A&O SHEARMAN

The SEC's Final Climate Disclosure Rules

PERSPECTIVES

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On March 6, 2024, almost two years after its originally proposed rules, the Securities and Exchange Commission (SEC) adopted final rules relating to the enhancement and standardization of climate-related disclosures. While the final rules still represent a sweeping overhaul of current disclosure requirements and will substantially expand the reporting obligations for public companies, the SEC scaled back some of the most onerous proposals, eliminating Scope 3 greenhouse gas (GHG) emissions disclosures entirely, scaling back attestation requirements, eliminating the requirement to disclose director expertise, narrowing the financial statement disclosures, and further scaling disclosures benefitting smaller reporting companies, as well as adding materiality qualifiers throughout.

As expected, the final rules quickly became the subject of several legal challenges, and on March 15, 2024, the Court of Appeals for the Fifth Circuit stayed the effectiveness of the final rules pending review in the proceeding before it, which had been brought by an energy company and had been joined by the U.S. Chamber of Commerce, among others. The plaintiffs brought this action in the same court that vacated the SEC's share repurchase disclosure rules in 2023. Additionally, other groups have brought legal challenges asserting that the final rule did not go far enough. At this point, it is too early to predict the ultimate outcome of the various legal challenges.

In this client alert, we first provide a brief high-level summary of the final rules and our take on their impact on public companies, including foreign private issuers. This is then followed by a more detailed description of each of the new disclosure requirements and a number of action items for public companies.

SUMMARY OF FINAL RULES

New Disclosure of Climate-Related Information

The final rules contain the following requirements for climate-related disclosures to be presented outside the financial statements in registration statements and otherwise on an annual basis:

Climate-Related Risks. Companies must describe climate-related risks that have materially impacted or are reasonably likely to materially impact the company. The description must include risk type (physical or transition), nature and extent.

Impacts. Companies must also discuss actual or potential material impacts of disclosed climate-related risks on strategy, business model and outlook; describe the integration of impacts of disclosed climate-related risks into strategy; describe transition plans, if adopted; include annual climate-related MD&A that discusses how disclosed climate-related risks have materially impacted or are reasonably likely to materially impact business, results of operations or financial condition; and describe scenario analysis and internal carbon price, if used.

Governance. Companies must further describe board oversight of climate-related risks, including responsible committees, processes by which board or committee is informed, and oversight of progress against disclosed targets or transition plans. Companies must also discuss management's role in assessing and managing material climate-related risks, including responsible management positions or committees and relevant expertise and risk management processes, and reporting to the board or board committees.

Risk Management. In addition, companies must describe processes for identifying, assessing and managing material climate-related risks, including risk identification, decisions to mitigate, accept or adapt to such risks, prioritization of climate-related risks, and integration into the overall risk management system. As part of that description, the SEC suggests discussing how companies: determine the relative significance of climate-related risks; consider regulatory

requirements, shifts in customer or counterparty preferences, technological changes or changes in market prices; and determine materiality.

Targets and Goals. Finally, companies must disclose any climate-related target or goal that has materially affected or is reasonably likely to materially affect them, along with information necessary to understand the impact. Companies must also annually update on progress made to meet such target or goal and how such progress has been achieved, including quantitative and qualitative disclosure of any directly resulting material expenditures and material impacts on financial estimates and assumptions.

New Financial Statement Disclosures

The final rules also contain scaled-back requirements for the disclosure of specified information in the notes to the company's annual audited financial statements, where it will be subject to audit procedures and to the company's internal control over financial reporting. These new financial statement disclosures comprise the following, in addition to contextual information:

Expenditure Effects. The notes to the financial statements must disclose capitalized costs, expenditures expensed, charges and losses incurred as a result of "severe" weather events and other natural conditions. Disclosure will be required if the resulting financial statement effect meets a specified one-percent (1%) disclosure threshold based on pretax income or stockholders' equity.

Financial Estimates and Assumptions. The new note disclosure must also describe the impact on financial estimates and assumptions from severe weather events and other natural conditions, or any climate-related targets or transition plans.

Scope and Compliance Dates

The final rules apply to both domestic and foreign companies that file reports with the SEC, except for Canadian companies that use the multijurisdictional disclosure system (MJDS). Compliance will be phased in based on filer status, with large accelerated filers having to provide the most new climate-related disclosures, including the new notes to the financial statements, for fiscal years beginning in 2025 and later, except for (1) the MD&A-type information about material expenditures and impacts on financial estimates and assumptions from mitigation or adaptation activities, transition plans and targets or goals and (2) GHG emissions Scope 1 and 2 information, both of which will only be required for fiscal years beginning in 2026 and later. Accelerated filers, other than smaller reporting companies (SRCs) and emerging growth companies (EGCs), get another year for most disclosures and two more years for GHG emissions information. Non-accelerated filers and SRCs and EGCs get two more years than large accelerated filers and do not need to provide any GHG emissions information. Attestations for GHG emissions information, which are only required for large accelerated filers and accelerated filers (other than SRCs and EGCs), will be phased in starting with filings covering fiscal years beginning in 2029 at the earliest.

