Government Contracts Alert

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Proposed Changes to the Federal Acquisition Regulation Addressing Disclosure of Greenhouse Gas Emissions and Climate-Related Financial Risk

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In November 2022, the U.S. government, acting through the Department of Defense, General Services Administration, and National Aeronautics & Space Administration, issued a proposed rule that would amend the Federal Acquisition Regulation (FAR) to require certain U.S. government contractors to disclose their greenhouse gas emissions (GHG) and climate-related financial risk, as well as set science-based targets to reduce their GHG emissions. The proposed rule implements section 5(b)(i) of Executive Order (EO) 14030 "Climate-Related Financial Risk" and is in furtherance of the EO's recognition that the impacts of climate change present physical risk to assets and potential supply chain disruptions. In addition, the proposed rule would advance the Biden-Harris administration's goal of achieving a net-zero emissions economy by no later than 2050.

Key Takeaways for the Government Contracts Community

- The proposed rule establishes two new categories of government contractors: "significant contractors" and "major contractors."
- Absent falling within one of the available exceptions, both significant and major contractors would be required to undertake annual GHG emissions inventories. Major contractors would, in addition, be subject to an annual climate disclosure requirement that would include development of science-based emissions reduction targets.
- From a government contracts perspective, existing commercial and non-commercial FAR provisions would be amended to require new representations from contractors; the System of Award Management (SAM) would be revised to collect new climate-related information.
- Significantly, under the proposed rule, U.S. government contracting officers would be directed to make "responsibility" determinations based on a contractor's compliance with the new climate-focused elements of the FAR.

"Significant" and "Major" Contractors

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EO 14030 Sec. 5(b)(i) directs the FAR Council and the Council on Environmental Quality to "require major Federal suppliers to publicly disclose greenhouse gas emissions and climate-related financial risk and to set science-based reduction targets." The proposed rule implements that directive by separating "major federal suppliers" into "major contractors" and "significant contractors." A "significant contractor" is one that has received $7.5 million or more, but less than $50 million, in federal contract obligations in the prior fiscal year. In contrast, a "major contractor" is one that has received more than $50 million in federal contract obligations in the prior fiscal year.

According to the proposed rule, the "major" and "significant" thresholds would cover 86 percent of the government's annual spend and about 86 percent of the supply chain GHG impacts. In terms of the number of contractors affected, the proposed rule notes, using fiscal year (FY) 2021 data, that there would be 4,413 entities within the definition of a "significant contractor" and 1,353 entities within the definition of a "major contractor."

Notably, the proposed rule does include several exceptions from the inventory and disclosure requirements. Significant and major contractors would not be required to conduct Scope 1 or Scope 2 emissions inventories (discussed in more detail below) and a major contractor would not be required to make an annual climate disclosure or set science-based emissions reduction targets if it the contractor is:

- An Alaska Native Corporation;
- An institution of higher education;
- A non-profit research entity;
- A state or local government; or
- An entity deriving 80 percent or more of its annual revenue from federal management and operation contracts.[1]

There are also additional exceptions for major contractors. If such a contractor is a small business—based on its primary North American Industry Classification System (NAICS) code—or is a non-profit organization, it need not make an annual climate disclosure or set science-based emissions targets but would still be required to conduct Scope 1 and Scope 2 emissions inventories and report the results of those inventories.

Those contractors required to register in SAM would have to represent annually whether they are a significant or major contractor and whether an exception applies. Additional representations would address compliance with required GHG inventories, climate disclosures and/or science-based emissions targets.

Compliance Obligations

A. GHG Inventories

The proposed rule calls for both significant and major contractors to complete a GHG inventory of Scope 1 and Scope 2 emissions. The rule cites to Office of Management and Budget (OMB) Memorandum M-22-06[2] as defining GHGs to include carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, nitrogen

trifluoride and sulfur hexafluoride. Scope 1 emissions are considered those direct GHG emissions emanating from sources that are owned or controlled by the contractor. Scope 2 emissions include those associated with generating electricity, heating, cooling or steam when purchased or acquired by the reporting company for its own consumption but that occur at sources owned or controlled by another entity. Inventories must comply with the GHG Protocol Corporate Accounting and Reporting Standard.[3] According to the proposed rule, the inventory must capture emissions during a continuous 12-month period that ends no more than 12 months before the inventory is completed. In addition, the inventory must be completed within one year after the publication of a final rule. Contractors would be required to disclose in SAM the total annual Scope 1 and Scope 2 emissions identified by the inventory.

Unlike significant contractors, major contractors are required to inventory their relevant Scope 3 GHG emissions, which are considered a consequence of the operations of the contractor but that occur at sources other than those the contractor owns or controls. When necessary, the Scope 3 inventory would also have to be completed within two years after the promulgation of a final rule.

B. Annual Climate Disclosures

Within two years after the final rule, major contractors must complete an annual climate disclosure that is consistent with a series of recommendations put forward by the Task Force on Climate-Related Financial Disclosures (TCFD).[4] Among other areas, the TCFD recommendations address governance, strategy, risk management and metrics, and targets. The proposed rule explains that the annual disclosure for a major contractor "includes not only the Scope 1 and Scope 2 emissions, but also relevant Scope 3 emissions." The disclosure would also include the contractor's climate risk assessment process and any identified risks. Disclosures are made by completing the sections of the CDP Climate Change Questionnaire that align with the TCFD. The disclosure must be made available on a publically available website, either the contractor's own or the CDP website.

C. Science-Based Targets

Under the proposed rule, major contractors would be required to develop science-based targets to reduce GHG emissions. The proposed rule describes a science-based target as one that is consistent with what the "latest" client change science considers necessary to meet the Paris Agreement's goals for limiting global warming. Once developed, the target must be validated by the Science-Based Targets Initiative (SBTi).[5] As is the case with the disclosure, the science-based targets must also be made publically available. This requirement would go in effect two years after the final rule.

D. Responsibility Determinations

In advance of receiving a government contract, an offeror must be deemed "responsible."[6] The proposed rule would create a new responsibility standard that would come into play when a potential offeror represents that it is not in compliance with the climate-related requirements or if there is a basis to question a representation of compliance. Under the proposed new standard, the Contractor Officer is directed to assume that the offeror is nonresponsible and therefore ineligible for award absent a determination that:

- The noncompliance was the result of “circumstances beyond the prospective contractor’s control”;
- The prospective contractor is able to provide enough documentation showing “substantial efforts” to comply; and
- The prospective contractor publically commits to achieve compliance “as soon as possible.”

E. Next Steps

Government contractors should consider the feasibility of and costs associated with compliance with the proposed rule, the risks of being found nonresponsible in the event of noncompliance, and consider comments raising any areas of concern or uncertainty. Comments may be submitted through January 13, 2023.

[1] A management and operation contract is “an agreement under which the Government contracts for the operation, maintenance, or support, on its behalf, of a Government-owned or -controlled research, development, special production, or testing establishment wholly or principally devoted to one or more major programs of the contracting Federal agency.” FAR 17.601

[2] Available here https://www.whitehouse.gov/wp-content/uploads/2021/12/M-22-06.pdf.

[3] The GHG Protocol Corporate Accounting and Reporting Standard can be found at https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf.

[4] The TCFD is recommendations can be found at https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf.

[5] SBTi is a partnership comprised of CDP, the United Nations Global Compact, the World Resources Institute and the World Wide Fund for nature.

[6] See FAR 9.103 (“No purchase or award shall be made unless the contracting officer makes an affirmative determination of responsibility”).

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