Climate Change SEC Financial Disclosures: Will New Rules Come With A New President?

Incoming President-elect Biden climate change agenda will likely reach the Securities and Exchange Commission (SEC), which—under a new Chairperson— is expected to establish new disclosure requirements for publicly traded companies to inform investors of the exposure to climate change risks and the potential impacts of upcoming climate change-related regulations.

After SEC Chairman Clayton steps down by the end of the year, President-elect Biden will select a new SEC Chairperson and has signaled that his Administration will prioritize climate-related rulemaking. Current Democratic SEC Commissioner Allison Lee has advocated strongly for robust climate risk disclosures.[1] Janet Yellen, President-elect Biden's nominee for Treasury Secretary, a position that heads the Financial Stability Oversight Council that can recommend agencies undertake new rulemakings, has also shown interest in establishing climate risk disclosures.[2]

The debate over climate change disclosures

Proponents of climate risk disclosures argue that public companies are dramatically understating their potential future liabilities related to the physical and transitional risks associated with climate change. Physical risks relate to threats from severe weather claimed to be connected to climate change, whereas transitional risks are said to arise when companies are reliant on fossil fuels or other scarce resources that may be jeopardized by changing government policies and regulations. Proponents of more robust disclosures also argue that many shareholders want to know whether they are investing in a climate-conscious company that is committed to reducing its carbon footprint. For example, Larry Fink, Chairman and CEO of BlackRock, the world's largest asset manager, announced earlier this year that BlackRock would begin exiting investments presenting "a high sustainability-related risk," and would "vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."[3] In another sign of the push

[1] *See, e.g.*, SEC Public Statement by Commissioner Allison Harren Lee, *Regulation S-K and ESG Disclosures: An Unsustainable Silence* (Aug. 26, 2020), https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26.

[2] Avery Ellfeldt, *Biden To Shine Light on Corporate Climate Risk*, E&E NEWS (Nov. 13, 2020), https://www.eenews.net/stories/1063718415; Justin Guay, *The Most Important Climate Legislation Has Already Passed*, GREENTECH MEDIA (Nov. 23, 2020), https://www.greentechmedia.com/articles/read/the-most-important-climate-legislation-has-already-passed.

[3] Larry Fink, *A Fundamental Reshaping of Finance*, BlackRock (Jan. 2020), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

toward greater disclosure of climate risks, BP and other oil companies have begun to discuss "sustainability-related factors" in their SEC filings. [4]

Critics of mandating these disclosures argue that it is simply an exercise in shaming companies that fail to comply with a "social agenda," and that requiring such disclosures would force companies to report highly speculative and unreliable forecasts of future climate-related risks and liabilities. The outgoing Chairman of the SEC, Jay Clayton, also expressed his concern that SEC-mandated climate disclosures need to be flexible, rather than "one-size-fits-all." This is because, in his view, many climate-related risks are "very company-specific and sector-specific issues," and there should be appropriate safe harbors to reduce companies' liability for misstatements or omissions relating to such disclosures.[5]

Climate-related risk disclosures are not a new concept, and there is considerable guidance and literature the SEC can look to in formulating its own rules, including its own prior interpretive guidance on the matter. More than a decade ago, in February 2010, the SEC published interpretive guidance[6] stating that public companies are required to disclose the impact that climate change has on their business, and/or the costs of complying with climate-related laws, to the extent this information is "material" to the company's current or future financial condition. Securities law requires public companies to disclose "material" facts to investors. A fact is considered material "if there is a substantial likelihood that a reasonable shareholder would consider it important."[7] For instance, an energy company operating in a "cap and trade" state would typically need to publicly disclose information concerning the cost of its carbon emissions. The SEC also noted that companies need to consider the indirect costs associated with climate change, such as increased passed-along costs from suppliers forced to comply with stringent emission standards.

Despite wading into the area with its 2010 guidance, the SEC has never proposed rules specifically addressing climate-related disclosures. The 2010 SEC interpretive guidance has been widely criticized for lacking sufficient details concerning how a company should go about determining what climate risks are "material" and how these risks should be measured and reported to stakeholders.[8] In connection with a review of the SEC's efforts to clarify its climate-risk disclosure guidance, the General Accountability Office (GAO) found that, while companies in some industries were disclosing climate-related risks, such reporting was inconsistent and not easily comparable across companies.[9]

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[4] *See, e.g.*, BP, Annual Report (Form 20-F) (FY 2019); *see also* Jeffrey Karp, *Corporate Disclosures of Climate-Related Risks and Fulfilling Sustainability and Climate Commitments*, JDSUPRA (Dec. 8, 2020), https://www.jdsupra.com/legalnews/corporate-disclosures-of-climate-67680/ (discussing impacts of the BlackRock CEO letter on energy companies).