OUR TAKE

While the final rules reflect several accommodating changes from the SEC's original proposal, including most significantly the liberal application of materiality qualifiers and the complete elimination of required Scope 3 GHG emissions information, they still impose a very significant compliance and disclosure burden on public companies.

The SEC, after seeing a challenge to its share repurchase disclosure rules end in the invalidation of the rule, is now in litigation with several plaintiffs challenging the final climate-related disclosure rules, including various state attorney

generals, companies and the U.S. Chamber of Commerce and other business organizations. On March 15, 2024, the Court of Appeals for the Fifth Circuit issued an order staying effectiveness of the final rules pending review in the case before it. In addition, the Sierra Club has sued the SEC for abandoning its proposed Scope 3 GHG emissions disclosure requirement.

While it remains to be seen how the final rules will fare in these legal battles, companies may not want to wait. Mandatory compliance with most of the new disclosure requirements starts with respect to fiscal years beginning as early as next year, and putting in place the appropriate disclosure controls and procedures will take time and thought. We discuss concrete steps companies can take now at the end of this client alert, after first describing the new rules in more detail.

NEW DISCLOSURE OF CLIMATE-RELATED INFORMATION

The final rules add a new Subpart 1500 to Regulation S-K that sets forth the new requirements for climate-related disclosures outside the financial statements.

Disclosure of Climate-Related Risks

The final rules require a company to disclose any "climate-related risks" that have materially impacted or are reasonably likely to materially impact the company, including its strategy, results of operations or financial condition, as further described below.

Under the final rules, "climate-related risks" are defined as the actual or potential negative impacts of climate-related conditions and events on a company's business, result of operations or financial condition. They include physical risks and transition risks. The final rules simplify the disclosure obligation by aligning the definition with the existing definition used by the Task Force on Climate-related Financial Disclosures (TCFD), which a number of companies have already adopted for use in sustainability reports.

The definition of climate-related risks does not include impacts on a company's "value chain," as had originally been proposed. This would have included upstream and downstream activities related to a company's operation, such as supplier activities, materials processing, transportation and distribution and use of sold products, and required a company seek inputs from third parties to prepare this disclosure. The elimination of the reference to value chain means that a climate-related risk involving a registrant's value chain would generally not need to be disclosed except where such risk has materially impacted or is reasonably likely to materially impact the registrant's business, results of operations, or financial condition.

The final rules require that a description of climate-related risks address several factors:

Time Horizon. When describing material climate-related risks, a company must describe whether such risks are reasonably likely to manifest in the short-term (the next 12 months) and separately in the long-term (beyond the next 12 months). Companies, however, are allowed to further break down the longer-term risks to classify risks as reasonably likely to manifest in the more medium and longer-term if such classification is consistent with the company's assessment and management of these climate-related risks.

Type, Nature and Extent. The description of material climate-related risks must also disclose whether the risk is a physical or transition risk, providing information necessary to an understanding of the nature of the risk presented and the extent of the company's exposure to the risk.

Physical Risks. Physical risks, which the final rules do not define, but which are described in the adopting release as related to the physical impacts of the climate, are further subcategorized by the final rules into acute and chronic risks. Acute risks are event-driven and may relate to shorter-term severe weather events, such as hurricanes, floods, tornadoes, and wildfires. Chronic risks relate to longer-term weather patterns, 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. The disclosures are required to include the geographic location (but not the ZIP code, as had been proposed) and nature of the properties, processes, or operations subject to the physical risk.

Transition Risks. Transition risks are actual or potential negative impacts attributable to regulatory, technological and market changes to address the mitigation of, or adaptation to, climate-related risks, which, by way of example, include increased costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products leading to decreased sales, prices, or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, and reputational impacts (including those stemming from the company's customers or business counterparties) that might trigger changes to market behavior, consumer preferences or behavior, or the company's behavior. The adopting release notes that, if a company has significant operations in a jurisdiction that has made a GHG emissions reduction commitment, it should consider whether the company is exposed to a material transition risk related to implementation of such commitment.

The SEC noted that classifications and discussions required (such as whether a physical risk should be categorized as an acute or chronic risk) may involve judgments based on relevant facts and circumstances and evolving interpretation of the climate risks over time. As such, companies may make determinations on classifications and discussions using their best understandings of the relevant facts and circumstances so long as they strive to provide clear and consistent disclosure and properly capture the changing risks as the nature of the risk evolves over time.

Impact Disclosures

The final rules require companies to disclose actual or potential material impacts of climate-related risks on their strategy, business model and outlook, including on business operations. These disclosures would include the nature and location of the impact; products or services impacted; impacts on suppliers, purchasers or counterparties to material contracts filed with the SEC to the extent the required information is known or reasonably available; the impact of activities required to mitigate or adapt to climate-related risks, including adoption of new technologies or processes; and expenditures for research and development. These disclosure requirements are generally subject to materiality qualifiers, but will likely still require public companies to collect relevant information, prepare relevant disclosures, and establish corresponding disclosure controls.

Integration of Impacts of Climate-Related Risks into Strategy. Companies will also need to describe how they consider any disclosed material impacts of climate-related risks as part of their strategy, financial planning, and capital allocation. This includes a discussion of whether such impacts have been integrated into companies' business models or strategies (including whether and how resources are being used to mitigate climate-related risks). Companies should also discuss, if applicable, how any disclosed climate-related targets or transition plans relate to their business model and strategy.

