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Shedding Light on Climate Risk in 2025: Upcoming Debates About the SEC's Climate Disclosure Rule

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SHEDDING LIGHT ON CLIMATE RISK IN 2025: UPCOMING DEBATES ABOUT THE SEC'S CLIMATE DISCLOSURE RULE

Andrew Bernstein, Cynthia Hanawalt, Lisa Sachs, and Chloe Field

November 2024

Columbia Center
on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL
AND COLUMBIA CLIMATE SCHOOL

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The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and Columbia Climate School at Columbia University, is a leading applied research center and forum dedicated to the study, practice, and discussion of sustainable international investment. Its mission is to develop and disseminate practical approaches and solutions, as well as to analyze topical policy-oriented issues, in order to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multistakeholder dialogue, educational programs, and the development of resources and tools.

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The Sabin Center for Climate Change Law is an academic think tank affiliated with Columbia Law School. The Sabin Center develops legal techniques to fight climate change, trains law students and lawyers in their use, and provides the legal profession and the public with up-to-date resources on key topics in climate law and regulation. It works closely with the scientists at Columbia University's Climate School and with a wide range of governmental, non-governmental and academic organizations.

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I. Introduction

The climate disclosure rule adopted by the U.S. Securities and Exchange Commission in March 2024 requires registrants to disclose how their businesses and financial results will be impacted by climate-related risks, plans, targets, and goals. Much has been written about the rule's requirements and objectives. This paper contends with novel questions of implementation and enforcement that companies and the SEC will face under new agency leadership in 2025.

Publication of this analysis follows the recent presidential election in the United States. The rule's fate is now uncertain given the upcoming transition to a new administration. Should the new administration seek to revise or abandon the rule, the process will take time to finalize, involving a public comment process and requiring a majority vote by SEC Commissioners. In the near term, a new SEC Chair will face immediate decisions about whether and how to enforce the rule, which is currently suspended pending court review. That litigation will also have implications for the rule's ultimate scope and enforcement. Meanwhile, many companies are already taking steps to comply with the rule, given the lead time necessary to prepare and verify the required disclosures, and given similar disclosure requirements that will apply to many companies in other jurisdictions, including California and the European Union.

The purpose of this paper is to contribute to the upcoming debate about the impact and fate of domestic climate disclosure regulations as the United States prepares for a new administration. Questions of implementation and enforcement merit careful consideration in this transition, and the findings and analysis in this report are instructive to the decisions facing the SEC under its next Chair.

Climate Disclosure Today

To a large extent, the new SEC rule requires companies to disclose information they already provide to their investors. This is what the agency found in adopting the rule, and it is corroborated by an in-depth survey prepared for this report. However, companies typically do not include this information in their SEC filings, instead publishing it in sustainability reports available on their websites. This means the disclosure is neither standardized, nor subject to internal disclosure controls or external verification, nor reviewed by the SEC staff. The information companies currently disclose is portrayed as overwhelmingly positive, with companies advertising themselves as good corporate citizens, but very few of them providing meaningful disclosure about the climate-related risks they face. Absent climate disclosure rules, companies can announce climate-related targets and goals without an obligation to report on their progress, and they can change or abandon targets without explaining their decisions to investors.

This will change for many companies when new climate disclosure rules in California and the European Union take effect over the next few years, no matter what happens to the SEC rule. The rules in California and the European Union are in many ways stronger than what the SEC adopted and will necessitate changes in corporate reporting practices. But they will not be subject to the rigor of the SEC review and comment process, they will not be subject to verification and due diligence procedures typically applied to SEC disclosure, and they will not be subject to the heightened liability standards of the US federal securities laws.

What the SEC Climate Disclosure Rule Will Actually Do

In deciding how to proceed, the new administration should consider what the SEC climate disclosure rule does and does not require. Under the rule, companies will disclose how severe weather events, new technologies, and regulatory changes are likely to affect their businesses and financial outlook. Other SEC rules already require this outside the climate context – for example, if a company's main product is rendered obsolete by technological advances of its competitors, or if its markets are impacted by new, restrictive regulations. The climate disclosure rule applies the same concepts in a

new context. And where companies believe that climate issues will not impact their businesses and financial outlook in a way that is material – meaning important to reasonable investors – they do not have to disclose anything under the new rule.

For those who fear the specter of abusive litigation under the new rule, this report finds that unlikely. Private litigation over climate disclosure will face significant legal obstacles, and SEC enforcement may be constrained by limited resources and perhaps by policy decisions of the new administration. Instead, disclosure under the new rule is likely to be shaped primarily by SEC staff guidance and comments, focused on how companies decide what climate risks, plans, targets, and goals are (or are not) material enough to disclose in their SEC reports.

This paper considers all these issues, setting aside ideological factors to evaluate how the rule is likely to be applied in practice. Section II reviews how companies disclose climate issues today, and how those disclosures are likely to change under the new SEC rule. Section III analyzes some of the difficult judgments that companies will have to make in deciding how to comply with the new rule. Next, Section IV describes how verification mechanisms applicable to securities disclosure are likely to apply to climate information disclosed under the new rule. Section V discusses issues relating to private enforcement actions, and the role the SEC can play to ensure the effective application of the new rule.

Whatever position the new administration decides to take on the SEC's climate disclosure rule, the impacts of climate change on corporations and the economy will remain, and essentially every company will face risks, whether from physical weather events, new domestic or foreign regulations, or changes in market dynamics. How effectively companies communicate these risks to investors as they adapt their businesses and seek to raise capital will be shaped by the disclosure rules they are subject to, including the implementation of the SEC's new rule. This paper offers a framework and analysis to ground these questions as a new context for climate issues emerges in the United States.

The SEC Climate Disclosure Rule: What It Will Do and How It Will Work

Climate Disclosure Today: In-Depth Survey Results

- Most companies disclose climate targets and data in sustainability reports, not SEC filings
- Many companies publish Scope 1 & 2 emissions in sustainability reports, some publish Scope 3
- Reporting not standardized, level of verification unclear
- Little or no information on historical or expected climate expenditures
- Climate risk disclosure in SEC reports often formulaic, rarely precise

How Will Companies Comply With the SEC Rule?

- What information is “material” and must be disclosed?
- When will companies need to go beyond “bare minimum” disclosure?
- Do companies have to include information in SEC filings if it appears in sustainability reports or GHG reports under California or EU rules?
- Does climate information have to be updated when companies offer securities?
- It will take time for practices to develop on all of these questions

Enhanced Verification of Climate Disclosure

- Companies must integrate climate information in their disclosure controls and procedures
- Auditor assurance reports for large companies likely to impose standardization and prescriptive verification processes
- Investment banks likely to integrate climate issues in securities due diligence

Enforcing the New Climate Disclosure Rules

- Private “stock-drop” actions might not be viable, mainly because climate disclosure will often impact long-term company value but not short-term share prices
- Prominent SEC enforcement actions could set market expectations, but impact will depend on SEC policy decisions and resource constraints
- SEC staff guidelines and disclosure comments likely to significantly influence how companies comply with the new rules

II. Corporate Climate Disclosure

"Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[1]

Louis Brandeis thus argued vividly in favor of disclosure of corporate behavior, convinced that transparency would reduce malfeasance. When the future Supreme Court Justice made these statements in a 1913 article in Harper's Weekly, a producer of disinfectants was not concerned about the greenhouse gas emissions from its operations, and the utility company generating the light (undoubtedly by burning coal) did not give a thought to its impact on the global climate. Today, companies making disinfectants, producing electricity, and engaging in almost every other activity on the planet, are telling the world about the greenhouse gas emissions they create, and what they are doing to reduce those emissions. Their efforts to produce Brandeis-style sunlight are in many cases eclipsed by a smoky haze surrounding the climate outcomes they claim to be pursuing. And some companies eschew emissions disclosure altogether, leaving investors and other stakeholders in the dark.

The climate disclosure rule adopted by the SEC in March 2024[2] attempts to correct for these flaws. If it becomes effective, the rule will require U.S. public companies to include a broad range of climate-related information in the annual reports they file with the SEC, and in the prospectuses they use to offer and sell securities.

A. The Current Status of Climate Disclosure

The SEC's climate rule was met with fanfare and controversy when it was finalized in March 2024, but corporate climate disclosures are hardly new; they have been around for decades.[3] In the late 1990s, partially in response to the Kyoto Protocol signed in 1997, global groups recognized the need for an international standard for corporate greenhouse gas (GHG) accounting and a standardized way to measure GHG emissions.[4] In 2001, an initial corporate standard for GHG emissions reporting was published by the Greenhouse Gas Protocol organization.[5] In the last quarter-century, these standards have been updated with guidance that clarifies how companies can measure emissions from a variety of inputs, and account for emissions throughout their value chain.

1 Louis D. Brandeis, *"What Publicity Can Do,"* Harper's Wkly, Dec. 20, 1913, at 10, https://www.sechistorical.org/collection/papers/1910/1913_12_20_What_Publicity_Ca.pdf.

2 The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities and Exchange Commission, Securities Act Release No.11275, Exchange Act Release No. 99678, 89 FR 21668 (Mar. 28, 2024) [hereinafter Adopting Release]. For simplicity, this report refers to page numbering in the Adopting Release based on the version published on the website of the SEC, available at https://www.sec.gov/rules-regulations/2024/03/s7-10-22.

3 Press Release, Sec. & Exch. Comm'n, SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 6, 2024), https://www.sec.gov/newsroom/press-releases/2024-31.

4 Kyla Aiuto et al., *What Are Greenhouse Gas Accounting and Corporate Climate Disclosures? 6 Questions, Answered,* World Res. Inst. (Mar. 7, 2024), https://www.wri.org/insights/ghg-accounting-corporate-climate-disclosures-explained.

5 *About Us*, Greenhouse Gas Protocol, https://ghgprotocol.org/about-us (last visited Oct. 17, 2024).

Today, companies around the world regularly disclose substantial amounts of climate information. Of the 2,000 largest publicly-traded companies in the world by revenue, 1,179 claim to have net-zero targets.[6] Private firms lag behind this metric, but of the 100 largest private firms, 40% claim to have net zero targets.[7] According to CDP's environmental action tracker, as of 2022, there were 2,191 companies disclosing emissions in the United States, and there has been a significant increase over time, as shown in the following graphic:

Source: CDP Environmental Action Tracker

The SEC has recognized that many U.S. reporting companies[8] already publish significant climate disclosure. But in adopting the new climate disclosure rule, the SEC found that "the climate-related information that companies currently provide … is inconsistent and often difficult for investors to find and/or compare across companies."[9]

The SEC's conclusions were based on its review of more than 50,000 annual reports filed from 2016 to 2022, which found that the words "climate risk" and similar terms appeared in more than one-third of the annual reports.[10] In 2022, these terms appeared in approximately half of the annual reports of accelerated filers, and more than two-thirds of the annual reports of large accelerated filers ("accelerated filers" are generally companies with a market capitalization of at least $75 million, and "large accelerated filers" are generally companies with a market capitalization of at least $700 million[11]). The SEC's analysis was limited, however, to a keyword search for the appearance of these terms and did not evaluate how climate risks were disclosed.

The SEC also cited a study finding that, among companies in the Russell 1000 Index, 90% publicly disclose some climate-related information and almost 60% provide disclosures regarding their GHG emissions.[12] Most of this disclosure was published outside of SEC filings, in sustainability reports or similar documents available on company websites. According to the SEC, "[w]hile some registrants may currently provide disclosure about their climate-related targets or goals, those voluntary disclosures generally do not provide investors with an understanding of whether and how the climate-related targets or goals materially impact or are reasonably likely to materially impact the registrant's business, results of operations, or financial condition."[13]

6 *Data Explorer*, Net Zero Tracker, https://zerotracker.net/#companies-table (last visited Oct. 17, 2024).

7 https://zerotracker.net/insights/privately-owned-firms-unprepared-for-incoming-climate-regulation.

8 "Reporting companies" are companies that are required to file reports with the SEC because they have publicly offered or listed securities in the United States, or because they have more than a given number of security holders (US security holders, in the case of foreign companies). For simplicity, this report refers to "companies," meaning "reporting companies" unless the context otherwise requires.

9 Adopting Release, *supra* note 2, at 12.

10 Adopting Release, at 611.

11 17 CFR § 240.12b-2(1) & (2) (2023).

12 Adopting Release, at 11, 625.

13 Adopting Release, at 624.

There are a number of reasons companies may publish climate information outside their SEC annual reports. First, the existing rules simply do not require the information to be in SEC reports, except to the extent of limited risk disclosure the SEC said was required in guidance it published in 2010.[14] Second, while climate disclosure has developed over approximately two decades, it has only recently become a focus of investor interest. Companies that developed the practice of publishing separate sustainability reports, often under the responsibility of teams different from those responsible for SEC reports and financial disclosure, may be continuing their long-standing practices. Third, companies may be concerned that including climate information in SEC reports could increase their risk of litigation for alleged greenwashing. Fourth, companies may fear that much of their climate disclosure, particularly relating to plans and targets, would constitute forward-looking information, which companies typically do not include in their SEC reports.

The last point may be particularly important. Disclosure practices regarding climate information seem to resemble practices regarding forward-looking financial information, which many companies regularly communicate to investors, although rarely in SEC reports. Companies frequently publish financial "guidance" with targets for items such as revenues, operating income, or debt levels, but the guidance typically is included in financial press releases and slide presentations, not in SEC filings. The reason relates largely to liability risk. Forward-looking information is inherently difficult to verify and potentially wrong. Under the U.S. federal securities laws (particularly Rule 10b-5 under the Securities Exchange Act of 1934), private plaintiffs generally must allege (and ultimately prove) intentional misstatement to succeed with a claim based on misstatements or misleading omissions in financial press releases and slide presentations.

In contrast, SEC reports are incorporated by reference into the prospectuses used to offer and sell new securities to investors. Under Sections 11 and 12(a)(2) of the Securities Act of 1933, investors can bring claims for materially misleading or incomplete disclosure in prospectuses without having to allege or prove fraud. While both laws contain "safe harbor" provisions limiting liability for forward-looking information under certain circumstances, in practice, parties are reluctant to rely on the safe harbor alone to address liability risk, in part due to litigation cost. For this reason, companies generally prefer to include their financial forward-looking information in documents that are subject to a fraud standard, rather than the stricter liability standard associated with securities offerings.

In addition, liability risk for prospectuses is imposed not only on the companies that issue the securities, but also on the investment banks that underwrite securities offerings. Many investment banks thus discourage companies from including forward-looking information in their prospectuses to reduce their risk of strict liability, fearing that if a company experiences financial difficulty, the investment banks might be the only "deep pocket" from which investors can seek to recover their losses. Generations of securities lawyers have been trained to exclude forward-looking information from prospectuses.

This training may lead securities lawyers (or company general counsels who are former securities lawyers) to recommend that companies avoid including climate information in SEC reports, particularly with respect to future plans, targets, and goals. These recommendations are unlikely to meet resistance from executives or investor relations teams, who are generally content to have the information available in slide presentations and communications documents such as sustainability reports.

B. Survey of Recent Climate Disclosures

In connection with this report, the authors conducted a review of the SEC annual reports and sustainability reports of a sample of public companies from various sectors. The findings were broadly consistent with those reported by the SEC.[15] In particular, almost all of the companies surveyed publish climate-related disclosure, and very few of them include this disclosure in their SEC reports.

14 Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61469, FR-82 (Feb. 8, 2010) [hereinafter, 2010 Guidance].

15 There is a range of additional literature surveying or studying corporate climate disclosures, across industries and at varying levels of detail. Select examples include: Lee Reiners and Charlie Wowk, *Climate Risk Disclosures & Practices: Highlighting the Need for a Standardized Regulatory Disclosure Framework to Weather the Impacts of Climate Change on Financial Markets*. Climate Risk Disclosure Lab, Glob. Fin. Mkts. Ctr., Duke U. Sch. of L., (2020), https://econ.duke.edu/sites/econ.duke.edu/files/documents/Climate-Risk-Disclosures-and-Practices.pdf; Persefoni AI Inc. and Society for Corporate Governance, *The State of Climate Disclosure & Governance 2023*, (Aug. 2023), https://www.persefoni.com/expert-publications/the-state-of-climate-disclosure-and-governance-2023?utm_campaign=LP_2023_State_Of_Climate_Disclosure_And_Governance&utm_source=press-release; Nako Kobayashi and Philippe Atallah, *Taking Stock: The State of Climate Action and Disclosure in the Food Sector*, Ceres (Sept. 2024), https://www.ceres.org/resources/reports/taking-stock-the-state-of-climate-action-and-disclosure-in-the-food-sector; Barbara Davidson and Rob Schuwerk, *Flying blind: The glaring absence of climate risks in financial reporting*, Carbon Tracker (Sept. 2021), https://carbontracker.org/reports/flying-blind-the-glaring-absence-of-climate-risks-in-financial-reporting/; *Sustainability Disclosure Practices*, The Conference Board, https://www.conference-board.org/topics/sustainability-practices (last visited Oct. 30, 2024).

Most of the information appears in sustainability reports or similar documents published on company websites, available to investors through links on investor relations web pages.

The survey also confirms that disclosure in sustainability reports is highly variable in quality and nature. Companies with businesses that are particularly subject to climate-related risks (including oil and gas sector companies) tend to provide the most detailed disclosure. Large accelerated filers provide more information than accelerated filers. Significantly, the sustainability reports are overwhelmingly positive and focus on how companies are acting as good corporate citizens. They rarely discuss difficulties companies encounter in trying to meet their climate ambitions (whatever those ambitions might be). With a few exceptions, companies generally do not explain the variation in GHG emissions from one year to the next. And while many companies mention climate change as part of their risk disclosures, very few provide specific information about the way in which climate change risk impacts (or could impact) their business, results, or financial condition.

The survey reviews the most recent (as of September or November 2024, depending on the company) SEC annual reports and separate sustainability reports of 30 reporting companies,[16] including 20 large accelerated filers and 10 accelerated filers.[17] These companies operate in a range of sectors including technology, aviation, oil and gas, steel, building materials, supermarkets, food & agriculture, pharmaceuticals, pulp & paper, shipping, hotels, and industrial automation, among others. The survey does not include financial sector companies, as their climate disclosures raise complex issues that go beyond the scope of the survey. The companies in the survey are mainly U.S. companies, although three foreign companies were included to compare their climate disclosure practices.

