CONFRONTING THE NEW SEC CLIMATE DISCLOSURE RULE

Georgetown University Law Center

Hotel & Lodging Legal Summit Webinar
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PART TWO: Panel Discussion:

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PANEL DISCUSSION OUTLINE

I. Overview of the Proposed Rule

A. Some Basics: The proposed rule is titled, *"**The Enhancement and Standardization of Climate-Related Disclosures for Investors**."* and is published at 87 Fed Reg. 21334. Link here for a copy of the proposed rule.

- 490-page proposed rule released on March 21, 2022
- Comment period ended this June
- SEC had aimed to publish the final rule this month
- Comment period reopened on October 7, 2022 for a brief period
- No completion date targeted by SEC, but final rule not expected until early 2023
- If adopted, phase in periods based on filer status, and phase in for the assurance requirement and level of assurance

- Applies to public company SEC disclosures and financial statements, but will impact the entire industry (public & private)

B. Key Elements of the Proposal include Disclosure on a Number of Topics:

1. **Climate-related risks** reasonably likely to have a material impact on the business or financial statements
   - Specifies time horizons of short, medium and long term
   - Extends to climate-related risks from the value-chain
   - Physical and transition risks, including additional details for flood hazard areas and regions of high-water stress

2. **Impacts of climate-related risks** on the business, financial statements, strategy, business model and outlook
   - Includes information about an internal carbon price, if any, including the price and how it is set
   - Includes scenario analysis, if any, plus the parameters, assumptions, analytical choices, and projected principal financial impacts

3. **Internal climate-related risk management** and whether any such processes are integrated into the overall risk management system or processes
   - Includes transition plans, if any, and annual updates

4. **Financial statement metrics** in the notes to the financial statements, measured at 1% threshold

5. **GHG emissions**
   - Scope 1 and Scope 2
   - Attestation report from an independent attestation service provider required for LAFs and AFs
   - Scope 3 only if material or included in a GHG emissions target or goal (subject to a liability safe harbor)

6. **Climate-related targets or goals**, including:
   - Scope of activities and emissions included in the target, the time horizon, and interim targets
   - How the registrant intends to meet the climate-related targets or goals
   - Data to indicate whether and how the registrant is making progress, with annual updates
   - Information about any carbon offsets or renewable energy certificates ("RECs") used

7. **Oversight and governance** of climate-related risks by the board and management
   - Identify directors responsible and whether any director has climate risk expertise

- Processes for board discussions, how the board is informed, and frequency of discussions
- Whether certain management positions or committees are responsible for assessing and managing climate-related risks and a description
- Processes by which such management is informed about and monitors climate-related risks
- Whether and how frequently such management reports to the board on climate-related risks
- Management's role in assessing and managing climate opportunities

II. Is the Rule Lawful?

A. "Major Questions Doctrine"
   - In *West Virginia v. EPA* (2022), the Supreme Court limited EPA's authority under a Clean Air Act provision to regulate greenhouse gas emissions from power plants.
   - The decision restricts federal agencies' authority to enact sweeping regulation absent a clear congressional mandate.
   - This could be an avenue to challenge the SECs proposed climate-related disclosure rules.
   - The decision increases the likelihood that SEC rules will face legal challenge (for which there appears to be a foundation for challenge).

B. Controversial Components of the Proposed Rule that may be Discarded or Successfully Challenged
   - Scope III disclosures
   - Materiality standard

III. How Should Companies Prepare to Comply with the Rule?

A. Key Considerations for Initiation of Reporting

   1. Building the Foundation for Effective Reporting
      - The right people
      - The right processes
      - Accurate and verifiable reporting

   2. Disclosures should be subject to standard SEC disclosure certification
      - Certification by CEO and CFO
      - Potential personal liability

B. Disclosure required of management involvement in climate related risk assessment, analysis, and business strategy
   1. Evaluation of climate change in business strategy and decisions
   2. Documentation of risk determination and impact on business