Transition Plans. Companies that have adopted a transition plan to manage a material transition risk must describe this plan. "Transition plan" is defined as a company's strategy or implementation plan to reduce climate-related risks, which may include plans to reduce GHG emissions in line with internal or regulatory commitments. The SEC noted that transition plans do not need to have been adopted by a company's board of directors to trigger disclosure. Companies

are not, however, required to adopt transition plans or disclose why they do not have a transition plan if one is not adopted.

Annual "Climate MD&A". The final rules also require companies to discuss, in a manner similar to a discussion of financial results in MD&A, how disclosed climate-related risks have materially impacted or are reasonably likely to materially impact their business, results of operations or financial condition. In connection with this discussion, companies will also need 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. The SEC explained that this is intended to capture relevant expenditures made during the fiscal year, regardless of whether they were capitalized on the balance sheet or expensed through the income statement.

In similar MD&A-like fashion, companies that have adopted and disclosed a transition plan must update the relevant disclosure annually by describing any actions taken during the year under the plan, including how such actions have impacted the company's business, results of operations, or financial condition. This discussion is intended to facilitate an understanding of the company's progress under the plan over time. Like the discussion of the impact of climate-related risks, this must include quantitative and qualitative disclosure of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the transition plan. Unlike the corresponding disclosure about the impact of mitigation of climate-related risks, however, this requirement is not qualified by referring to management's assessment.

Scenario Analysis. If a company uses scenario analysis to assess the impact of climate-related risks and determines, based on its scenario analysis, that a climate-related risk is reasonably likely to have a material impact, then it must describe each scenario used, including a brief description of related parameters, assumptions and analytical choices, as well as the expected material financial and other impacts on the company under each scenario. The final rules do not mandate companies to perform scenario analyses, however, and disclosures related to the use of analytical tools other than scenario analyses are not required.

Internal Carbon Pricing. If a company uses an estimated cost of carbon emissions internally within its organization (referred to as an "internal carbon price") and such use is material to how the company evaluates and manages disclosed material climate-related risks, the company must disclose certain information in its reporting currency, including: the carbon price per metric ton of carbon dioxide and the total price, including how the total price is estimated to change in the next 12 months and, separately, beyond the next 12 months. If the scope of entities and operations involved in the use of an internal carbon price differs materially from the organizational boundaries used to calculate the company's disclosed GHG emissions, the company must briefly describe this difference.

Oversight and Governance of Climate-Related Risks

The final rules require disclosures relating to the oversight of climate-related risks by the board of directors and management's role in assessing and managing those risks.

Board Oversight. The final rules require a description of the board's oversight of climate-related risks, including identification, if applicable, of:

- any board committee or subcommittee (but not specific board members) responsible for the oversight of climate-related risks;

- the processes by which the board or board committee or subcommittee is informed about climate-related risks (but not the frequency of such discussions); and,
- if there is a climate-related target, goal or transition plan disclosed pursuant to the final rules, whether and how the board oversees progress against the target, goal or transition plan. Unlike the corresponding requirement to describe management's role, the one relating to the board's oversight is not subject to a materiality qualifier because the SEC believes that any climate-related risks that are elevated to the board level will likely be material.

The SEC did not require disclosure with respect to the identity of specific board members responsible for climate-risk oversight; director expertise in climate-related risks; board or board committee processes for climate-related risks; whether and how boards or board committees consider climate-related risks as part of business strategy, risk management and financial oversight; and whether and how the board itself sets climate-related targets or goals and oversees progress against those targets or goals.

Management Role. The final rules require disclosure related to management's role in assessing and managing the company's material climate-related risks. In describing management's role in assessing and managing the company's material climate-related risks, the company should address:

- whether and which management positions or committees are responsible for assessing and managing climate-related risks and the relevant expertise of such members of management in such detail as necessary to fully describe the nature of the expertise;
- the processes by which such positions or committees assess and manage (but not how they are informed about or monitor) climate-related risks; and
- whether (but not how frequently) such positions or committees report information about such risks to the board or a board committee or subcommittee.

Climate-Related Risk Management

The final rules require disclosure describing any processes companies have for identifying, assessing and managing material climate-related risks. The adopting release identifies the following factors that a company could consider for inclusion in the description of its processes:

- how it determines the relative significance of climate-related risks compared to other risks;
- how it considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks;
- how it considers shifts in customer or counterparty preferences, technological changes or changes in market prices in assessing potential transition risks; and
- how it determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk.

In terms of processes for identifying climate-related risks, a company will have to disclose: how it identifies whether it has incurred or is reasonably likely to incur a material, physical or transition risk; how it decides whether to mitigate, accept or adapt to a particular risk; and how it prioritizes whether to address climate-related risks.

If a company is managing material climate-related risk, it must disclose whether and how any of the processes it has described for identifying, assessing, and managing the material climate-related risk have been integrated into the company's overall risk management system or processes. The final rules do not require a company to identify whether it has a separate board or management committee responsible for assessing and managing climate-related risks. In

practice, any company that has any such committee will likely disclose the role it plays in the risk management processes.