A number of companies provide information in their SEC reports about how climate change issues impact their business strategies. Several companies claim that the use of their products will reduce the emissions of their customers compared to the use of products offered by competitors. Many companies say that sustainability is a significant part of their strategies while providing few details of how this is the case. A few companies provide more detail, such as ExxonMobil, which explains that its ambition to reduce emissions depends to a significant extent on the deployment of carbon capture technology.

The picture is different in sustainability reports, which generally contain extensive detail on how companies intend to meet their climate and other sustainability goals. Sustainability reports are often 75 to 100 pages long, with numerous examples of steps that companies have taken or intend to take - but, notably, without financial information - in pursuit of their climate and sustainability ambitions. The reports generally address many subjects other than climate, including biodiversity, water usage, energy conservation, recycling, and a variety of issues specific to the businesses of individual companies (Kroger Supermarkets, for example, focuses on reducing food waste, and Pfizer on sustainable medicines). Many sustainability reports cover ESG strategies more generally, with a focus on human resources and governance, as well as climate and environmental issues. But despite the detail, there generally is little information about problems or obstacles companies face in addressing climate-related risks.

The vast majority of the surveyed companies publish disclosure on emissions targets and/or emissions data (in most cases, they publish both targets and data), although this is almost exclusively outside SEC reports. Emissions targets and/or data are published by all of the large accelerated filers except one (a low-cost airline), and half of the accelerated filers. Twelve large accelerated filers publish data on Scope 1, 2, and 3 emissions (or emissions intensity, for Scope 3), while one accelerated filer (an oil and gas company) publishes Scope 1, 2, and 3 information. The remaining companies that publish emissions data limit the information to Scope 1 and 2 (although some say they are working on Scope 3 information).

In almost all cases, the information on emissions targets and data is published only in sustainability reports or similar documents available on company websites. Only three companies publish emissions data in their SEC reports, two of which are European companies that include the same information in their SEC filings that they include in their home country financial reports. The only U.S. company in our survey that includes emissions data in its SEC filings is United Airlines. Ten companies include emissions targets or net zero goals in their SEC filings, meaning that seven of them include these

16 The companies are (in alphabetical order by category): Large accelerated filers – Berkshire Hathaway Energy, Carrier, Eagle Materials, ESAB, ExxonMobil, Ingersoll Rand, Kroger Supermarkets, Marriott, Microsoft, Navitas Semiconductors, Ovintiv, Pfizer, Procter & Gamble, Rockwell Automation, SAP (foreign issuer), Sun Country Airlines, TotalEnergies (foreign issuer), United Airlines, US Steel, Valero Energy; Accelerated filers – AMC Networks, Ardmore Shipping (foreign issuer), Clearwater Paper, Eastman Kodak, Forrester Research, Havertys Furniture, Marine Products, Northern Oil & Gas, Oil States International, Seneca Foods.

17 This paper does not review the filings or reports of any emerging growth companies or smaller reporting companies, as they are not subject to the requirement of the SEC climate disclosure rule to disclose GHG emissions. 17 C.F.R. § 229.1505(3)(i) (2023).

targets or goals without providing any underlying emissions data. In a few cases, companies refer in their SEC reports to the existence of their sustainability reports, but they generally state explicitly that the sustainability reports are not incorporated by reference into the SEC reports.

Most sustainability reports claim to provide information in accordance with a recognized standard, most frequently the GHG Protocol or the standards of the SASB (Sustainability Accounting Standards Board), which has been absorbed by the International Sustainability Standards Board (ISSB) of the IFRS Foundation. Some companies provide TCFD reports or include TCFD information in their sustainability reports, claiming that their disclosures meet the standards recommended by the TCFD. The TCFD is the Task Force on Climate-Related Financial Disclosure (also absorbed by the ISSB), whose recommendations largely inspired the SEC's rule, as discussed below. None of the companies publish third party assurance reports confirming that their information complies with the standards they cite. A few companies say they have obtained third party reports, but they do not include copies in their sustainability reports.

The emissions data published in sustainability reports is variable in nature. In many cases, tables of GHG emissions data include long, dense footnotes indicating exclusions from or qualifications to the indicators defined in the standards referenced. It is not always clear whether this is because the information is not considered to be relevant, or whether it is a choice of the company. A few companies publish their own indicators that appear intended to be similar to those of the recognized standards, but not the same. Berkshire Hathaway Energy, for example, publishes data on "owned generation" emissions and "purchased power" emissions, which seem to be conceptually close to Scope 1 and 2 emissions.

With respect to climate-related risks, the trend is precisely the opposite, as companies publish risk information primarily in SEC reports, but not in sustainability reports or other communication documents. Sixteen large accelerated filers and seven accelerated filers mention climate change in the risk factor disclosure in their SEC reports, while only three companies (TotalEnergies, Pfizer, and Procter & Gamble) mention climate-related risks in their sustainability reports. In the SEC reports, the risk factor disclosure is usually formulaic, containing a general statement that a company's results and financial condition might be affected by climate change issues, most frequently referring to physical risk (from natural disasters, flooding, wildfires, and the like). This suggests that the SEC's survey, based on keyword searches for "climate change" and similar terms, almost certainly overstates the proportion of companies providing meaningful risk disclosure. Only one company in the survey (Berkshire Hathaway Energy) provides information on the exposure of facilities to specific categories of severe weather events and conditions, while two companies report on recent severe weather events that have impacted significant facilities. Several companies (mainly in the oil and gas sector) mention the transition risk of changing regulations resulting from climate change.

None of the US companies provides information about anticipated expenditures relating to climate issues, although one (Pfizer) says it expects such expenditures will not be material. Two European companies, TotalEnergies and SAP, provide such information in accordance with the European Taxonomy Regulation.[18] None of the companies provides information with respect to the impact of climate mitigation, adaptation, transition plans, targets, or goals on financial estimates and assumptions, as the new SEC rule will require them to do.

C. The SEC Climate Disclosure Rule

The SEC's climate disclosure rule has generated a tremendous amount of interest since it was first proposed. The SEC took two years to approve the rule, sifting through 4,500 unique comments and 18,000 form letter comments.[19] And it is still not in force - after adoption, the final rule was challenged in federal courts, mainly based on assertions that the SEC exceeded its authority by focusing on climate rather than its traditional mandate of investor protection.[20] The legal challenge seems hard to sustain, largely because the rule limits its disclosure requirement to climate information that is material to a company's business, results, and financial condition, topics that have been subject to SEC disclosure requirements since the federal securities laws were adopted by Congress more than ninety years ago. But until the

18 The European Taxonomy Regulation established definitions and standards for various types of sustainability disclosures. In particular, Article 8 of the Taxonomy Regulation requires companies subject to CSRD (and its predecessor) to publish information on the percentage of their revenues associated with qualified sustainability activities, and the percentage of their capital expenditures and operating expenditures relating to assets or processes associated with such activities. Council Regulation 2020/852, art. 8, 2020 O.J. (L 198) 13 (EU).

19 Adopting Release, at 16.

20 *State of Iowa et. al. v. SEC*, No. 24-1522 (8th Cir. 2024).

court decides on this (assuming the SEC continues to defend the rule), the rule remains suspended. Even so, many companies are not waiting, already preparing to comply with the new disclosure requirements.

By mandating the inclusion of material climate information in SEC reports, the SEC's climate disclosure rule will change existing practices in a number of ways, with potentially substantial impacts. The rule will require companies to publish more extensive climate information, including forward-looking financial information on anticipated expenditures relating to climate-related plans, targets, and goals. It will require climate disclosure to converge around recognized standards (such as the GHG Protocol). It will subject climate information to disclosure controls and procedures and due diligence practices intended to make information more reliable (as discussed in Section IV). It will impose new verification procedures in the form of third-party assurance reports on emissions data. It will give the SEC the ability to review and comment on company climate disclosure, allowing the SEC (if it chooses to do so) to push companies to adopt what it views to be best practices regarding climate disclosure. It will subject climate disclosure to heightened liability standards, along with the risk of SEC scrutiny and enforcement actions.

The SEC's rule was derived largely from recommendations in a report published in 2017 and updated in 2021 by the Task Force on Climate-Related Financial Disclosures (TCFD), a task force of financial industry leaders established by the Financial Stability Board, an international body created by the G20 to address risks to the international financial system after the global financial crisis.[21] The mission of the TCFD (which has recently been absorbed by the ISSB) was to develop voluntary, consistent climate-related financial disclosures that would be useful to investors, lenders, and insurance underwriters in understanding material climate-related risks. The focus of the SEC rule, like that of the TCFD report, is on disclosure of climate issues that have significant business and financial implications, of relevance to investors.[22] Like the TCFD report, the SEC rule does not focus on information relating to how a company's activities impact the climate, or to the appropriateness, rigor, or suitability of risk assessments or risk mitigation or management measures.

The SEC rule's principal requirements have been summarized many times, including in the SEC's helpful fact sheet published when the final rule was adopted,[23] and in numerous memoranda published by law firms.[24] In short, the new rule as published will require a reporting company to disclose the following in its SEC annual reports:[25]

- The actual or potential impacts of climate-related risks on its strategy, results, or financial condition, separately identifying physical risks (such as risks from severe weather events, wildfires, and flooding) and transition risks (such as technological or regulatory changes that could impact a company's business), and explaining whether the risks are short-term (12 months or less) or longer term.
- The impact of identified risks on the company's strategy, business model, and outlook, including how those impacts are considered in strategic and financial planning, as well as capital allocation.
- Processes for managing climate risks, including the roles of the board of directors and management in these processes.
- Any climate-related transition plan (generally meaning plans to change business activities and operations) adopted to address material transition risks.
- Any climate-related target or goal that has materially affected or is reasonably likely to materially affect the company's business, results of operations, or financial condition.
- The material expenditures incurred and material impacts on financial estimates and assumptions directly resulting from climate mitigation and adaptation activities, and from actions to implement climate transition plans and to achieve targets and goals (what is meant by "financial estimates and assumptions" is discussed later).

21 Task Force on Climate-related Fin. Disclosures, Final Report, Recommendations of the Task Force on Climate-Related Financial Disclosures iii (June 2017); Adopting Release, at 24.

22 Id.

23 *Fact Sheet: The Enhancement and Standardization of Climate-Related Disclosures: Final Rule*, Sec. & Exch. Comm'n (Mar. 6 2024), https://www.sec.gov/files/33-11275-fact-sheet.pdf.

24 Helena K. Grannis et al., *It's Not Going to Be Easy Being Green: Final SEC Climate Rules*, Cleary Gottlieb Steen & Hamilton (Mar. 7, 2024), https://www.clearygottlieb.com/news-and-insights/publication-listing/its-not-going-to-be-easy-being-green-final-sec-climate-rules; *Amid storm of controversy, SEC adopts final climate disclosure rules*, Davis Polk & Wardwell (Mar. 11, 2024), https://www.davispolk.com/insights/client-update/amid-storm-controversy-sec-adopts-final-climate-disclosure-rules; John W. White et al., *A Deeper Dive into the SEC's Landmark Climate Disclosure Rules for Public Companies*, Cravath Swaine & Moore (Mar. 18, 2024), https://www.cravath.com/news/a-deeper-dive-into-the-secs-landmark-climate-disclosure-rules-for-public-companies.html.

25 The SEC climate disclosure rule appears primarily in new Item 1500 of Regulation S-K, 17 C.F.R. § 229, and in new Article 14 of Regulation S-X (for the financial statement requirements), 17 C.F.R. § 210. For simplicity, when referring to provisions of the new rule, this report generally does not cite to the individual parts or sub-parts of Item 1500 or Article 14.

- For a large accelerated filer or accelerated filer, Scope 1 and 2 GHG emissions, if such emissions are material. Emissions data for a fiscal year must be published no later than 225 days after the end of that fiscal year (i.e., mid-August for a company with a fiscal year ending December 31). A company must disclose the "protocol or standard" used to calculate GHG emissions. It also must publish a third-party attestation report on the data, at the "limited assurance" level after three years, and at the "reasonable assurance" level after seven years if it is a large accelerated filer. A limited assurance report confirms that the verifier knows of no material misstatement or omission after performing diligence procedures, while a reasonable assurance report is more rigorous and confirms that the emissions information was prepared in accordance with the relevant protocol or standard.[26]
- In a note to the company's audited financial statements, the expenses and capitalized costs incurred as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise, if they exceed a de minimis threshold (1% of pre-tax income or equity, subject to minimum absolute levels).

The aspect of the SEC's rule that garnered the greatest amount of attention is the requirement for larger companies to disclose data on GHG emissions. Yet this requirement was limited in the final rule to Scope 1 and 2 emissions data, which many larger companies already disclose outside of their SEC reports. What is new in the SEC rule is that companies must bring this data into their SEC reports, backed by third-party attestation reports.

Another novel aspect of the new rule is the requirement that companies disclose expenditures relating to severe weather events and other natural conditions in a note to their audited financial statements. By requiring companies to place this disclosure in financial statements, rather than in other parts of their SEC reports, the SEC is requiring it to be subject to scrutiny by a company's auditors, as well as being incorporated into a company's internal control over financial reporting, which is also subject to auditor review.[27] The SEC rule also requires a company to engage in the difficult process of allocating expenditures to these events and conditions, which they are not required to do for many other types of expenditures.

Perhaps most significantly, the SEC rule requires extensive disclosure about how climate issues impact a company's future plans, with quantitative and qualitative disclosure about material expenditures they expect to incur to address climate-related risks and to implement climate-focused transition plans, targets, and goals – so-called "forward-looking information." The rule requires companies to disclose "quantitative and qualitative" information on how plans, targets, and goals are expected to impact "financial estimates and assumptions" used in a company's financial statements. According to the SEC, financial estimates and assumptions include "the *projected financial information* used in impairment calculations, estimated loss contingencies, estimated credit risks and commodity price assumptions".[28] As the SEC explains, "these disclosures will allow investors to evaluate material impacts on future cash flows, which will help investors make more informed investing decisions."[29]

As described by the SEC, the rule seems to require that companies disclose quantitatively their expected material future expenditures on climate-related plans, targets, and goals. This goes beyond the forward-looking information companies currently disclose. With limited exceptions, the SEC's existing disclosure rules do not require a company to disclose forward-looking financial information. It would be unusual for a company to provide quantitative information on its non-climate "future cash flows" in its SEC reports, as the SEC seems to contemplate companies will do with respect to climate-related issues in the new rule.

26 INT'L. AUDITING & ASSURANCE STANDARDS BD., INTERNATIONAL STANDARD ON ASSURANCE ENGAGEMENTS (ISAE) 3000 (REVISED) ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OR REVIEWS OF HISTORICAL FINANCIAL INFORMATION (Dec. 9, 2013), ¶ 12(a)(i), https://www.iaasb.org/publications/international-standard-assurance-engagements-isae-3000-revised-assurance-engagements-other-audits-or. The IAASB has approved a standard (ISAE 5000) for sustainability assurance, which is scheduled to take effect in 2025. The definitions of reasonable and limited assurance in the ISAE 5000 Exposure Draft are the same as those in ISAE 3000. Proposed International Standard on Sustainability Assurance 5000 General Requirements for Sustainability Assurance Engagements, Exposure Draft (August 2023).

27 Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Securities Act Release No. 8238, Exchange Act Release No.47986, 68 FR 36636 (June 5, 2003).

28 Adopting Release, at 496, 508.

29 Adopting Release, at 506.

D. Other Recent Corporate Climate Disclosure Rules

The SEC's new rule is not the only climate disclosure initiative adopted in recent years. Two of the most prominent are the climate disclosure laws adopted by the State of California in October 2023,[30] and the reinforced climate disclosure requirements adopted by the European Union (EU) in December 2022 through the Corporate Sustainability Reporting Directive (CSRD).[31] The California and EU rules are stronger in several significant respects than the SEC's rule.

California's climate disclosure laws will require large companies doing business in California to publish more information than the SEC rule, including data on emissions from a company's suppliers and customers (Scope 3) that the SEC deleted from the requirements of its final rule. The European Union's Corporate Sustainability Reporting Directive (CSRD) will require companies subject to its rules (including US companies with significant EU revenues) to report information on climate, pollution, biodiversity, water usage, and a large number of other ESG topics, under highly prescriptive reporting standards that go well beyond what the SEC requires. Companies subject to CSRD will have to report climate information not only when it has a significant financial impact on them, but also when their activities have a significant impact on the climate. The SEC does not have the authority to adopt such a broad disclosure rule, which is why its rule only covers climate issues that have a financial impact on companies, making it significantly weaker than the disclosure rules adopted in the EU.

California

The California climate disclosure laws are currently scheduled to take effect in 2026. Once effective, the rules will require companies with total annual revenues above $1 billion that do business in California to publish information on their Scope 1 and 2 emissions in 2026, and their Scope 3 emissions 180 days later (effectively, starting in 2027). The inclusion of a requirement to disclose Scope 3 emissions is probably the most significant difference compared with the final SEC rule. The emissions information is not limited to those generated by activities in California but includes emissions from sources that an entity owns or directly controls, regardless of location. The data must be prepared in accordance with the GHG protocol, a contrast with the SEC rule, which allows companies to use any recognized standard. Emissions data will need to be covered by third-party assurance reports (initially, limited assurance, but evolving over time to reasonable assurance for all companies subject to the California law).

The California climate disclosure laws also require companies (other than insurance companies) doing business in California with annual revenues equal to or in excess of $500,000,000 to report their climate-related financial risks on a biennial basis, without any materiality qualifier. Climate reports are to be published on company websites.

