) perform engagements in accordance with professional standards and applicable legal and regulatory requirements, and (2) enable the issuance of reports that are appropriate under the circumstances."

[23] In determining independence, Item 1506(b)(2) looks at whether there is a conflict of interest, including whether the provider is put in the position of attesting its own work (i.e., if an outside consultant is hired to assist with Scope 1 and/or Scope 2 emissions disclosure, it cannot also act as attestation provider), results in the attestation provider being acting as management or employee, or places the provider in a position of being an advocate for the registrant, and all other relevant circumstances, including financial and personal relationships.

[24] *See* 17 CFR 210.14-01, 14-02.

- **Costs, Expenditures and Losses from Climate-Related Events**: Rules 14-02(c) and (d) require disclosure of certain costs and expenditures in a note to the registrant's audited financial statements, subject to a threshold discussed below, of: [25]
  - the aggregate amount of expenditures expensed as incurred and losses, excluding recoveries, incurred during the fiscal year as a result of severe weather events and other natural conditions, and
  - the aggregate amount of capitalized costs and charges, excluding recoveries, recognized during the fiscal year as a result of severe weather events and other natural conditions.
- **Scope of Climate-Related Events**: In response to comments received from registrants and stakeholders asking for clarity regarding the scope of "severe weather events and other natural conditions," in the Final Rules, the SEC included hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise as a non-exhaustive list of examples of severe weather events and other natural conditions, and such expenditures, losses, capitalized costs and charges.[26] Such events may relate to the following non-exhaustive list of activities: restoring operations, relocating or repairing assets, retiring assets, recognizing related impairments or losses, or other activities related to responding to such events. [27]
- **One Percent Threshold***:* Disclosure of expenditures, costs and losses pursuant to Rules 14-02(c) and (d) are subject to a 1% disclosure threshold applied to the following specific categories in aggregate amounts incurred as a result of severe weather events and other natural conditions:
  - Expenditures expensed as incurred and losses if the aggregate amount of such expenditures expensed as incurred and losses equals or exceeds one percent of the absolute value of income or loss before income tax expense or benefit for the relevant fiscal year; and
  - Capitalized costs and charges recognized if the aggregate amount of the absolute value of capitalized costs and charges recognized equals or exceeds one percent of the absolute value of stockholders' equity or deficit, at the end of the relevant fiscal year.
  - Relevant expenditures and costs related to carbon offsets and RECs (discussed below) are not subject to this 1% disclosure threshold. Instead, if such carbon offsets and RECs are a material component in a registrant's plan to achieve climate-related targets or goals disclosed under Item 1504, then relevant expenditures and costs must be disclosed notwithstanding they are under the 1% threshold.[28]
- *De minimis* amounts that aggregate to less than $100,000 of expenditures expensed or losses incurred (Rule 14-02(c)), or less than $500,000 of capitalized charges and costs (Rule 14-02(d)) can be excluded.[29]
- **Attribution***:* In an attempt to add clarity to the Proposed Rules and minimize the potential costs associated with complying with the disclosure requirements, Rule 14-02(g) was adopted and requires registrants to determine whether a capitalized cost, expenditure expensed, charge, loss or recovery is "as a result of" a severe weather event or other natural condition based on whether such event or condition is a significant contributing factor to such cost, expenditure, charge, loss, or recovery. [30]
- **Carbon Offsets and Renewable Energy Credits***:* Under Rule 14-02(e), if carbon offsets or RECs are a material component of a registrant's plan to achieve climate-related targets or goals disclosed under Item 1504, registrants must disclose the aggregate amount relating to such carbon offsets and RECs of (i) expenditures expensed, (ii) capitalized costs and (iii) losses incurred on such capitalized amounts. Registrants must also disclose the yearly beginning and ending balance sheet amounts of capitalized carbon offsets and RECs, and must note where in the financial statements such capitalized costs, expenditures

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[25] *See* 17 CFR 210.14-02(c), (d).

[26] *See id*.

[27] *See id*.

[28] *See* 17 CFR 210.14-02(b).

[29] *See id*.

[30] *See* 17 CFR 210.14-02(g).

expensed and losses related to carbon offsets and RECs are presented.[31] Carbon offset and REC disclosures are not subject to the one percent threshold that applies when disclosing severe weather events and other natural conditions.

