Skadden

SEC Reporting & Compliance Alert

April 9, 2024

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

1440 New York Ave., N.W.
Washington, D.C. 20005
202.371.7000

SEC Climate Disclosure Rules: Your Questions Answered

The Securities and Exchange Commission's climate-related disclosure rules pose a host of issues for companies. Below are answers from Skadden's SEC Reporting and Compliance and Environmental Practice Groups to some of the questions submitted after our March 14, 2024, webinar "The SEC's New Climate-Related Disclosure Rules: What Companies Need To Know."

Pending Legal Challenges

1. What is the outlook for the various legal challenges to the SEC's climate rules?

Challenges to the rules, which were filed in various circuits, have been consolidated in the U.S. Court of Appeals for the Eighth Circuit. On April 4, 2024, while a request for a judicial stay to prevent the rules from taking effect was pending, the SEC voluntarily stayed the rules pending the outcome of judicial review.

Filer Status Impact on Implementation

2. What does the timeline look like for filers who change filer status during the implementation period? For example, a non-accelerated filer who becomes a large accelerated filer?

During the implementation period, the issuer's filer status as of the beginning of the fiscal year generally would determine the applicable rules for that year's annual report. So, for example, a non-accelerated filer with a December 31 fiscal year-end that becomes a large accelerated filer as of January 1, 2026 would need to comply with all requirements of the new rules other than those relating to third-party assurance for GHG emissions disclosure, for the issuer's annual report for fiscal year 2026. Conversely, an accelerated filer with a December 31 fiscal year-end that becomes a non-accelerated filer as of January 1, 2026 would not need to comply with the new rules for its annual report for fiscal year 2026.

One potential exception is for issuers that newly qualify as smaller reporting companies (SRCs) in the middle of a fiscal year based on their public float as of the end of the second quarter. Those issuers would follow the applicable phase-in periods and requirements for SRCs for their annual report for that fiscal year. In this regard, the adopting release notes that "[a] registrant will be exempt from any requirement to disclose its GHG emissions for any fiscal year in which it qualified as an SRC" and that "[a] registrant that previously qualified as an SRC also will be exempt from the GHG emissions disclosure requirements in the first fiscal year in which it no longer so qualifies."

© Skadden, Arps, Slate, Meagher & Flom LLP. All rights reserved.

Although filer status determinations are made as of the end of each fiscal year (other than for SRCs, as noted above), those determinations are based on issuers' public float on the last business day of the most recently completed second fiscal quarter, which should provide issuers an early notice of compliance obligations for the upcoming fiscal year.

Defining Climate-Related Risks

3. Are all environmental risks now considered climate-related? For example, an energy supplier moving to renewables that started many years ago, not for climate-related reasons, but for clean air and water purposes. Is all of that now climate? What about water efficiency or moving away from single-use plastics? That used to be recycling. Is that now a climate-related risk?

No, not necessarily. The definition of "climate-related risks" refers to the actual or potential negative impacts of climate-related conditions and events on a company's business, results of operations or financial condition. The Commission acknowledged that companies need time to develop, modify and implement processes and controls necessary to assess whether something is a material climate-related risk. Although much of the discussion has focused on materiality judgments, companies also will need to assess the relevant facts and circumstances to make a judgment as to whether something is climate-related.

Board Committee Oversight

4. If the charter of a board committee (*e.g.*, nominating/governance committee) explicitly assigns that committee oversight of "sustainability strategies" and "environmental matters relevant to the company's business" but not specifically "climate risk," do we still need to describe board oversight? Can we avail ourself to the materiality carve-out if there is no significant climate change risk/impact?

The requirement under the rules is to describe board (or board committee) oversight of climate-related risks (or climate-related targets or goals), regardless of whether such oversight is memorialized in a committee charter. A committee charter that references oversight of sustainability or environmental matters might create the impression that the committee's oversight includes climate-related risks, but that is not necessarily the case. Importantly, the Commission stated in the adopting release that disclosure is not required in the event that the board (or a board committee) does not exercise oversight of climate-related risks. Note, however, that the Commission explicitly declined to adopt a materiality qualifier with respect to board oversight of climate-related risks.