European Union

The EU has required large public companies to disclose climate information and data since 2017,[32] and many EU member states have required similar disclosure for years before that.[33] The EU requirements are in the process of being expanded and reinforced significantly under CSRD, which was adopted in December 2022. The first reports under the CSRD regime will be published in 2025 (covering 2024 fiscal years) by large companies with securities publicly listed in the European Union as well as certain large financial institutions. The regime will apply progressively to other companies, including U.S. companies with significant EU revenues, beginning in 2030 (reporting on 2029 fiscal years), even if they do not have securities publicly listed in the EU.[34]

Like the SEC rule, CSRD requires companies to disclose information about climate-related risks, plans, targets, and goals, as well as data on GHG emissions. But that is where the similarity ends. The CSRD regime applies to a much broader range of companies, which are required to follow detailed, prescriptive disclosure requirements well beyond what is required by the SEC rule. These disclosure requirements

30 Cal. Health & Safety Code § 38532 (2024); Cal. Health & Safety Code § 38533 (2024).

31 Council Directive 2022/2464, O.J. (L 322) 15 (EU) [hereinafter, CSRD]. CSRD is not a stand-alone directive, but is an amendment to the EU Auditing Regulation, the EU Transparency Directive and the EU Accounting Directive. The article numbers in CSRD referred to in this report correspond to the numbers of the amended articles in the Auditing Regulation, the Transparency Directive and the Accounting Directive.

32 Council Directive 2014/95, O.J. (L 330) 1 (EU) [hereinafter, NFRD].

33 In France, for example, this has been required under the "NRE" (new economic regulations) law adopted in 2001. *Loi n° 2001-420 du 15 mai 2001 relative aux nouvelles régulations économiques*.

34 Accounting Directive (as amended by CSRD), Art. 40a.

are set out in a 2023 European Commission Regulation adopting the European Sustainability Reporting Standards, or ESRS, a 245-page document (plus a definition annex) that contains extensive disclosure requirements.[35] The CSRD also requires disclosure of a broad range of topics that go well beyond climate-related issues, including pollution, bio-diversity, water usage, resource use, and circular economy, and a variety of workforce, community, consumer, and business conduct issues.[36]

The CSRD regime requires disclosure based on a materiality standard that is completely different from that of the SEC rule. The SEC rule only requires companies to include information in SEC reports if it is material (meaning important to reasonable investors) to its business, results, or financial condition. The CSRD requires disclosure of information based on a "double materiality" standard, under which information is considered material based on its anticipated financial effects on the reporting company (financial materiality) or when the company's activities have a material impact on the climate or other covered topic (impact materiality).[37] Companies are required to describe their materiality analysis in their reports, as well as the reasons why they consider information they do not disclose to be immaterial.[38]

Like the SEC rule, the CSRD requires companies to describe information relating to their business model and strategy, including the resilience of the business model and strategy to risks related to sustainability, as well as adaptation and mitigation plans and transition plans. Unlike the SEC rule, which requires no disclosure when a company lacks a plan, the CSRD requires a large company to disclose its "plans to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5°C in line with the Paris Agreement," and a 2050 net zero objective (net zero is generally defined to mean a reduction of at least 90% to 95% in emissions within a company's value chain, with the residual emissions offset by removals).[39] ESRS allows companies to omit this disclosure if they have not adopted the relevant policy or plan, but in that case they must disclose when they intend to have the policy or plan in place.[40] Arguably, the CSRD effectively obligates companies to have a 1.5°C compatible plan or to set a timetable for adopting one, failing which they risk being viewed as non-compliant.[41]

Under the ESRS, companies subject to the CSRD regime must publish a broad array of metrics, including Scope 1, 2, and 3 GHG emissions and intensity (emissions divided by net revenue based on a prescribed calculation method), and numerous metrics relating to energy usage (including the sources of energy consumed), pollution, water usage, biodiversity, and other topics. With respect to emissions, companies must disclose decarbonization targets for multiple years, broken into multiple categories.[42] Where targets and plans will require specific expenditures, companies must describe the financing sources to be used for the targets and plans, including a description of any sustainable financing instruments.[43] They also must disclose the historical and anticipated financial effects of climate-related risks.[44] "Anticipated financial effects" are defined to mean how a company expects its financial position, financial performance, and cash flows to change over the short-, medium-, and long-term, given its strategy to manage risks and opportunities.[45]

CSRD disclosures must be covered by third-party assurance reports from auditors or other qualified experts. The assurance reports are much broader than those required by the SEC rule, which cover only Scope 1 and 2 emissions data. The reports to be provided pursuant to the CSRD must confirm the compliance of a company's sustainability disclosures with the CSRD/ESRS requirements, as well as the requirements of any international protocol or standard governing the information in the company's sustainability report.[46]

35 Commission Delegated Regulation 2023/2772, 2023 O.J. (L 2722) 1 (EU). This report refers to the European Sustainability Reporting Standards by using the references contained in Annex 1 to this Commission Delegated Regulation or definitions contained in Annex 2 to this Commission Delegated Regulation.
36 Accounting Directive (as amended by CSRD), Art. 29b(2).
37 CSRD, Recital 29; ESRS 1, §§ 2.3, 3.2, 3.3.
38 ESRS 1, Art. 3.
39 Accounting Directive (as amended by CSRD), Art. 19a(2)(iii); ESRS Annex 2, definition of "net zero."
40 ESRS 1, ¶ 33.
41 Based on a literal reading, CSRD does not permit a company to exclude disclosure relating to a plan consistent with the 1.5°C objective of the Paris Agreement. ESRS does not (and cannot) provide an exemption from the CSRD requirement, but it allows companies to omit the specific disclosures called for by ESRS if they have no plans. Given that CSRD imposes only a disclosure requirement and not a substantive one, and that these disclosure requirements are laid out in ESRS, the ESRS exception would seem to constitute an exception to the CSRD requirement as a practical matter.
42 ESRS 2, ¶AR 31.
43 ESRS 1, ¶ 69.
44 For environmental matters, these requirements are in ESRS2, Disclosure Requirements E1-9, E2-6, E3-5, E4-6 and E5-6.
45 ESRS Disclosure Requirement SBM-3, ¶ 48.
46 Accounting Directive, as amended by CSRD, Art. 34(a)(ii)(aa).

III. Implementing the SEC Climate Disclosure Rule

The threefold purpose of the SEC's climate disclosure rule is to require the publication of more meaningful climate disclosure, to require companies to use recognized standards for their disclosure, and to concentrate disclosure on information that is important for investors. The success of the SEC's climate disclosure rule will largely depend on how companies implement the rule in practice, assuming the rule becomes effective.

This section addresses the main considerations for companies in determining how to comply with the new SEC rule. Their decisions will likely depend on their interpretation of the text of the rule, their view of the legal context, and the actual and perceived liability and enforcement risks associated with their disclosure decisions.

The main decisions companies will need to make in deciding how to implement the SEC climate disclosure rule fall into two primary categories. First, companies will need to decide what information on climate risks, plans, targets, and goals is "material." Second, companies will have to determine whether and to what extent to go beyond "bare minimum" compliance with the itemized requirements of the new rule to ensure their disclosure is not misleading.

A. Materiality

The SEC's climate disclosure rule is shaped by materiality qualifiers (based on financial materiality); indeed, the word "material" and its derivatives are used 1,840 times in the final SEC release. Climate disclosure generally is required only when it is material to a company's business, results, and financial condition. The proliferation of materiality qualifiers was a significant change from the proposed rule, which would have imposed a number of climate-related disclosures without providing for companies to assess whether they are material. This section grapples with the implications of that change.

The SEC's heavy reliance on materiality in the climate disclosure rule means the provision of climate disclosure will largely depend on a company's materiality judgment, which will itself depend on its assessment of its own compliance and liability risks. This will particularly be true in the first few years after the rule is implemented, as best practices are developed. Over time, SEC guidance and court decisions will clarify the quality and level of detail necessary to meet the materiality threshold for the various categories of climate information required by the rule.

Because the climate-risk disclosure rule incorporates traditional notions of materiality as a basis for most elements of the required disclosures, registrants will need to grapple with materiality determinations they may not have considered previously. In many cases this will not be an easy task. As Professor George Georgiev noted in his testimony about the then-proposed rule before the House of Representatives:

> Materiality-qualified disclosure requirements may appear attractive due to their flexibility, but they can also be very time- and resource-intensive because issuers must engage in particularized materiality testing of each piece of information in order to determine whether they have a legal duty to disclose.[47]

Given the potential costs of making these determinations, and the potential risks of getting things wrong, the materiality qualifiers may ultimately not be advantageous for many companies. Rather than bearing these costs and risks, some companies may be well advised to disclose their climate risks, plans, targets, and goals, and their GHG emissions, even if the materiality of the information for investors is not certain. Some companies are likely to take the opposite approach, construing the concept of materiality narrowly.

47 George S. Georgiev, *Congressional Testimony: The Legality of the SEC's Proposal and Process for Climate-Related Disclosure* (Jan. 18, 2024), at 16, https://ssrn.com/abstract=4730777.

1. Applying Traditional Materiality Standards to Climate Disclosure

The concept of materiality is central to U.S. securities laws, yet it is difficult to apply in practice. Materiality has been described as "a notoriously slippery concept, unpredictable and elusive in application," with no bright lines to guide the test.[48]

This difficulty exists even though the concept of materiality has remained essentially the same since it was defined by the Supreme Court nearly half a century ago. In *TSC Industries v. Northway Inc.*, decided in 1976, Justice Thurgood Marshall articulated the concept in the context of an omission of information from a proxy statement (a proxy statement is an information document used to solicit shareholder votes):

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. [...] It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.[49]

The Supreme Court also said the statutory scheme broadly favors disclosure. While acknowledging there would be doubts as to the materiality of some information, the Court cited the "prophylactic" purpose of securities laws to protect investors and the conclusion that "it is appropriate that these doubts be resolved in favor of those the statute is designed to protect," a position also expressed several years earlier by the Court in *Mills v. Elec. Auto-Lite Co.*[50]

In its 1988 decision in *Basic Inc. v. Levinson*,[51] the Supreme Court adopted the same materiality standard in the context of Section 10(b) of the Exchange Act and Rule 10b-5, which prohibit fraudulent misstatements and misleading omissions in connection with the purchase and sale of securities. Since then, the SEC has adopted a definition of "Material" in a rule under the Securities Exchange Act of 1934, using essentially the formulation in *TSC* and *Basic*.[52] This formulation is generally accepted by the SEC and courts for all purposes under the securities laws, including liability in connection with securities offerings under the Securities Act of 1933,[53] and determining the materiality of errors or omissions in financial statements, which the SEC says must involve both quantitative and qualitative considerations based on the materiality standards set out in these Supreme Court decisions.[54]

In applying materiality qualifiers to the new climate disclosure rule, the SEC specifically confirmed that "traditional notions of materiality" should be applied, referring to the standards laid out in *TSC v. Northway* and *Basic v. Levinson*.[55] Companies must now consider how to apply this materiality standard in deciding what climate information to disclose.

Companies regularly make materiality determinations in the context of their financial disclosures, and those determinations are often difficult. A company might need to decide, for example, whether to disclose a decline in revenues in one of its business units, based on its assessment of the importance of the information to the company's business as a whole. It might need to assess whether a just-discovered environmental problem is likely to result in significant remediation costs or fines that investors would consider important, often before it has sufficient information to estimate those costs or fines. If a company determines that its next reported earnings are likely to be lower than the consensus of securities analysts, it might need to consider whether investors would consider this shortfall to be important, in which case it might need to issue a "profit warning" statement to minimize the risk of leaks and insider trading.

48 Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 Bus. L. 319 (2007).
49 *TSC Indus. v. Northway Inc.*, 426 U.S. 438, 449 (1976).
50 *TSC v. Northway at 448; Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375 (1970).
51 *Basic Inc. v. Levinson*, 485. U.S. 424, 432 (1988).
52 17 C.F.R. § 240.12b-2 (2023) (definition of "Material").
53 *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175 (2015).
54 SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 12, 1999) [hereinafter, SAB 99].
55 Adopting Release, at 105.

In making these determinations, companies often consider whether the information in question, if disclosed, would be likely to have a negative impact on the price of its securities (usually shares, although sometimes the inquiry is made in relation to bonds). The reason is twofold. First, information that has no impact on the price of securities is less likely to be important to investors than information that has such an impact,[56] although this is not universally true – *TSC v. Northway* involved the omission of information on conflicts of interest from a proxy statement relating to a shareholder vote on a proposed merger. Second, a company's liability risk is much lower when the price of its securities is not impacted by a disclosure issue.

Climate disclosure may require a different framework for making materiality judgments. Often, information on climate risks, plans, targets, and goals is likely to impact the long-term value of a company's business, and therefore the long-term price of its securities. However, as explained in Section V, misstatements or omissions may be less likely to impact the short-term price of those securities. The impact of a ten-year climate goal, for example, is unlikely to have the same immediate impact on the price of a company's securities as information on quarterly earnings. Indeed, some climate information, such as the abandonment of a costly plan to reduce GHG emissions, could positively impact the short-term price of a company's securities.

The consequence of concluding that a category of climate information is or is not material is different from the typical consequence of a materiality question that arises in connection with traditional business and financial disclosure. Under the SEC climate disclosure rule, if a company determines that a category of information (such as GHG emissions data) is not material to its business, results, or financial condition, it does not have to disclose that information at all. More traditional materiality determinations usually relate to discrete items of information, not to a complete category. In the hypothetical case discussed above, for example, a company might determine that revenues relating to a specific business unit are not material, but it could not decide to do away with a discussion of its revenues altogether (and indeed SEC rules would not permit it to do so).[57] In contrast, if a company decides that a climate-related transition plan does not address a "material" transition risk, it is not required to disclose any information about the transition plan.

2. The "Reasonable Investor" in the Climate Context

To determine whether a company's climate information is material, the company needs to determine whether it is important to a reasonable investor in deciding how to vote or whether to invest in the company's securities. A threshold question, therefore, is how to identify a "reasonable investor."

There is some academic literature on this question but little judicial authority. The academic literature has focused primarily on whether there is only one "reasonable investor" or several types of "reasonable investor" depending on the context. Scholars have expressed divergent views on whether a reasonable investor is a sophisticated one or an ordinary retail investor, and on whether this question should be determined based on the same analysis used to determine who a "reasonable person" is for purposes of tort law.[58] Some authors question whether the notional "reasonable investor" even exists or can exist.[59]

The Supreme Court has on several occasions ruled on what information is important to a hypothetical reasonable investor, but not on the characteristics that define the reasonable investor. For example, in a prominent 2015 decision involving Omnicare, a provider of pharmaceutical products to retirement homes, the Supreme Court ruled that reasonable investors do not consider a statement of opinion in a disclosure document to be a guarantee of results.[60] The Court went on to analyze extensively what a reasonable investor "expects" and "understands" (or "naturally understands") and "generally considers" and "thinks," but it never considered who that reasonable investor might be.

56 SAB 99, at 5; *see also, Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27 (2011) (citing share price movements as evidence that adverse reports relating to a pharmaceutical company's leading product were material).

57 17 C.F.R. § 229.303(a)(3) (2023).

58 *Amanda M. Rose, The "Reasonable Investor" of Federal Securities Law: Insights from Tort Law's "Reasonable Person" & Suggested Reforms*, 43 J. Corp. L. 78 (2017); Barbara Black, *Behavioral Economics and Investor Protection: Reasonable Investors, Efficient Markets*, 44 Loy. U. Chi. L.J. 1493 (2013); Kurt S. Schulzke & Gerlinde Berger-Walliser, *Toward a Unified Theory of Materiality in Securities Law*, 56 Colum. J. Transnat'l. L. 6 (2017); Hana V. Vizcarra, *The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures*, 50 Env't. L. Rep. 10106 (2020).

59 Tom C.W. Lin, *Reasonable Investors*, 95 B.U. L.J. 461 (2015).

60 *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175 (2015).

In *United States v. Litvak*,[61] the influential Court of Appeals for the Second Circuit ruled that, while the standard of a "reasonable investor" is objective, it needs to account for the particular characteristics of the relevant market (in the Litvak case, one in which substantially all investors are highly sophisticated), implying that determining who is a "reasonable investor" may depend on the context. The Third Circuit ruled in a case involving pharmaceutical studies that a reasonable investor need not be a scientific expert, but is instead an investor of "ordinary intelligence."[62]

What all iterations of the "reasonable investor" have in common across the academic literature and relevant court decisions is the desire of investors to earn a financial return on investment, and not to be misled by inaccurate or incomplete statements about the earnings capacity of the relevant company. Every investor is presumed to have the objective of making a profit.

In the context of climate disclosure, reasonable investors may have different views about the importance of that disclosure. Those views could include several different perspectives:

- A reasonable investor might view climate disclosure as important because climate risks, their impact, and a company's response to those risks can "significantly affect the company's financial performance and position," as the SEC asserted in the very first sentence of the release in which it adopted the final climate disclosure rule.[63]
- A reasonable investor could consider climate disclosure significant because its investment policy requires it to invest in companies that meet defined sustainability criteria, such as having plans to reduce GHG emissions. A climate-focused investment fund might fall into this category.
- A reasonable investor might focus on climate disclosure because the investor believes it is important for society that companies combat global warming, so the investor invests in companies and votes for directors committed to making this a priority. These investors may fall within a category sometimes knowns as "impact investors," who make investments with the intention of generating a societal impact alongside a financial return. A climate foundation might have this focus with respect to its investments.
- A reasonable investor might make voting and investment decisions based solely on financial considerations, without taking discrete climate issues into account at all.

The SEC says it adopted the final climate disclosure rule to address several of these investor needs. According to the SEC, "many investors and those acting on their behalf—including investment advisers and investment management companies—currently seek information to assess how climate-related risks affect a registrant's business and financial condition and thus the price of the registrant's securities." [64] In the next sentence, it said that "[i]nvestors also seek climate-related information to assess a registrant's management and board oversight of climate-related risks so as to inform their investment and voting decisions."[65] Accordingly, a reasonable investor certainly focuses on the financial impact of climate issues, but perhaps also considers climate issues more broadly.

To decide what information is material and thus required to be disclosed, a company will need to take a position on the characteristics of a "reasonable investor." That decision may be influenced by the company's analysis of its own investor base, which may include investors who fall into one or more of the above categories. At the same time, there is no judicial authority or apparent academic support for the notion that a "reasonable investor" is limited to investors who are interested in a particular company's securities; to the contrary, the notion that the "reasonable investor" standard is objective seems to suggest that the standard goes beyond the investor base of any particular company. On this basis, it would not seem appropriate for a company to omit climate disclosure from its SEC reports based solely on the view that its own investors do not care about climate issues. The company should instead consider how a hypothetical, objective reasonable investor would consider climate issues in the context of that company's business and the relevant market.

