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## US Government Proposes Climate-Related Requirements for Government Contractors

*Major federal suppliers would need to perform certain climate-related actions, resulting in potential knock-on implications, expectations, and risks.*

### Key Points:

- The federal government's proposed regulations would require major federal suppliers to prepare various climate-related disclosures, depending on the value of their federal contracts.
- Major contractors could see implications for developing and implementing a climate strategy, particularly if they are also public companies and subject to the potentially intersecting disclosure requirements of the Securities and Exchange Commission.

A recent [proposed rule](#) (the Proposal) to the Federal Acquisition Regulation (FAR) would require certain federal contractors to disclose climate-related information, including greenhouse gas emissions and financial risks, and to establish science-based emissions reduction targets. The FAR Council's<sup>1</sup> Proposal responds to President Biden's May 2021 Executive Order on climate-related financial risk ([EO 14030](#)), which directed the FAR Council to consider amending the FAR to "require major Federal suppliers to publicly disclose greenhouse gas emissions and climate-related financial risk and to set science-based reduction targets."

The Proposal is one of many federal climate-related developments this year. If the Proposal is finalized in its current form, it could affect contractors' obligations under other rules, such as the Securities and Exchange Commission's climate disclosure proposal (the SEC Climate Proposal).<sup>2</sup> Interested parties can comment on the Proposal until January 13, 2023.

### Requirements

The Proposal would require disclosures from any contractor (subject to a few exceptions) that received at least \$7.5 million in federal obligations in the preceding federal fiscal year. The Proposal further divides "major Federal suppliers" into (i) significant contractors and (ii) major contractors. Significant contractors are those receiving \$7.5 million to \$50 million, while major contractors are those who received more than \$50 million, each in total federal contract obligations in the prior federal fiscal year. Major contractors other than small businesses would need to meet all of the requirements of the Proposal, whereas

significant contractors (as well as small businesses that are major contractors) would need to comply only with certain GHG emissions reporting requirements.

### **Requirements for Significant and Major Contractors**

Within one year after publication of the final rule, a significant or major contractor would need to:

1. complete an inventory<sup>3</sup> of their Scope 1 (direct) and Scope 2 (indirect from purchased energy) GHG emissions within the current or previous fiscal year; and
2. report the total annual Scope 1 and Scope 2 emissions identified through the most recent GHG inventory in the government's System for Award Management (SAM.gov).

### **Additional Requirements for Major Contractors**

Starting two years after publication, major contractors would also need to:

3. submit an annual climate disclosure by completing those portions of the CDP Climate Change Questionnaire that align with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, as identified by CDP,<sup>4</sup> within the current or previous fiscal year;
4. develop science-based targets and validate such targets via the Science-Based Targets Initiative (SBTi) within the previous five calendar years; and
5. publish such disclosure and validated targets on a publicly accessible website.

### **Exemptions**

The proposal would exempt:

- Alaska Native Corporations, Community Development Corporations, Indian tribes, a Native Hawaiian Organization, or a Tribally owned concern;
- higher education institutions;
- nonprofit research entities;
- state and local governments; and
- any entity deriving 80% or more of its annual revenue from federal management and operating contracts that are subject to agency annual site sustainability reporting requirements.

Limited waivers and exemptions would also apply in certain situations. For example, if a major contractor constitutes a small business for the primary North American Industry Classification System (NAICS) code identified in its SAM registration or is a nonprofit, then the additional requirements for major contractors would not apply.

These disclosure requirements for significant and major contractors would be mandatory under the Proposal. As currently structured, the amendment to the FAR would require contractors to make these disclosures as part of their annual representations on SAM.gov. Moreover, the requirements would become a prerequisite to receiving federal contracts immediately after the one- or two-year phase-ins discussed above.

## Knock-On Implications

While comprising only a few requirements, the Proposal implicates several other key developments in climate disclosures that have the potential to shape contractors' obligations, particularly for any companies that may also be subject to the SEC Climate Proposal, if finalized. These additional implications will primarily affect major contractors.

## CDP-Based Annual Climate Disclosure

The Proposal's incorporation of CDP for the annual climate disclosure may eventually require major contractors to perform scenario analysis. CDP currently only requires disclosure of the use of climate-related scenario analysis, which would align with the expectations under the SEC Climate Proposal that a company disclose details of scenario analysis only to the extent the company performs such an analysis.

