The U.S. Moving Toward Adopting New Climate Disclosures

Posted by J. Paul Forrester, Andrew Olmem, and Christina Thomas, Mayer Brown LLP, on Friday, July 9, 2021

Editor's note: J. Paul Forrester, Andrew Olmem, and Christina Thomas are partners at Mayer Brown LLP. This post is based on a Mayer Brown memorandum by Mr. Forrester, Mr. Olmem, Ms. Thomas, and Meicy Hui.

On June 21, 2021, US financial regulators met with US President Joe Biden to discuss the US economy and update him on their efforts to address climate-related risks. According to the White House readout of the meeting, the regulators said "they were making steady progress" on implementing President Biden's executive order on climate-related risk. The briefing follows last week's passage of HR 1187, the Corporate Governance Improvement and Investor Protection Act, by the US House of Representatives[1] by a vote of 215 to 214. HR 1187 would mandate that the SEC create an ESG disclosure regime for public companies and provides numerous statutory requirements for those disclosures, including climate-related disclosures. Although the bill is unlikely to become law due to expected opposition in the US Senate, which requires a 60-vote supermajority to pass legislation, the passage of the HR 1187 by the House—combined with President Biden's focus on climate-related risks in his meeting with financial regulators—should bolster and influence the US Securities and Exchange Commission's (SEC) ongoing development of new ESG disclosure requirements for US public companies under its existing statutory authorities. With regulators telling President Biden that they are "making steady progress," new disclosure requirements for US public companies appear to be just around the corner.

Addressing climate change has become a central focus of US policymakers. President Biden has made addressing climate change a top domestic policy priority. As part of implementing this policy, on May 20, 2021, he signed an executive orders directing federal financial regulators to take a broad range of actions to assess and respond to climate-related financial risks, including enhancing the disclose of climate-related financial risks.[2] Concurrently, the State of California is also putting pressure on the federal government to adopt climate disclosure requirements by advancing its own legislation, the Climate Corporate Accountability Act (CCAA)[3], that would impose disclosure obligations on any California company and any company doing business in California. Whether California will ultimately adopt the CCAA once the SEC adopts its anticipated climate disclosure requirements is unclear. Nevertheless, California companies and companies

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[1] HR 1187, the ESG Disclosure Simplification Act (available here).

[2] https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/

[3] SB-260 Climate Corporate Accountability Act: https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220SB260

doing business in California should be aware that the possibility exists for the adoption of overlapping federal and state disclosure rules.

This post summarizes HR 1187, the status of the Biden Administration's efforts to establish climate disclosure requirements, and the CCAA, which at present time are the most significant climate-disclosure measures under consideration in the US. Even if neither HR 1187 nor the CCAA is ultimately enacted, as is likely at this point, their provisions are likely to influence how the SEC designs its disclosure requirements, which are expected to be proposed later this year. Indeed, public companies should note the broad scope of information that HR 1187 would require companies to disclose, which is not limited to climate change-related information but also includes a range of ESG information from workforce composition to supply chain information. Indeed, SEC Chair Gary Gensler has said that the new disclosure requirements will not be limited to climate but also cover other ESG issues.[4]

A. HR 1187, The Corporate Governance Improvement and Investor Protection Act

HR 11887 was originally introduced in the House as the ESG Disclosure Simplification Act (EDSA) on February 2, 2021 and was reported out of the House Financial Services Committee on June 8, 2021. The bill was amended before passage by the House to include several other ESG-related bills and provisions and was re-titled, the Corporate Governance Improvement and Investor Protection Act. As passed by the House, HR 1187 contains the following bills and provisions.

(a) ESG Disclosure Simplification Act

The EDSA would require the SEC to adopt rules defining ESG metrics and requiring issuers to disclose ESG metrics in certain filings. Each public company also would be required to disclose its views on the link between ESG metrics and its long-term business strategy, and a description of the process the company uses to make this determination. The EDSA would make ESG metrics *de facto* material disclosures under the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exchange Act). The SEC is authorized to phase-in the ESG disclosures for small issuers. Finally, the EDSA would establish a Sustainable Finance Advisory Committee (SFAC), responsible for recommending policy changes to facilitate sustainable investments and generally advising the SEC on sustainable finance. The SFAC would consist of no more than 20 members, who would serve 4 year terms, and would be selected by the SEC.

(b) The Shareholder Political Transparency Act

The Shareholder Political Transparency Act would direct the SEC to adopt rules requiring public companies to report quarterly the amount and date of any political activity expenditures, a description of such activities, and the name of any political candidates (as well as their political affiliation and political office sought) and of any 501(c) organizations that received payments, including as dues. The SEC also would be required to adopt rules requiring public companies to

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[4] https://www.reuters.com/business/sustainable-business/us-sec-chair-planing-new-workforce-data-disclosures-public-companies-2021-05-13/

include in their annual reports to shareholders a summary of each political activity expenditure made during the prior year in excess of $10,000, and a description of any political expenditure that the company intends to make in the forthcoming fiscal year.