If a company has not identified a material climate-related risk, no disclosure about climate-related risk management is required.

Targets and Goals

The final rules require companies to disclose climate-related targets or goals only if they have materially affected or are reasonably likely to materially affect their business, results of operations or financial condition. Disclosure must include any additional information necessary to understand the actual or reasonably likely material impact of the target or goal, which may include:

- the scope of activities included in the target;
- the unit of measurement;
- the defined time horizon by which the target is intended to be achieved, and whether the time horizon is based on one or more goals established by a climate-related treaty, law, regulation, policy or organization;
- if the company has established a baseline for the target or goal, the defined baseline time period and the means by which progress will be tracked; and
- a qualitative description of how the company intends to meet its climate-related targets or goals.

Companies that must disclose targets or goals are also required to disclose on an annual basis relevant data on the progress made toward meeting the relevant target or goal and how such progress has been achieved during such fiscal year, including disclosure of any material impacts to their business, results of operations or financial condition as a direct result of the target or goal or the actions taken to make progress toward meeting the target or goal; and quantitative and qualitative disclosure of any material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal.

In addition, if carbon offsets or renewable energy credits/certificates (RECs) have been used as a material component of a company's plans to achieve climate-related targets or goals, the company must separately disclose the amount of carbon avoidance, reduction or removal represented by the offsets or the amount of generated renewable energy represented by the RECs, the nature and source of the offsets or RECs, a description and location of the underlying projects, any registries or other authentication of the offsets or RECs and the cost of the offsets or RECs.

GHG Emissions Metrics and Attestation

The final rules contain significantly scaled-back requirements for the disclosure of GHG emissions metrics and related attestation reports.

GHG Emissions Disclosure Requirements. Instead of requiring the disclosure of Scope 1 and Scope 2 emissions by all companies regardless of their materiality, as originally proposed, the final rules require such disclosures only to the extent either or both of such categories of emissions are material to the company, and only if the company is a large accelerated filer or accelerated filer and not a SRC or EGC.

In one of the most significant departures from the proposed rules, the final rules do not require any disclosure on Scope 3 emissions (i.e., emissions that typically result from the activities of third parties in the company's value chain).

The SEC has defined Scope 1 and Scope 2 emissions in a manner substantially similar to the corresponding definitions provided by the Greenhouse Gas Protocol:

- "Scope 1 emissions" are direct GHG emissions from operations that are owned or controlled by a company.
- "Scope 2 emissions" are indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a company.

When evaluating whether any GHG emissions are material, companies should rely on traditional notions of quantitative and qualitative materiality.

Presentation of GHG Emissions Metrics, Methodologies and Assumptions. Large accelerated filers and accelerated filers with material Scope 1 or Scope 2 emissions are required to comply with the following GHG emissions disclosure requirements, among others:

- *Aggregated disclosure*. The disclosure of any described scope of emissions is required to be expressed in the aggregate in terms of carbon dioxide equivalent (CO2e). If any constituent gas of the disclosed emissions is individually material, the company must also disclose such constituent gas disaggregated from the other gases.
- *Disclosure in gross terms*. Companies will need to exclude the impact of any purchased or generated offsets when calculating Scope 1 and 2 emissions.
- *Description of methodology, significant inputs, and significant assumptions used to calculate the GHG emissions*. Companies will need to describe the methodology, significant inputs, and significant assumptions used to calculate the disclosed GHG emissions, in a manner that best fits with each company's particular facts and circumstances. When providing this description, companies will need to disclose:
    - the organizational boundaries used when calculating Scope 1 or Scope 2 emissions, including the method used to determine these boundaries;
    - if the organizational boundaries materially differ from the scope of entities and operations included in the company's consolidated financial statements, a brief explanation of this difference;
    - a brief discussion of the operational boundaries used, including the approach to categorization of emissions and emissions sources; and
    - a brief description of the protocol or standard used to report the GHG emissions, including the calculation approach, the type and source of any emission factors used, and any calculation tools used to calculate the GHG emissions.
- *Use of reasonable estimates*. A company may use reasonable estimates when disclosing its GHG emissions as long as it also describes the assumptions underlying, and its reasons for using, the estimates.

Unlike the proposed rules, which would have required companies to disclose their GHG emissions in both absolute terms and in terms of intensity, the final rules do not require intensity disclosure.

Timeline for Reporting GHG Emissions Metrics. To the extent Scope 1 or Scope 2 emissions are determined to be material, large accelerated filers and accelerated filers will be required to disclose such emissions for their most recently completed fiscal year, and, to the extent previously disclosed in a SEC filing, for the historical fiscal year(s) included in the consolidated financial statements in the filing.

GHG emissions metrics required to be disclosed in an annual report on Form 10-K may be forward incorporated by reference to the company's Form 10-Q for the second fiscal quarter in the fiscal year immediately following the year to which the GHG emissions metrics disclosure relates, or may be included in an amended annual report on Form 10-K no later than the due date for such Form 10-Q. Foreign private issuers (FPIs) that are required to disclose applicable GHG

emissions metrics in their annual report on Form 20-F may elect to do so in an amendment to the Form 20-F, which will be due no later than 225 days after the end of the fiscal year to which the GHG emissions metrics disclosure relates.