However, the CDP questionnaire is subject to change. CDP has revised its climate change questionnaire several times in recent years, as well as the associated technical note on disclosing in line with the TCFD recommendations. As such, the questions that CDP designates as part of TCFD-alignment could also change.

Of particular note, CDP recently announced plans to incorporate the International Sustainability Standard Board's (ISSB's) IFRS S2 Climate-related Disclosures Standard (IFRS S2) into its global environmental disclosure platform. While IFRS S2 has not yet been finalized, ISSB [confirmed](#) on November 1, 2022, that IFRS S2 would require companies to use climate-related scenario analysis to inform their resilience analysis. Thus, the Proposal's incorporation of CDP for the annual climate disclosure may ultimately require major contractors to perform scenario analysis and disclose details of the use of scenario analysis. Scenario analysis can be a resource- and time-intensive undertaking, as it involves assessing the resilience of the company's operations and plans under various hypothetical future circumstances. As such, any requirement to perform scenario analysis would significantly differ from the SEC Climate Proposal and likely impose greater burdens for affected contractors.

## SBTi-Validated Targets

The Proposal's requirement for major contractors to set SBTi-validated targets may also impact any disclosures under the SEC Climate Proposal, as well as the strategies available to major contractors. Currently, the SEC Climate Proposal would require companies to disclose any GHG emissions reduction targets, as well as Scope 3 emissions metrics to the extent that (i) material or (ii) the company has established targets covering Scope 3 emissions. If neither of these criteria is met, then Scope 3 emissions metrics would not be required. However, the Proposal may impact this analysis for certain companies, as it would likely require many major contractors to develop Scope 3 emissions targets. The [SBTi criteria](#) require Scope 3 emissions targets for companies if their Scope 3 emissions are at least 40% of total emissions. If the Proposal's SBTi-validated targets requirement leads to a major contractor developing targets that cover Scope 3 emissions, additional disclosure requirements would arise regarding both the target and the company's Scope 3 emissions metrics if the company is subject to the SEC Climate Proposal.

Separately, SBTi's methodological requirements may shape the tools available to companies in designing their climate strategies. SBTi references the GHG Protocol Corporate Standard, the premier framework standard for GHG emissions accounting, and prohibits the use of carbon credits/removals beyond neutralizing residual emissions to achieve net zero. This may prove particularly challenging for certain "hard-to-decarbonize" sectors, including many industrial manufacturers, which may rely on technologies such as carbon capture and sequestration to address GHG emissions from their operations. This

restriction may also frustrate companies relying on biological feedstocks or that focus on converting GHGs from higher to lower warming potential, e.g., renewable natural gas.

SBTi currently does not validate targets from companies in the oil and gas sector, including companies that receive any revenue from the production of fossil fuels or more than 50% of their revenue from the sale, transportation, or distribution of fossil fuels. Any major federal contractors in those sectors would therefore not currently be able to comply with the requirement for an SBTi-validated target, and the Proposal does not currently provide an alternative solution for these contractors.

## Looking Further Out: Liability Implications

The Proposal's requirements also expand potential avenues of liability for major contractors. Compliance with requirements in the FAR is subject to enforcement through the federal government's contract remedies and also through the False Claims Act (FCA). The FCA prohibits the knowing submission of false claims to the government and provides for treble damages and penalties for violations. Further, the FCA includes *qui tam* provisions, allowing private plaintiffs to sue on the government's behalf and to recover up to 30% of any proceeds. The incorporation of climate-related metrics into mandatory government contractor disclosure requirements that are required in order to receive contracts may increase the FCA's use to enforce accurate climate-related disclosures.

While the Proposal does not by itself create any new cause of action, it does require companies to publicly disclose various information, not all of which may have otherwise been available. This could heighten disclosure liability risks, including under federal securities law, for certain companies, particularly for emissions reduction targets that companies may not have otherwise established or publicized. Similarly, given the trend of various states advocating either for or against ESG policies, the disclosure requirements may expose federal contractors to potentially increased scrutiny from state-level officials.

