ALERT MEMORANDUM MARCH 7, 2024

Summary of Significant Changes Between the Proposed and Adopted SEC Climate Rules

Notable Changes from the Proposed Rules

1. **GHG Emissions and Attestation Report**
    a. *Scope and nature of GHG emissions disclosures:*
        i. The biggest change is that the final rules only require Scope 1 and Scope 2 GHG emissions and related methodology disclosures (and only to the extent material), and Scope 3 has been removed entirely from the final rules
            1. The adopting release says that materiality is judged by the importance to investment and voting decisions about a particular company and not to issues outside of those decisions
        ii. The final rules only require historical period GHG emissions disclosures to the extent previously disclosed in an SEC filing, so the initial year of compliance will not need to include historical GHG emissions disclosures
        iii. GHG emissions disclosures no longer need to be disaggregated by constituent gas; disclosures only need to be in the aggregate in terms of CO_2e, unless any one constituent gas is individually material (in which case only that constituent gas must be disaggregated)
        iv. GHG intensity, or carbon intensity, disclosure requirements have also been removed
    b. *Covered filers and filing timing:*
        i. GHG emissions disclosures are only required for large accelerated filers and accelerated filers; non-accelerated filers, SRCs and EGCs do not need to disclose any GHG emissions disclosures
        ii. To provide additional time to finalize GHG emissions data, GHG emissions disclosures can be delayed to the Q2 Form 10-Q immediately following the fiscal year to which the GHG emissions disclosures relate (companies that prefer not to include the disclosures in the 10-Q can file an amendment to their Form 10-K by the Q2 10-Q filing deadline). FPIs can wait to file GHG emissions disclosures within 225 days after the end of the fiscal year to which the GHG emissions disclosures relate in an amendment to their Form 20-F; however, these amendments cannot be furnished on Form 6-K
            1. Any companies taking this approach must state in the annual report its intention to incorporate by reference or amend its filing for this information
            2. For disclosures in registration statements, GHG emissions disclosures must be provided for the most recently completed fiscal year that is at least 225 days prior to the effectiveness of the registration statement

c. *Attestation report requirements*
    i. Only large accelerated filers will need to obtain limited assurance at the outset and eventually obtain reasonable assurance; accelerated filers only need to obtain limited assurance (in both cases, the lead time prior to compliance is much longer than in the proposed rules – see below for exact dates)
    ii. The attestation reports are not required for the first three years of GHG emissions disclosure reporting (although companies can voluntarily provide it earlier)
    iii. Such reports continue to be required from an independent provider pursuant to standards established by a group that adheres to due process and comment procedures, but the form and content of the attestation reports are now governed by the standard itself and the SEC has removed the line-item requirements previously contemplated in the proposed rules
    iv. Similar to certain disclosures required for auditors, the final rules require disclosure about any changes to providers (including by resignation, declination to stand for re-appointment, or dismissal) and whether there were any disagreements with any former providers
    v. Rather than including the report directly in the filing as contemplated by the proposed rules, the attestation report must be filed as an exhibit 27 to applicable annual report and registration statement filings

2. Notes to the Financial Statements

a. *Modification to the 1% threshold:*
    i. Most notably, the requirement to disclose any climate-related impact of 1% or more *per line item* in a footnote to the audited financial statements has been modified to a requirement to disclose the impact of 1% of *the absolute value* of the company's:
        1. income or loss before taxes for the fiscal year, in the case of expenditures expensed as incurred and losses, or
        2. stockholders' equity or deficit at the end of the fiscal year, in the case of capitalized costs and charges, subject to a de minimis $100,000 threshold

b. *Modification of expenditures required to be disclosed*
    i. Rather than requiring disclosure of expenditures related to transition activities as proposed, the final rules require registrants to disclosure material expenditures related to:
        1. activities to mitigate or adapt to climate-related risk (in management's assessment)
        2. disclosed transition plans and
        3. disclosed targets and goals

c. *Carbon offsets and renewable energy credits (RECs*)
    i. In a new addition to the proposal, the final rules require financial statement footnote disclosure, if carbon offsets or RECs have been used as a material component of plans to achieve disclosed climate-related targets or goals, of the aggregate amount of:
        1. carbon offsets or RECs expensed,
        2. capitalized carbon offsets or RECs recognized and
        3. losses incurred on the capitalized carbon offsets and RECs

d. *Attribution principle*
    i. Several commenters raised concerns about the ability of companies to isolate, attribute and quantify expenditures related to severe weather events and other natural conditions
    ii. In response, the SEC adopted an attribution principle that requires companies to attribute an expenditure or recovery to a "severe weather event or other natural condition" and disclose the *entire amount* of the expenditure or recovery when the event or condition is a

