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March 18, 2024

The SEC's Climate Disclosure Rule Has Arrived: Scope 3 Is Out—But What Is In?



After nearly two years of public comments and deliberation, the U.S. Securities and Exchange Commission (SEC) adopted a [Final Rule on Mandatory Climate Disclosures](#) (Final Rule).

While less sweeping than initially proposed, the Final Rule sets detailed and wide-ranging climate-related requirements for publicly traded companies in a document that spans 886 pages. Most notably, the Final Rule requires companies to report certain greenhouse gas (GHG) emissions and material climate impact information in their registration statements and annual reports. Those requirements do not, however, include reporting of Scope 3 emissions occurring in the upstream and downstream activities of a company's value chain.

**March 25, 2024 UPDATE:** Multiple federal lawsuits have been filed throughout the United States challenging the Final Rule, with some public companies and state attorneys general raising arguments that the rule exceeds the SEC's authority, and the Sierra Club and the Natural Resources Defense Council (NRDC) arguing that the rule did not go far enough. On March 19, 2024, the SEC requested consolidation from the U.S. Judicial Panel on Multidistrict Litigation. On Thursday, March 21, 2024, the Panel consolidated the nine lawsuits and assigned the consolidated case by lottery to the U.S. Court of Appeals for the Eighth Circuit. The Final Rule remains temporarily stayed. No timeline or briefing schedule has yet been publicly announced for deciding the issues raised.

**April 5, 2024 UPDATE:** After consolidation in the Eighth Circuit, several parties filed for an emergency order preventing the Final Rule from going into effect during the course of the litigation. In an effort to speed up the litigation, the SEC announced on April 4, 2024, that it is voluntarily delaying the implementation of the Final Rule. The SEC believes that the Final Rule is a lawful exercise of its regulatory authority, but a voluntary stay will allow the consolidated cases to focus on the merits of the appeal and avoid regulatory uncertainty in the meantime.

The Final Rule is intended to enhance and standardize climate-related disclosures for investors who are increasingly interested in climate-related risks that can affect a company's business and its long-term financial position. Building on the Task Force on Climate-Related Financial Disclosure's (TCDF) framework and the [GHG Protocol](#), the Final Rule is the result of the SEC's efforts to create a consistent climate-reporting framework for all publicly traded companies, with many new disclosures aligning with the TCDF's recommendations on governance, risk management, strategy, and metrics.

On Friday, March 15, the U.S. Court of Appeals for the Fifth Circuit issued a one-sentence temporary stay on the Final Rule's implementation. The administrative stay does temporarily halt implementation of the rule but is not the final word on the rule's legality. Additional litigation is also pending in numerous other circuit courts of appeal, including litigation arguing that the Final Rule did not go far enough, and we anticipate that these various challenges will be consolidated. We will monitor developments and provide further updates in the weeks ahead.

This Update addresses the key takeaways, the disclosure requirements, the phase-in periods for compliance, and implications for companies affected by the Final Rule moving forward.

## Key Takeaways

- Scope 1 and Scope 2 GHG emissions will be required disclosures only for large accelerated filers (LAFs) and accelerated filers (AFs) and only *when the emissions are deemed material*.
- Smaller reporting companies (SRCs), emerging growth companies (EGCs), and nonaccelerated filers are exempt from the GHG emission disclosure requirements.
- The Final Rule lengthened the phased-in timeline for adoption based on the type of filer, with extended phase-in periods for (1) disclosures that are expected to require companies to implement more extensive new internal reporting systems and disclosure controls and (2) GHG emissions disclosures and related assurance.
- Financial statement footnote disclosure will be required for certain expenditures and capitalized costs resulting from severe weather events and other natural conditions, carbon offsets and renewable energy credits (RECs) expensed, and the impact of severe weather events and other natural conditions on financial estimates and assumptions.
- The Final Rule provides a safe harbor to shield companies from liability for disclosures related to transition plans, scenario analysis, internal carbon pricing, and targets and goals.
- Numerous legal challenges have already been filed, and the Fifth Circuit issued a temporary stay on implementation of the Final Rule pending more thorough litigation of the issues. This litigation will play out in the months ahead, including potential consolidation of cases and potential Supreme Court review.
- Adoption of the Final Rule signals the SEC's continued prioritization of providing material climate-related information to investors and other stakeholders, and while the SEC is less likely to scrutinize good faith implementation in the short term, it will likely look to make examples of public companies that fail to reasonably implement the rule or ignore obvious climate-related risks in required disclosures.