[5] Tom Zanki, *SEC Chair Says Climate Disclosures Aren't One-Size-Fits-All*, LAW360 (Nov. 19, 2020, 4:18 PM), https://www.law360.com/securities/articles/1330459/sec-chair-says-climate-disclosures-aren-t-one-size-fits-all?nl_pk=4ca642ea-4cc1-4cda-a1e1-1c9e6293aca4&utm_source=newsletter&utm_medium=email&utm_ campaign=securities.

[6] U.S. Securities and Exchange Commission, Commission Guidance Regarding Disclosure Related to Climate Change, Rel. Nos. 33-9106, 34-61469 [82 Fed. Reg. 6,290 (Feb. 8, 2010)].

[7] *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[8] *See, e.g.*, Nina Hart, *Moving at a Glacial Pace: What Can State Attorneys General Do About SEC Inattention to Nondisclosure of Financially Material Risks Arising From Climate Change?*, 40 COLUM. J. ENVTL. L. 99, 111–19 (2015) (arguing that additional guidance is necessary to ensure better quality of disclosures and informed investment decisions for shareholders).

[9] U.S. GENERAL ACCOUNTABILITY OFFICE, REPORT TO CONGRESSIONAL REQUESTERS, CLIMATE-RELATED RISKS: SEC HAS TAKEN STEPS TO CLARIFY DISCLOSURE REQUIREMENTS 15–16 (Feb. 20, 2018), https://www.gao.gov/assets/700/690197.pdf.

The SEC has, however, through the financial filing comment process provided at least some clarification on the adequacy of certain individual corporate disclosures. For instance, the SEC issued a letter to Chevron Corporation requesting that it expand its explanation of climate change-related compliance obligations in its annual filing.[10] In another comment letter issued on May 1, 2019, the SEC asked a natural gas company to "address, if material, the risks of potential decreased demand for [ ] services from the oil and gas industry due to the related greenhouse gas emissions regulations."[11]

Recommended climate disclosures

Despite a lack of clear rules on this issue, over the past decade a growing number of companies across industries have begun including voluntary climate-related disclosures in their annual reports and other public reports. Many of these companies follow the climate disclosure framework proposed by the Task Force on Climate-related Disclosures (TCFD), which was created in 2015 by the Financial Stability Board (FSB) to develop consistent, comparable, and reliable climate-related financial risk disclosures for use by companies. The United Kingdom recently became the first country to commit to making TCFD-aligned disclosures fully mandatory across the economy by 2025.[12] The New York State Department of Financial Services has also begun pressing banks and insurers to report climate disclosures through the TCFD framework.[13]

The TCFD recommends that climate change disclosures contain four core elements: (1) disclosure of the company's internal governance around climate-related risks and opportunities, including the role of management and board members; (2) disclosure of actual and potential climate change risks that will impact the company's business strategy and operations; (3) disclosure of the processes used by the company to identify, assess, and manage climate-related risks; and (4) disclosure of metrics and targets used to assess and manage relevant climate-related risks and opportunities.[14] A company's disclosures must be tailored to address the unique risks posed to its business by climate change, which varies significantly across industries. The following are examples of the types of climate-related disclosures that align with the TCFD framework:[15]

- The Coca-Cola Company discloses the amount of financial loss it incurs as a result of extreme weather events in the Business & Sustainability Reports it publishes on an annual basis, including losses stemming from floods in Thailand and Japan, and hurricanes in the United

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[10] *Id.*; U.S. SEC, Comment Letter on Form 10-K to Chevron Corporation (Sept. 26, 2016), https://www.sec.gov/Archives/edgar/data/0000093410/000000000016094595/filename1.pdf.

[11] U.S. SEC, Comment Letter on Form 20-FR to FLEX LNG Ltd. (May 1, 2019), https://www.sec.gov/Archives/edgar/data/0001772253/000000000019007895/filename1.pdf.

[12] Dieter Holger & Emese Bartha, *U.K. Requires Companies to Report on Climate Change by 2025*, WALL STREET JOURNAL (Nov. 9, 2020, 6:23 PM), https://www.wsj.com/articles/u-k-requires-companies-to-report-on-climate-change-by-2025-11604964183; *see also* The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, https://www.legislation.gov.uk/uksi/2013/1970/contents/made (requiring companies to disclose GHG emissions in annual reports).