(c) Greater Accountability in Pay Act

The Greater Accountability in Pay Act would require public companies required to file an annual report under the Exchange Act to disclose in such report metrics comparing the annual increases in compensation for company executives with the annual increases in compensation for all company employees.

(d) Climate Risk Disclosure Act

The CRDA would mandate that public companies required to file an annual report under the Exchange Act disclose in such report the physical and transition risks posed to the company by climate change, the company's management strategies and governance processes for identifying, assessing, and managing such risks, and a description of the actions that the company is taking to mitigate those risks. The CRDA would require specific disclosures related to a company's (i) direct and indirect greenhouse gas emissions; (ii) the total amount of fossil-fuel related assets that it owns or manages; (iii) how its valuation would be affected if climate change continues at its current pace or if policymakers successfully restrict greenhouse gas emissions to meet the 1.5 degrees Celsius goal; and (iv) the total cost attributable to direct and indirect greenhouse gas emissions of the company. The SEC would be authorized tailor these disclosure requirements to different industries and impose additional disclosure requirements on companies engaged in the commercial development of fossil fuels. In addition, the SEC would be authorized to require disclosure of any other information or climate-related metrics that it determines are necessary, appropriate to safeguard the public interest, or directed at informing investors of the risks of climate change as described in the bill's Sense of Congress preamble.

(e) Disclosure of Tax Havens and Offshoring Act

Disclosure of Tax Havens and Offshoring Act would mandate the disclosure of specified tax information by any issuer that is a member of multinational enterprise group that has annual revenues above a threshold set by the SEC in conformance with country-by-country reporting requirements. The required disclosures are designed to reveal the use of tax haven jurisdictions by global companies and include (i) the tax jurisdictions of constituent entities; (ii) tax identification numbers; (iii) revenues generated (and not generated) from transactions with other constituent entities; (iv) profits and losses before income for each tax jurisdiction; and (v) total income taxes paid on a cash basis to all tax jurisdictions.

(f) Workforce Investment Disclosure Act

The Workforce Investment Disclosure Act would mandate that public companies required to file annual reports under the Exchange Act disclose in such report information regarding workforce management policy, practices, and performances. The SEC would issue implementing regulations that would include requiring the disclosure of information on: (i) workforce demographics; (ii) workforce stability; (iii) workforce composition; (iv) workforce skills and capabilities; (v) workforce health, safety, and well-being; (vi) workforce compensation and incentives; (vii) workforce recruiting and needs; and (viii) workforce engagement and productivity. The SEC is granted authority to exempt emerging growth companies from certain of these disclosures.

(g) Preventing and Responding to Workplace Harassment

Title VII of HR 1187 would mandate that the SEC issue rules to require public companies to include in their annual Form 10-K filings information on workplace harassment, including the number of settlements reached by the company as a signatory or beneficiary of a release of claims, whether any judgments or awards were entered against the company or payments made in release of claims, and the total amount paid by the company or another party as a result of a settlement or judgment.

(h) Cybersecurity Disclosure

The Cybersecurity Disclosure Act would mandate that the SEC issue rules requiring public companies to disclose in their annual reports or proxy statements whether any member of their boards of directors has any experience in cybersecurity and to describe such experience. If no member of the board of directors has such experience, a company must describe “what other aspects of the [company’s] cybersecurity were taken into consideration” by any person responsible for identifying and evaluating nominees for membership on the board.

(i) Improving Corporate Governance Through Diversity Act

The Improving Corporate Governance Through Diversity Act would mandate that public companies required to file an annual report under the Exchange Act disclose in any proxy statement demographic information (the racial, ethnic, gender identity, and sexual orientation composition; veteran status) of their boards of directors, nominees to be board members, and executive officers. Companies would also have to disclose if they have adopted any policy or plan to promote racial, ethnic, and gender diversity among their boards of directors, nominees to be board members, and executive officers.

(j) Uyghur Forced Labor Disclosure Act

The Uyghur Forced Labor Disclosure Act would mandate that public companies required to file annual reports and proxy statements under the Exchange Act disclose in such annual reports and proxy statements whether during the past year the company or any of its affiliates engaged with any entity or an affiliate of any entity to import (i) manufactured goods sourced or through the Xinjiang Uygur Autonomous Region (XUAR) of China; (ii) goods containing materials sourced from or through XUAR; (iii) good manufactured by an entity engaged in labor transfers from XUAR; or (iv) goods manufactured by an entity engaged in labor transfers from the XUAR. Companies also would be required to disclose if any goods or materials in any of the aforementioned categories originated in forced labor camps, and the nature and extent of any commercial activity and the gross revenue and net profit related to such goods or materials. In addition, companies would have to disclose if they or any affiliates plan to continue importing such goods and materials.

(k) Study and Report on Small Business and ESG Disclosures

Title XI of HR 1187 would require the SEC, in coordination with the Director of the Office of the Advocate for Small Business Capital Formation and the Investor Advocate of the Office of the Investor Advocate, to study the issues small businesses face with respect to complying with ESG disclosure obligations and submit the report to Congress with the results of the study and recommendations on small business compliance with ESG disclosure requirements. The report is due not more than 1 year after the enactment of HR 1187.