Attestation Requirement. Accelerated filers and large accelerated filers, including FPIs, that are required to provide Scope 1 or Scope 2 emissions disclosure under the final rules must include, in the filing that contains the GHG emissions disclosure to which the report and disclosure relate, an attestation report covering such disclosure in the relevant filing, as follows:

- *Accelerated filers*. Attestation reports will need to provide "limited assurance" beginning with the fiscal year beginning in 2031 and will not be required to scale-up to "reasonable assurance."
- *Large accelerated filers*. Attestation reports will need to provide (i) "limited assurance," beginning with the fiscal year beginning in 2029, and (ii) "reasonable assurance" beginning with the fiscal year beginning in 2033.

The final rules prescribe the following minimum requirements for the GHG emissions attestation provider and for the engagement itself:

- *Report standards*. The SEC chose not to provide a definition of "limited assurance" and "reasonable assurance" in the final rules. Instead, the final rules provide that any attestation report must be provided pursuant to standards that are publicly available at no cost or that are widely used for GHG emissions assurance, and established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment.
- *Report requirements*. The final rules require the form and content of the GHG emissions attestation report to follow the requirements set forth by the attestation standard or standards used by the GHG emissions attestation provider.
- *Attestation provider*. The final rules require that the GHG emissions attestation report be prepared and signed by a GHG emissions attestation provider, which shall be a person that is an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting or attesting to GHG emissions, and is independent with respect to the company and any of its affiliates, for whom it is providing the attestation report, during the attestation and professional engagement period.

The SEC clarified that the final rules apply on a prospective basis only, with disclosure for historical periods phasing in over time. Specifically, in the first year that a large accelerated filer or an accelerated filer is required to provide an attestation report, such report is only required to cover the Scope 1 or Scope 2 emissions for its most recently completed fiscal year. To the extent the company disclosed such emissions for a historical period, it would not be required to obtain an assurance report covering such historical period in the first year of the attestation rule's applicability.

In addition to including the GHG emissions attestation report as described above, the company must disclose, alongside the GHG emissions disclosure to which the attestation report relates: (i) whether the GHG emissions attestation provider is subject to any oversight inspection program, and if so, whether the GHG emissions attestation engagement is included within the scope of authority of such oversight inspection program, and (ii) whether any GHG emissions attestation provider that was previously engaged to provide attestation over the company's GHG emissions disclosure for the fiscal year period covered by the attestation report resigned (or indicated that it declined to stand for re-appointment after the completion of the attestation engagement) or was dismissed, and if so, certain information about the circumstances.

“Expert” Liability of Attestation Providers. The final rules adopted a bifurcated approach by exempting the GHG emissions attestation providers that perform limited assurance engagements from liability under section 11 of the Securities Act and the consent requirements associated with expertized reports, and requiring consent with corresponding section 11 liability only with respect to the heightened level of review associated with reasonable assurance.

Placement of New Disclosures

Companies may elect to place most of the new Regulation S-K subpart 1500 disclosures in a separately captioned “Climate-Related Disclosure” section. Alternatively, companies may elect to include these climate-related disclosures in applicable, currently existing, parts of the registration statement or annual report (e.g., Risk Factors, Description of Business, or MD&A). The adopting release notes that if a company chooses the latter alternative, it should consider whether cross-referencing the other disclosures in the separately captioned section would enhance the presentation of the climate-related disclosures for investors.

Safe Harbor for Forward-Looking Statements

The final rules provide that forward-looking statements regarding transition plans, scenario analysis, internal carbon pricing and targets and goals will constitute “forward-looking statements” for purposes of the safe harbor under the Private Securities Litigation Reform Act (PSLRA), and extend the safe harbor to such statements made in the context of certain transactions to which the PSLRA does not apply, including initial public offerings (IPOs). Consistent with the PSLRA, the safe harbor is not available for forward-looking statements made in consolidated financial statements or incorporated by reference therefrom, and there is no safe harbor for statements consisting solely of historical fact. As a reminder, the PSLRA safe harbor provides some protection against private securities litigation, but does not shield forward-looking statements from SEC scrutiny.

NEW FINANCIAL STATEMENT DISCLOSURES

The final rules add a new Article 14 to Regulation S-X that will require companies to disclose certain financial statement effects in a note to their audited financial statements whenever such financial statements are required to be included in a filing that also requires the climate risk-related disclosures under the new Subpart 1500 of Regulation S-K. The final rules on financial statement disclosures have been significantly narrowed in scope from the proposed rules in response to comments raising significant concerns regarding the resulting compliance burden for companies.

Expenditure Effects

As described in greater detail below, the final rules require companies to disclose (i) capitalized costs, expenditures expensed, charges and losses incurred as a result of severe weather events and other natural conditions and (ii) capitalized costs, expenditures expensed, and losses related to carbon offsets and RECs, each subject to specified thresholds.