## What Are the New Requirements?

The Final Rule amends Regulation S-K and Regulation S-X to require several new disclosures. The table below highlights some of the new disclosure requirements, which are described in greater detail in subsequent sections of this Update.

## Regulation S-K

Items 1500-1506—Quantitative and qualitative disclosures in periodic filings

- **GHG emissions.** For LAFs and AFs, Scope 1 and 2 emissions, if material; attestation reports to be filed with emissions disclosures on a phased-in basis.
- **Governance.** Board's oversight of and management's role in assessing and managing climate-related risks.
- **Strategy, business model, outlook.** Climate-related risks that have materially affected or are reasonably likely to have a material impact on the company.
- **Material expenditures and impacts.** Material expenditures incurred and material impacts on financial estimates from activities to mitigate/adapt to climate-related risks.
- **Risk management.**
  - Processes for identifying, assessing, and managing material climate-related risks.
  - Plans to mitigate transition risks, including how such plans impact the company's business and related material expenditures.
- **Targets and goals.** Material climate-related targets and goals (including GHG emissions reduction targets).

## Regulation S-X

Articles 8, 14—Disclosures in footnotes of financial statements

- **Severe weather and other natural conditions.**
  - The aggregate expenditures incurred and losses, if the amount equals or exceeds 1% of the absolute value of income or loss in a relevant fiscal year, unless the value is less than \$100,000.
  - The aggregate capitalized costs and charges, if the amount equals or exceeds 1% of the absolute value of stockholders' equity or deficit at the end of the relevant fiscal year, unless the value is less than \$500,000.
- **Carbon offsets and Renewable Energy Certificates (RECs).** The aggregate amount of carbon offsets and RECs expensed, if material to the company's plans to achieve disclosed climate-related goals.
- **Estimates and assumptions.** Financial estimates and assumptions materially affected by severe weather events, other natural conditions, or any disclosed targets or transition plans.

In addition to the table above, the Final Rule also requires companies to electronically tag climate-related disclosures in [Inline XBRL](#).

Despite the long list of new disclosures, it should be noted that the Final Rule extends the Private Securities Litigation Reform Act's (PSLRA) safe harbor for forward-looking statements so that companies will be protected from liability for disclosures of transition plans, scenario analysis, internal carbon pricing, and targets and goals.

### What Are Material Climate-Related Risks?

The Final Rule requires companies to disclose *material* climate-related risks on a company's business and consolidated financial statements in the short term (the next 12 months) and in the long term (beyond the next 12 months). Companies must provide information necessary to give investors an understanding of the nature of the risk and the extent of the company's exposure to the risk.

The Final Rule defines "climate-related risks" as the actual or potential negative impacts of climate-related conditions and events on a company's business, results of operations, or financial conditions. Climate-related

risks include both "physical risks"—extreme weather events that may affect business—and "transition risks"—negative effects attributable to regulatory, technological, and market changes that occur to mitigate or adapt to climate-related risks. Physical risks may be "acute risks," such as hurricanes, tornadoes, floods, and heatwaves, or "chronic risks," such as rising temperatures, sea levels, wildfire risks, or drought. Transition risks represent costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products, the risk of climate-related legal liability, or changes in consumer behavior.

