The Potential Impact of the Climate Risk Disclosure Act

Corporate News: A Legal Update

By Eric Fogel and Karen Tobin on March 24, 2022

On March 21, 2022, in an effort to provide consistent, comparable, and reliable data for investors to enable them to make informed judgments about the impact of climate related risks on current and potential investments the Securities and Exchange Commission ("Commission") proposed for public comment amendments to its rules under the Securities Act of 1933 ("Securities Act") and Securities Exchange Act of 1934 ("Exchange Act"). Known as the Climate Risk Disclosure Act (S. 1217; H.R. 2570) the rules would require domestic and foreign public registrants to provide climate-related information in their registration statements and annual reports. The proposed rules would require information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition. The required information about climate-related risks would also include disclosure of a registrant's greenhouse gas emissions ("GHG")("Scope 1"), indirect emissions from purchased electricity or other forms of energy ("Scope 2"), and GHG emissions from upstream and downstream activities in its value chain ("Scope 3") which have become a commonly used metric to assess a registrant's exposure to such risks. In addition, under the proposed rules, certain climate-related financial metrics would be required in a registrant's audited financial statements.

These new reporting requirements could have an impact on public companies financial performance and may have a significant impact on shareholder voting decisions. The proposed rules would be phased in with the compliance date dependent on the registrant's filer status, and an additional phase in for Scope 3 emissions disclosure. Under the new reporting, companies would have to provide information about Scope 1 and Scope 2 emissions and also include a related attestation report from an independent attestation service provider if the company is an accelerated or large accelerated filer. Reporters would also need to include Scope 3 disclosures to the extent they are material.

Critics point to the costs of preparing all the disclosures and that this would further impede capital formation, while proponents indicate that the cost of not providing Environmental, Social and Governance Disclosures ("ESG") leads to investments being held back, and cite that companies face higher costs in responding to investor demand for ESG information because there is no consensus relating to ESG reporting systems. Some critics fear that applying the same constraints on smaller companies would be too burdensome. Some also indicate this reporting will deter companies from becoming publicly traded, therefore denying investment opportunities. The Commission continues to push to narrow the gap in reporting requirements for public companies and privately-held companies. SEC Commissioner Allison Herren Lee states that "We should consider the broader array of ESG disclosure issues…That means working toward a comprehensive ESG disclosure framework." The Commissioner indicated in her October 2021 speech she is concerned over the lack of regulatory visibility for the largest private companies.

The proposed release will remain open for comment thirty days after publication in the Federal Register, or 60 days after the date of issuance and publication on sec.gov, whichever period is longer.