[13] Dieter Holger, *New York Banks Need to Brace for Climate Change, Regulator Says*, WALL STREET JOURNAL (Oct. 29, 2020, 12:20 PM), https://www.wsj.com/articles/new-york-banks-need-to-brace-for-climate-change-regulator-says-11603988421?mod=article_inline.

[14] TCFD, RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES: FINAL REPORT (June 2017), https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf.

[15] TCFD, TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES: STATUS REPORT (2019), https://assets.bbhub.io/company/sites/60/2020/10/2019-TCFD-Status-Report-FINAL-0531191.pdf.

States.[16] The company also tracks trends in its carbon emissions arising from each segment of its business (including packaging, manufacturing, and ingredients).

- Large banks have begun disclosing various metrics used to track how successful they are in managing climate change risks. For instance, UBS Group AG discloses its net credit exposure to "carbon-related assets," which are assets (*e.g.*, loans) tied to the energy and utilities sector, minus "non-carbon-related assets," such as assets tied to renewables and nuclear power. In addition, UBS discloses its greenhouse gas (GHG) "footprint," measured in kilotons of CO_2, which includes direct GHG emissions by UBS, indirect GHG emissions associated with the generation of imported or purchased electricity, and other indirect GHG emissions associated with business travel, paper consumption, and waste disposal.

- Companies in the transportation sector (including air, railway, trucking and maritime transportation of passengers and freight) have also begun disclosing the impact that climate change will have on their business strategies and operations going forward. Some companies have gone so far as to undertake scenario analyses to examine the resilience of their business strategies in light of these impacts, as recommended by the TCFD. For instance, International Airlines Group disclosed how it believed a two-degree Celsius increase in temperature due to global warming would affect company operations versus a four-degree Celsius increase.

- Companies in the raw materials and mining sector have also become more diligent in tracking and disclosing emissions using a variety of metrics, with one South African mine operator, Gold Fields, publishing a presentation containing many disclosures and analyses recommended by the TCFD on climate-related matters.[17] For example, Gold Fields identified South Africa, Australia and Peru as "water-stressed" countries that are likely to continue to suffer from water scarcity due to climate change, and the company disclosed trends and metrics concerning how much water was being used and reused/recycled in connection with its mining operations.

The Sustainability Accounting Standards Board (SASB) and the Climate Disclosure Standards Board (CDSB), which are non-profit organizations dedicated to developing environmental financial disclosure standards, have also published practical, industry-specific guidance that companies can use to implement TCFD climate-related financial disclosures.[18] Given the complexity of mandating climate-related disclosures, including metrics that are appropriately relevant for various industries and geographies, it is possible that the SEC may look to existing frameworks like the TCDF, SASB, or CDSB as the backbone for any disclosure rule proposal. As a member of the FSB, an international body that monitors and regulates the global financial system, the SEC provided input on the TCFD; thus, the framework is one which the career staff is already familiar.[19]

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[16] COCA-COLA COMPANY, 2019 BUSINESS & SUSTAINABILITY REPORT (Sept. 16, 2020), https://www.coca-colacompany.com/content/dam/journey/us/en/reports/coca-cola-business-and-sustainability-report-2019.pdf.

[17] GOLD FIELDS, GOLD FIELDS TCFD REPORT AND ESG OVERVIEW (Oct. 2019), https://www.goldfields.com/pdf/tcfd-report/tcfd-presentation.pdf.

[18] *See, e.g.*, CLIMATE DISCLOSURE STANDARDS BOARD & SUSTAINABILITY ACCOUNTING STANDARDS BOARD, TCFD IMPLEMENTATION GUIDE: USING SASB STANDARDS AND THE CDSB FRAMEWORK TO ENHANCE CLIMATE-RELATED FINANCIAL DISCLOSURES IN MAINSTREAM REPORTING (2019), https://www.cdsb.net/sites/default/files/sasb_cdsb-tcfd-implementation-guide-a4-size-cdsb.pdf.

[19] *See* SEC Public Statement by Chairman Jay Clayton, *Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure* (Jan. 30, 2020), https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30.

Enactment and enforcement of climate disclosure obligations

Once a new Chairperson is appointed, the SEC may either release additional interpretive guidance or begin drafting formal rules governing climate risk disclosures. If climate disclosure rules are drafted, the SEC will first issue a proposed rule and a notice and comment period will follow. The SEC will then consider any comments received before adopting final climate risk disclosure rules applicable to public companies. The rulemaking leading to promulgation of final rules will likely take at least a year.