61 *United States v. Litvak*, 889 F.3d 56 (2d Cir. 2018).
62 *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342, 347 (3d Cir. 2009).
63 Adopting Release, at 10.
64 Adopting Release, at 10.
65 Adopting Release, at 10.

3. What Information is Important?

Once a company determines who a reasonable investor is in the climate disclosure context, the next step is to decide what information is important to the voting and investment decisions of that investor. The task is a difficult one.

Companies that already publish sustainability reports (or similar documents) will need to determine which information in those reports is important to reasonable investors. Companies might have a difficult time arguing that the information in their sustainability reports is not material to investors, given that most companies hyper-link sustainability reports on their investor relations web pages (this is the case for all of the companies in our survey that publish sustainability reports). This suggests that companies generally believe that sustainability information is important to investors, or at least something that a good corporate citizen makes available to investors.

On the other hand, some of the information in a typical sustainability report is either not subject to the climate disclosure rule at all (because it concerns topics other than climate), or not material. Sustainability reports often contain substantial amounts of "corporate image" information that companies generally would not include in SEC reports. More difficult questions may arise regarding strategy presentations, as climate issues are often a component of a broader sustainability strategy that also covers non-climate issues.[66] For some companies, it might be difficult to extract and isolate the climate component from other aspects of its environmental or ESG strategies, or they might conclude that the climate component, taken alone, is not important to reasonable investors. In such cases, the requirement to present the impact of climate risks and the management of those risks on a company's strategy, business model and outlook, may effectively obligate them to describe their broader sustainability strategy in their SEC reports, rather than excusing them from disclosing the narrow climate-specific information.

The calculus may be similar for companies required to publish substantial climate-related information under other regimes, such as California's climate disclosure law or the European Union's CSRD regime. Yet given the different emphasis of these rules, which do not limit disclosure to items material to a company's business and financial condition, many companies might conclude that information disclosed under these regimes is not necessarily material under the SEC's narrower climate disclosure rule. This is particularly true for information disclosed under the CSRD, which, as discussed earlier, explicitly encompasses a "double materiality" standard that requires companies to describe the material impact of their activities on the climate, beyond the impact of climate risks on their business and financial condition. Like sustainability reports that companies publish voluntarily, CSRD reports will cover a broad range of sustainability issues beyond climate risk.

The substantive difficulty companies are likely to face can be illustrated by considering the requirements of the new rule relating to climate targets and goals, which a company must disclose if they have "materially" affected or are reasonably likely to "materially" affect the company's business, results of operations, or financial condition. In some cases, it will be clear whether a target or goal has such a material effect. For example, an automobile manufacturer that invests significantly in switching production to electric vehicles to meet a target for Scope 3 emissions is likely to conclude this target is material.

The assessment is likely to be more difficult for many other companies. As an example, a company might have established a goal of reducing Scope 1 emissions by 30% by 2030. If the company plans to do this by outsourcing emissions-intensive functions (converting the Scope 1 emissions to Scope 3), at approximately the same total cost that it currently pays for those functions internally, is the goal material? If the company believes that a reasonable investor is interested only in the financial impact of targets and goals, it may conclude this Scope 1 goal is not material. On the other hand, impact investors and foundations established to combat climate change, considering themselves to be reasonable investors, would likely argue the Scope 1 goal (and particularly the method by which the company has chosen to accomplish the goal) is material.

66 The proposed rule provided examples of climate-related targets and goals that include those related to issues such as energy usage, water usage, conservation or ecosystem restoration. Securities Act Release No. 11042, Exchange Act Release No. 94478, 87 Fed. Reg. 21334 (Apr. 11, 2022), proposed Item 1506(a)(1), at 480 [hereinafter Proposing Release]. Some of those issues arguably are environmental-related, but not necessarily climate-related. The SEC deleted the examples from the final rule, explaining that an "overly broad" requirement could impose a burden on companies that outweighs the benefit to investors. Adopting Release, at 210, 212.

If the company determines it is required to disclose a climate target or goal, it then must disclose the "material" impacts on financial estimates and assumptions of actions it plans to take to meet the target or goal. As discussed above, this might include disclosure about the impact on future cash flow projections. Assessing materiality in this context may be difficult, particularly where a company does not already disclose its cash flow projections in its SEC reports, or where the anticipated financial impact is uncertain (for example, where the financial impact is expected to be felt only after several years, it may be difficult to project its likely magnitude). A reasonable investor focused on financial issues might view the cash flow impact as immaterial if it is relatively small or uncertain, while a more climate-focused reasonable investor might believe it is important to have information on the budget devoted to achieving a target or goal to assess its credibility.

Companies will face a similarly difficult analysis in deciding whether Scope 1 and 2 emissions data are "material" and thus must be disclosed under the climate disclosure rule. In adopting the rule, the SEC justified its decision to require this disclosure based on both the potential financial impact of emissions data, and on the importance of the data in enabling investors to evaluate a company's plans. It says disclosure may be material, for example, where emissions "are reasonably likely to be subject to additional regulatory burdens through increased taxes or financial penalties." [67] Disclosure might also be needed because the information may be "necessary to enable investors to understand whether the registrant has made progress toward achieving a target or goal or a transition plan that the registrant is required to disclose under the final rules."[68] If a company prominently discloses a "Net Zero" goal, for example, emissions data may be essential to allow investors to measure the company's progress towards achieving that goal.

Given the emphasis placed by the SEC on risks, plans, targets, and goals that materially impact a company's business and financial condition in adopting the new rule, it seems likely that the SEC would view information as important to investors primarily when it is expected to have a significant financial impact. This is particularly true in light of the SEC's insistence that the new rule is focused on financial disclosure in its defense of the rule before the Court of Appeals for the Eighth Circuit.[69] But companies (particularly in climate-sensitive sectors) will need to be prepared for some investors to take a broader position on materiality, including before the courts.

B. Is "Bare Minimum" Climate Disclosure Sufficient?

Many companies are likely to implement the new rule by seeking to comply, item-by-item, with the disclosure specifically called for in the rule, to the extent material to their business and financial results. In some cases, that disclosure will only tell part of the story. Companies will need to consider whether additional information is needed to ensure the disclosure is not misleading.

Like materiality determinations, it is not unusual for companies to consider whether to provide traditional business and financial disclosure beyond what is specifically provided for in the SEC's rules. In some cases, this is not optional – Rule 12b-20 under the Securities Exchange Act of 1934 requires companies to include information in their annual reports beyond what is expressly required by the SEC's rules, to the extent necessary to ensure that all statements in the report are not misleading. Rule 408 under the Securities Act of 1933 imposes essentially the same requirement for registration statements and prospectuses prepared for securities offerings. The SEC cited these rules in its 2010 climate guidance, as part of its rationale for stating that companies might need to disclose information on climate-related risks despite the absence of specific references to climate issues in the SEC's rules then in effect.[70]

This section discusses some areas where companies might face difficult decisions in determining whether to provide more information than the specific line-items of the climate disclosure rule require, in order to ensure that their statements are not misleading.

67 Adopting Release, at 246.

68 Adopting Release, at 246.

69 Consolidated Brief for Respondent SEC, State of Iowa et. al. v. SEC, No. 24-1522,24-1624, 24-1626, 24-1627, 24-1628, 24-1631, 24-1634, 24-1685& 24-2173 (8th Cir., Aug. 6, 2024), at 41-54.

70 2010 Guidance, at 12.

1. Emissions Data

The SEC's final climate disclosure rule limits the emissions data that companies are required to disclose to material Scope 1 and 2 GHG emissions – meaning emissions from operations the companies control (Scope 1), and emissions from purchased energy (Scope 2). The final rule deleted a provision of the proposed rule that would have required companies to disclose Scope 3 information (emissions generated in producing other goods and services they purchase, or the use of their products by customers) where material, or where they have Scope 3 targets.

For many companies, including several in the survey prepared for this report, Scope 3 emissions represent the vast majority (often over 95%) of total emissions. Notably, most emissions of oil and gas companies result from the consumption of fuel by their customers. For automobile manufacturers, most emissions come from the production of the steel they purchase, and from customers driving their cars. Several companies in our survey say their strategy is to market products intended to reduce emissions of customers compared to the emissions generated through the use of rival products. Yet under the SEC's final rule, those companies are not expressly required to disclose data on the emissions from suppliers and customers.

Can Scope 3 disclosure nonetheless be necessary in some specific cases? Consider the case of Microsoft's 2024 environmental sustainability report (reporting on the fiscal year ending June 30, 2023),[71] which shows an increase in emissions of 29% since 2020, largely due to the purchase of cement needed for the construction of data centers to accommodate artificial intelligence applications. This caused Microsoft's Scope 3 emissions, which represented 96% of the company's total emissions, to increase by 30.9% compared to 2020. During the same period, Scope 1 and 2 emissions fell by 6.3%. If Microsoft had been subject to the SEC's new disclosure rule for its SEC annual report, could it have disclosed the decline in Scope 1 and 2 emissions without also disclosing its Scope 3 figure?

While the company disclosed its percentage increase in Scope 3 emissions in its June 2023 annual report on Form 10K filed with the SEC,[72] its June 2024 10K report eliminated this information, saying only that it was "not yet on track" for its target to reduce Scope 3 emissions.[73] The question it will face when it discloses absolute Scope 1 and 2 emissions in future SEC reports is whether it can limit Scope 3 disclosure to qualitative information of this type, or whether it also needs to provide quantitative Scope 3 information to ensure its Scope 1 and 2 disclosure is not misleading. Given the significant divergence between trends in Scope 1 and 2 information compared to Scope 3, and the fact that Microsoft has an overall climate target that includes all three scopes, it would seem appropriate for Microsoft to disclose at a minimum that its Scope 3 emissions trend is different from that of its Scope 1 and 2 emissions, and arguably it should disclose the percentage increase and/or the absolute Scope 3 emissions. However, a company in Microsoft's situation might plausibly take the view that it cannot be required to disclose Scope 3 data given the express deletion of the Scope 3 obligation from the final rule. If the company provides qualitative Scope 3 information in its SEC report, and particularly if it provides quantitative information in a separate sustainability report, it might plausibly argue that the omission of Scope 3 data from the SEC report does not impact the "total mix" of available information within the meaning of *TSC v. Northway*, and therefore is not a material omission.

Other limitations in the SEC climate disclosure rule may raise similar issues. While the SEC requires companies to report annually on their progress in achieving climate plans, targets, and goals, the climate disclosure rule does not require them to publish an analysis of the year-on-year variations in their emissions. This is a sharp contrast with the SEC's financial disclosure rules, which require companies to publish a "management's discussion and analysis" that includes a discussion of year-on-year changes in revenues, operating expenses and other components of their results.[74] In some cases, companies might need to consider whether they should publish a sort of "climate discussion and analysis" to explain annual changes in emissions, so the raw data is not misleading.

This is illustrated by the example discussed above in the context of materiality determinations. If a company reduces its Scope 1 emissions by outsourcing a function (such as transportation of its

71 Microsoft Corp., 2024 Environmental Sustainability Report, https://www.microsoft.com/en-us/corporate-responsibility/sustainability/report (last visited Oct. 24, 2024).

72 Microsoft Corp. Annual Report (Form 10-K) (June 30, 2023), https://microsoft.gcs-web.com/static-files/e2931fdb-9823-4130-b2a8-f6b8db0b15a9.

73 Microsoft Corp., Annual Report (Form 10-K) (June 30, 2024), https://microsoft.gcs-web.com/static-files/1c864583-06f7-40cc-a94d-d11400c83cc8.

74 17 C.F.R § 229.303 (2023).

products) to a third party or an unconsolidated joint venture, this would transform its emissions from Scope 1, which must be disclosed, to Scope 3, which do not have to be disclosed. A company in this situation might consider disclosing that its Scope 1 emissions reduction was due to the outsourcing decision and was offset by a corresponding increase in Scope 3 emissions. To take another example, if a company discloses an increase in the percentage of its energy derived from renewable sources, but its total Scope 2 emissions increase due to greater overall business activity, a company might need to explain the increase in its annual report.

2. Duty to Update

In addition to completeness, companies will need to decide whether and when their climate disclosure needs to be updated. The climate disclosure rule requires companies to provide information annually about their progress in implementing climate mitigation and adaptation plans, transition plans, targets, and goals (including, presumably, a lack of progress). It also requires companies to provide Scope 1 and 2 emissions data for each fiscal year, which must be filed with the SEC within 225 days after the end of their fiscal year.

Because many climate plans, targets, and goals have long-term objectives, companies must determine when and how to update information in their SEC reports to ensure that, overall, their disclosure is not misleading. Consider, for example, a company that discloses in its SEC annual report for year 1 that it plans to reduce Scope 2 emissions by 30% by 2030, primarily by ensuring that all new electricity purchase contracts will be from renewable sources.

- In year 2, the company's Scope 2 emissions increase by 5%. The reason is an increase in overall business activity, which in turn resulted in an increase in electricity purchases under existing (fossil-fuel-based) contracts. The company still believes it can achieve its 2030 goal, and indeed all of its new electricity contracts have been for renewables. Does the company have to explain the 5% increase in Scope 2 emissions? Or can the company consider that the information is immaterial to its disclosed goal?
- In year 3, the company divests a business that is a heavy user of electricity from fossil fuel sources. As a result, its Scope 2 emissions decline by 10%. It is still on track to meet or exceed its overall 2030 goal. Does the company have to disclose the reason for its 10% Scope 2 emissions decline? Or can the company consider that the information is immaterial to, or does not represent progress toward, its disclosed goal?
- Before the publication of disclosure for year 4, the company agrees to a new contract to purchase non-renewable electricity due to a lack of available renewable electricity at competitive prices. It still expects to meet its 2030 goal. Does it have to disclose that it has deviated from its plan to purchase only renewable electricity? Or can the company consider that information immaterial to its disclosed goal?

The response to each of these questions depends largely on whether the only "progress" information that is material is whether the company remains on track to meet its 2030 goal, or whether the company should provide additional detail, not explicitly called for by a line-item in the climate disclosure rule, to ensure its disclosure as a whole is not materially misleading.

In addition to difficult issues arising in connection with annual updates, there may be cases in which a company's disclosure becomes stale or misleading before the date on which the rule requires it to be updated. For example, a company that discloses a target of reducing Scope 1 and 2 emissions by 30% by 2030 in its annual report might determine during the course of the following fiscal year that its emissions for that year are expected to be misaligned with achieving its target. Does the company have to publish a "climate warning," just as companies publish "profit warnings" when they know their financial results will not meet expectations? Perhaps it should do so to avoid leaks, or the risk of insider trading (which is the main reason why companies publish profit warnings), though this is not typically accomplished by amending its SEC annual report (companies use a press release or similar public communication).[75]

75 For a recent example, see the 2023 half year results announcement of Rio Tinto, which announced that it would be unable to meet its 2025 emissions targets unless it were to purchase carbon offsets (the same announcement, however, referred to the company's ESG accomplishments under the heading "Impeccable ESG"). Rio Tinto, 2023 Half Year Results (July 26, 2023), https://www.londonstockexchange.com/news-article/RIO/rio-tinto-2023-half-year-results/16056552.

If the company decides to offer and sell securities during the year, prior to the filing of its next annual report, it will face the question of whether it should update the emissions disclosure in the offering prospectus and registration statement. The SEC's Form S-3 (used by most large companies to register securities offerings) requires a company to describe "all material changes in the [company's] affairs which have occurred since the end of the latest fiscal year" to the extent not already disclosed in a quarterly report or a current report.[76] On the other hand, the climate disclosure rule added to Form S-3 an explicit requirement to include Scope 1 and 2 emissions data in a registration statement only as of the end of the latest fiscal year that is less than 225 days prior to the effective date of the registration statement. This suggests that the company might make a qualitative statement in its prospectus and registration statement about the fact that its emissions are not in line with its target, but it would not be required to provide updated data. Nonetheless, if the offering takes place at a time when the company is aware of the updated data but has not yet published it (and when all work on the required third-party assurance report has been completed), then it might be best practice to include the data in the prospectus and registration statement. This would ensure that it cannot be viewed as misleading with the benefit of hindsight, after the information is disclosed.

3. Comparability Issues

Another issue companies will need to address in their climate disclosure is comparability of information, particularly following acquisitions or divestitures. The SEC's rules on financial disclosure contain detailed requirements for pro forma financial information, intended to show how acquisitions and divestitures affect a company's financial statement information.[77] The SEC has published extensive interpretative guidance to complement these requirements.[78] The guidance for companies implementing the climate disclosure rule is much more limited.

The climate disclosure rule has amended the form (S-4) that companies use to register securities issued in a merger or other business combination transaction, requiring them to include their own climate disclosure and the climate disclosure of the company being acquired, if that company is already subject to SEC reporting requirements.[79] If the acquired company is not subject to those requirements, then no climate disclosure about that company is required.

The GHG Protocol corporate standard requires companies to recalculate base-year emissions (meaning emissions for a specified historical year, used as the starting point for subsequent emissions targets) to reflect the impact of significant acquisitions and divestitures (though not for insourcing or outsourcing).[80] For companies that use the GHG Protocol to report emissions in their SEC reports (or other standards with similar requirements), this will provide a certain degree of comparability for their emissions data. This requirement, however, does not require companies to explain other changes, such as those resulting from harmonizing reporting methodologies.

In some situations, companies may need to consider whether to do more to ensure the climate information they provide in connection with an acquisition or divestiture is not misleading. For example, if an acquisition calls into question the ability of a company to implement a transition plan or to meet a material climate-related target or goal, disclosure might be needed in connection with the acquisition. The company will also have to decide whether that disclosure should be reflected in a current report filed with the SEC or in the registration statement or proxy statement for the acquisition, if one exists. If a company undertakes a divestiture and expects its retained business to share significant facilities with the divested business, it might need to disclose the expected impact of the sharing arrangement on climate plans, targets, goals, and data, if that impact is material. If an acquisition or divestiture will significantly change expenditures in a way that is material to financial estimates and assumptions, the qualitative (or, if feasible, quantitative) disclosure might also be appropriate.