The SEC noted that the capitalized costs, expenditures expensed, charges and losses that will be required to be disclosed are already captured in a company’s income statement or balance sheet. Therefore, in complying with the new disclosure requirements, a company would only need to disaggregate the amounts already recognized in its financial statements. We expect that this may result in significant effort by companies to enable this disaggregation.

Severe Weather Events and Other Natural Conditions. The final rules do not offer a definition of “severe weather events and other natural conditions,” so it is up to companies to determine what constitutes an event or condition that triggers this financial statement disclosure. Unlike materiality determinations with which companies are familiar from other contexts, this requires a new severity determination. According to the SEC, companies will have “flexibility” in

making this severity determination based on the particular risks faced by the company, taking into consideration its geographic location, historical experience and the financial impact on the company. As an example of the relevance of historical experience, the SEC suggests that, in determining whether high temperatures constitute a severe natural condition, companies may want to consider average seasonal temperatures.

The adopting release identifies that financial impact on the company is one of the factors to be considered in the severity determination. This suggests that a weather event, even though extreme by historical standards, may not count as "severe" if its financial impact on the company, though measurable, has been minor. Conversely, it implies that a weather event that is only slightly out of the norm from a historical trend perspective may nonetheless qualify as "severe" if it caused the company significant economic harm.

While the final rules do not include a definition of disclosure-triggering severe weather events and other natural conditions, they do contain a non-exhaustive list of examples: hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures and sea level rise. Although the release is silent on this point, the better view appears to be that these events and conditions are not, per se, severe, and would thus not automatically trigger the corresponding financial statement analysis whenever they occur and affect the company. Instead, companies will need to determine, for example, whether a hurricane, tornado, flood or wildfire that damaged a company facility was in fact severe, or perhaps consistent with the historical experience in the area.

Under the final rules, a company does not need to determine that any such severe weather event or other natural condition was caused by climate change. In fact, the SEC even went so far as to state that the "severe natural conditions" that trigger the corresponding financial statement disclosure need not be climate-related at all, and may therefore include non-climate-related occurrences, such as earthquakes.

Disclosure Thresholds. Financial statement disclosures related to severe weather events and other natural conditions will only be required if the resulting financial statement effect meets a one-percent threshold, as further described below. In particular, a company must disclose:

- *Expensed Costs.* Expenditures expensed as incurred and losses, excluding recoveries, incurred during the fiscal year as a result of such events or conditions if the aggregate amount of such expenditures and losses equals or exceeds one percent (1%) of the absolute value of income or loss before income tax expense or benefit for the relevant fiscal year, unless the aggregate amount of such expenditures and losses is less than $100,000 for the relevant fiscal year.
- *Capitalized Costs*. Capitalized costs and charges, excluding recoveries, incurred during the fiscal year as a result of such events or conditions if the aggregate amount of the absolute value of such capitalized costs and charges recognized equals or exceeds one percent (1%) of the absolute value of stockholders' equity or deficit at the end of the relevant fiscal year, unless the aggregate amount of the absolute value of such capitalized costs and charges is less than $500,000 for the relevant fiscal year.

Attribution Principle. The final rules require a company to attribute a cost, expenditure, charge, loss, or recovery to a severe weather event or other natural condition and disclose the entire amount whenever the event or condition is a "significant contributing factor" in the incurrence, but not when the event or condition was only a minor factor. According to the SEC, the widespread use of the concept of significance in U.S. GAAP should help facilitate its application in this attribution context.

Recoveries. In addition, the final rules provide that, if a company is required to disclose capitalized costs, expenditures expensed, charges or losses incurred as a result of severe weather events and other natural conditions, then it must separately disclose, as part of the contextual information described below, the aggregate amount of any recoveries recognized during the fiscal year as a result of the severe weather events and other natural conditions for which capitalized costs, expenditures expensed, charges or losses are disclosed, such as any receipt of insurance proceeds.

Presentation. In presenting the disclosure, a company must separately aggregate the (1) capitalized costs and charges on the balance sheet, and (2) expenditures expensed as incurred and losses in the income statement. If the applicable disclosure threshold is met, a company is required to disclose the aggregate amount of expenditures expensed and losses and the aggregate amount of capitalized costs and charges incurred during the fiscal year and separately identify where on the income statement and balance sheet these amounts are presented. The final rules do not require the disclosure of any impacts on the statement of cash flows.

Disclosures Related to Carbon Offsets and RECs. If carbon offsets or RECs have been used as a material component of a company's plan to achieve its disclosed climate-related targets or goals, the final rules require the company to disclose the aggregate amount of carbon offsets and RECs expensed, the aggregate amount of capitalized carbon offsets and RECs recognized and the aggregate amount of losses from carbon offsets and RECs, during the fiscal year. Companies must then also separately disclose the beginning and ending balances of capitalized carbon offsets and RECs on the balance sheet for the fiscal year, and where on the balance sheet and the income statement the capitalized costs, expenditures expensed and losses related to carbon offsets and RECs are presented. In addition, companies that are required to provide this information must also state their accounting policy for carbon offsets and RECs as part of the contextual information described below.

Financial Estimates and Assumptions

The final rules require companies to disclose whether the estimates and assumptions the company used to prepare its consolidated financial statements were materially impacted by exposures to risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions, or any climate-related targets or transition plans disclosed by the company. If so, the company must provide a qualitative description of how the development of such estimates and assumptions were impacted by such events, conditions, targets, or transition plans.