In the interim, while any rulemaking is in progress, the SEC's path in the area of cybersecurity disclosures is illustrative of what may occur with climate disclosures. In 2011, in response to the growing frequency and severity of cyberattacks against U.S. companies, the staff of the SEC's Division of Corporation Finance issued interpretive guidance that provided general principles for monitoring and disclosing material business risks posed by cyberattacks.[20] Like the climate-risk disclosure interpretative guidance issued by the SEC in 2010, the SEC's 2011 cybersecurity guidance generally directed companies to consider the materiality of business risks posed by cyberattacks and incidents when preparing public disclosures, but failed to provide specific instruction regarding what risks and incidents companies were expected to disclose, and when.

In February 2018, the SEC released new interpretive guidance reiterating that cyberattacks posed "a grave threat to investors, our capital markets, and our country," and provided specific examples of the types of cybersecurity incidents or attacks that a company may be required to disclose.[21] Shortly after issuing this new interpretative guidance, the SEC began targeting companies that made "generic" cybersecurity disclosures lacking substance. For instance, the SEC pressed Luckin Coffee Inc. to "disclose the nature of the board's role in overseeing [] cybersecurity risk management, the manner in which the board administers this oversight function and any effect this has on the board's leadership structure."[22] Luckin Coffee promptly amended its Form F-1 Draft Registration Statement to address these comments. While the SEC continues to send comment letters to companies it believes are deficient in publicly disclosing cybersecurity risks, no formal rule has been proposed by the SEC specifically addressing how and when companies should go about making such disclosures.

Whether or not the SEC presses forward with proposing a formal rule specifically addressing climate-risk disclosures, public companies across all industries should be aware that regulatory pressure to disclose climate-related risks will certainly increase. Enforcement in this arena will primarily come from the SEC given that it may prove difficult for private shareholders to file successful lawsuits alleging material omissions or misstatements concerning climate risk disclosures. Such suits will likely need to prove both damages and loss causation,[23] neither of which are elements for an SEC charge.[24] Under Chairman Clayton,

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[20] U.S. SEC, Division of Corporation Finance, *CF Disclosure Guidance: Topic No. 2* (Oct. 13, 2011), https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.

[21] U.S. SEC, *Commission Statement and Guidance on Public Company Cybersecurity Disclosures*, Release Nos. 33-10459, 34-82746 (Feb. 21, 2018), https://www.sec.gov/rules/interp/2018/33-10459.pdf.

[22] U.S. SEC, Division of Corporation Finance, *Letter to Luckin Coffee Inc.* (Mar. 20, 2019), https://sec.report/Document/0000000000-19-005368.

[23] To establish a private cause of action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, 17 C.F.R. § 240.10b-5, a plaintiff must demonstrate (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission (transaction causation); (5) economic loss (damages); and (6) loss causation. *Stoneridge Investment Partners, LLC v. Scientific–Atlanta, Inc.*, 552 U.S. 148, 157, (2008); *see also, e.g.*, *Ramirez v. Exxon Mobil Corp.*, 334 F. Supp. 3d 832 (N.D. Tex. 2018) (denying Exxon's motion to dismiss for failure to state a claim, holding that the class action plaintiffs sufficiently alleged loss causation in context of their Rule 10(b)-5 claim).

[24] *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(b).

the SEC did not charge any public companies for failing to publish material climate-related disclosures. In fact, in 2018, the SEC dropped its investigation into the climate risk-disclosures of ExxonMobil.[25] This lack of enforcement will likely not continue during the Biden presidency, and companies should begin to prepare.

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Marten Law is one of the nation's premier environmental practices, advising clients on regulatory compliance, public lands issues, project siting, and environmental remediation issues. Its lawyers have represented clients in several of the largest environmental litigation cases in the country: including the 2010 Deepwater Horizon and 1989 Exxon Valdez oil spills and multi-billion Superfund cleanups. Its lawyers have held senior positions in environmental agencies, and collaborated on development projects in the mining, oil and gas, solar, and wind industries. It has also represented, in environmental matters, some of the country's largest manufacturing, transportation, e-commerce, forestry, technology, real estate development, agriculture and financial companies in complex regulatory, permitting, enforcement and administrative matters throughout the United States.

We look forward to helping our clients and friends navigate what will undoubtedly be a fast changing post-election landscape. Watch this space.

[25] *See* Erik Larson, *Exxon Mobil Accounting Probe by SEC Ends with No Action*, BLOOMBERG (Aug. 3, 2018, 9:44 AM), https://www.bloomberg.com/news/articles/2018-08-03/exxon-mobil-accounting-probe-by-sec-said-to-end-with-no-action.

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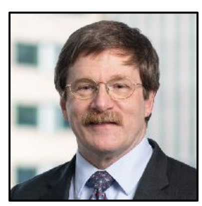

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