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76 17 C.F.R. § 239.13 (2023). Other registration forms, including Form S-1 that is used for initial public offerings, have been amended by the climate disclosure rule to include similar substantive requirements that would effectively require current information on climate plans, targets, and goals to be included in registration statements and prospectuses.

77 17 C.F.R. § 210.11 (2023).

78 Sec. & Exch. Comm'n, Div. of Corp. Fin., Financial Reporting Manual, https://www.sec.gov/files/cf-frm.pdf.

79 Adopting Release, at 876-77. Similar disclosure is required in proxy statements for mergers that do not involve the registration of new securities. Adopting Release, at 569, note 2485.

80 GHG Protocol, Corporate Accounting and Reporting Standard, ch. 5, at 34-39.

4. Non-Standard Disclosure

Some companies currently disclose climate information using indicators that are different from those prescribed by a recognized standard, such as the GHG Protocol or the standards of the ISSB. For example, Berkshire Hathaway Energy publishes GHG metrics under the headings “own generation” and “purchased power,” which seem to correspond roughly to Scope 1 and 2 emissions.[81] In 2024, some investors questioned whether it might be appropriate for the company to indicate how this information compares to more commonly used indicators.[82]

Tables of climate information contained in sustainability reports of many companies are accompanied by lengthy footnotes disclosing that the information labelled as Scope 1, 2, or 3 in the tables excludes certain categories of information. It is often unclear whether this is because the information is considered inapplicable or irrelevant, or because the company believes an adjusted indicator is more pertinent in the context of its business. Sometimes footnotes indicate changes in methodology from one year to the next, without indicating whether those changes significantly impact the comparability of information (the GHG Protocol corporate standard provides for the recalculation of historical data based on the revised methodology but recognizes that this is not always feasible[83]).

The SEC’s rules contain detailed requirements for companies that publish non-standard financial indicators (known as non-GAAP financial measures). Those companies are required to explain why the indicators are used, reconcile them to the nearest GAAP (generally accepted accounting principles) indicator, restrict the use of the term “non-recurring” with respect to certain indicators, and refrain from using labels that are confusingly similar to GAAP indicators.[84] These rules were adopted after a highly publicized SEC enforcement action against the Trump Hotel and Casino company, which published financial information that was misleading because it excluded one-time negative information without also excluding offsetting one-time positive information.[85]

Based on practices observed in sustainability reports, it seems likely that some companies will choose to include information that deviates from the standards set out in the GHG Protocol (or any other standard they use). Under the SEC climate disclosure rule, companies must describe not only the protocol or standard that they use, but also the calculation approach, the type and source of any emission factors used, and any calculation tools used to calculate the GHG emissions. For this reason, or more generally to ensure that their disclosure is not misleading, companies might need to describe any significant deviations from the indicators prescribed by the protocol or standard that they use. While this may not necessarily require the detailed disclosure required for non-GAAP financial measures, any approach should ensure that climate disclosure based on non-standard indicators is not misleading. This issue may become particularly important if, like many European companies, U.S. reporting companies begin to include climate-related targets in the formulas used to determine variable executive compensation, to the extent those targets deviate from the relevant protocol or standard used in the company’s climate disclosure.

81 Berkshire Hathaway Energy publishes metrics for its operating companies, using its own indicators. An example can be found for Nevada Power Company and Sierra Pacific Power Company. Berkshire Hathaway Energy, 2022 Sustainability Report (Dec. 31, 2022), https://www.nvenergy.com/publish/content/dam/nvenergy/brochures_arch/cleanenergy/sustainability/2022-sustainability-nvenergy.pdf.

82 Nolan Lundquist, *Who cares about Berkshire’s emissions?*, Ctr. for Active Stewardship Blog (May 2, 2024), https://blog.activestewardship.org/p/who-cares-about-berkshires-emissions.

83 GHG Protocol, at 38.

84 17 C.F.R. § 229.10(e) (2023); 17 C.F.R. §244 (2023).

85 *Trump Hotels & Casino Resorts, Inc.*, Exchange Act Release No. 45287, Accounting and Auditing Enforcement Release No. 1499, Admin. Proc. File No. 3-10,680 (Jan. 16, 2002).

IV. Verification and Due Diligence in the Context of Climate Disclosure

One purpose of the new SEC climate disclosure rule is to improve the reliability of climate information provided by companies by subjecting it to verification procedures that companies (and the investment banks that underwrite their securities) typically apply to information in SEC filings. The SEC noted in its adopting release that information published in sustainability reports or otherwise outside SEC filings is "not necessarily prepared with the informational needs of investors in mind" and "may not be prepared with the same level of rigor" as SEC filings, and therefore "may not be as reliable."[86]

This section discusses how the SEC's climate disclosure rule will require companies to adopt procedures for verifying the climate information in their SEC reports, assuming the rule becomes effective. Just as companies will need to rethink some aspects of their substantive disclosure practices, they will also need to reconsider how climate disclosure fits into their existing verification procedures, and whether such procedures should be adjusted.

A. Climate Disclosure Controls and Procedures

Since 2002, reporting companies have been required to adopt "disclosure controls and procedures" relating to the information they include in their SEC reports.[87] Management is required to evaluate the effectiveness of disclosure controls and procedures on a quarterly basis. The principal executive officer and principal financial officer of each company are required to participate in this evaluation and sign a certification confirming that they have read the SEC report, that the information does not contain a material misstatement or omission, and that they have designed the company's disclosure controls and procedures and evaluated their effectiveness. The certification must be filed with the SEC as an exhibit to the report, and the conclusion of the principal executive officer and principal financial officer must be disclosed in the report.[88]

"Disclosure controls and procedures" are defined as procedures designed to ensure that information required to be disclosed by a company in its SEC reports is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms, including ensuring that such information is accumulated and communicated to the company's management, including its principal executive and principal financial officers.[89]

While it may seem obvious that companies filing SEC reports should have procedures such as these, market experience prior to 2002 with companies such as Enron (whose collapse was the motivating factor behind the adoption of these requirements) showed that this was not always the case. By requiring companies to adopt, maintain and evaluate disclosure controls and procedures, the SEC imposed a degree of rigor on these processes, the most significant of which may be to require the principal executive officer and principal financial officer to certify that they have actually read the reports filed with the SEC.

Today, most reporting companies have disclosure procedures that include formalized processes for gathering information on topics such as significant business developments, risks, and litigation; management committees within each major business unit and at the parent company level (including the principal executive and financial officers) that review drafts of the SEC reports and discuss any difficult questions about what to disclose and how; and sub-certification processes by which the head of each major business unit and significant administrative function (such as legal and human resources) provides certifications relating to their unit or function that mirror the certifications the principal executive officer and principal financial officer are required to provide to the SEC.[90]

86 Adopting Release, at 48, 49, 58.

87 17 C.F.R. § 240.13a-15 (2023).

88 17 C.F.R. § 240.13a-14 (2023).

89 17 C.F.R. § 240.13a-15(c).

90 *Developing Procedures to Comply with the New SEC Certification Requirements*, Paul Weiss (Nov. 4, 2002), https://www.paulweiss.com/media/2374103/post40.pdf; *Disclosure Controls and Procedures*, Simpson Thacher & Bartlett, (Oct. 21, 2022), https://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/publication116_0.pdf.

In adopting the new climate disclosure rule, the SEC acknowledged that companies will need to adjust their disclosure controls and procedures to integrate considerations relating to climate disclosure,[91] and it has provided companies with extra time to phase-in compliance with some of the requirements given the need for these adjustments.[92] The SEC has not, however, indicated what these adjustments should entail.

Commentators and law firms began to suggest that companies adjust disclosure controls and procedures for climate issues well before the SEC first proposed its climate disclosure rule.[93] Some of those recommendations – such as following a recognized standard (the GHG Protocol or ISSB standards, for example), and obtaining third party assurance reports for climate data – are now required as part of the SEC's new rule, at least for larger companies. Other recommendations include integrating climate information in a company's enterprise reporting system rather than collecting it manually, applying the company's sub-certification process to climate information, and ensuring an appropriate level of management oversight.

The question for many companies will not be whether to adopt disclosure controls and procedures integrating their climate disclosures (they are mandatory), but rather what level of resources to devote to ensuring their effectiveness. Making the head of sustainability a member of the company's disclosure committee and requiring them to certify the climate information in the company's SEC reports is an obvious starting point. Companies may face more difficult questions when it comes to incurring expenses for information gathering and processing or devoting senior management time to considering the way in which climate risks, plans, targets, and goals should be disclosed. For larger companies, a key factor may be the need to demonstrate the effectiveness of their controls to auditors or other third-party verifiers who will provide the assurance reports required by the SEC's climate disclosure rule.

B. Assurance Reports

According to a February 2024 study by Florian Berg, Jaime Oliver Huidobro, and Roberto Rigobon,[94] firms that obtain third-party assurance over their carbon accounting report 13.7% higher absolute emissions and a 9.5% higher carbon intensity than their peers. Recognizing that reported carbon emissions are based on numerous estimates and assumptions, the authors suggest that firms that do not obtain assurance for their reporting might use more favorable assumptions or omit key parts in their estimation of carbon emissions. They also find that companies obtaining third-party assurance have reported substantial year-on-year declines in emissions and carbon intensity, while other companies they surveyed did not report statistically significant declines, although they do not claim to find a link of causation (it is possible that companies focused on reducing emissions are more likely to obtain third party assurance voluntarily than other companies).

The requirement in the SEC's climate disclosure rule that companies obtain third-party assurance for their disclosed emissions data generated substantial comment, both positive (including from two of the authors of the February 2024 study) and negative.[95] Not surprisingly, supportive commenters focused on the need to ensure the reliability of the emissions data in company SEC reports and the importance of third-party assurance in increasing reliability. Critics cited the likely cost and complexity of obtaining third-party assurance.

The final rule requires large accelerated filers and accelerated filers to obtain assurance reports on GHG emissions data from an independent expert, which may be a company's auditor or a different third-party expert. Companies subject to the rule must obtain attestations at the "limited assurance" level starting three years after they are first required to disclose emissions data, while large accelerated filers must obtain assurance at a more rigorous "reasonable assurance" level starting seven years after their initial disclosure date.[96] The assurance reports must be prepared in accordance with a recognized standard (the SEC referred to several U.S. and international standards in adopting the climate disclosure rule[97]), and must be included in the SEC reports where the emissions data appears.

91 Adopting Release, at 124.

92 Adopting Release, at 125, 266.

93 David A. Bell et. al, *Best Practices for Establishing ESG Disclosure Controls and Oversight*, Harv. Corp. Gov't. F. (Feb. 3, 2022), https://corpgov.law.harvard.edu/2022/02/03/best-practices-for-establishing-esg-disclosure-controls-and-oversight/; Marc S. Gerber, *Enhancing Disclosure Controls and Procedures Relating to Voluntary Environmental and Social, Disclosures*, Skadden (June 29,2021), https://www.skadden.com/insights/publications/2021/06/enhancing-disclosure-controls-and-procedures.

94 Florian Berg et. al, *On the Importance of Assurance in Carbon Accounting* (Feb. 23, 2024), SSRN: https://ssrn.com/abstract=4734240.

95 Adopting Release, at 268-84.

96 As discussed above, a limited assurance report is one where the third-party expert confirms, based on specified verification procedures, that it is unaware of any material misstatement in the information covered, while a reasonable assurance report also confirms (like an audit) that the information is prepared in accordance with the standard that the company claims to apply (such as the GHG Protocol). *See* Assurance Standards, *supra* note 27.

97 Adopting Release, at 336, 347-50.

While these assurance reports are likely to increase the reliability of emissions data in SEC reports and impose rigor on the processes used by companies to produce that data, the scope of the reports is limited. In particular, they cover only the material emissions data disclosed by companies, and not other climate information required by the SEC rules, or even the question of whether emissions data is material and therefore required for a given company. This contrasts sharply with the attestation reports required of companies subject to the EU's CSRD sustainability reporting, which must cover more broadly the information contained in the sustainability reports and compliance with CSRD and ESRS standards.[98] The SEC did not propose or adopt such a broad attestation requirement, which undoubtedly would have met significant resistance, and might also have been impracticable given the subjectivity implicit in the rule's materiality qualifiers.

This means a company will be responsible, without any outside attestation, for information on climate mitigation and adaptation plans, transition plans, targets, and goals, including the progress made in achieving those plans, targets, and goals. The only exception will be information on historical material expenditures for severe weather events and other natural conditions, which will be included in the notes to a company's audited financial statements. With respect to a company's procedures for allocating other material expenditures to climate-related plans, or its disclosure relating to financial estimates and assumptions, it is too early to tell whether third-party assurance standards will require experts to apply procedures to review or otherwise verify the accuracy of that information. For example, one can imagine the need to confirm that historical information on expenditures is properly extracted from a company's accounting database.

C. Underwriter Due Diligence Practices

When a company offers and sells securities to the public in the United States, the investment banks that underwrite the offering can be liable for investor losses if the company's registration statement or prospectus contains a material misstatement or misleading omission, or if the registration statement fails to include material information required by SEC rules (not surprisingly, the banks are also liable for any false or misleading statements they knowingly make themselves).[99] The banks are not liable, however, if they did not know of the misstatement, omission or absence of required information, and if they demonstrate that they could not have known of it after a reasonable due diligence investigation.[100]

The Securities Act of 1933 does not specify what due diligence procedures would be sufficient to preclude underwriter liability. SEC Rule 176 under the Securities Act of 1933 provides some guidance, but it is not very helpful as a practical matter, as it says only that a reasonable due diligence investigation depends on things like the nature of the issuer, the type of security, and the availability of relevant information.[101]

Due diligence procedures have developed over decades as a matter of market practice, informed by a limited number of court decisions.[102] Investment banks and/or their legal counsel typically conduct question and answer sessions with company management and auditors, review internal company documents (such as the minutes of shareholder, board and audit committee meetings, significant contracts and internal reports on litigation or environmental matters), and obtain written comfort from auditors confirming they know of no significant change in certain financial statement items since the date of the latest financial statements they audited or reviewed. Due diligence procedures can range from extensive for a company undertaking its first public offering of securities, to relatively quick and limited for a large, well-known company that has published SEC reports for years and is closely followed on a regular basis by the investment banks and legal counsel.

Given the climate disclosure rule's novelty, there are no market practices for the due diligence procedures investment banks should perform to establish a liability defense with respect to climate disclosures. Some investment banks that underwrite securities of European issuers have developed detailed due diligence questionnaires and procedures for climate information, and in practice they often spend substantial time with companies (particularly in climate-sensitive sectors) discussing their climate plans,

98 Accounting Directive (as amended by CSRD), Art. 34; Auditing Directive (as amended by CSRD), Arts. 26a(3) & 28a.

99 Securities Act of 1933, §11, §12(a)(2); 17 C.F.R. § 240.10b-5 (2023).

100 Securities Act, §11, §12(a)(2). Exchange Act Rule 10b-5 contains no explicit due diligence exception, but it only imposes liability in the first place where a party acts with scienter (meaning knowing of or recklessly disregarding the misstatement or misleading omission).

101 17 C.F.R. § 230.176 (2023).

102 The leading cases are *Escott v. BarChris Construction Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968); *Feit v. Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971). *See*, William K. Sjostrom, Jr, *The Due Diligence Defense Under Section 11 of the Securities Act of 1933*, 44 Brandeis L.J. 549 (2006).

targets, and disclosure. But it is not clear to what extent those procedures will become standard for U.S. securities offerings. And U.S. law firms generally have not published views on this question.

To some extent, climate due diligence procedures will involve the same work as financial due diligence. Lawyers will review minutes of board and audit committee meetings, as well as disclosure committee deliberations on climate issues. If companies establish climate committees, their minutes will also be subject to review. Investment banks will also question company management, including sustainability officers, about significant issues in climate disclosure, and they might question third-party assurance providers on the procedures they implement to verify emissions data (if the assurance providers agree to respond to questions).[103]

However, it is unlikely that third-party assurance providers will be willing to confirm the absence of material changes in emissions data the same way auditors confirm no material changes in financial statement items, particularly since there is no specific requirement for companies to update climate data at the time of securities offerings. It is also unclear whether auditors will establish procedures for confirming to investment banks the methods companies use to allocate material expenditures to climate plans, targets, and goals (as opposed to their role in verifying material expenditures relating to severe weather events and other natural conditions, which will be part of the audited financial statements). Even if auditors do establish such procedures, they might be used only to establish their own comfort with a company's overall disclosure, meaning auditors might be reluctant to share the outcome of those procedures with underwriters.

In many cases, actual and anticipated expenditures on plans, targets, and goals will be among the most important climate disclosures published by companies in their SEC reports, as both the financial impact of implementing plans and the credibility of the plans, targets, and goals will depend significantly on the resources companies devote to achieving them. Absent comfort from auditors, investment banks will have to conduct their own investigation of the methods used by companies to allocate those expenditures.

More generally, underwriters will need to establish procedures, likely tailored to the specific business of the company issuing the securities, to become comfortable with the credibility of the plans, targets, and goals that the company discloses, and the actions the company takes and plans to take to achieve them. The question will be what those procedures should entail. In particular, while investment banks are generally thought to be knowledgeable on financial and general business information, that is not necessarily the case for the scientific information underlying climate-related disclosure. It is possible underwriters will need to call on scientific experts (either internal or external consultants) to assist in their due diligence procedures, particularly in sensitive cases or where climate plans and targets represent a significant part of the sales pitch used to convince investors to purchase the offered securities.

103 The SEC climate disclosure rule provides that emissions data covered by a reasonable assurance report is "expertized," while data covered by a limited assurance report (or none at all) is not expertized. 17 CFR § 229.436 (2023); Adopting Release, at 330-35. Underwriters are not liable under Section 11 for expertized information in a registration statement unless they know it to be untrue or misleading, without any requirement that they conduct a reasonable due diligence investigation.