## Climate-Related Risks

### Transition Risks

*Actual or potential negative impacts on a company's business, results of operations, or financial condition*

#### Regulatory

- Pricing of GHG emissions
- Exposure to litigation

#### Market

- Changing customer behavior
- Increased cost of raw materials

### Physical Risks

*Extreme weather events or natural conditions that may pose risks to a company's business operations*

#### Acute

- Increased severity of extreme weather events
- Hurricanes, tornadoes, floods, heatwaves

#### Technological

- Investment in new technologies
- Costs of transitioning to lower-emissions tech

#### Reputation

- Shifts in consumer preferences
- Stigmatization of industry

#### Chronic

- Rising temperatures
- Rising sea levels
- Wildfire risks
- Drought

*Source credit: Adapted from I4CE, TCDF, Recommendations of the Task Force on Climate-Related Financial Disclosures (2016).*

The Final Rule's definition of materiality is consistent with the definition established by the U.S. Supreme Court. Namely, a matter is material if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available. The Final Rule provides flexibility and emphasizes that materiality is based on facts and circumstances and takes into account qualitative and quantitative factors.

## Impacts of Climate-Related Risks on Companies' Strategy, Business Model, and Outlook

After identifying climate-related risks, the Final Rule requires companies to identify the actual and potential effects of those risks on a company's strategy, business model, and outlook. The Final Rule added an explicit materiality qualifier to clarify that a company is only required to disclose *material* impacts of identifiable climate-related risks. Companies must also discuss whether these impacts have been integrated into the company's business model or strategy, including whether and how resources are being used to mitigate climate-related risks.

In response to comments, the SEC amended certain proposed requirements to avoid a potential chilling effect on climate-related planning and action. For example, the Final Rule has removed references to a company's value chain as a required disclosure, replacing it with a reference to "suppliers, purchasers, or counterparties to

material contracts, to the extent known or reasonably available." The Final Rule also requires a company to provide information on any transition plans the company has adopted to manage a material transition risk, including the relevant metrics and targets used to identify and manage any physical and transition risks. As noted above, transition plan disclosure will be subject to a safe harbor.

### **Board Governance and Oversight**

The Final Rule also requires a description of a board of directors' oversight, assessment, and management of material climate-related risks. It will require the identification, if applicable, of any board committee or subcommittee responsible for the oversight of climate-related risks and a description of the processes used to inform that body of those risks. Additionally, if a respondent discloses a target, goal, or transition plan related to climate-related risk, the Final Rule requires disclosure of how the board oversees progress towards that goal.

The Final Rule requires a description of management's role in assessing and managing these risks as well. Companies must name the management members responsible for assessing and managing climate-related risks and describe the relevant expertise of those decision-makers.

The Final Rule reduced and eliminated many of the strictest proposed requirements in this category. For example, it eliminated requirements for companies to disclose the identity of board members responsible for climate-related risk oversight, the expertise of board members in climate-related risks, how frequently the board is informed of risks, and information regarding how the board sets climate-related goals. Instead, the SEC chose to focus on information that will facilitate investor understanding of how a company manages climate-related risk without requiring excess information about the internal mechanisms of a board of directors.

### **Risk Management Disclosure**

In line with other sections of the Final Rule, the SEC tacked on a materiality qualifier to required risk management disclosures and removed many of the proposed rule's prescriptive disclosure requirements. Now, the Final Rule requires a description of a company's processes for identifying, prioritizing, assessing, and managing *material* climate-related risks and whether such processes are integrated into a company's overall risk management system or processes. This includes disclosure of how a company identifies whether it has incurred or is reasonably likely to incur climate-related risks and how it makes determinations whether to mitigate, accept, or adapt to particular risks.

Notably, the SEC has removed the definition and use of "climate-related opportunities" from the Final Rule. Information related to these opportunities will remain optional, treated the same as other voluntary disclosures.

