Cos. Can Expect Tougher Climate Risk Disclosure Mandates

By **Christopher Treanor, Kenneth Markowitz and Bryan Williamson** (June 17, 2021)

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This spring, Democratic members of both houses of Congress reintroduced the Climate Risk Disclosure Act, or CRDA, a bill that would require every public company to issue climate-related financial disclosures. While prior versions of the bill lacked any reasonable chance of succeeding, the House Financial Services Committee finally reported the act out of committee last month, albeit by a narrow margin, and on a party-line vote.

Consistent with recently stated priorities of the U.S. Securities and Exchange Commission, the CRDA aims to accelerate the promulgation of rules to require public companies to disclose climate risk information and their strategies to mitigate and build resilience to those risks.

The goal, according to the CRDA's sponsors, is to help investors evaluate companies' climate risk profiles and make investment decisions in line with the transition to a clean-energy, climate-friendly future. Regulators have long eyed this type of disclosure as a way to increase market transparency, and force companies to bear responsibility in the public eye for their negative environmental externalities.

If the CRDA becomes law, public companies and in-house counsel will need to build effective and efficient systems to track and evaluate climate data, and disclose it in a sensible manner that minimizes reputational and legal risk. This type of data might include, for example, data on greenhouse gas emissions, threats from climate change to a company's physical assets, and any rising energy costs.

New climate disclosure requirements will upend the status quo, as most companies disclose only climate risks in securities filings that they deem material in accordance with the SEC's 2010 guidance. Currently, only very large emitters must report their direct greenhouse gas emissions to the U.S. Environmental Protection Agency.

The CRDA would change that, by requiring all public companies to submit to the federal government interactive, electronic reports disclosing direct and indirect GHG emissions, as well as the input parameters and assumptions — e.g., discount rates and time horizons — used to support those figures.

These requirements go way beyond reporting emissions, and include identifying the total amount of fossil-fuel-related assets owned and managed, and the total cost of emissions, which companies will need to calculate pursuant to the federal government's social cost of carbon figures. While the Biden administration's interim social cost of greenhouse gases remain mired in litigation, it is likely that the final figures, targeted for January 2022, will build on values promulgated in the 2016 technical support document by the Interagency Working Group on the Social Cost of GHGs.

This approach may portray the climate impacts of many companies in staggering dollar values — further providing ammunition to the public and environmental groups who closely scrutinize corporate disclosures in their efforts to demand more aggressive GHG mitigation.

The CRDA's emissions reporting requirements are similar, but not identical, to those proposed recently in California, raising possible preemption concerns if both pieces of legislation pass — or, at the very least, the potential for duplicative disclosure requirements. Like the proposed California rules, the CRDA would require the SEC to publish a report each year on its website that compiles companies' disclosures.

Many companies already publish disclosures in online sustainability reports. They would need to ensure that the climate disclosures contained therein do not conflict with those provided to the SEC and published on the agency's website.

Not only would the CRDA require disclosure of emissions, but it also would force companies to quantify the financial impact of climate risks on their bottom line, describe their overarching climate strategies, and detail board-level oversight of climate risks and opportunities. Eschewing the current, principles-based disclosure regime, companies would need to account for different scenarios, including one where global temperatures rise to more than 1.5 degrees Celsius above preindustrial levels, and another in which they do not.

Additionally, the CRDA would require companies to identify specific steps taken to respond to climate risks — including physical risks and those resulting from the political, legal and economic transition to a climate-resilient society — and the evolution of their strategies over time. Companies would need to support qualitative disclosures with quantitative analyses, to address, at least partially, concerns over so-called greenwashing, or providing misleading impressions about environmental practices.

These components of the rules would not impose much more work on companies that already provide robust disclosures using recognized reporting frameworks, like those championed by CDP. Many other companies, however, would need to follow a new or modified reporting regime, or at the very least, scrutinize their existing disclosures, to ensure compliance with these new rules and the SEC's inevitable enforcement practices.