V. Enforcement of Climate Disclosure Rules

The Science-Based Targets Initiative (SBTi) has reported that companies with science-based emissions reductions targets or commitments to such targets represented 39% of global market capitalization as of the end of 2023. In North America, the companies with such targets and commitments at the end of 2023 represented nearly half of total market capitalization, or approximately $26.6 trillion of total stock market value.[104] The share of companies in the U.S. S&P 500 index with SBTi approved targets or commitments as of year-end 2023 was also about half.[105] While these figures may have declined in 2024 following the delisting of a number of companies, the market capitalization of companies with emissions targets remains substantial. Under the SEC climate disclosure rule, the targets adopted by these companies must be disclosed in future SEC filings if they are material, along with a discussion of plans to achieve them and regular progress reports.

What happens if they are not disclosed, or if the disclosure is incomplete or misleading? What if companies take the position that the targets are not material to their financial condition? What if the targets are fully disclosed, but later abandoned, and the relevant company does not communicate the abandonment, or delays its communication? Like other possible misstatements and misleading omissions in SEC reports, these issues would be addressed through enforcement.

Enforcement decisions involve two fundamental questions: how clear is the violation, and how difficult will it be to prove? For private investors, financial incentives usually impact case selection: as the lawyers who represent these investors (or litigation funders) typically invest their own funds to pursue the litigation, simple cases that require less cost to pursue are often more appealing to the plaintiffs' bar. Similar considerations exist for public enforcement. In the resource-constrained environment of government prosecutors, the likelihood of success and the cost associated with the effort are paramount concerns. Public enforcement decisions are also likely to be shaped by policy considerations.

This section discusses some of the ways litigation and enforcement relating to the SEC climate disclosure rule might align or diverge from actions relating to traditional financial disclosure. This is important because the quality of climate disclosure under the new SEC rule may depend on companies' perception of the liability and enforcement risks they face. Litigation risk was a key issue cited by commenters who expressed concern about the SEC's initial rule proposal.[106] The SEC modified the final rule in several respects to address these concerns, while acknowledging that litigation might be one of the costs resulting from enhanced climate disclosure.

The U.S. federal securities laws and the disclosure obligations of companies are enforced by the SEC, through its Division of Enforcement, which works in tandem with the Department of Justice on cases involving potential criminal penalties. The SEC's Enforcement Division, with relatively limited resources, also covers a broad range of topics beyond company disclosure, such as insider trading, market manipulation, Ponzi schemes, accounting fraud, crypto fraud, and misconduct by broker-dealers and investment advisors.[107]

Securities laws are also enforced through private lawsuits, typically in the form of class actions, alleging that disclosure by companies is fraudulent or misleading, and seeking damages or rescission of securities transactions. The Supreme Court "has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the [SEC]."[108]

The SEC climate rule will be subject to the same enforcement mechanisms as other securities disclosure rules, assuming it becomes effective. But the nature of climate disclosure can differ from traditional

104 Sci. Based Targets, SBTi Monitoring Report 2023 11 (July 2024).

105 *Id.* at 19.

106 Adopting Release, at 270, 288, 563, 595, 653, 667, 802.

107 *About the Division of Enforcement – Types of Cases Brought by the Division*, Sec. & Exch. Comm'n (last updated June 28, 2024), https://www.sec.gov/about/divisions-offices/division-enforcement/about-division-enforcement.

108 *Tellabs, Inc. v. Makor Issues & Rights*, Ltd., 551 U.S. 308 (2007) (citing *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 345 (2007) and *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964)).

financial disclosure. In particular, a significant part of climate disclosure focuses on long-term issues such as climate plans, targets, and goals for the future, in 2030, or 2040, or 2050 and beyond. Disclosure relating to these plans, targets, and goals, or their modification or abandonment, may not significantly impact short-term share prices. This issue, coupled with the SEC's expansion of a liability safe harbor for forward-looking statements in the final rule, may present new challenges to private litigants seeking to initiate enforcement actions in the climate context.

Given these challenges, the effective application and enforcement of the climate disclosure rule is likely to depend on the SEC's appetite for enforcement under the new administration, and the resources it can devote to climate disclosure issues. The SEC's role will encompass not only actual and threatened formal enforcement proceedings when violations are discovered, but a range of "soft law" mechanisms, such as published interpretative guidance and comments on company disclosure. Whether these mechanisms effectively motivate companies to provide meaningful climate disclosure in their SEC reports will depend in part on how vigorously the SEC applies and enforces the new rule.

A. Private Enforcement of Climate Disclosure Rules

Investors who suffer losses from misleading disclosure in SEC reports and other financial communications can seek compensation for those losses through private securities litigation. Because the losses suffered by individual investors are generally small, plaintiffs and their counsel typically seek to aggregate damages claims of numerous investors through class action lawsuits. The class action mechanism involves filing a lawsuit on behalf of a group of similarly situated shareholders, followed by class certification to ensure a number of legal requirements: the commonality of legal issues or facts, a sufficient number of allegedly aggrieved parties, typicality of named plaintiffs' claims across the entire class, and adequacy of representation.[109]

Private plaintiffs may bring securities fraud cases under the SEC's new climate disclosure rule if companies fail to accurately disclose material climate-related risks or impacts when required to do so. For example, if a company underreports its carbon emissions or misrepresents the financial impact of climate risks, investors might argue that they relied on these disclosures in making investment decisions, leading to financial losses when the truth emerged.

Private class actions under the federal securities laws generally assert liability based on Section 10(b) of the Securities Exchange Act of 1934 and the SEC's Rule 10b-5, which prohibit material misstatements and misleading omissions in connection with the purchase or sale of securities. While Rule 10b-5 does not explicitly provide for private lawsuits, courts have interpreted it for decades to allow private rights of action.[110] To establish liability under Rule 10b-5, plaintiffs must prove that the defendant made material misstatements or misleading omissions with "scienter"[111] (knowledge or reckless disregard of the misleading nature of a statement or omission); that the misstatement or omission was connected to the purchase or sale of securities; and that the plaintiff relied on those statements or omissions.[112] Additionally, loss causation must be demonstrated, showing that a stock price drop or economic loss was linked to a corrective disclosure of the fraud.

Investors who claim to suffer losses following the purchase of securities in public offerings may also assert liability under Sections 11 and 12(a)(2) of the Securities Act of 1933, which impose liability against issuers, underwriters and controlling parties (such as senior officers and directors) for material errors and omissions in registration statements and prospectuses relating to such offerings. The liability standards of Sections 11 and 12(a)(2) are drafted in a similar way to those of Rule 10b-5, but there are two important differences. First, a Rule 10b-5 action based on an omission requires a plaintiff to demonstrate that the omission makes the statements in the document misleading, while Section 11 imposes liability for the omission of information that SEC rules require to be in a registration statement, without any demonstration that omission causes the rest of the disclosure to be misleading.[113] Second, Sections 11 and 12(a)(2) do not require proof of "scienter," or even proof that the plaintiff read the registration statement or prospectus. While this creates powerful tools for plaintiffs to recover losses, Sections 11 and 12(a)(2) are available only to a more limited class of investors who purchase securities

109 Fed. R. Civ. P. 23; Adam Eric Polk, *Class Actions 101: How to Obtain (or Defeat) Class Certification* (Oct. 22, 2019), https://www.americanbar.org/groups/litigation/resources/newsletters/class-actions-derivative-suits/class-actions-101-how-obtain-or-defeat-class-certification/.

110 *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975).

111 *Aaron v. SEC*, 446 U.S. 680, 691 (1980).

112 *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005).

113 *Macquarie v. Moab*, 144 S.Ct. 885, 891-892 (2024).

in public offerings directly or can trace their securities to those offerings, rather than investors who purchase them in the market.[114]

1. Impact of Climate Disclosure on Share Prices

Even though climate disclosure is subject to the same liability standards as traditional financial disclosure, plaintiffs may face obstacles in bringing actions for climate-related misstatements and omissions if they are unable to show an impact on a company's share price.

Some climate issues will impact company share prices in the same way as traditional financial disclosure. A company that has a catastrophic accident resulting from a climate problem may face accusations that the risks underlying the accident were not adequately disclosed. If the share price declines when the accident happens, the company may face private securities litigation. A prominent example in the HSE context (health, safety, environment) was a case involving the Brazilian mining company Vale, which faced both an SEC enforcement action and class action litigation following the collapse of a dam that it operated. The plaintiffs alleged that Vale, which is listed on the New York Stock Exchange, failed to disclose safety risks in its SEC reports and investor communications, and that investors suffered losses when Vale's share price declined sharply following the announcement of the accident and related investigations in January and February 2019.[115]

The Vale case (particularly the SEC enforcement action) has been widely cited as an example of enforcement efforts directed at ESG issues.[116] However, the case follows a classic pattern of private litigation following a drop in share prices, using the common practice of "piggybacking" on the SEC's enforcement action.[117] The lawsuit started before the SEC climate disclosure rule was even proposed (and indeed is unrelated to climate issues), as was another action brought against Vale (and since settled) relating to the earlier collapse of another dam.[118] The key factor motivating the plaintiffs in both cases was not the HSE issues themselves, but rather the substantial stock price drop after the announcement of the accidents.

Studies of the impact of climate disclosure on company valuations and share prices have produced inconclusive results. While a survey of the vast literature on this topic is beyond the scope of this paper, the difficulty of establishing a link between valuations and emissions disclosure can be illustrated with a few examples. A study conducted in September 2023 (and updated in March 2024) for the Bank for International Settlements found that a "green" index that progressively eliminated shares of "brown" companies outperformed other indices in the study.[119] A 2022 National Bureau of Economic Research (NBER) study found that green securities had historically performed better than brown securities due to growing climate concern among investors, but forecast that green securities would be expected to have lower future returns.[120] Another NBER study published in 2020 found that companies with higher CO2 emissions generally had higher returns.[121] A June 2023 IMF-sponsored study, focusing on Canadian markets, found evidence that stock prices of oil and gas companies incorporate information about climate mitigation policies, but that climate-unfavorable news produced a statistically significant positive impact on share prices, while climate-favorable news produced a negative (but not statistically significant) impact.[122] A May 2023 LSE Grantham Institute study (based on Sabin Center data) found that the announcement of climate litigation and adverse court decisions had a negative impact on company valuations, particularly for large emitters in the energy, utilities, and materials sectors.[123] A December 2023 study by the European Securities and Markets Authority found that greenwashing allegations did not have a clear financial impact on firms.[124]

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114 *Slack Technologies, LLC, FKA Slack Technologies, Inc., et al, v. Pirani,* 598 U.S. __ (2023).

115 *In re Vale S.A. Sec. Litig.*, No. 19-CV-526-RJD-SJB (E.D.N.Y. Mar. 31, 2022).

116 Lydia Wang, Vale and the Rise of Securities-Based Climate Litigation, Colum. J. Transnat'l. L.: The Bulletin (Mar. 25, 2023), https://www.jtl.columbia.edu/bulletin-blog/vale-and-the-rise-of-securities-based-climate-litigation.

117 Alexander I. Platt, *"Gatekeeping" in the Dark: SEC Control Over private Securities Litigation Revisited*, 72 Admin. L. Rev. 39 (2020), http://www.administrativelawreview.org/wp-content/uploads/2020/03/ALR-72.1_Platt.pdf.

118 Judgment Approving Class Action Settlement, In Associated Cases: 1:15-cv-09539-GHW, 1:16-cv-00658-GHW (S.D.N.Y. June 10, 2020).

119 Gong Cheng et al., *The impact of Green Investors on Stock Prices 3* (BIS Working Papers, Paper No. 1127, Sept. 2023, rev. Mar. 2024), https://www.bis.org/publ/work1127.pdf.

120 Lubos Pastor et al., *Dissecting Green Returns* (Nat'l Bureau of Econ. Rsch, Working Paper No. 28940, June 2021, rev. June 2022), https://www.nber.org/system/files/working_papers/w28940/w28940.pdf.

121 Patrick Bolton & Marcin Kacperczyk, *Do Investors Care about Carbon Risk?* (Nat'l Bureau of Econ. Rsch, Working Paper No. 26968, Apr. 2020), https://www.nber.org/system/files/working_papers/w26968/w26968.pdf.

122 Yuanchen Yang et al., *Decomposing Climate Risks in Stock Markets 4* (IMF, Working Paper No. WP/23/141, June 2023).

123 Sato M et al., *Impacts of climate litigation on firm value* (Ctr. for Climate Change Econ. & Policy, Working Paper No. 397 & Grantham Rsch. Inst. on Climate Change & the Env't, Working Paper No. 421, May 2023).

124 Julien Mazzacurati et al., *The financial impact of greenwashing controversies*, Eur. Sec. & Mkts. Auth. (Dec. 19, 2023), https://www.esma.europa.eu/sites/default/files/2023-12/ESMA50-524821-3072_TRV_Article_The_financial_impact_of_greenwashing_controversies.pdf.

With respect to climate targets and goals specifically, a December 2023 study by professors at Harvard Business School and the University of California, Berkeley, found that the market impact of announcements of missed climate targets was minimal, a sharp contrast to missing earnings targets.[125] The study examined CDP (formerly Carbon Disclosure Project) data for 1,041 companies with Scope 1 and 2 emissions targets ending in 2020, of which 88 failed to meet the targets and 320 stopped reporting information relating to their targets. It found low awareness of the missed targets and very limited media coverage. The authors observed significantly positive reactions in media sentiment when the targets were initially announced, but after the firms failed to meet their targets in 2020, they "[did] not observe significant market reaction, changes in media sentiment, environmental scores and environment-related shareholder proposals."[126]

The findings of the climate target study are consistent with recent anecdotal evidence on the impact of failing or abandoning climate targets on short-term share prices. For example, in July 2023, the mining company Rio Tinto announced that it would not meet its 2025 Scope 1 and 2 emissions targets without purchasing carbon offsets, while confirming its 2030 and 2050 targets.[127] The company's share price declined after the announcement, but this was attributed in the press to its simultaneous announcement of lower earnings and a cut in dividends.[128] This also illustrates the difficulty of isolating the share price impact of adverse news relating to climate targets, which is often disclosed as part of results announcements that can mask any impact the climate target announcement might have if made in isolation.

In 2024, several companies prominently announced the loosening of climate-related targets and policies, including Unilever, Shell, BP, and Bank of America. [129] Reporting on this trend, the Financial Times quoted BP's CEO saying the company was "really, really driven by returns."[130] When BP announced in October 2024 that it was abandoning its already-scaled-back target of reducing oil production (following the announcement three weeks earlier of the sale of a wind power affiliate), its share price increased on the date of the announcement, while on the following day it declined somewhat more than the share price of other oil companies (affected by a drop in oil prices that day). Commenting on the announcement, one analyst stated that "[t]he u-turn on renewables will certainly upset a significant number of climate-conscious investors, but it augurs well for those who are keen on near-term profits."[131]

These studies and examples do not mean that climate disclosure is irrelevant to the value of companies. Quite the contrary, given the substantial risks associated with climate change, the long-term value of most companies is almost certainly intrinsically tied to their preparations to address climate risks. But the impact of climate disclosure on valuations is difficult to measure and may not manifest itself in short-term share price movements given the long-term focus of most climate-related plans, targets, and goals.

2. Challenges for Private Enforcement Actions

If investors find it difficult to show a link between climate disclosure and short-term share prices, they may have a hard time proving economic loss from misstatements about climate-related risks, which is typically established based on negative share price movements during the period immediately following significant corporate announcements. Absent the ability to prove loss causation and damages, investors and members of the plaintiff bar will have limited financial incentives to pursue private enforcement actions based on allegedly misleading climate information. Further, even if investors and their counsel elect to pursue private enforcement actions relating to climate disclosure despite uncertain potential economic recoveries, they will face several procedural obstacles.

Many of the obstacles apply primarily to Rule 10b-5 claims, and present less of an issue (or no issue at all) in claims brought under Section 11 or 12(a)(2) of the Securities Act. In particular, investors may be able to claim damages in the latter cases without proving loss causation, so they can recover for a drop in share prices even if it is not linked to the misleading or incomplete climate disclosure. But Sections 11 and 12(a)(2) apply only when companies offer and sell securities to the public, and actions

125 Xiaoyan Jiang, Shawn Kim & Shirley Lu, *Accountability of Corporate Emissions Reduction Targets* (December 27, 2023), https://ssrn.com/abstract=4676649.

126 *Id*. at 1, 37.

127 *2024 Half year results*, Rio Tinto, https://www.riotinto.com/en/invest/financial-news-performance/results (last visited Oct. 29, 2024).

128 Melanie Burton & Rishav Chatterjee, *Rio Tinto Profit Misses on Iron Ore Price Slump*, Cuts Dividend, Reuters (July 26, 2023, 5:10 AM), https://www.reuters.com/markets/commodities/rio-tintos-first-half-profit-falls-34-easing-iron-ore-prices-2023-07-26/.

129 Kenza Bryan and Attracta Mooney, *"How companies are starting to back away from green targets,"* Fin. Times (June 21, 2024).

130 *Id*.

131 Michael Abadha, *BP Share Price Pauses Uptrend on Fears Over China Stimulus*, Investing Cube (Oct. 8, 2024, 14:58 BST), https://news.investingcube.com/bp-share-price-pauses-uptrend-on-fears-over-china-stimulus/.

under those sections can be brought by only a limited class of investors who can demonstrate that they purchased the securities sold in those offerings.

a) Class Certification Issues

The first potential obstacle in a Rule 10b-5 case relates to the process of class certification, during which a court decides whether a case can be brought as a class action, rather than as an individual action (or multiple individual actions). As mentioned earlier, one of the requirements for class certification is to demonstrate commonality of law and facts among members of the plaintiff class.[132] To pursue a Rule 10b-5 claim, plaintiffs must show reliance on the misleading statement or omission. In its 1988 decision in *Basic v. Levinson*, the Supreme Court decided that, rather than requiring an individual showing of reliance, all investors are presumed to rely on the market price of publicly listed shares, which is in turn considered to reflect all publicly available information (including misrepresentations).[133] While this notion (known as the fraud-on-the market theory) has been debated by scholars,[134] it was confirmed by the Supreme Court in 2014 in *Halliburton Co. v. Erica P. John Fund*.[135]

In *Halliburton*, the Court was asked to overrule *Basic v. Levinson*, but it declined to do so. At the same time, the Court ruled that a defendant can rebut the presumption of reliance and contest class certification by showing that the relevant misrepresentation did not affect the share price (although it ruled that it was the defendant's burden to show this, and not the plaintiff's burden to demonstrate a price impact).[136] Previously, such a showing could only be made at the merits stage, long after class certification.