### **GHG Emissions**

The Final Rule requires a company to disclose certain GHG emissions for its most recently completed fiscal year and for the historical fiscal years included in its consolidated financial statements, to the extent such data is reasonably available. Based on the GHG Protocol's emissions reporting framework, the Final Rule requires disclosure of material Scope 1 and Scope 2 emissions for LAFs and AFs that are not SRCs or EGCs. Scope 1 emissions are those emissions that directly result 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 consumed by internal operations.

In addition, LAFs and AFs will need to file attestation reports with their GHG emissions disclosures, but this requirement will be phased in. Attestation reports at a limited assurance level (i.e., negative assurance that the

attester is unaware of any material issues in the disclosure) will be required after four years. In the ninth year of compliance, LAFs—not AFs—will be required to obtain an attestation report at the reasonable assurance level (i.e., affirmative attestation that information is fairly presented in all material respects).

Importantly, the proposed rule would have required companies to provide information regarding material Scope 3 emissions, which are indirect GHG emissions occurring in the upstream and downstream of a company's value chain. The Final Rule eliminated this requirement, which would have resulted in a laborious and difficult process for companies.

### **Climate-Related Targets and Goals Disclosure**

If a company has set any climate-related targets or goals, including internal targets or goals, the Final Rule requires information on those that have materially affected or are reasonably likely to materially affect a company's business, results of operations, or financial condition. Disclosures include detailed information regarding how a company intends to meet a target or goal and progress toward meeting that target or goal. As applicable, this includes descriptions of:

- Scope of activities encompassed by the target or goal and envisioned timeline.
- Unit of measurement and baseline against which progress will be tracked.
- Use of carbon offsets or RECs, if they are a material component of the plan to achieve climate-related targets or goals.

The Final Rule also requires information on the quantitative and qualitative disclosure of any material expenditures and material impacts on financial estimates and assumptions as a direct result of the target goal or actions taken to make progress toward meeting the target or goal. For prospective targets and goals, disclosures need only include qualitative information.

### **Regulation S-X: Financial Statement Metrics Disclosures**

Under the Final Rule, companies will also be required to disclose certain information in footnotes to their audited financial statements. Specifically, three items will need to be addressed:

- **Severe weather events and other natural conditions.** The capitalized costs, expenditures expensed, charges, and losses incurred as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise, subject to applicable 1% and *de minimis* disclosure thresholds.
- **Carbon offsets and RECs.** If a company uses carbon offsets or renewable energy credits or certificates to achieve disclosed climate-related targets or goals, the aggregate amount expensed, aggregate capitalized amount recognized, and aggregate amount of losses incurred on capitalized carbon offsets and RECs.
- **Estimates and assumptions.** If the estimates and assumptions a company uses to produce the financial statements were materially affected by exposures to risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans, a qualitative description of how the development of such estimates and assumptions were impacted.

Importantly, these footnote disclosures will be subject to audit by the company's independent auditor—signaling that companies will need to incorporate these disclosures into their internal controls.

### **Phase-In Periods and Accommodations**

The Final Rule has extended the phase-in period for all companies with specific compliance dates dependent on a company's filer status. Five separate disclosure compliance dates are broken out by Regulation S-K and Regulation S-X filings: material expenditures and impacts (covered in Items 1502(d)(2), 1502(e)(2), and 1504(c)(2)), GHG emissions, attestation of GHG emissions, Inline XBRL tagging, and all other Regulation S-K and S-X disclosures. For example, if an LAF has a December 31 fiscal year end, the compliance date for the related disclosures would be:

- All Regulation S-K and S-X disclosures (excluding items listed below): fiscal year 2025 (filed in 2026).
- Material expenditures and impacts, GHG emissions, Inline XBRL tagging: fiscal year 2026 (filed in 2027).
- Attestation of GHG emissions: fiscal year 2029 (limited assurance, filed in 2030), fiscal year 2033 (reasonable assurance, filed in 2034).

