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SEC Poised to Take Action on Climate Disclosure Requirements

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The Securities and Exchange Commission (SEC) is set to formally consider the possibility of enhanced climate disclosure requirements at its upcoming Open Meeting on March 21, 2022. This meeting will be the latest in a series of steps the SEC has taken towards implementing climate risk and environmental, social, and governance (ESG) disclosures. Since the Biden Administration SEC's initial announcement creating the Climate and ESG Task Force, the SEC has requested comments on climate and ESG disclosure matters, has increased enforcement efforts under existing climate risk reporting standards, and has published a sample letter providing insight into the kind of information the SEC will look for when reviewing current disclosures. Meanwhile, the California Senate recently passed the Climate Corporate Accountability Act seeking to impose climate reporting requirements on certain businesses. These efforts at both the state and federal level suggest that heightened mandatory climate disclosure requirements in the U.S. may be inevitable, and that companies should carefully review the policy options on the table.

Background

In 2010, the SEC published its initial interpretative guidance (the 2010 Guidance) for public companies on how the SEC's disclosure requirements apply concerning climate change matters. That guidance, which remains in effect, addressed the disclosure of certain material direct and indirect risks presented by the physical impacts of climate change, increased climate change regulation, business trends, and other matters. Since 2010, investors in public companies have sought additional disclosure requirements, a chorus that has grown louder over the past few years. In 2020, President Biden announced he would direct the SEC to evaluate additional or more refined disclosure requirements related to climate change.

The SEC was originally expected to publish a proposed rulemaking or (announce its intent to revise existing guidance) on climate disclosures in Fall 2021. Recent reports indicate that disputes over the content of the proposed rule have delayed publication.

Examples of open questions that have been the subject of debate include:

- whether requirements should be based on the current materiality standard, or require disclosures beyond material information;
- whether specific voluntary reporting frameworks should be identified as the basis for disclosure;
- whether companies should be required to disclose the greenhouse gas emissions from their direct operations (Scope 1), energy use (Scope 2), and value chain (Scope 3); and
- whether disclosures should be verified by a third-party auditor; and
- whether additional disclosure on ESG matters and statements should be required by the SEC.

The SEC has, however, repeatedly emphasized the need for "consistent, comparable, and decision-useful" disclosures related to climate risk, and is broadly expected to tighten and clarify its climate disclosure requirements.

Companies and investors may soon have insight into the timing of when the SEC's position on these questions could be revealed. The notice for the SEC's upcoming March 21 meeting states that the agency will consider whether to "propose amendments that would enhance and standardize registrants' climate-related disclosures for investors." The SEC's proposed rulemaking, if it decides to move forward, could be issued with or shortly after the meeting.

Hurdles to Implementing Climate Disclosure Requirements

The SEC has faced opposition to its efforts regarding climate disclosures. Several state attorneys general have argued that the SEC lacks the authority to require disclosures that are not financially material. One state attorney general informed the SEC that it would file suit against the SEC should it continue to pursue implementing climate risk disclosures, arguing that it is beyond the SEC's authority. Other opponents argue that requiring climate disclosures will discourage firms from becoming publicly traded, and that publicly-traded companies could sell their greenhouse-gas-related assets to privately held companies. These objections will likely continue and intensify as the SEC decides its course.

California's Proposed Climate Corporate Accountability Act

California's Climate Corporate Accountability Act (Act) would require the State Air Resources Board (CARB) to adopt regulations requiring "reporting entities" to annually disclose Scope 1, 2, and 3 emissions for the prior calendar year using the Greenhouse Gas Protocol standards and guidance developed by the World Resources Institute and the World Business Council for Sustainable Development. Notably, companies subject to the Act would be required to use a CARB-approved third-party auditor to verify their greenhouse gas emissions inventory. Under the Act, "reporting entities" are U.S. companies that do business in California (a concept that is not defined in the text) with total annual revenues in excess of one billion dollars ($1,000,000,000). The enforcement provision of the Act would allow the Attorney General to seek civil penalties for violations.

The Act now sits before a committee of the California Assembly. A final version is expected to be drafted and ultimately sent to Governor Newsom for signature.

Broader Implications and Potential Next Steps for Companies

Companies operating within the U.S. may soon face climate disclosure obligations at both the state and federal level, with multinational companies also grappling with emerging requirements in the European Union and beyond, raising questions regarding how companies will manage inconsistencies across multiple regimes. These requirements can also be expected to broadly impact the value chain through private contractual mechanisms or other stakeholder pressures, particularly if disclosure mandates cover Scope 3 emissions. Companies should, at a minimum, ensure they understand the unique features of these emerging frameworks; review current greenhouse gas estimation, data gathering, and reporting processes in anticipation of new compliance obligations and expectations; and continue to prepare for heightened attention to corporate messaging and disclosures regarding climate and ESG topics.

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