Materiality Determinations

5. Do we have to disclose the process by which we determine whether climate-related risks are material to our business?

No, not necessarily. While new Regulation S-K Item 1501(b) requires disclosure of management's role in assessing and managing the company's material climate-related risks, including, among other things, "[t]he process by which [management] positions or committees assess and manage climate-related risks," those process may be separate from the company's process for analyzing the materiality of climate-related risks. Note that this requirement is similar to the risk management and strategy disclosure requirement under Regulation S-K Item 106(b) relating to cybersecurity.

6. Current rules require companies to disclose all material information in any event, so does adding the new climate-related disclosures lay the groundwork for plaintiffs to argue that the company should have already been disclosing the information?

Facts and circumstances continue to evolve, so that a risk that was judged not to be material in the past could at some later point be deemed material. There is always a risk that prior materiality judgments will be second-guessed with the benefit of hindsight.

7. In connection with risk mitigation, would it be easier for some companies to support a "not material" determination than to defend against "false and misleading" claims by plaintiffs based on climate-related disclosures?

Of course, these materiality judgments always depend upon a company's unique facts and circumstances. Presumably, plaintiffs could allege that the absence of climate-related disclosure constitutes a material omission as easily as they could allege that climate-related disclosures included in an annual report are materially false and misleading.

GHG Emissions Disclosures

8. Can you confirm that we do not need to disclose Scope 1 and Scope 2 GHG emissions by segment?

Yes. The final rules do not specifically require a breakdown of Scope 1 and Scope 2 GHG emissions by segment.

9. Do you need to actually measure Scope 1 and 2 to determine materiality, or can you make a qualitative determination?

Not necessarily. While it will depend on specific factors for each reporting company, we believe there are ways to make a

materiality determination without actually calculating emissions. For example, the Sustainability Accounting Standard Board (SASB) has identified a number of sustainability topics by industry that its research has suggested are most likely to be useful to investors. For certain industries, the SASB standards include GHG emissions as a material topic, but not for all industries.

Likewise, if management reasonably determines that it is unlikely that the reporting company will be subject to any climate-related transition or regulatory impacts and the company has not set any material goals related to emission reductions, then, absent any company-specific factors, we believe that would be sufficient to conclude that the company's Scope 1 and Scope 2 emissions are not material.

However, as noted during our webinar, even if the emissions do not need to be disclosed under the SEC rules, they may be subject to disclosure requirements in other jurisdictions such as California and the European Union.

10. If Scope 3 GHG emissions are part of a transition plan to manage a material transition risk or a material climate-related target or goal, do they need to be disclosed?

Scope 3 GHG emissions data is not required by Regulation S-K Item 1505 and does not need to be disclosed, even if Scope 3 GHG emissions are relevant to a transition plan or climate-related target or goal under the final rules.[1]

Qualitative discussion of Scope 3, however, may be required in describing a transition plan pursuant to Regulation S-K Item 1502(e) or to provide the "additional information or explanation necessary to an understanding of the material impact or reasonably likely material impact of the [disclosed material climate-related] target or goal" pursuant to Regulation S-K Item 1504(b). In particular, qualitative discussion of Scope 3 may be required to provide context in explaining a company's net zero target or any progress made toward meeting the disclosed climate-related target or goal pursuant to Regulation S-K Item 1504(c).

GHG Emissions Assurance

11. What disclosure is required if you already receive some sort of validation or limited assurance for your GHG emissions?

A registrant that voluntarily obtains assurance for GHG emissions will be required to provide certain disclosures, depending on filer status and timing relative to the phase-in periods. Voluntary assurance during the phase-in period will be subject to Regulation S-K Item 1506(e), which requires limited disclosures about the assurance provider, assurance standard used, level and scope of assurance services, the results of the assurance services, whether the assurance provider has any material business relationships with or has provided any material professional services to the registrant and information about any oversight inspection program applicable to the assurance provider.

Once Scope 1 and Scope 2 assurance becomes mandatory, a registrant that voluntarily discloses Scope 3 GHG emissions and also voluntarily obtains third-party assurance of such Scope 3 emissions would become subject to the full attestation report and disclosure requirements under Items 1506(b) through (d).

