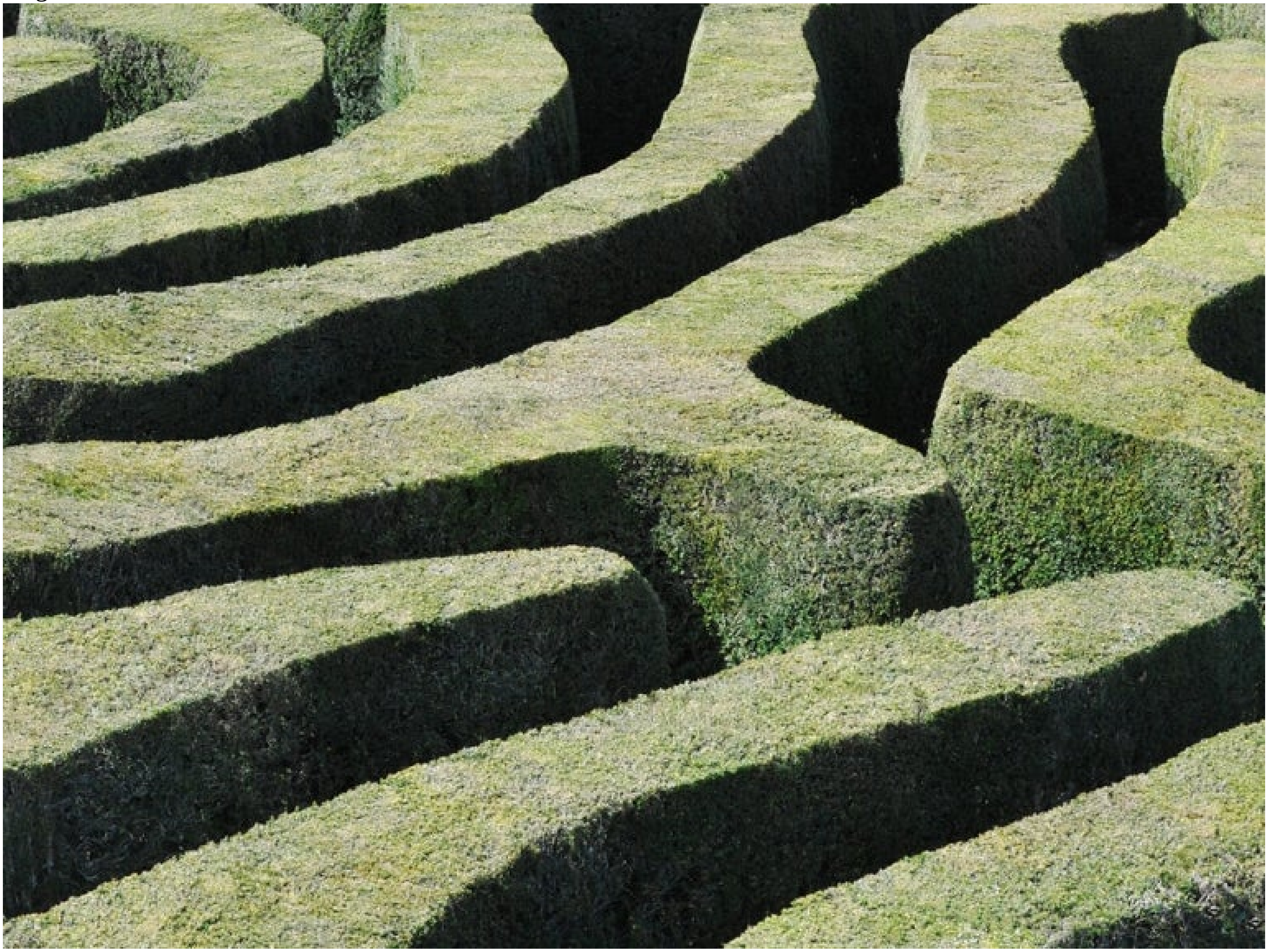
Blogs
August 09, 2024



This is another in a series of blogs we will be posting breaking down the SEC's new climate disclosure rules (here's the **last blog** we posted).

We're near the end of Regulation S-K Item 1502, Strategy. For the full text, see pages 852 through 855 of the **SEC's adopting release.** This is the section of the new rules that requires discussion of climate-related risks, including how these risks impact the business and how the company considers these risks in planning its business and strategy.

Today's blog addresses Item 1502(e), which requires a company that has adopted a transition plan to manage a material transition risk to provide certain disclosures regarding the plan. These disclosures include a description of the transition plan, annual updates regarding actions taken under the plan during the year, and quantitative and qualitative disclosure of material expenditures incurred and material impacts on financial estimates and assumptions resulting from the transition plan.

The forward-looking statement safe harbor provision in Item 1507 applies to disclosures made pursuant to Item 1502(e), except for historical facts.