Greenwashing could also be a concern for such companies. The Proposal would require companies to set targets in alignment with approved pathways in order to receive SBTi-validation. However, to the extent contractors do not believe such targets are actually achievable but adopt them to qualify for federal contracts, publishing them may result in claims that company disclosures were materially misleading. Such actions could also raise the risk of liability under a company's government contracts as well as under the FCA and federal securities laws.

Even if greenwashing is not a concern, the Proposal may impact companies' climate calculus. Depending on the portion of revenue derived from government contracts, any finalized rule based on the Proposal may itself influence the importance of certain climate-related disclosures or actions. For example, companies that may have previously pursued a strategy that did not meet SBTi-criteria may revisit such plans in order to maintain compliance with requirements for major contractors. In some situations, this may require companies to reconsider existing strategies and/or targets. This can be costly and may, in certain circumstances, require a second strategy/target to be pursued in parallel for SBTi-validation. However, this can create additional risks of gaps or conflicts between strategies, particularly as time goes on.

## How Can Contractors Prepare?

Potentially affected contractors should first identify key players, both internal and external, to evaluate and support a response plan to the Proposal.

Major federal suppliers, as defined by the rule, may also want to consider the following four actions:

1. **Commenting on the Proposal.** The FAR Council must review and respond to the arguments and concerns raised in such comments as part of the rulemaking process. Comments also form part of the administrative record, which serves as the body of evidence for any legal challenge to the rule. Interested parties can submit comment [here](#) by searching for “FAR Case 2021-015” and selecting the link “Comment Now.”

For example, companies may wish to raise any technical or methodological concerns regarding the incorporated third-party standards or request clarification on provisions of the rule, such as the required timescale of targets (e.g., near-term versus long-term or net zero) as well as request exemptions from the SBTi portion of the Proposal for industries that are not covered by the SBTi, such as oil and gas.

2. **Assessing Data and Internal Controls.** As with the SEC Climate Proposal, the Proposal would require significant data collection, analysis, and disclosure for many companies.

This is particularly important for the SBTi-validated target criterion. Establishing SBTi-validated goals is a multi-step process that involves certain items that can be time- or resource-intensive. For example, companies that do not have a full scope GHG emissions inventory would need to develop that inventory before creating goals or submitting them for validation. Additionally, wait times for validation may be longer than average if a swath of companies are seeking validation at the same time, e.g., in response to a finalized Proposal.

3. **Preparing for Compliance.** Federal contractors impacted by the Proposal may wish to take steps now to ensure they have the ability to accurately and quickly disclose by the time that the proposed requirements come into effect. The Proposal frames these disclosure obligations as a matter of contractor responsibility, which means that, once effective, the government will not be able to award contracts to a significant or major contractor without the required disclosures. Being able to accurately disclose will also be of key importance, since inaccurate disclosures could trigger FCA allegations from whistleblowers or government investigators once these requirements are in effect.
4. **Analyzing Whether the Proposal Impacts Other Disclosure Considerations.** As discussed above, the various disclosure regimes in development may overlap. The Proposal may implicate considerations for Scope 3 emissions disclosures by public companies that are also major contractors, such as by triggering requirements to set Scope 3 targets under the SBTi criteria. However, the Proposal may also intersect with other aspects of the SEC Climate Proposal, such as financial statement disclosures, to the extent compliance requires expenditures for certain activities (e.g., scenario analysis), or risk factors, if non-compliance with the climate requirements would put a significant percentage of the contractors’ total revenues at risk.

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**Endnotes**

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<sup>1</sup> The FAR Council membership includes the Administrator for Federal Procurement Policy, the U.S. Secretary of Defense, the Administrator of National Aeronautics and Space and the Administrator of General Services.

<sup>2</sup> For an overview of the SEC Climate Proposal, see Latham's prior Client Alerts [2945](#) and [2950](#).

<sup>3</sup> The Proposal would require the GHG emissions inventory to be developed using the GHG Protocol Corporate Accounting and Reporting Standard, though contractors would be able to use the calculation tool of their choice so long as it is aligned with that standard.

<sup>4</sup> The Proposal references the CDP guidance at <https://www.cdp.net/en/guidance/how-cdp-is-aligned-to-the-tcfd>; however, CDP updates its questionnaires annually, and the related determinations of what CDP considers pertinent for TCFD-alignment may change as well.