- **Recoveries***:* Rule 14-02(f) requires disclosure of the aggregate amount of any recoveries resulting from severe weather events and other natural conditions to reflect the net effect that climate-related events have on a registrant.[32] This would include insurance proceeds received for any climate-related impact. The Final Rules note that disclosure of recoveries should complement the contextual information required under Rule 14-02(a) (discussed below) as it allows investors to see the net climate-related financial statement effects when compared to the aggregate expenditure and cost disclosures under Rules 14-02(c) and (d) above.

- **Identification of Effected Line-Items***:* Disclosure of any amounts under Rule 14-02(c) (expenses and losses), Rule 14-02(d) (costs and charges), Rule 14-02(f) (recoveries) and Rule 14-02(e) (carbon offsets and RECs) must also identify the line items on which such amounts are presented.[33]

Climate-Related Risks and Impacts on Financial Statement Estimates and Assumptions

Registrants must disclose pursuant to Rule 14-02(h) whether any of the estimates or assumptions used to produce the audited financial statements were materially impacted by (i) exposures to climate-related risks or uncertainties, or (ii) known climate-related impacts. If any risks or impacts are identified, a qualitative description must be provided of how such estimates or assumptions were impacted by such "events, conditions, targets or plans."

Scope of Climate-Related Risks and Impacts: The scope of climate-related events under Rule 14-02(h) includes the same events noted under Rules 14-02(c) and (d) above (severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise), with the addition of risks or impacts related to "any climate-related targets or transition plans" disclosed under Item 1504. The final prong of this definition was narrowed in the Final Rules, from impacts related to "a potential transition to a lower carbon economy" in the Proposed Rules, to only those risks or impacts relating to targets or transition plans disclosed by the registrant under Item 1504. This change was made in response to concerns over the broad scope of activities caught by the Proposed Rule's definition and difficulties in identifying and quantifying such impacts.

Materiality: Unlike the expenditures disclosure under Rules 14-02(c) and (d) above, climate-related risks and impacts disclosed under Rule 14-02(h) are subject to a materiality qualifier. If climate-related risks or impacts did not materially impact the estimates or assumptions used to prepare the audited financial statements, then no disclosure is required.

Disclosure Presentation and Requirements

Contextual Information*:* Rule 14-02(a) requires a contextual description of the climate-related risks and impacts affecting the audited financial statements discussed above, which includes disclosures under Rules 14-02(b) through (h). This includes: a description of how each effect disclosed under Rules 14-02(b) through (h) were derived, as well as the significant inputs, assumptions and judgements underpinning each effect, and any other information that may be important. This includes any policy decisions made in calculating such impacts.[34] The Final Rules note that any recoveries disclosed under Rule 14-02(f) (discussed above) should complement the contextual information described under Rule 14-02(a).

Historical Periods: Rule 14-01(d) requires the financial statement disclosure described above to be provided for the historical fiscal years included in a registrant's audited financial statements on a prospective basis only. Under the Final Rules, registrants are required to provide financial statement disclosure for the registrant's most recently completed fiscal year, and to the extent previously disclosed or required to be disclosed, for all years where audited financial statements are included in the filing, to the

[31] *See* 17 CFR 210.14-02(e).

[32] *See* 17 CFR 210.14-02(f).

[33] *See id.*

[34] *See* 17 CFR 210.14-02(a) and 17 CFR 210.14-01(c).

extent climate-related financial disclosure was required to be disclosed for those years.[35] It is important to note that this requirement is subject to the compliance dates discussed in the Final Rules and referenced above.[36]

8. Compliance with Other Climate Standards

For registrants subject to the European Union ("**EU**") Corporate Sustainability Reporting Directive ("**CSRD**"), recently passed laws in California related to climate disclosure, or the EU's recent proposal of the Corporate Sustainability Due Diligence Directive ("**CSDDD**"), it is unclear to what extent compliance with the Final Rules will overlap with or satisfy other standards. Given the current global regulatory landscape, U.S. multi-national companies with operations in California, the EU, or with securities listed on an EU securities exchange, will likely be subject to multiple and likely differing disclosure regimes.[37]