Contextual Information and Basis of Calculation

Under the final rules, a company must provide certain types of contextual information to enhance understanding of the financial statement disclosures. In particular, companies must describe how each specified financial statement effect was derived (including significant inputs and assumptions used, significant judgments made and other information that is important to understand the financial statement effect) and, if applicable, policy decisions made by the company to calculate the specified disclosures.

Periods Covered

Companies must include the required financial statement disclosures for the most recently completed fiscal year and, to the extent previously disclosed or required to be disclosed, for any historical fiscal years, for which audited consolidated financial statements are included in the filing.

Inclusion of Disclosures in the Financial Statements

While many commenters asserted that the required financial disclosures should instead be presented in MD&A or in the new climate-related discussion section, the final rules adopted by the SEC maintain the proposed requirement that the financial statement effects be presented in a note to the financial statements. This inclusion makes such disclosures

subject to the company's financial statement audit and ICFR, and the SEC resisted calls for any exemptions in this regard.

AFFECTED COMPANIES AND FORMS

All domestic and foreign registrants, other than Canadian issuers that use MJDS and file their annual reports on Form 40-F, must provide the climate-related disclosures required under the final rules, subject to the compliance phase-in schedule described below. Non-accelerated filers, SRCs and EGCs are exempt from the Scope 1 and Scope 2 GHG emissions and attestation disclosure requirements but must provide all other disclosures. The SEC declined to adopt an exemption or transition rule for companies conducting an IPO.

Domestic issuers must provide the required climate-related disclosures in their annual reports filed on Form 10-K as well as registration statements on Form 10 and Forms SA S-4 (except with respect to parties to the business combination transaction that are not SEC reporting companies) and S-11, as applicable. FPIs (other than Canadian MJDS issuers) must provide the required disclosures in their annual reports or registration statements filed on Form 20-F as well as registration statements on Form F-1 and F-4 (subject to the same exception for non-SEC reporting companies as Form S¬4). Registrants may incorporate by reference the climate-related disclosures to the extent they are permitted to do so under the applicable SEC form.

Unlike the proposed rules, the final rules do not require registrants to disclose any material change to the climate-related disclosures provided in a registration statement or annual report in interim reports on Form 10-Q or Form 6-K.

FILED, NOT FURNISHED

The climate-related disclosures provided pursuant to the final rules will be treated as "filed," and not "furnished." Accordingly, such disclosures will be subject to the same liability as other business or financial information that a company includes in its periodic reports and registration statements, including potential liability pursuant to Exchange Act Section 18 and Securities Act Section 11 (if climate-related disclosures are included in, or incorporated by reference into, a Securities Act registration statement).

STRUCTURED DATA REQUIREMENT

The final rules require registrants to tag climate-related disclosures in Inline eXtensible Business Reporting Language (Inline XBRL), including block text tagging and detail tagging of narrative and quantitative disclosures. Large accelerated filers will be required to comply with such tagging requirements for all disclosures beginning one year after initial compliance with the disclosure requirements. Other categories of filers will be required to comply with such tagging requirements upon their initial compliance with Subpart 1500 of Regulation S-K.

COMPLIANCE DATES

The final rules will become effective 60 days following the publication of the adopting release in the Federal Register. Normally, we would expect this publication to occur over the course of the next few weeks, but the legal actions related to this rule may impact the timing of publication and, ultimately, the effective date of the rule.

The SEC established multiple phase-in compliance dates depending on filing status and disclosure content. Disclosures may be voluntarily provided prospectively upon adoption of the final rules. Otherwise, large accelerated filers are first required to begin making certain disclosures for fiscal years beginning in 2025, and other filers' mandatory requirements will be phased-in (see table below).

The compliance dates apply to both annual reports and registration statements; provided, that in the case of registration statements, compliance is required when audited financial statements for the fiscal year noted in the table below are required in such registration statement.

<table>
<tr><th>FILER TYPE</th><th>ALL DISCLOSURES NOT SEPARATELY NOTED BELOW</th></tr>
<tr><td>Large accelerated filers</td><td>Fiscal year beginning in 2025</td></tr>
<tr><td>Accelerated filers (other than SRCs and EGCs)</td><td>Fiscal year beginning in 2026</td></tr>
<tr><td>Non-accelerated filers</td><td rowspan="3">Fiscal year beginning in 2027</td></tr>
<tr><td>Smaller reporting companies</td></tr>
<tr><td>Emerging growth companies</td></tr>
</table>

<table>
<tr><th>FILER TYPE</th><th>MATERIAL EXPENDITURES AND IMPACTS ON FINANCIAL ESTIMATES AND ASSUMPTIONS FROM MITIGATION OR ADAPTATION ACTIVITIES, TRANSITION PLANS AND TARGETS OR GOALS</th></tr>
<tr><td>Large accelerated filers</td><td>Fiscal year beginning in 2026</td></tr>
<tr><td>Accelerated filers (other than SRCs and EGCs)</td><td>Fiscal year beginning in 2027</td></tr>
<tr><td>Non-accelerated filers</td><td rowspan="3">Fiscal year beginning in 2028</td></tr>
<tr><td>Smaller reporting companies</td></tr>
<tr><td>Emerging growth companies</td></tr>
</table>