Under Item 1500, "transition plan" is defined as a strategy and implementation plan to reduce climate-related risks, which may include reducing GHG emissions in line with internal commitments or commitments of a jurisdiction within which significant operations are located.

Here are seven key concepts to consider in drafting disclosure responsive to Item 1502(e):

1. **Adoption of Transition Plan Not Mandated.** Note that the SEC's rules don't mandate adopting a transition plan, as made clear on page 132 of the SEC's adopting release. If a company does not have a transition plan, no disclosure is required under this item. Nor is there any requirement that the transition plan be board-approved to be deemed captured by this subpart.

2. **Materiality Qualifier.** This subpart only requires disclosure if a company adopted a transition plan to manage a *material* transition risk.

   In addition, Item 1502(e)(2) includes further materiality qualifiers on the requirements to provide quantitative and qualitative disclosure of *material* expenditures incurred and *material* impacts on financial estimates and assumptions.

   As noted on pages 137-138 of the adopting release, companies should consider not only individual expenditures but overall expenditures related to actions taken under the plan to gauge materiality for Item 1502(e)(2). In other words, a series of immaterial expenditures can result in a company having a material overall expenditure.

3. **Flexibility of Disclosure Content.** Beyond the requirement to provide quantitative and qualitative dictates under Item 1502(e)(2), companies have considerable flexibility in what they disclose about their transition plan once the materiality threshold is triggered. Companies can consider the particular facts and circumstances of their material transition risk in crafting their disclosure.

4. **Annual Update of Transition Plan Progress.** Under Item 1502(e)(1), companies are required to update their disclosure about the transition plan each fiscal year 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. Under Item 1502(e)(2), this disclosure 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.

   The purpose of this disclosure is to allow investors to track a company's progress under a transition plan over time, including tracking the impact on a company's business, as noted on page 134 of the adopting release. This would include disclosure of progress made under each step that a company has previously disclosed as part of its transition plan.

5. **Expenditure Disclosure Different Than Item 1502(d)'s Expenditure Disclosure.** As noted on page 136 of the adopting release, Item 1502(e)(2) is different than the expenditure disclosure elicited by Item 1502(d) because Item 1502(e)(2) is limited to transition plan disclosures. As a reminder, Item 1502(d)(2)

requires quantitative and qualitative disclosure regarding material expenditures incurred and material impacts on financial estimates and assumptions that, in management's assessment, directly result from activities undertaken to mitigate or adapt to climate-related risks. If the disclosure that would be made under Item 1502(e)(2) is already covered by what a company discloses under Item 1502(d), it need not repeat the disclosure.

Also notable is that the Item 1502(e) requirement does not refer to "management's assessment" like Item 1502(d) does. That's because the SEC, as noted on page 137 of the adopting release, assumes that management will oversee actions taken under a transition plan, and therefore, these material expenditures or impacts "will have been assessed by management as being the direct result of such actions."

This distinction may not align with operational realities. While the rule and adopting release implicitly acknowledge that it may be hard to parse out which corporate actions "directly result" from activities undertaken to mitigate or adapt to climate-related risks (recognizing that many corporate actions are the result of decisions made in the context of a wide range of risks and other considerations), 1502(e)(2) seems to assume that transition plans evolve in a vacuum. For example, management might approve a major capital expenditure needed for ongoing business operations. If the result of that capital investment is also a significant reduction in the company's Scope 2 GHG emissions, in line with the company's stated GHG emissions goals, does that make management's decision part of a "transition plan"?

As companies start to draft disclosures to address this rule, they may find that there is significant judgment involved in preparing these quantitative metrics. In addition, providing context with qualitative disclosures will be critical to making the quantitative disclosures useful.

6. **Physical Risk Management Covered by Item 1503 Risk Management Disclosure.** As noted on pages 138-139 of the adopting release, Item 1502(e)(2) doesn't refer to physical risk in an effort to make the disclosure requirement for transition plans more consistent with voluntary disclosures based on TCFD recommendations. However, the adopting release makes clear that a company that faces material physical risk may be required to disclose how it is managing that risk as part of its Item 1503 risk management disclosure.

7. **Extended Compliance Date for Quantitative and Qualitative Disclosure.** Item 1502(e)(2)—but not (e)(1)—is one of the items that is called out for longer implementation in the adopting release. For each type of filer, the compliance date for this item is one fiscal year after the bulk of the Regulation S-K and Regulation S-X requirements (e.g., for fiscal years beginning in 2026 for large accelerated filers on the original timeline, which is subject to change depending on when and how litigation over this rule is resolved).

Authors

Allison C. Handy

Partner
AHandy@perkinscoie.com 206.359.3295
Blog series

Public Chatter

Public Chatter provides practical guidance—and the latest developments—to those grappling with public company securities law and corporate governance issues, through content developed from an in-house perspective.

View the blog