- **CSRD**: One of the most significant differences between the Final Rules and the CSRD is that the CSRD requires disclosure of Scope 3 GHG emissions that are associated with registrants' up-stream and down-stream activities, including supply chains and customers, whereas the Final Rules do not. Thus, for U.S. multi-national companies with operations in the EU, Scope 3 GHG emissions disclosure may nonetheless be required for a portion or all of their operations. In addition, the CSRD has much broader disclosure requirements that relate not only to information that is material to the business, but also to broader stakeholders, including the material impacts a company has on society and the environment.
- **California Climate Disclosure Laws**: Like the CSRD, California law requires disclosure of Scope 3 GHG emissions.[38] The state also now requires disclosure of certain information regarding a company's climate-related financial risks.[39] These laws apply to any public or private company that "does business" in the state of California and meets certain annual revenue thresholds. Notably, unlike the CSRD and the Final Rules, California law does not have a materiality threshold, meaning all in-scope companies must disclose their emissions and financial risks.
- **CSDDD**: If adopted, the CSDDD will require companies, including those in the financial services industry, to adopt and implement a climate transition plan, whereas registrants are not required to adopt a transition plan under the Final Rules. In addition, the CSDDD's transition plan would require time-bound targets for climate change mitigation to ensure that the business strategy is compatible with limiting global warming to 1.5 degrees Celsius.

9. What happens next?

Litigation

The Final Rules were immediately met with controversy, and the SEC is already facing multiple legal challenges related to the scope of its authority and the potential burden the Final Rules may place on registrants. Multiple states, business groups and environmental activist groups filed lawsuits that challenge the SEC's statutory authority to implement the rule and claim that the Final Rules are arbitrary and capricious under the Administrative Procedure Act.

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[35] *See* 17 CFR 210.14-01(d).

[36] *See,* Final Rule, section II.K.6.b.iii., which provides the following example: "subject to the compliance date, a registrant that files its annual report will only be required to provide the applicable disclosure for the registrant's most recently completed fiscal year for which audited financial statements are included in the filing. For each subsequent fiscal year's annual report, the registrant will be required to provide the applicable disclosure for an additional fiscal year until the required disclosure is provided for the entire period covered by the registrant's financial statements."

[37] Directive (Eu) 2022/2464 of the European Parliament and of The Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU; Proposal for a Directive of The European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937.

[38] Cal. Health & Safety Code 38532.

[39] Cal. Health & Safety Code 38533.

On March 21, 2024, the U.S. Court of Appeals for the Eighth Circuit was selected to decide the various challenges asserted against the Final Rules. This comes after the Judicial Panel on Multidistrict Litigation consolidated the challenges and used a lottery system to select a single court of appeals to hear all challenges.

What Registrants Should Do Now

Until the stay is no longer subject to further appeals, registrants should prepare for compliance under the Final Rules in accordance with the phased-in compliance dates above.

To prepare for compliance, registrants should begin by reviewing current climate-related disclosure language and identifying current plans or processes related to climate-related targets and goals and assess how current plans or processes may need change.

With respect to quantitative data disclosure requirements, registrants should begin compiling such data now. LAFs and AFs should begin to compile material Scope 1 and/or Scope 2 GHG emissions data, as well as begin to consider the methodologies, significant inputs and assumptions that will underpin such data. If registrants do not have appropriate plans, processes or methodologies in place, now is the time to refine existing, or establish new, controls and procedures to implement these changes, begin collecting the relevant data and disclosure information, and review qualitative and quantitative disclosures in advance of the relevant compliance dates.

Registrants listed on an EU exchange or that have operations in the EU or California should immediately begin assessing their obligations under those regimes, including preparing to disclose Scope 3 GHG emissions data.

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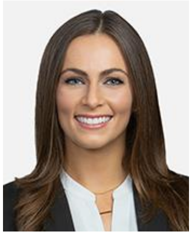
The Final Rules can be found here. For further information and to discuss what the Final Rules might mean for you, please get in touch with the attorneys listed on this alert or your Baker McKenzie contact.

Contact Us

Jeremy Moore
Partner
Houston, Texas
jeremy.moore@bakermckenzie.com

David Hackett
Senior Counsel
Chicago, Illinois
david.hackett@bakermckenzie.com

Adam Buehler
Associate
Miami, Florida
adam.buehler@bakermckenzie.com



Sarah Rodrigue
Associate
Houston, Texas
sarah.rodrigue@bakermckenzie.com

Francesca Gottardi
Associate
Houston, Texas
francesca.gottardi@bakermckenzie.com

Baker McKenzie.