

A Proposed Addition to SEC's Quiver—Climate Change Disclosures

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The Securities and Exchange Commission (“SEC”) recently issued release (“Release”) seeks public comment on proposed amendments to its rules (“Amendments”) to provide certain climate-related information in registration statements and annual reports (“CRI”). The Amendments would apply to registrants under the Securities Act of 1933, as amended and Securities Exchange Act of 1934 (collectively, “Federal Acts”).

The Release

The Release is entitled “The Enhancement and Standardization of Climate-Related Disclosures for Investors” (found at SEC Release Nos. 33-11042, 34-94478; RIN 3235-AM87; dated March 21, 2022). The comment period on the Amendments ended as of May 20, 2022. The Amendments (or a variation on them) can become effective thereafter.

On March 15, 2021, the SEC sought public input on climate disclosure. The Release states the SEC received approximately 600 unique letters and over 5,800 form letters in response. The Release is almost 500 pages in length (with over 1,000 footnotes).

The Release sets forth Amendments requiring a registrant to disclose CRI risks reasonably likely to have a material impact on the registrant’s business, results of operation or financial condition. CRI includes disclosure of a registrant’s greenhouse gas emissions (“GHG”) and CRI financial metrics in the corresponding audited financial statements.

The Release posits existing disclosures on CRI risks do not provide adequate investor protection. It further states the Amendments are to provide decision-useful information to investors relating to the impact of CRI risks on investments.

The Amendments

Overview. The following is a brief outline of some of the Amendment features.

Registrants subject to the Amendments include a “smaller reporting company,” an “accelerated filer,” and a “large accelerated filer” as the terms are defined in the SEC rules. See, 17 CFR 229.10(f)(1), 230.405 and 240.12b-2. The Amendments treat smaller reporting companies differently from the other two categories of companies. Suffice it to say, they all are companies with larger capitalizations or annual revenues.

CRI changes to financial statement disclosures are to be subject to audit by an independent registered public accounting firm coming within the scope of the registrant’s internal control over financial reporting. Also, accelerated filers and large accelerated filers are required to provide attestations as to GHG disclosures.

Basis. The Amendments are based, in part, on several national and international climate-related efforts as set forth in the Release, one of which is the Greenhouse Gas Protocol (“GHG Protocol”). The Release states the GHG Protocol has become a leading accounting and reporting standard for GHG.

Under the GHG Protocol, emissions by a company are divided into three types:

- **Scope 1**-- Direct GHG occurring from sources owned or controlled by the company.
- **Scope 2**—Those emissions primarily resulting from generation of electricity purchased and consumed by the company.
- **Scope 3**—All other indirect emissions not accounted for in Scope 2.

Disclosures. The Amendments require a registrant to disclose numerous items including:

- Oversight and governance by the registrant’s board and management of CRI risks.
- How registrant-identified CRI risks are likely to have material impact on the registrant’s business model and outlook.
- Process for identifying, assessing and managing CRI risks and whether the process is integrated in the registrant’s overall risk management system.
- Impact of climate-related events and transaction activities on line items of registrant’s consolidated financial statements and related expenditures.
- Scope 1 & 2, separately described.
- Scope 3 and intensity (if material) or, if the registrant has set a GHG emissions reduction target, and transition plan, if any.
- Registrant’s climate-related target and transition plan, if any.

Possible Risks

Central Focus. The Release goes to great lengths in describing CRI risks. At the same time, the Release states the central focus of the Amendments is identification and disclosure of registrant CRI risks. The Release further states CRI risk means actual or potential negative impacts of climate-related conditions and events that affect the registrant’s consolidated financial statements, business operation or “value chains,” i.e., upstream and downstream activities.

The Release defines “upstream” activities as those by one other than the registrant relating to initial stages of production of goods or services of the registrant. The Release also defines “downstream” activities as including those by one other than the registrant relating to processing materials into finished products and delivering or providing service to an end user.