B. Federal Rule-Making and Other Initiatives

(a) Executive Order on Climate-Related Financial Risk[5]

President Biden's May 20, 2021, Executive Order on Climate-Related Financial Risk (Executive Order) established as policy of the administration to "advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk." The Executive Oder also directed Treasury Secretary Janet Yellen, as Chair of the Financial Stability Oversight Council (FSOC), to have the FSOC assess and mitigate climate-related financial risk and produce a report within 180 days on any efforts by the regulators to integrate consideration of climate-related financial risk in their policies and programs, including, among others, the necessity of any actions to enhance climate-related disclosures, how climate risk can be mitigated through new or revised regulatory standards, and a recommended implementation plan for taking those actions.

(b) SEC and Treasury Initiatives

The SEC has already taken steps to create climate and other ESG disclosure requirements even before the issuance of the Executive Order or the passage of HR 1187. On June 11, the Office of Management and Budget released the SEC's planned regulatory agenda, which includes rule proposals that would require disclosure of information relating to climate change, human capital management, and corporate board diversity.[6] In March 2021, then-Acting Chair Allison Herren Lee launched a 90-day request for public input on climate-related disclosure rules to help inform the staff as it considers, among other things, updates to the 2010 Climate Change Guidance and if new disclosure rules or frameworks should be adopted or incorporated into existing rules such as Regulation S-K and Regulation S-X. The public comments submitted to date from market participants have been robust and varied.

The SEC also has set up a Climate and ESG Task Force in the Division of Enforcement tasked with identifying material gaps or misstatements in issuers' disclosure of climate risks under existing rules and analyzing disclosure and compliance issues relating to investment advisers' and funds' ESG strategies.

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[5] Discussed in more detail in our May 24, 2021 Legal Update "*President Biden Signs Executive Order on Addressing Climate Change Risk through Financial Regulation*".

[6] https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=7CE97CC2D49C9B6B70868F7B2752E582C86F1945A4A46F34426C18AF1ABE101E611318F64B67159C3A36E7556BD0FB872C8F

Separately, on April 19, the US Treasury Department announced a coordinated climate policy strategy aiming to leverage finance and financial risk mitigation to tackle the threat of climate change and position the US economy for strong and sustainable growth consistent with a net-zero emissions future. It has also set up a new Climate Hub and appointed a coordinating Climate Counselor to help implement this strategy and coordinate climate-related efforts.

C. California Climate Corporate Accountability Act[7]

The CCAA, the California Senate Bill 260, was introduced on January 26,2021, and passed the State Senate's Environmental Quality Committee on April 12, 2021 and Judiciary Committee on April 27, 2021. In the suspense file hearing on May 20, 2021, the Appropriations Committee decided that the CCAA should be held in committee and will only be considered again next year. The CCAA would require companies doing business in California and generating over $1 billion in gross annual revenue to disclose all of their greenhouse gas (GHG) emissions to the California Air Resources Board (CARB).

The CARB will have until January 1, 2023 to develop and adopt regulations to implement the CCAA, pursuant to which companies would be required to make disclosures with a complete carbon emissions inventory for the prior calendar year encompassing three scopes by a certain date to be determined in 2024: (i) the reporting entity's direct emissions from owned or controlled sources, such as fuel combustion, company vehicles or fugitive emissions (Scope 1); (ii) the reporting entity's indirect emissions from purchasing and using electricity, regardless of location (Scope 2); and (iii) all other indirect emissions stemming from sources that the reporting entity does not own or directly control, for example, emissions associated with the reporting entity's supply chain, regardless of location (Scope 3). Companies will also be required to use a CARB-approved third party auditor to conduct their carbon emissions inventory.

Once the reporting entities have disclosed their GHG emissions, CARB will publish a report by July 1, 2025 laying out (i) the best reasonable estimate of the required aggregated GHG emissions levels of reporting entities that would be necessary to maintain global temperatures within 1.5 degrees Celsius of preindustrial levels, taking into account the most current protocols and guidance of the Science Based Targets initiative (SBTi); (ii) the best reasonable estimate of the projected GHG emissions from reporting entities based on successful implementation of California's existing GHG reduction, clean energy, and other similar regulations to which reporting entities are subject; such estimate shall, at a minimum, include an estimate of the projected GHG emissions from reporting entities for the calendar years 2030 and 2045; and (iii) recommendations, based on the information submitted by the reporting entities, that reporting entities may consider to effectively reduce their remaining emissions in line with what is recommended by the SBTi.

The CCAA, if enacted, would have a far-reaching impact on corporate climate disclosure in the US since the CCAA will not only cover companies with headquarters in California, but also all companies that do business in California. The broad reach of the bill will likely capture companies

[7] For the full text and legislative history, see https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=202120220SB260

across various sectors and based throughout in the US, raising questions of whether the bill violates the US Constitution’s Commerce Clause or is preempted by the SEC’s disclosure rules.