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Alert | Environmental, Social & Governance (ESG)

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SEC Issues Long-Awaited Proposed Rule on Climate Disclosures

This GT Alert covers the following:

- SEC proposes climate-related disclosure rule for registered public companies.
- If finalized, first reports would be due in 2024.
- Public comment period on proposed rule open until later of 30 days after publication in Federal Register or May 20, 2022.

Registered public companies would be required to report their greenhouse gas (GHG) emissions and certain information regarding climate-related financial risks and metrics, including any actual or likely material impacts to their businesses, pursuant to a long-awaited proposed rule the U.S. Securities and Exchange Commission (SEC) voted 3-1 to issue on March 21, 2022. If the rule becomes effective by December 2022, the first reports under the rule would be due from "large accelerated filers" in 2024, covering data from fiscal year 2023.

The public will have until 30 days after publication of the over 500-page proposed rule in the Federal Register, or until May 20, 2022 (whichever is later), to submit comments on the proposed rule.

In announcing the proposed rule, the SEC recognized that many companies are already reporting climate metrics and risks to meet investor demands. The goal of the rule is to provide consistency across these disclosures and to allow equity issuers to "more efficiently and effectively disclose these risks," benefiting both the regulated community and investors alike.

If finalized, the new rule would require registrants to report on:

- Climate-related risks and their actual or likely material impacts on the registrant's business, strategy, and outlook;
- The registrant's governance and management of these risks;
- The registrant's GHG emissions, starting first with Scope 1 and Scope 2 (direct emissions and indirect emissions from power purchase) and growing to include Scope 3 (indirect emissions from upstream and downstream entities in its value chain);
- Audited climate-related financial risk metrics and related disclosures; and
- Information regarding a registrant's climate-related targets, goals, and transition plan, if any.

The proposed rule comes as U.S. public interest in ESG (environmental, social and governance) metrics is growing. A Gallup poll from April 2021 found that while most Americans remain unfamiliar with the term "ESG," an overwhelming majority of consumers consider ESG factors a "great deal" or a "fair amount" when deciding to buy products or services from a company. In providing consistency among public company disclosures, the proposed rule, if finalized, may help consumers and investors evaluate risks and benefits, and modify their purchasing and investing decisions accordingly.

Longer-term, if finalized, the SEC rule may wind up supplying a standard of care in shareholder derivative suits and in greenwashing litigation generally. (Greenwashing is the term applied to companies that overstate or exaggerate their environmental bona fides.) Such suits are on the rise and are poised to continue, with or without the new rule. Moreover, a final rule would provide the SEC's Division of Enforcement with a significant tool to pursue potential climate-related disclosure violations against public companies. Thus far, the SEC has had to rely upon the standard anti-fraud provisions when bringing enforcement actions in this area.

In light of the varied approaches taken by public companies in their compliance and governance programs, it is critically important for those who would be subject to the proposed rule to provide comments directly or through trade groups to identify any substantial logistical challenges, benchmarking complexities, or anticipated financial burdens in complying with the proposed rule. The SEC's response to these comments may offer guidance on appropriate methods to comply with the new rule – including insight into whether a company's current or proposed ESG disclosures or reports would comply – and may inform how businesses set up their ESG reporting structures. This active participation may help reduce uncertainty and mitigate potential enforcement or litigation risk.

The proposed rule constitutes one of the most comprehensive packages of disclosure reform ever proposed by the SEC; it will take time for market participants to parse, analyze, and comment on the rule.

Authors

This GT Alert was prepared by:

- Bernadette M. Rappold | +1 202.331.3127 | rappoldb@gtlaw.com
- Elaine C. Greenberg | +1 202.331.3106 | greenberge@gtlaw.com
- Christopher J. Neumann | +1 303.572.6551 | neumannc@gtlaw.com

Albany. Amsterdam. Atlanta. Austin. Boston. Chicago. Dallas. Delaware. Denver. Fort Lauderdale. Germany.¬ Houston. Las Vegas. London.* Long Island. Los Angeles. Mexico City.+ Miami. Milan.» Minneapolis. New Jersey. New York. Northern Virginia. Orange County. Orlando. Philadelphia. Phoenix. Portland. Sacramento. Salt Lake City. San Francisco. Seoul.∞ Shanghai. Silicon Valley. Tallahassee. Tampa. Tel Aviv.^ Tokyo.¤ Warsaw.~ Washington, D.C.. West Palm Beach. Westchester County.