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Companies Brace For New Liability As SEC Nears Climate Disclosure Plan

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By Abigail Mihaly

Lawyers are outlining how an "imminent" Securities and Exchange Commission (SEC) proposal to require climate-related risk disclosures might affect a host of publicly traded companies, which might face new exposure to liability given that they aren't currently required to disclose such risks.

Some major companies such as large domestic banks are not yet subject to far-reaching climate disclosures, so mandated disclosures in this area could considerably change many companies' calculations and information-gathering practices.

The SEC last year **clarified 2010 guidance** that asks companies to disclose how the physical effects of climate change might affect them financially. But the forthcoming rulemaking would more clearly spell out the information companies must share. This could include granular information like the locations of operations, which would be relevant to climate risk calculations if a company works in an area more exposed to extreme weather, for example.

Companies, environmentalists and other stakeholders are eagerly awaiting the first-time mandatory climate disclosure framework from the SEC, which was originally expected to be released last year.

The proposal is "coming imminently," according to remarks from former SEC Commissioner Robert Jackson (D) at a Feb. 15 event co-hosted by the State Energy & Environmental Impact Center at New York University, Woodwell Climate Research Center, and the Massachusetts Office of the Attorney General. He expects the SEC will hold an open meeting "within a month" to propose the rules.

SEC Chairman Gary Gensler (D) on Feb. 11 **tweeted** about the plan but gave no indication of timeline.

Some news reports claim internal negotiations and **agency infighting** over the scope of the disclosure requirements.

Jackson, a current NYU law professor, provided insight into the internal SEC debates, noting officials are debating two main issues: whether to include so-called "scope 3" greenhouse gas emissions in the disclosure requirements; and whether and how to involve third-party auditors and insurance firms to ensure the data gathered via the new requirement "means something."

This latter issue refers to how much the SEC can lean on outside accounting or consulting firms that specialize in climate finance to ensure thorough disclosure.

The forthcoming SEC rules are the first among a broader, **changing regulatory landscape**. For example, the Office of the Comptroller of the Currency (OCC) is considering how banks should deal with climate-related risks, in **draft guidance** with comments that were due Feb 14.

10-K Filings

Some major energy companies "already are subject to -- particularly on the emissions side -- multiple regulatory regimes globally," according to remarks from Jennifer Hayes, senior counsel with Chevron New Energies, during a Feb. 10 event hosted by the American Law Institute-Continuing Legal Education (ALI-CLE).

But for many companies, increased required disclosures comes with increased liability. The proposal will be "the beginning of a very exciting rulemaking process," Jackson told the NYU event, though he predicted that "inevitably, industry will sue the SEC."

Right now, companies in a variety of sectors disclose climate risk in both mandatory and voluntary frameworks. This means many companies under SEC's purview already voluntarily disclose -- or at least internally calculate -- much of what the SEC might require, either for internal planning purposes or because investors are seeking such information.

Many companies align their reporting with recommendations from the Task Force on Climate-related Disclosures (TCFD). For example, Coca-Cola discloses the amount of financial loss it incurs due to extreme weather events in annual Business & Sustainability reports outside the scope of its formal financial statements known as 10-Ks. Various stakeholders have encouraged the SEC to leverage this widespread existing disclosure framework.

Regarding voluntary reporting, Chevron's Hayes says the voluntary frameworks allow them the "freedom" to test different data collection and address topics that "don't rise to the level of having a mandatory reporting obligation."

But the notion of a mandatory SEC framework is still popular, even among companies that might have to significantly change their reporting. For instance, Bank of America in **June 13 comments** to the SEC writes that a single, unified disclosure standard would help solve both current investor confusion due to the range of reporting methodologies companies use, and company confusion around what information they should report.

Still, companies are wary of the potential legal risk from mandatory disclosures. They're watching closely to see if the SEC requires climate disclosures in their annual 10-Ks -- which would subject them to liability under the 1934 Securities and Exchange Act and the Securities Act of 1933.

Gensler in his Feb. 11 tweet wrote SEC "should consider whether these disclosures should be filed in the Form 10-K, living alongside other info that investors use to make their investment decisions," but the commission hasn't announced a decision on the matter.

Bank of America is one of many companies pressing for these disclosures to be merely "furnished" rather than "filed," and also that SEC implement a safe harbor to "encourage fulsome disclosure" and "protect registrants' good faith efforts to comply with those disclosure requirements."

Net-Zero Targets

The imminent SEC proposal comes as companies enter both "10-K season" and "proxy season" -- with companies' climate disclosure practices and voluntary climate steps in the limelight.

During the 10-K season, publicly traded companies prepare their financial disclosures to the SEC including a variety of information such as events and litigation that could affect profits. Companies are increasingly including net-zero carbon commitments in these filings, raising new questions about how the SEC might regulate such commitments.

Betty Huber, a partner with Latham & Watkins who works with a wide range of companies on climate disclosures, told the ALI-CLE event that this season she's "seeing a lot of draft 10-Ks describing net-zero commitments," but that other companies either have not adopted these targets or have not yet decided how best to report them.

Companies and their boards are asking various related securities law questions, including "Should companies include a risk factor that describes what the risks are if the emissions targets are not met fully or in time?" and "What is the appropriate level of board oversight of climate-related risks and opportunities to discharge our fiduciary duties?"

Huber said: "Generally speaking, the business judgment rule should protect directors, but increasingly directors are going to be asking increasingly more questions about climate-related risks, opportunities, data, goals and disclosure and companies should be prepared to answer them."

The SEC **has also floated** regulating companies' net-zero requirements to prevent "greenwashing."

And, during proxy season, shareholders can vote on statements outlining a company's "proxy statements," which can include new climate initiatives. Tracey Lewis, policy counsel for Public Citizen's Climate Program, tells *Inside EPA's Climate Extra* this could bring "offshoot efforts to hold companies' feet to the fire," with investors asking companies questions around their climate disclosure practices.

Another major question is whether the SEC will include indirect emissions in its mandatory disclosures.

Although Chevron already calculates and reports certain scope 3 emissions, some major banks have run into problems calculating their "financed" emissions -- those GHGs emitted by companies they invest in via debt or equity -- due to

lack of a widely accepted framework. Industry has generally pushed back on including scope 3 emissions in the rule, citing concerns around double-counting emissions and saying they would be too challenging to calculate.

This issue could be reflected in future lawsuits, says Lewis, noting that industry groups could challenge the SEC's future requirements on the grounds that the cost of producing information to comply with the reporting requirement -- especially scope 3 emissions data -- is too high.

She added that other legal tactics could engage the question of "materiality" -- whether climate-related risks are material to a reasonable investor and therefore whether the SEC can regulate them. Or, groups could choose to look at First Amendment concerns around compelled government speech. -- *Abigail Mihaly* (**amihaly@iwpnews.com**)

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