The following summary chart is excerpted from pages 302-303 of the Commission's adopting release:

[1] *See* footnote 2494 of the SEC's adopting release ("All registrants subject to the final rules, including SRCs and EGCs, are not required to disclose GHG emissions metrics other than as required by Item 1505, including where GHG emissions are included as part of a transition plan, target or goal."). In recent remarks at an American Bar Association conference, the director of the SEC's Division of Corporation Finance, Erik Gerding, confirmed that Scope 3 GHG emissions data is strictly voluntary and therefore such quantitative disclosures are not necessarily required in the discussion of transition plans, targets or goals.

	After the Compliance Date for GHG Emissions Disclosure but before the Compliance Date for Assurance	After the Compliance Date for Assurance
LAFs and AFs subject to Items 1505 and 1506(a) through (d) **(*e.g.*, registrants that are required to disclose GHG emissions and obtain assurance)**	Any voluntary assurance over any GHG emissions disclosure must comply with the disclosure requirements in Item 1506(e).	Any voluntary assurance obtained over GHG emissions disclosures that are not required to be assured pursuant to Item 1506(a) (*e.g.*, voluntary Scope 3 disclosures) must follow the requirements of Item 1506(b) through (d), including using the same attestation standard as the registrant's required assurance over Scope 1 and/or Scope 2 disclosure.
Registrants not subject to Items 1505 or 1506(a) through (d) (*e.g.*, registrants that are not required to disclose GHG emissions)	Any voluntary assurance over any GHG emissions disclosure must comply with the disclosure requirements in Item 1506(e).	Any voluntary assurance over any GHG emissions disclosure must comply with the disclosure requirements in Item 1506(e).

Financial Statement Disclosures

12. For purposes of the financial statement footnote disclosures, what amounts qualify to be disclosed? For instance, is it possible that market issues, such as interest rates or stock prices that are impacted by severe weather events, could trigger disclosures?

The disclosure requirements in new Regulation S-X, Article 14 (Disclosure of Severe Weather Events and Other Information) are focused on capitalized costs, expenditures expensed, charges, and losses incurred as a result of severe weather events and other natural conditions and capitalized costs, expenditures expensed, and losses related to carbon offsets and renewable energy credits (RECs).

These capitalized costs, expenditures expensed, charges, and losses represent quantitative information that is derived from transactions and amounts recorded in a company's books and records underlying the financial statements. These new disclosure requirements do not change the accounting for amounts companies record on their books. As a result, to trigger disclosures of market issues under the new rules, such as interest rates or stock prices, those issues would need to (i) have an accounting basis to be recorded in the company's books and records, (ii) be deemed to have resulted from severe weather events and (iii) be at amounts above the disclosure and de minimis thresholds provided in the new rules.

SEC Climate Disclosure Rules: Your Questions Answered

Contacts

Brian V. Breheny
Partner / Washington, D.C.
202.371.7180
brian.breheny@skadden.com

Raquel Fox
Partner / Washington, D.C.
202.371.7050
raquel.fox@skadden.com

Marc S. Gerber
Partner / Washington, D.C.
202.371.7233
marc.gerber@skadden.com

Andrew J. Brady
Of Counsel / Washington, D.C.
202.371.7513
andrew.brady@skadden.com

Ryan J. Adams
Counsel / Washington, D.C.
202.371.7526
ryan.adams@skadden.com

Caroline S. Kim
Counsel / Washington, D.C.
202.371.7555
caroline.kim@skadden.com

Liz Malone
Counsel / Washington, D.C.
202.371.7239
elizabeth.malone@skadden.com

Leo W. Chomiak
Associate / Washington, D.C.
202.371.7511
leon.chomiak@skadden.com

Jeongu Gim
Associate / Washington, D.C.
202.371.7223
jeongu.gim@skadden.com

Nicholas D. Lamparski
Associate / Washington, D.C.
202.371.7323
nicholas.lamparski@skadden.com

Khadija L. Messina
Associate / Chicago
312.407.0116
khadija.messina@skadden.com

Joshua Shainess
Associate / Washington, D.C.
202.371.7594
joshua.shainess@skadden.com