"significant contributing factor" in incurring the expenditure or recovery; the SEC has not provided definitions of those terms or provided a way to cabin the incurred expenditures

3. **Governance, Risk and Targets/Goals Disclosures and New Safe Harbor**
    a. *Reductions in scope of disclosures*
        i. The final rules added materiality qualifiers in a number of places, including to:
            1. Limit the discussion of management oversight to only *material* climate-related risks;
            2. Limit climate-related risk disclosure to material physical or transition risks (with no disclosure required if there are no material climate-related risks); and
            3. Limit discussion of targets or goals to just those that are material, eliminating the need to disclose preliminary targets and goals that are used for internal planning purposes and are not yet material (although a formal adoption of a target or goal is **not** required for disclosure to be triggered)
        ii. The final rules eliminate the requirement to disclose any "climate expert" on the Board, but registrants are still required to disclose management expertise
        iii. The final rules limit the disclosure of climate-related targets and goals to only those that have or are reasonably likely to materially affect the business, results or financial condition of the company (rather than requiring disclosure of any climate targets and goals) and reduce the level of detail of disclosure, including removing disclosure of interim targets, although annual disclosure of the progress made towards targets and goals during each fiscal year and how the progress was achieved remains in the final rule and disclosure of material expenditures and impacts on financial estimates as a direct results of the target has been added
    b. *Safe harbor:*
        i. The safe harbor in the proposed rules was limited to Scope 3 emissions disclosure and is therefore not included in the final rules
        ii. The final rules instead provide a safe harbor for climate-related disclosures pertaining to transition plans, scenario analysis, the use of an internal carbon price and targets and goals disclosed under the relevant Items of Regulation S-K
        iii. The safe harbor also provides that all of the information required by the specified sections, except for historical facts, is considered "forward-looking information" for purposes of the PSLRA safe harbors for forward-looking statements, including in IPOs

4. **Other Changes**
    a. Elimination of the proposed requirement that material changes to the climate-related disclosures would need to be updated in a subsequent Form 10-Q or Form 6-K

Consistent with what was contemplated by the proposed rules, sovereign issuers are generally not subject to the final rules.

Finalized Compliance Dates

The final rules provide compliance dates that are dependent on the particular disclosure requirement and on the registrant's filing status:

- **GHG Emissions Disclosures (Scope 1 and Scope 2)**
    - For large accelerated filers, beginning fiscal year 2026 (filed in 2027 for 12/31 FYE filers)
    - For accelerated filers, beginning fiscal year 2028 (filed in early 2029 for 12/31 FYE filers)

  - N/A for non-accelerated filers, SRCs and EGCs

- **Attestation Report Requirement**
  - For large accelerated filers, limited assurance beginning fiscal year 2029 (filed in 2030 for 12/31 FYE filers) and reasonable assurance beginning fiscal year 2033 (filed in 2034 for 12/31 FYE filers)
  - For accelerated filers, limited assurance beginning fiscal year 2031 (filed in 2032 for 12/31 FYE filers) and N/A for reasonable assurance
  - N/A for non-accelerated filers, SRCs and EGCs

- **Disclosures regarding material expenditures incurred and material impacts on financial estimates and assumptions (applicable to Item 1502(d)(2), 1502(e)(2) and 1504(c)(2))**
  - For large accelerated filers, beginning fiscal year 2026 (filed in 2027 for 12/31 FYE filers)
  - For accelerated filers, beginning fiscal year 2027 (filed in 2028 for 12/31 FYE filers)
  - For non-accelerated filers, SRCs and EGCs, beginning fiscal year 2028 (filed in 2029 for 12/31 FYE filers)

- **Everything Else (including all Regulation S-X requirements)**
  - For large accelerated filers, beginning fiscal year 2025 (filed in 2026 for 12/31 FYE filers)
  - For accelerated filers, beginning fiscal year 2026 (filed in 2027 for 12/31 FYE filers)
  - For non-accelerated filers, SRCs and EGCs, beginning fiscal year 2027 (filed in 2028 for 12/31 FYE filers)