<table>
<tr><th>FILER TYPE</th><th>SCOPE 1 AND 2 GHG EMISSIONS</th><th>LIMITED ASSURANCE</th><th>REASONABLE ASSURANCE</th></tr>
<tr><td>Large accelerated filers</td><td>Fiscal year beginning in 2026</td><td>Fiscal year beginning in 2029</td><td>Fiscal year beginning in 2033</td></tr>
<tr><td>Accelerated filers (other than SRCs and EGCs)</td><td>Fiscal year beginning in 2028</td><td>Fiscal year beginning in 2031</td><td>Exempted</td></tr>
<tr><td>Non-accelerated filers</td><td rowspan="3">Exempted</td><td rowspan="3">Exempted</td><td rowspan="3">Exempted</td></tr>
<tr><td>Smaller reporting companies</td></tr>
<tr><td>Emerging growth companies</td></tr>
</table>

FILER TYPE	INLINE XBRL TAGGING FOR SUBPART 1500 OF REG. S-K[1]
Large accelerated filers	Fiscal year beginning in 2026
Accelerated filers (other than SRCs and EGCs)	
Non-accelerated filers	Fiscal year beginning in 2027
Smaller reporting companies	
Emerging growth companies	

[1] Financial statement disclosures under Article 14 of Reg. S-X will be required to be tagged in accordance with existing rules pertaining to the tagging of financial statements.

The final rules do not provide guidance on how the phased-in compliance timelines would be affected in the event a company's filer status changes. Conceivably, since filer status is affected by changes in market value on an annual basis, a company could begin preparing for the disclosure requirements with one timeline in mind based on then-current status and be required to substantially accelerate the timeline based on a subsequent change in status. This may present difficult challenges for companies as they begin to plan for the new disclosures if they anticipate significant stock price appreciation or expect to emerge from EGC status.

WHAT SHOULD COMPANIES BE DOING NOW?

In preparation for the effectiveness of the final rules and the related disclosure requirements, many of which will cover fiscal years beginning in 2025, companies can start taking concrete steps.

Assemble Task Force. Companies should consider assembling a task force or steering committee to evaluate the new disclosure requirements, clarify applicability, assign tasks and lay out implementation and compliance calendars. The compliance and disclosure plan should be integrated with a company's disclosure controls and procedures and internal control over financial reporting processes.

Evaluate Current Processes. Part of a company's evaluation should be a comprehensive assessment of current climate-related risk management processes, commitments and disclosures to ensure that the reporting and compliance effort is consistent throughout the organization. Where the company has existing climate-related targets or goals, whether or not currently disclosed, it should assess the materiality of any actual or reasonably likely impacts of such targets or goals to enable evaluation of the direct results of such targets and goals and the implications for disclosure, including material expenditures and impacts on financial estimates and assumptions. Where a company uses scenario analysis to evaluate climate change risks, it should consider the nature of any disclosures about such analysis that may be required.

Factor in Public Perception. In preparation for the spotlight that the final rules will place on a company's processes for assessing and overseeing climate-related risks, companies and their boards should evaluate existing structures and processes not just from a disclosure controls perspective but also from the viewpoint of how they may be perceived under the new disclosure framework and determine if changes are desirable. While many companies already include disclosures related to climate-related risk oversight and the role of the board or a board committee in such oversight, companies will want to consider peer and best practices and, where necessary, enhance their existing practices and policies with a view to annual public disclosure in future SEC filings.

Plan Information Collection About Third Parties. Companies should consider how to collect information about material impacts of climate-related risks on the company's suppliers, purchasers and counterparties to material contracts. While the SEC narrowed the required disclosure to information that is "known or reasonably available," the rule still implies an obligation to conduct a reasonable investigation and potentially to request information from third parties.

Update ICFR. In preparation for the new financial statement disclosures, companies will need to design, implement and test appropriate controls to capture the relevant information and prepare the corresponding note. For example, companies should be prepared to identify "severe weather events and other natural conditions" and track related expenditures and other items that will need to be disclosed under new Article 14 of Regulation S-X. These processes should be integrated with the company's other internal control over financial reporting.

Conduct Materiality Analysis of GHG Emissions. Companies, especially those in industries without significant GHG emissions or dependencies on others with such emissions, will need to commence an evaluation of the materiality of their emissions to determine whether Scope 1 or Scope 2 emissions data is required at all. Such evaluation should be conducted on the basis of traditional notions of materiality taking into account both quantitative and qualitative factors. Companies that have material Scope 1 or Scope 2 emissions data and do not currently report such data will have to put in place processes to track and verify such information in advance of the new disclosure requirement.

Monitor Filer Status. Companies that currently qualify as something other than large accelerated filers may want to consider the implications of potential changes in their reporting status in developing a compliance calendar and plan. Companies should plan for contingencies like losing smaller reporting company or emerging growth company status or for float increases that might push the company into accelerated filer or large accelerated filer status or make them lose SRC or EGC status.

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