Assessing Materiality. The Amendments emphasize, when assessing materiality of a CRI risk, the registrant ought to consider its magnitude and probability over short, medium and long terms. The Release surmises the magnitude and probability of climate risk can significantly vary over such time periods. It gives as an example, recent wildfires in California and their resulting effect on business access to insurance for such liability.

Opportunities. In providing disclosure relating to governance, strategy and risk management, the Amendments allow the registrant to disclose climate-related “opportunities.” Such opportunities are described in the Release as actual or potential positive impacts on climate-related conditions and events on consolidated financial statements, business operations or chain values.

Possible Physical and Transitional Risks. The Release divides climate-related conditions and events presenting risks into “physical risks,” i.e., those related to physical impact of climate, and “transitional risks,” i.e., those related to climate-related changes in law or policy.

The Release further surmises that physical risks might include harm to a registrant’s business and assets arising from acute climate disasters, e.g., wildfires, hurricanes, tornadoes, floods and heatwaves. It further surmises that such companies may face chronic risks and more gradual impacts from long-term temperature increase, drought and sea level rise. Finally, it surmises that such physical risks may include potential transition to a less carbon intensive economy, climate-related litigation and changing body of consumers.

Disclosure Phase-In

The Amendments allow for phasing in CRI disclosures, depending on the registrant’s filer status. For Scope 1 and 2 disclosures, the compliance date for registrants is qualified (should the Amendments become effective in December 2022) as fiscal year 2023 for large accelerated filers and fiscal year 2024 for large accelerated filers and non-accelerated filers.

Scope 3 disclosure would be delayed an additional year for these filers. However, smaller reporting companies are given an additional year to report Scope 1 and 2 disclosures and are exempted from mandatory Scope 3 disclosure, all as further defined in the Amendments.

All filers are provided a safe harbor for Scope 3 disclosure. That is, such disclosure would be deemed not to be fraudulent statements unless shown that such statements were made without reasonable basis or made otherwise than in good faith.

Where actual reporting data are not reasonably available, a registrant may use a reasonable estimate of its GHG under limited circumstances as set forth in the Amendments.

Application to Alaska

You say, you only advise small business, not involving registrants. Why should you worry?

While application of the Amendments is limited to registrants under the Federal Acts, it does raise the question of possible materiality of CRI risk regarding securities offerings by non-registrants or issuers in private offerings, generally, under those Federal Acts. If CRI risk is material for registrants, does it not follow it may be relevant for non-registrants or smaller offerings, regardless of whether the issuer is a registrant?

An issuer is, under the Federal Acts, required to make full and fair disclosure of all material facts related to its securities offering, regardless of registration under, or exemption from registration under, those acts. For that matter, the disclosure underpinnings of the Alaska Securities Act as to a securities offering in Alaska and under the Alaska Securities Act (AS 45.56) are essentially the same as under the Federal Acts.

For example, a company, because of the nature of its business (and regardless of whether it is a registrant) and contemplating a securities offering in Alaska, may need to address CRI (or some portion of it which may be relevant). That is, separate from the Amendments, CRI may be material in an issuer’s securities offering and as to proposed or ongoing operations of the issuer’s business.

Summary—

The SEC's effort on CRI is detailed and broad in scope. It remains to be seen what portion of the Amendments is adopted as final SEC rules. It also remains to be seen as to whether the SEC proposes rules in the future which apply some portion of the Amendments to companies other than registrants or in the context of private offerings, regardless of whether the issuer is a registrant.

While this article covers some of the Amendments in limited fashion, a prudent practitioner, in advising an issuer of, or purchaser in, a security offering under the Federal Acts, ought to become familiar with all of the Amendments.

Good luck on your read of the Release!

This article was prepared solely to provide general information about the topic. Its content was not prepared as, and must not be construed as, legal, tax, investment or other advice to anyone. Nothing in this article is intended in any way to form an attorney-client relationship or any contract.

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