The *Halliburton* decision could impact the ability of plaintiffs to obtain class certification in some climate disclosure cases, particularly those involving missed climate targets and goals. Defendants are likely to rely on studies like the ones cited above to show that share prices are unaffected by news that companies will fail to meet, or are abandoning, their targets. Companies are likely to produce bespoke expert reports showing the absence of any correlation between their share prices and their climate disclosure, or possibly a positive impact on short-term prices if they reduce expenditures on climate initiatives to focus on returns. Whether this will be sufficient to overcome the presumption of reliance (and class certification) will depend on the level of certainty that courts will require defendants to show with respect to the lack of share price impact.

This issue would not preclude class certification in cases based on Section 11 or 12(a)(2) of the Securities Act, as reliance is not a required element of claims under those sections.

b) Omissions

Investors may have a difficult time bringing Rule 10b-5 actions based solely on the omission of climate information by companies from their SEC reports. By its terms, Rule 10b-5 only applies to the "omission to state a material fact necessary, in light of the circumstances under which they are made, to make the statements [in a disclosure document] not misleading." Put in simpler terms, and as the Supreme Court has recently confirmed,[137] Rule 10b-5 claims cannot be based on the omission of information just because it is required by SEC rules; a plaintiff must show the omission makes the disclosure in the company's disclosure document misleading (a half-truth).

This may impact the prospects of Rule 10b-5 litigation relating to disclosure required by the SEC climate rule. For example, if a company has a climate transition plan that is material to its long-term business strategy, but it fails to describe the transition plan or to provide information on actual or planned expenditures in its SEC annual report, an investor will need to show that the omission of this information makes other disclosure in the annual report misleading in order to succeed under Rule 10b-5. It may be difficult for an investor to point to statements that would be rendered misleading by such an omission.

As discussed earlier, investors making claims under Section 11 of the Securities Act would face fewer challenges, because Section 11 allows private actions based on a company's omission to include

132 *See*, Fed. R. Civ. P. 23.

133 *Basic Inc. v. Levinson*, 485 U.S. 424 (1988).

134 Daniel R. Fischel, *Efficient Capital Markets the Crash and the Fraud on the Market Theory*, 74 Cornell L. Rev. 907 (1989); Gregory C. Avioli, *Basic Inc. v. Levinson: An Unwise Extension of the Fraud-on-the-Market Theory*, 67 UNC L. Rev. 1161 (1989); Lev & de Villiers, *Stock Price Crashes and 10b–5 Damages: A Legal, Economic, and Policy Analysis*, 47 Stan. L. Rev 7 (1994).

135 *Halliburton Co. v. Erica P. John Fund*, Inc., 573 U.S. 258 (2014).

136 *Id*.

137 *Macquarie v. Moab*, 144 S. Ct. 885 (2024).

disclosure required by the SEC's rules, regardless of whether the omission renders other statements misleading. On the other hand, the issue would arise in a claim based on 12(a)(2) of the Securities Act, which uses the same wording as Rule 10b-5 and thus provides relief only for omissions that make disclosure in a prospectus misleading.

c) Materiality

Companies accused of making misstatements on climate issues or omitting required climate disclosure are likely to argue that the statements or omissions are not material, and on this basis they will seek to have enforcement actions dismissed. This issue is not limited to Rule 10b-5 actions but will equally be an issue in actions brought under Section 11 and 12(a)(2) of the Securities Act, as materiality is a required element of claims under those sections.

As discussed earlier, it may be difficult for an investor to demonstrate the materiality of a misstatement or an omission relating to climate disclosure unless it can show an impact on share prices. Without such impact, companies might take the position that the misstatement or omission is unimportant to the reasonable investor, arguing that a reasonable investor is interested in climate information only when it has the potential to impact share prices.

Investors may face other challenges in demonstrating materiality due to the Supreme Court's definition of the term in *TSC v. Northway* as confirmed in more recent cases.[138] Investors might argue, for example, that information about a climate plan or target disclosed by a company in a CSRD sustainability report should be disclosed in the same level of detail in the company's SEC annual report. Under the Supreme Court definition, however, the missing information must alter the "total mix" of information available to investors in order to be material. If the information is available in a public CSRD sustainability report (or perhaps even in a sustainability report that is voluntarily published by a company on its website), the company might argue that the sustainability report is part of the "total mix" of available information, making the omission of that information from the SEC annual report (and from a registration statement or prospectus that is the subject of a Section 11 or 12(a)(2) action) immaterial. Such an interpretation would seem to be at odds with the purpose of the SEC climate rule, and investors would undoubtedly argue strenuously against it, but it cannot be summarily dismissed.

d) Safe Harbors for Forward-Looking Statements

The SEC climate disclosure rule requires companies to include substantial forward-looking disclosure in their SEC annual reports. This includes information on the impact of climate risks on their business model and outlook, climate adaptation and mitigation plans, transition plans, scenario analysis, targets, and goals. Companies are also required to provide information on the impact of anticipated material expenditures on climate plans, targets, and goals on their financial estimates and assumptions, which might require them to disclose cash flow projections.

By definition, there is a significant risk that forward-looking information might turn out to be wrong. In such cases, companies that publish forward-looking information are subject to heightened risk of securities litigation. Some have argued, and the Supreme Court has acknowledged, that some litigation relating to forward-looking information can impose substantial costs on companies whose behavior complies with the law.[139]

To address the perceived risk of abuse in private securities litigation, Congress enacted the Private Securities Litigation Reform Act of 1995 (PLSRA).[140] The PLSRA contains a safe harbor that insulates a reporting company and certain parties acting on its behalf from liability in private actions for material forward-looking statements that are either (i) identified as such in SEC disclosure documents and accompanied by meaningful cautionary statements identifying factors that could cause actual results to differ materially from those projected, or (ii) made without the relevant individuals or the company's responsible offices having actual knowledge that the information was false or misleading.[141]

In the proposed climate disclosure rule, the SEC noted that forward-looking climate disclosure would benefit from the PSLRA safe harbor, while acknowledging that the availability of the safe harbor would be limited by several exceptions, including that the safe harbor does not apply to initial public offerings.

138 *TSC Industries, Inc. v. Northway*, Inc., 426 U.S. 438, 449 (1976); Matrixx Initiatives, *Inc. v. Siracusano*, 563 U.S. 27 (2011).
139 *Tellabs v. Inc. v. Makor Issues & Rights Ltd.*, 551 U.S. 308 (2007).
140 Private Securities Litigation Reform Act of 1995, Pub. Law 104-67, 109 Stat. 737.
141 Securities Act of 1933, § 27A; Securities Exchange Act of 1934, § 21E.

It solicited comment on whether to expand the safe harbor.[142] In response to comments, the final rule provides specifically that the safe harbor applies to climate-related disclosures pertaining to transition plans, scenario analysis, the use of an internal carbon price, targets, and goals, and it expands the safe harbor to cover forward-looking information in registration statements for initial public offerings and certain other transactions.[143]

The safe harbor may present a significant obstacle to private litigation on some of the most significant climate disclosures required by the new rule, including disclosures relating to transition plans, targets, and goals. The extent to which the safe harbor precludes liability for these disclosures will depend largely on the effectiveness of cautionary statements included by companies in SEC reports and registration statements. There may be litigation about whether those statements are adequate, particularly where plaintiffs allege that plans and budgets to achieve targets and goals are plainly inadequate. Nonetheless, overcoming the PSLRA safe harbor is likely to be a challenge for private actions based on forward-looking information disclosed under the new SEC climate rule.

B. The Role of the SEC in Promoting Compliance and Enforcing the Climate Disclosure Rules

Given the potential challenges to private enforcement of the SEC climate disclosure rule, the effectiveness of the new rule is likely to depend on how the SEC applies and enforces it, to a greater extent than is the case for traditional financial disclosure. The SEC has a range of tools at its disposal – from the publication of disclosure comments and guidance, to more formal enforcement actions. How the SEC uses these tools will depend on its policy decisions under the new administration (assuming the climate disclosure rule becomes effective), as well as the resources it is able to devote to the climate rule.

The SEC's enforcement powers are best known for their use in major fraud cases such as those involving Bernard L. Madoff and Enron, as well as prominent insider trading cases against moguls such as Ivan Boesky and Michael Milken. However, the vast majority of SEC cases remain well under the radar for the general public, with most enforcement cases settled with little fanfare in the press.

The tool used most frequently – and arguably most effectively – by the SEC to address disclosure issues is even less well-known to the public. The SEC significantly influences disclosure decisions through the process of publishing disclosure guidance and issuing comment letters to companies on the contents of their reports and registration statements.

This section begins with an analysis of the comment letter and guidance process and its potential use with respect to the climate disclosure rule, followed by a discussion of possible avenues for SEC enforcement of the rule.

1. Comment Letters and Guidance

Federal agencies may clarify existing obligations, or new obligations, through non-binding guidance documents, which are exempt from the notice-and-comment requirements applicable to formal rulemaking.[144] Guidance documents are critical because they are statements of general applicability, intended to impact the behavior of reporting companies by announcing the agency's view on a regulatory or technical issue.[145]

The SEC uses a variety of tools to provide this type of guidance to companies on disclosure issues. An example is the climate guidance published by the SEC in 2010, when the SEC expressed its views on how existing disclosure requirements applied to climate change matters.[146] Among other things, the SEC said that companies should disclose what the new rule now defines as physical and transition risks in their SEC reports, as well as considering climate issues in their financial disclosure more generally. The SEC climate guidance was similar in nature to previously published interpretative guidance relating to traditional business and financial disclosure issues such as "management's discussion and analysis" (MD&A) of a company's results and financial condition.[147]

142 Proposing Release, at 66-67, 92.

143 Adopting Release, at 35, 393-97.

144 Exec. Order No. 13,891, 84 Fed. Reg. 55,235 (Oct. 15, 2019), https://www.federalregister.gov/documents/2019/10/15/2019-22623/promoting-the-rule-of-law-through-improved-agency-guidance-documents.

145 *Id*.

146 *See*, 2010 Guidance.

147 Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 10751, Exchange Act Release No.88094; FR-87 (Feb 25, 2020).

The SEC also addresses disclosure issues in Staff Legal Bulletins and Staff Accounting Bulletins, which are documents that express the views of the staff responsible for the review of company disclosure, but do not constitute a formal position of the SEC (although they are sometimes used as if they represented a more formal position). Staff Accounting Bulletin 99, for example, addresses the concept of materiality (under the *TSC v. Northway* standard) as it applies to financial statement errors and misstatements, indicating that materiality in this context does not depend on a strict quantitative threshold (such as 5% of net income), but also requires companies to apply a qualitative analysis, including those in an indicative list set out in the bulletin.[148] The staff has also used Staff Legal Bulletins to address disclosure relating to issues such as Y2K risk, the impact of the transition to the euro and the staff's views relating to a rule requiring that certain disclosures be provided in "plain English."[149] The SEC's Division of Corporation Finance also publishes staff disclosure guidance on issues such as cybersecurity and COVID-19, as well as reports on recurring issues observed during the review and comment process. It also publishes a Financial Reporting Manual addressing a variety of issues about the way in which companies disclose financial matters.[150]

While the SEC's guidance materials can influence company disclosure decisions and carry with them the implicit threat of enforcement (even though they lack the force and effect of law), the SEC influences company disclosure most directly through the Division of Corporation Finance's review and comment process.[151] The SEC is required to review annual reports submitted by companies at least once every three years.[152] It also reviews and comments on registration statements filed for initial public offerings and certain other securities offerings, which cannot go forward until the SEC's comments are cleared. The review process is often rigorous and probing, asking companies to explain their materiality analysis or to justify decisions not to include certain information published in press releases or presentations in their SEC filings. The staff also regularly asks for clarification of substantive issues in company filings, particularly in risk factor and MD&A disclosure, as well as accounting questions. In addition, sample comment letters are available on the SEC website, indicating the comments that companies are likely to receive on a variety of topics, including climate issues (under the 2010 guidance).[153]

Importantly, comment letters issued by the SEC staff and company responses are published and searchable on the SEC's website,[154] and companies regularly use them for guidance on the SEC's views relating to disclosure questions. Companies are also required to disclose in their annual reports the substance any material staff comments that have not been fully addressed within 180 days after receipt (companies may also include their own positions on those comments).[155]

The guidance and comment process will likely have a significant influence on how companies apply the new climate disclosure rule. The sample comment letter under the 2010 guidance asks a hypothetical company why its sustainability report contains more disclosure than its SEC reports; reminds it to disclose climate-related transition risks and litigation risks; suggests that it disclose the impact of climate regulation on business trends; asks that it disclose and quantify material past and expected capital expenditures relating to climate projects; and requests disclosure of the impact of severe weather events and other physical events on the company's results and financial condition.[156] These comments in many respects go beyond the strict scope of the 2010 guidance, covering issues that will constitute mandatory disclosure items under the SEC climate rule, to the extent they are material.

148 SAB 99.

149 SEC Staff Legal Bulletins Nos. 5, 6, 7 & 7A.

150 *Disclosure Guidance*, Sec. & Exch. Comm'n (last updated June 28, 2024), https://www.sec.gov/rules-regulations/staff-guidance/disclosure-guidance; *Financial Reporting Manual,* Sec. & Exch. Comm'n (last updated June 12, 2024), https://www.sec.gov/about/divisions-offices/division-corporation-finance/financial-reporting-manual.

151 Alexander, supra note 119.

152 *Filing Review Process*, Sec. & Exch. Comm'n, https://www.sec.gov/about/divisions-offices/division-corporation-finance/filing-review-process-corp-fin.

153 *Sample Letter to Companies Regarding Climate Change Disclosures*, Sec. & Exch. Comm'n (last updated June 28, 2024), https://www.sec.gov/rules-regulations/staff-guidance/disclosure-guidance/sample-letter-companies-regarding-climate.

154 Comment letter searches can be conducted through the SEC's EDGAR database, *How to Search for EDGAR Correspondence, Sec. & Exch. Comm'n* (last updated Dec. 1, 2011), https://www.sec.gov/answers/edgarletters.htm.

155 17 C.F.R. § 249.310 (2023).

156 Sample Letter, *supra* note 152.

By issuing guidance and comment letters, the SEC will influence how companies view many of the uncertainties described in Section III of this report, and it may seek to discourage companies from interpreting these issues in the most restrictive way. Most significantly, the SEC can:

- probe the materiality decisions made by companies and ask for explanations of their analysis;
- question whether disclosure in sustainability reports (including those published under the CSRD, once that becomes applicable) should be added to SEC reports;
- ask companies to consider whether to include at least qualitative disclosure of Scope 3 emissions when they represent a large part of a company's total emissions;
- seek disclosure of capital expenditures anticipated with respect to adaptation and mitigation plans, transition plans, and climate targets and goals;
- suggest that companies provide sufficient details on the way in which they expect to achieve their targets and goals and their progress in doing so (including explaining year-on-year variations in emissions as part of their progress reports); and
- question the use of indicators that do not conform strictly to the requirements of the GHG Protocol or any other recognized standard used by companies.

The SEC staff is also likely to ask questions about the compliance of company disclosures with the GHG Protocol and other standards, as the staff regularly does with respect to accounting principles.

Over time, the SEC staff can publish summary reports on issues addressed in the comment process and other disclosure guidance. Once the SEC has substantial experience with company climate disclosures, it can also publish more formal interpretative guidance on climate disclosure issues.

SEC staff positions expressed in comment letters, guidance releases, and other publications expressing views on disclosure issues represent a powerful tool, as the SEC staff can tailor questions and guidance to specific disclosure decisions reflected in SEC annual reports and registration statements. They can go into significant detail on numerous disclosure issues. While companies are not obligated to revise disclosure in response to comments or to apply published SEC guidance, they typically choose to do so. Where they do not, they expose themselves to the risk of enforcement action.

2. Enforcement Actions

The SEC is authorized under the Securities Act of 1933 and the Securities Exchange Act of 1934 to enforce compliance with those laws (including disclosure obligations) with a broad variety of remedies available, including injunctions, civil monetary penalties, suspension of trading in a company's securities, barring officers and directors from holding positions, and disgorgement of profits or executive compensation following accounting restatements.[157] The federal securities laws also provide for criminal penalties for willful violations, enforced by the SEC in tandem with the Department of Justice.[158]

Enforcement by the SEC is not subject to many of the limitations of private actions discussed above. The SEC can investigate and bring actions in federal courts for any violations of the federal securities laws or the SEC's rules and regulations, including the climate disclosure rule.

While the enforcement powers of the SEC are broad, its resources are not. The total number of lawyers working at the SEC's Division of Enforcement is the equivalent of one moderately large law firm.[159] These enforcement lawyers, along with the rest of the enforcement staff, investigate and enforce the securities laws in numerous areas other than company disclosure, including insider trading, market manipulation, accounting fraud, foreign corrupt practices, and misconduct by broker-dealers and investment advisors.

Because of the SEC's limited enforcement resources, many potential cases are settled. When the Division of Enforcement believes a material violation has occurred, it sends a notice (known as a "Wells Notice") indicating that the company or its officers and directors may be subject to an enforcement action.[160] A negotiation typically ensues, with targeted companies and individuals targeted by the

157 Securities Exchange Act of 1934, § 10D,12(j), 21; Securities Act of 1933, § 8A, 20, 32.

158 Securities Exchange Act of 1934, § 32.

159 According to one study, the SEC enforcement division has more than 1,000 enforcement lawyers. John D. Burretta et al., *Basic Anatomy of Enforcement Investigations in the United States*, Global Investigations Rev. (Dec. 7, 2023), https://globalinvestigationsreview.com/guide/the-guide-international-enforcement-of-the-securities-laws/third-edition/article/basic-anatomy-of-enforcement-investigations-in-the-united-states#:~:text=The%20enforcement%20division%20has%20more,laws%20and%20prosecuting%20these%20violations.