More information on compliance dates is included in the table below.

Filer Status	Disclosure and Financial Statement		GHG Emissions/Assurance		Electronic Tagging
	<i>All Reg S-K and S-X disclosures*</i>	<i>Material expenditures and impacts</i>	<i>GHG emissions disclosures</i>	<i>Attestation of GHG emissions disclosures</i>	<i>Inline XBRL tagging</i>
LAFs	FYB** 2025	FYB 2026	FYB 2026	Limited assurance: FYB 2029; reasonable assurance: 2033	FYB 2026
AFs	FYB 2026	FYB 2027	FYB 2028	Limited assurance: FYB 2031	FYB 2026
SRCs, EGSs, and NAFs	FYB 2027	FYB 2028	Not required	Not required	FYB 2027

\*Other than material expenditures and GHG emission disclosures.

\*\*"FYB" refers to any fiscal year beginning in the calendar year listed.

## Looking Ahead

The Final Rule follows the trend of recent voluntary and mandatory climate- and environmental, social, and governance (ESG)-related disclosure requirements that have been issued or adopted in the last two years, including the IFRS® Sustainability Disclosure Standards, the EU Corporate Sustainability Reporting Directive (CSRD) and related European Sustainability Reporting Standards, and California's climate disclosure laws. Legal challenges were anticipated, and as of March 15, the Fifth Circuit issued a temporary stay on implementation of the Final Rule. That temporary stay will be more fully litigated in the weeks ahead. Litigation in multiple other jurisdictions is also pending, and we anticipate the potential for some of these challenges to be consolidated and ultimately appealed to the Supreme Court.

Although the Final Rule covers a vast number of climate-related disclosures, several items remain open. SEC Commissioner Caroline Abbey Crenshaw suggested that the SEC should issue an order recognizing other reporting frameworks that would satisfy compliance with the Final Rule. Although companies are required to



provide financial metrics on the occurrence of "natural conditions," the term was not defined in the Final Rule. With all the flexibility built into the Final Rule, there is also some uncertainty as to how the SEC will evaluate disclosures—signaling that we may be entering another "comply or explain" era.

There are plenty of details in the Final Rule calling for immediate corporate action. Of course, every company will need to evaluate whether to adjust its response strategy based upon the pending legal challenges, or to move forward recognizing the time and investment that may be needed to comply and the nature of related disclosures called for under the CSRD and elsewhere. The SEC's Division of Enforcement has signaled that it is focused on ensuring all public companies disclose material information, which includes material information about climate impacts. Moreover, the SEC's Climate and ESG Task Force, first established in 2021, has proven willing to investigate and enforce ESG-related rules in the past. For example, it has brought actions against companies for making false safety claims and misleading technology claims, and it has brought actions against investment management firms alleging that they failed to follow their own ESG policies and procedures and for misleading claims about ESG quality review processes. We anticipate that the Division of Enforcement generally, and the Climate and ESG Task Force specifically, will continue to pursue ESG- and climate-related investigations and potential enforcement actions in the months ahead. The new set of climate-related disclosure requirements included in the Final Rule will most certainly be an additional area of focus as the implementation deadlines arrive. However, the Final Rule's safe harbor, provided for forward-looking statements (involving disclosures of transition plans, scenario analysis, internal carbon pricing, and targets and goals), will provide some safety for companies as they work to implement the new requirements in the months ahead.

Considering the above, we recommend that companies evaluate how climate issues fit into their current compliance programs and reporting structures. For some companies, this may mean developing or restructuring climate-related systems, processes, and controls across many—if not all—departments. It may also mean developing additional data collection and disclosure control procedures and internal controls to address the new disclosure requirements. In addition, companies will need to assess materiality considerations that will guide the disclosures, including with respect to Scope 1 and 2 GHG emissions. What and how disclosures are made are also likely to influence how investors, key stakeholders, and consumers measure a company's commitment to sustainability in the future.

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