Notably, while the CRDA's requirements would apply to all public companies, it imposes more fulsome disclosure obligations for companies engaged in the commercial development of fossil fuels. These additional requirements include:

- An estimate of total and disaggregated amounts of direct and indirect GHG emissions attributable to combustion, flaring, process emissions, directly vented emissions, fugitive emission/leaks and land use changes;
- The sensitivity of reserve levels to future price scenarios, informed by the government's social cost of carbon estimates;
- The percentage of companies' reserves developed under different scenarios;
- A forecast for development prospects under different scenarios;

- Potential GHG emissions embedded in proved and probable reserves; and

- Methodologies used for detecting and mitigating fugitive methane emissions.

This final category requires a number of very specific disclosures of particular relevance to the oil and gas sector, such as data or information concerning the frequency of leak checks; processes and technology to detect leaks; the percentage of assets covered by disclosed methodologies; reduction goals for methane leaks; the amount of water withdrawn from freshwater sources to support operations; and the percentage of water from regions of waste stress or wastewater management challenges.

The pursuit of additional disclosure requirements should not come as a surprise for companies in fossil-fuel-based industries that already face multifaceted pressure from the Biden administration, shareholders and investors to reach net zero carbon emissions by 2050.

These compounding factors include the eventual replacement of the Obama administration's Clean Power Plan; delayed decisions on requests for the continued use of coal combustion residuals storage facilities; the nationwide moratorium on the issuance of new oil and gas leases; and potentially a longer suspension of oil and gas leasing activity in the Arctic National Wildlife Refuge, among others. Under the CRDA, companies might need to disclose not only their climate impacts, but also the impact of these and other regulatory pressures on their financial outlooks.

Moreover, to further the goal of providing complete climate-related information to investors, the CRDA directs the SEC to promulgate disclosure standards that foster comparisons both within and across industries, coupled with a mechanism to track how companies mitigate exposure to climate risks over time.

While the CRDA leaves it to the SEC to promulgate specific standards applicable to the finance, insurance, transportation, electric power and mining sectors, it defaults to disclosure pursuant to the Task Force on Climate-Related Financial Disclosures, or TCFD, in the event the SEC fails to issue standards within two years of the CRDA's enactment.

This default provision suggests that the SEC likely would draw from the well-recognized TCFD standards in promulgating its own standards. Companies looking to prepare for eventual SEC requirements, whether mandated by the CRDA or imposed through unilateral rulemaking, will benefit from familiarizing themselves with the TCFD standards and other well-known disclosure frameworks.

In mid-May, the bill moved to the House floor; now it is up to Speaker Nancy Pelosi, D-Calif., to determine whether to wrap the CRDA into a broader climate package, or move the bill directly to a floor vote on its own. The Senate Banking Committee has not yet considered the counterpart bill from Sen. Elizabeth Warren, D-Mass.

The bills being undoubtedly controversial, there is a realistic possibility that neither passes. Their failure to become legislation, however, would not doom mandatory climate disclosure requirements, as the SEC continues its review of the 2010 guidance and consideration of new climate and environmental, social and governance, or ESG, disclosure rules.

While the SEC might wait for Congress to act, in order to increase the likelihood that its regulations survive judicial review, we expect the commission to be prepared to publish updated guidance or proposed rules promptly in the absence of congressional action. SEC Chairman Gary Gensler's public statements all but confirm that the commission is poised to move forward with new disclosure rules, as he recently characterized climate risk and human capital disclosure rules as one of his "top priorities" and "an early focus" of his tenure.

These developments toll the bell for companies to establish or improve sustainability programs that apply to not only climate but also the broader spectrum of ESG issues. Climate will be a natural priority for most companies, which should cause them to focus — if they have not already — on their energy management practices, including total energy consumed and percentage of renewable energy used.

Likewise, companies unaware of the full extent of their GHG footprints should work to quantify those as soon as possible, identifying both emissions directly attributable to operations — i.e., Scope 1 emissions — and indirect emissions from upstream and downstream operations, including value chain emissions — i.e., Scope 2 and 3 emissions.

All public companies, regardless of industry and size, should find ways to integrate climate and other environmental considerations into strategic planning throughout the organization, and at the very least at the highest levels. Finally, familiarity with prominent ESG frameworks and reporting standards is key to adapting to mandatory disclosure requirements, which likely will overlap with, or be derived from, existing voluntary systems.

Taking these steps in close coordination with higher-level management, ESG managers and counsel will best prepare companies for a seamless transition to compliance with climate disclosure rules.

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