160 Sec. & Exch. Comm'n, Div. of Enf't, Enforcement Manual § 2.4 (Nov. 28, 2017), https://www.sec.gov/divisions/enforce/enforcementmanual.pdf [hereinafter SEC Enforcement Manual].

investigation incentivized to cooperate, primarily to save litigation costs, but also by the prospect of reduced penalties. Most negotiations end in settlements, with companies and individuals agreeing to pay civil penalties and/or to implement various behavioral remedies (such as ceasing and desisting the offending behavior). Settlements are publicly disclosed in press releases that are often written to dissuade other parties from engaging in similar behavior.

Even when they end in settlement, enforcement actions can require substantial SEC staff resources. To address this issue, the SEC has the discretion to rank enforcement priorities.[161] It has a stated practice of focusing on enforcement addressing wrongdoing prohibited under newly-enacted legislation or regulatory rules.[162] Accordingly, enforcement of the new climate disclosure rule could become a priority, though the SEC has not indicated publicly whether this will be the case, and its decision as to whether to prioritize enforcement will likely be influenced by the policies of the new administration.

Historically, SEC enforcement cases relating to company disclosure have focused on cases in which investors suffer significant financial losses. As an example, the SEC recently announced the settlement of an enforcement action against Zymergen, a biotechnology company accused of unsupported hype of the market potential for its touch-based screens ahead of its $530 million initial public offering, even though the hype was reportedly at odds with the market analysis of the company's own finance and sales teams.[163] The company, which filed for bankruptcy two years after the IPO, agreed to pay a $30 million fine as part of the settlement.

Based on summaries published by several law firms active in the enforcement area,[164] the SEC filed 784 enforcement actions (including 501 stand-alone actions)[165] in its fiscal year 2023 (ended September 30, 2023), collecting more than $1.5 billion in civil penalties. A significant part of these penalties related to cases involving off-channel communications (such as texts and WhatsApp) by bank employees who are required by SEC rules to communicate in the trading room only through official mechanisms in which conversations are recorded. Prominent enforcement cases identified by the law firms relating to financial reporting and disclosure involved accounting misstatements and related control violations, over-hyped business statements, or cybersecurity incidents. The SEC also increased its focus on individual accountability (as opposed to corporate responsibility) for misleading disclosure, again in cases where the disclosure issue had financial consequences.[166] Not surprisingly, no climate-related cases were cited in the law firm summaries reviewed.

However, over the past few years, the SEC has publicly sought to make ESG issues a priority for enforcement. In March 2021, the SEC announced the creation of a Climate and ESG Task Force within the Division of Enforcement, with a "focus … to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules."[167] In April 2022, the SEC announced an enforcement action against Vale in the case discussed earlier involving allegedly misleading disclosures about the company's safety standards prior to the collapse of its dam in Brazil.[168] This case was touted in the SEC's press release as an example of its focus on enforcement in the ESG area, although as previously discussed, this was not so much an environmental case as a traditional disclosure case that involved an environmental matter (and it pre-dated the new climate rule). The SEC settled the Vale enforcement case in 2023 without the company admitting to scienter allegations (the settlement was based on negligence).[169] Three other recent cases have been publicly described as ESG enforcement

161 SEC Enforcement Manual, at § 2.1.1.

162 *Id*.

163 Press Release, Sec. & Exch. Comm'n, SEC Charges Zymergen Inc. With Misleading IPO Investors About Company's Market Potential and Sales Prospects, (Sept. 13, 2024), https://www.sec.gov/newsroom/press-releases/2024-129.

164 Robin M. Bergen et al., *SEC Announces FY 2023 Enforcement Results with Second-Highest Penalties on Record*, Cleary Gottlieb: Cleary Enforcement Watch (Nov. 27, 2023), https://www.clearyenforcementwatch.com/2023/11/sec-announces-fy-2023-enforcement-results-with-second-highest-penalties-on-record/; Jones Day, *SEC Announces FY 2023 Enforcement Results with Second-Highest Penalties on Record* (Jan. 31, 2024), https://www.jonesday.com/en/insights/2024/01/sec-enforcement-in-financial-reporting-and-disclosure-2023-yearend-update; *SEC enforcement against public companies – A recap of 2023*, Davis Polk (Jan. 3, 2024), https://www.davispolk.com/insights/client-update/sec-enforcement-against-public-companies-recap-2023; Harris Fischman et al., *SEC Enforcement: 2023 Year in Review*, Harv. Corp. Gov't. F. (Feb. 3, 2022), https://corpgov.law.harvard.edu/2024/03/13/sec-enforcement-2023-year-in-review/.

165 Stand-alone actions are actions that do not involve merely revocation actions against delinquent filers or follow-on proceedings based on other orders.

166 Press Release, Sec. & Exch. Comm'n, Former Wells Fargo Senior Executive Carrie Tolstedt Agrees to Settle SEC Fraud Charges for Misleading Investors About Abusive Sales Practices to Inflate a Key Performance Metric (last updated Sept. 18, 2024), https://www.sec.gov/newsroom/press-releases/2024-129.

167 Press Release, Sec. & Exch. Comm'n, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues, (last updated Mar. 4, 2021), https://www.sec.gov/newsroom/press-releases/2021-42.

168 Press Release, Sec. & Exch. Comm'n, SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse (last updated Apr. 28, 2022), https://www.sec.gov/newsroom/press-releases/2022-72.

169 Press Release, Sec. & Exch. Comm'n, Brazilian Mining Company to Pay $55.9 Million to Settle Charges Related to Misleading Disclosures Prior to Deadly Dam Collapse (last updated Mar. 28, 2023), https://www.sec.gov/newsroom/press-releases/2023-63.

matters; two involved the failure by asset managers to maintain adequate controls for incorporating ESG factors into research and investment recommendations for ESG integrated products,[170] and the other was brought against a video game company for failing to maintain adequate disclosure controls and procedures to determine whether complaints of workplace misconduct should be disclosed. [171] Again, no enforcement cases involving climate disclosure were featured by the task force, and only 16 cases were listed on its website in September 2024, when Bloomberg reported that the SEC's Climate and ESG Task Force was quietly disbanded.[172] An SEC spokesperson told Bloomberg at the time of the disbandment that the relevant expertise now lies across the Division of Enforcement. This may indeed be the case, as illustrated by a recent enforcement proceeding that resulted in a cease and desist order and civil monetary penalty against Keurig Dr. Pepper for publishing disclosure claiming that extensive testing showed its new coffee pods were recyclable, even though a major recycling company consulted during the testing process indicated that it would not accept the pods for recycling.[173]

Regardless of the past record, SEC enforcement could play a significant role in fostering compliance with the new climate disclosure rule. If the SEC decides to pursue enforcement of the new rule, it is likely that its climate enforcement resources will be concentrated on a limited number of prominent or precedent-setting cases, particularly where investors suffer significant financial losses in connection with climate disclosure. While enforcement actions of this type, if well publicized, could send a message about the importance of compliance efforts, they are not likely to address the many detailed issues involved in the difficult judgment calls that companies face. Those questions are likely to be addressed more directly in the comment and guidance process.

Whether and to what extent the SEC under the new administration will use the enforcement process to send strong compliance messages to companies in the climate disclosure area is an open question. However, assuming the rule becomes effective, past practice suggests that the SEC will enforce the rule, at least in particularly egregious cases of non-compliance.

C. Greenwashing

Whether or not climate disclosure will ultimately fit into the context of traditional public and private enforcement under the federal securities laws, there remains the question of whether different types of enforcement actions, specific to climate issues, might arise from the new rules. In particular, climate disclosure about future plans, targets, and goals may open a novel area for securities disclosure enforcement, relating to the new SEC rule's intersection with concerns about "greenwashing." Greenwashing is the practice of making false or misleading statements about the environmental benefits of a product or practice.[174] The term has entered common parlance as investors and consumers have placed more emphasis on sustainability in recent years. According to a study by McKinsey & Company, more than 60% of respondents said they would pay more for a product with sustainable packaging, and products making ESG-related claims averaged 8% higher cumulative growth between 2018 and 2023 than products making no such claims.[175] This may incentivize some companies to exaggerate or mislead the public to believe that they are doing more to protect the environment than they really are.[176] Examples of greenwashing include publicizing net zero targets without sufficient plans to achieve them, applying misleading "eco-friendly" labels to products that are in fact not sustainable, and making broad statements about sustainable corporate practices that are vague and opaque.[177]

170 Press Release, Sec. & Exch. Comm'n, Deutsche Bank Subsidiary DWS to Pay $25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG Investments, (last updated Sept. 25, 2023), https://www.sec.gov/newsroom/press-releases/2023-194; Press Release, Sec. & Exch. Comm'n, SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments, SEC Press Release 2022-209 (last updated Nov. 22, 2022), https://www.sec.gov/newsroom/press-releases/2022-209.

171 Press Release, Sec. & Exch. Comm'n, Activision Blizzard to Pay $35 Million for Failing to Maintain Disclosure Controls Related to Complaints of Workplace Misconduct and Violating Whistleblower Protection Rule (last updated Feb. 3, 2023), https://www.sec.gov/newsroom/press-releases/2023-22.

172 Andrew Ramonas, *SEC Abandons ESG Enforcement Group Amid Broader Backlash*, Bloomberg (Sept. 12, 2024).

173 In the Matter of Keurig Dr. Pepper, Inc., Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Securities and Exchange Commission Admin. Proc. File No. 3-22100, Release No. 100983 (Sept. 10, 2024).

174 Courtney Lindwall, *What Is Greenwashing?*, Nat. Res. Def. Council (Feb. 9, 2023), https://www.nrdc.org/stories/what-greenwashing.

175 Sherry Frey et al., *Consumers care about sustainability—and back it up with their wallets*, McKinsey & Co. (Feb. 6, 2023), https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/consumers-care-about-sustainability-and-back-it-up-with-their-wallets#/.

176 *Greenwashing – the deceptive tactics behind environmental claims*, United Nations (last visited Oct. 20, 2024), https://www.un.org/en/climatechange/science/climate-issues/greenwashing.

177 For a description of six categories of Greenwashing (some of which are relevant to SEC disclosure and others are more consumer oriented), see, John Willis et al., The Greenwashing Hydra, Planet Tracker (Jan. 2023), https://planet-tracker.org/wp-content/uploads/2023/01/Greenwashing-Hydra-3.pdf.

Many greenwashing cases will not raise issues under the SEC climate disclosure rule or even more generally under the federal securities laws. But some cases could derive from company climate disclosures under the new rule, as investors may argue that disclosed targets are misleading where they cannot reasonably be achieved based on the plans described by reporting companies. These cases may require a different analysis from private securities actions focused mainly on recovering damages for financial losses.

As discussed, private actions for securities law violations relating to the SEC climate rule may face challenges arising from the fact that such violations often will not have a discernible impact on short-term prices of securities. But these challenges will be an obstacle primarily for investors whose objective is to recover financial losses through securities litigation. Investors concerned about greenwashing may seek to achieve other goals through the enforcement of the SEC climate rule, such as exposing cases of greenwashing or obtaining settlements in which companies agree to change their practices.[178]

There is precedent for actions under the securities laws based on goals that are not strictly financial. Investors in many public companies have sought to address non-financial issues through shareholder proposals in proxy statements for shareholder meetings, and their efforts have been supported to some extent by SEC rules and Staff Legal Bulletins.[179] Companies are required to provide extensive disclosure on executive compensation in their proxy statements,[180] much of which is not directly related to the company's financial performance (this may become an avenue for climate enforcement as climate targets start to be integrated into compensation formulas). And some cases involve conflicts of interests that have no direct financial impact – the *TSC v. Northway* case that established the materiality standard used for over half a century was such a case, as it involved the omission of information on conflicts of interest in a proxy statement for a shareholder meeting to vote on a merger.[181]

A climate-focused foundation seeking to target greenwashing at companies in which it invests might not be concerned about its ability to obtain class certification or to prove substantial financial losses. If it believes an investee company failed in its SEC reports to disclose material climate-related plans, targets, and goals disclosed elsewhere (such as in corporate sustainability reports or CSRD reports), or that the actions planned by the company have little or no reasonable prospect of allowing the company to implement its plans or to achieve its targets and goals, it might initiate an action alleging the company's non-compliance with the SEC disclosure rule. The purpose of the action might be to compel compliance (or to reach a settlement in which the company agrees to improve its compliance[182]) rather than seek financial damages.

Since the foundation would be alleging that the company's disclosure as presented is misleading, it would not be precluded from initiating a Rule 10b-5 action for omissions, assuming its case would be that the omissions are part of what makes the disclosure misleading.

Other challenges would nonetheless remain. For example, the foundation would need to demonstrate that the misleading disclosure is important to the investment or voting decision of a reasonable investor. It would squarely face the issue of whether a "reasonable investor" is one interested in climate issues generally (such as the foundation itself), or only as they relate to financial performance. But unlike areas such as class certification and the treatment of omissions, there are no statutory obstacles or Supreme Court precedents that would stand in the foundation's way. The question is an open one, and the foundation would be able to try and make its case.

A second challenge would be the "puffery" defense. Puffery is a "vague statement of corporate optimism" which generally is unenforceable as a basis for bringing a claim of corporate fraud.[183] Statements categorized as puffery generally are not actionable. As an example, the Court of Appeals for the Second Circuit found statements in a company's SEC annual report about a "culture of high ethical standards, integrity, operational excellence, and customer satisfaction" and its "reputation for upholding the highest standards of personal integrity and business conduct" to be immaterial puffery, precluding an action where the company allegedly engaged (with knowledge of directors) in an ongoing kickback scheme and improper timekeeping practices for statements.[184]

178 This avenue would only be open to investors. Climate-focused groups and individuals who are not investors in a company's securities would not be able to initiate private enforcement actions against the company under the federal securities laws.

179 17 C.F.R. §240.14a-8; SEC Staff Legal Bulletin No. 14L (Nov. 3, 2021), https://www.sec.gov/rules-regulations/staff-guidance/staff-legal-bulletins/shareholder-proposals-staff-legal-bulletin-no-14l-cf.

180 Securities Exchange Act of 1934, sched. 14A, Item 8; 17 C.F.R. § 229.402 (2023).

181 *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

182 Kessler Topaz Meltzer Check LLP, A Primer on Shareholder Litigation 9, https://www.ktmc.com/files/522_Primer.pdf (last visited Oct. 30, 2024).

183 David A. Hoffman, The Best Puffery Article Ever, 91 Iowa L. Rev. 1395, 111 (2006).

184 *Indiana Public Retirement System v. SAIC*, 818 F.3d 85 (2d. Cir. 2016); *see also*, *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 183 (2d Cir. 2014) ("It is well-established that general statements about reputation, integrity, and compliance with ethical norms are inactionable 'puffery,' meaning that they are 'too general to cause a reasonable investor to rely upon them.'").

The puffery defense might be available in a case based on general statements about a company's "commitment to sustainability" or the "importance it attaches to combatting climate change." But those types of statements are unlikely to be the basis for an action relating to the SEC climate rule. An action based on a target or goal is likely to relate to more specific disclosure on plans for achieving the target and goal, or to the alleged absence of such specific disclosure. A greenwashing claim might, for example, allege that a company's plan to achieve a target and goal understates or omits disclosure of the necessary expenditures, or the extent of the operational change needed to achieve a target or goal, and on this basis is misleading. Thus, while the foundation's objective might be to expose the substantive inadequacy of the resources devoted to achieving the company's target or goal, the mechanism to do this would be to challenge the description of those resources or the lack of disclosure of that they are inadequate. Such an action may be more likely to avoid the puffery defense than one based on more general statements.

A parallel scenario arose in a case involving a company called Signet Jewelers.[185] Investors brought a securities fraud action against Signet for misrepresenting its alleged pervasive culture of sexual harassment. In the face of credible, in-court accusations that the company suffered from a rampant culture of sexual harassment, the company included representations in SEC filings that it denied these allegations by pointing to corporate policies. The court found that a reasonable investor could have relied upon those stated policies in the company's disclosures and taken Signet at its word and been reassured, wrongly, that there was no risk of rampant misconduct. The company's actions and statements in court were in contravention of its SEC disclosures pointing to internal policies. The court found the internal policies were sufficiently detailed not to constitute puffery and found that a reasonable investor might have relied upon the company's disclosures.

Even if a plaintiff overcomes the puffery hurdle, it will still have to overcome other issues in claiming that alleged greenwashing based on unrealistic climate plans, targets, or goals violates the SEC climate disclosure rule. First, the plans, targets, and goals will be covered by the PSLRA safe harbor, and companies will undoubtedly seek to include meaningful cautionary language in their SEC reports to benefit from the safe harbor. In particular, companies will likely say that their implementation plans and budgets may turn out to be inadequate to allow them to achieve the targets and goals, and also that changes in market conditions (including implementation costs) and regulatory requirements might make it difficult to achieve the targets and goals or cause the company to revise them (which the company will certainly reserve the right to do at any time). Second, statements relating to targets and goals will often be expressed as opinions ("we believe these actions could reduce our emissions by 30% if we are able to implement them fully"), which are actionable only if a plaintiff can demonstrate that the disclosure did not accurately represent the opinions or that the opinions were not honestly held.[186] Whether this practice becomes pervasive will depend in part on the extent to which the SEC asks companies in the comment process to express climate targets as specific objectives, rather than using the language of opinions. Third, courts might question whether securities actions are the right way to address claims that, at bottom, will be based on the inadequacy of a company's plans to achieve an announced climate target or goal. Companies will defend themselves by arguing that the disclosure accurately describes their plans, and that the actions are intended to change the climate-related practices of companies rather than addressing inadequate securities disclosure.

These types of challenges are inherent in any new type of litigation, and it may be that they are so formidable that resources devoted to challenging greenwashing might better be deployed in areas other than actions under the federal securities laws. And any investor seeking to overcome such challenges will have to find the "right" target company that not only describes inadequate plans to achieve disclosed climate goals but does so with sufficient precision to be actionable. Yet regardless of whether the SEC climate disclosure rule would ultimately create a new path for greenwashing litigation, investors interested in the impact and credibility of a company's climate plans, targets, and goals will benefit from disclosure that is standardized, verified, subject to SEC review, and prepared in accordance with the requirements of the US federal securities laws.

185 *In re Signet Jewelers Ltd. Sec. Litig.*, 389 F. Supp. 3d 221, 224 (S.D.N.Y. 2019).
186 *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175 (2015).

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