- **Electronic Tagging**
  - For large accelerated filers, beginning fiscal year 2026 (filed in 2027 for 12/31 FYE filers)
  - For accelerated filers, beginning fiscal year 2026 (filed in 2027 for 12/31 FYE filers)
  - For non-accelerated filers, SRCs and EGCs, beginning fiscal year 2027 (filed in 2028 for 12/31 FYE filers

Litigation Challenges

- Legal challenges to the final rules have already begun and we expect that others will be filed in the coming days
  - Only hours after the final rules were adopted, a coalition of ten states led by West Virginia and Georgia announced that it had filed suit in the Eleventh Circuit challenging the final rules
  - Liberty Energy Inc. and Nomad Proppant Services LLC also filed a suit in the Fifth Circuit, which is a common forum for petitioners to challenge SEC Rules and the court that recently struck down the Repurchase Rules. The petitioners in the Liberty Energy case have said they intend to seek emergency relief, including requesting a ruling within ten days
  - The U.S. Chamber of Commerce Center for Capital Markets Competitiveness also announced that they are considering whether to challenge the final rules
  - Opponents will have 60 days from the date the final rules are adopted to file a petition seeking judicial review. Here, that would be May 6, 2024
- The petition filed by the coalition of ten states argues that the final rules "exceed[] the agency's statutory authority and otherwise is arbitrary, capricious, an abuse of discretion and not in accordance with law." The petition itself does not contain more detail on these legal arguments, which will come once the Eleventh Circuit orders a schedule for substantive briefing on the issues
- The coalition and other petitioners may make several arguments against the final rules, including:

  - First, as previewed by the coalition's petition, petitioners may argue that the SEC lacks statutory authority to promulgate rules requiring climate-related disclosures, including because the final rules go beyond disclosures material to reasonable investors to instead advance public policy goals of addressing the effects of climate change and reducing greenhouse gas emissions
  - Second, petitioners may argue that the final rules are arbitrary and capricious under the Administrative Procedure Act. As with the Repurchase Rules, petitioners may argue that the SEC failed to respond to comments concerning the economic effects of the final rules and failed to substantiate the benefits and costs of the final rules, particularly given that the SEC has already conceded that it lacked the data to accurately assess the cost-benefits of the final rules. As Commissioner Peirce argued today, we expect petitioners will argue the final rules are burdensome and expensive and will result in a "flood of climate-related disclosures [that] will overwhelm investors, not inform them"
  - Third, petitioners may argue that the final rules unconstitutionally compel speech because the final rules force disclosures of information that is not material to reasonable investors and therefore not sufficient for the government to compel such speech
- Though we expect a number of legal challenges to be filed against the final rules, we note that any such petitions do not have an immediate tolling effect on the final rules themselves. A petitioner would have to either seek a stay from the SEC pending judicial review, which may be granted when "justice so requires," or request a stay from the court, which may be granted to the extent necessary to prevent irreparable injury. Unless a stay is granted, the final rules will go into effect in 60 days and the first disclosures will be required for the fiscal year beginning 2025

Recommended Next Steps towards Compliance

Now that the final rules are out, companies can further refine and focus the preparation and compliance efforts that have been ongoing over the past year. In particular as important next steps, companies should consider:

- Socializing the final rules (and the key differences from the proposed rules) with the relevant teams internally, including with the board
- Coordinating with internal audit and external auditors, any GHG emissions experts, advisors or other consultants, and any current attestation report providers engaged by the company on the changes to the GHG emissions disclosure requirements and the notes the financial statements disclosure requirements to refresh the gap analysis between the company's current status and where it needs to be under the final rules
- Preparing a plan for fine-tuning and test running the company's internal controls, disclosure controls and other processes as they relate to these new climate-related disclosure requirements to ensure everything works as intended
- Coordinating with management and other relevant personnel on published or planned targets and goals, usage of carbon credits and offsets, climate transition plans, scenario analysis calculations and climate-related risk assessments and prepare a strategy for rolling them out (in light of the new rules) or disclosing them pursuant to the new requirements (if already published)

Link to the final rules
Link to the SEC factsheet

….

CLEARY GOTTLIEB