3. Disclosure of processes used to identify risks

C. Board level impact of the Proposed Rule
    1. Disclosure required of board level oversight of climate related risks, including specific individuals and committees
    2. Disclosure includes board members' *qualification* for climate change oversight
    3. Expertise may play a heightened role in board member qualification
    4. Potential *Caremark* implications for board members

D. The Right People and the Right Processes

    1. The Right People
        - Cross functional team needed for data collection, consolidation and verification
            - Operations
            - Accounting
            - Legal
            - HR
            - IT
            - Environmental
        - Competency for this function may involve new or refined skillsets
        - ESG/ GHG "fluency" will be important to allow for informed and on-point decision making
            - Financial Accounting ≠ GHG Accounting
            - GHG reporting requires legal, operational, and technical knowledge

    2. The Right Processes
        - Shining Additional Light on Environmental Data
        - GHG/ air emissions reporting and analysis typically has fallen under the "environmental umbrella"
        - Now- subject to governance and internal controls consistent with all other SEC disclosures
            - Integration into risk management processes
            - Decision makers must be fully informed
        - Data Development
            - Must be verifiable and reconciled on a corporate wide basis
            - Need for automation and data integration into a company's Enterprise Resource Planning ("ERP") Systems
        - Integration into Organizational Backbone
            - Climate Change Risks analyzed and verified through reporting and control structure akin to other required disclosures
            - Key Issues:
                - Data consolidation
                - Auditability

E. Accurate and Verifiable Reporting

1. Data Gap Analysis
   - What is the company currently doing
   - What is required by the rule
   - What systems exist vs. needed for compliance

2. Reporting Coordination
   - "Public statements" may require additional scrutiny
     - Securities disclosures
     - Sustainability reports
     - Earnings calls

3. Need for Coordination in Reporting
   - Verification requirement may give rise to potential restatement of GHG emissions reflected in pre- rule sustainability reports
   - Materiality scrub or qualification of materiality terminology often used in ESG reporting
   - Forward looking statement issues

4. Industry Specific Challenges
   - Consolidation/ Consistency and Reconciliation of Data
   - Potential Divisional Challenges: Different Systems/ Different Inputs
     - Equity interest vs. controlled
     - Luxury Resort vs. Extended/ Family Living vs. Boutique
     - Owned vs. Managed vs. Leased
     - Acquisition vs. developed
   - Accounting for Embodied Carbon
     - Potentially up to 21% of Global Emissions
     - Accounting for ongoing renovation and construction will be an issue
     - GHG accounting goes beyond fossil fuel use, and emissions associated with water use and waste
     - Offsets are not standardized

5. Supply Chain Analysis: Scope 3 Emissions Impacted by Materials Pricing/ Availability
   - Food and beverage
   - Furniture, fixtures, and equipment
   - Operational supply and equipment
   - Utilities and services

6. Considerations for the Hotel & Lodging Industry
   - Emissions Determination and Disclosure
     - □ Effective, Verifiable Data Collection is key

    - Disclosure of Scope 3 emissions would likely include those associated with a broad and non-static supply chain
    - Scope 3 emissions are generally estimated to be 700x direct emissions, raising challenges to Net 0 commitments
    - No clear standard for reporting Scope 3 emissions- could this undermine cross- industry comparative analyses
  - TCFD Reporting Framework
  - Begin preparation now to mitigate the heavy lift of transitioning to the Proposal's requirements
  - Climate scenario analysis
    - Once initiated, must disclose even if outcome is not material
    - Likely transition plans and emissions reduction targets and goals, would be required disclosures
  - GHG Intensity Reporting
    - Presents unique challenges to all industries, including the hospitality industry- what is the appropriate "unit of production" or "service"
    - Will impact public and privately owned businesses and will likely become an increasingly important branding consideration for *all* companies
  - Third Party Data Assimilation/ Correlation
    - Lack of uniform disclosure standards may affect gathering, presentation, and disclosures
    - Data Analytics will be important for the hospitality industry

7. More Best Practices
   - Review and draft ESG reports for consistency with SEC disclosures
   - Scrub "materiality" from ESG reports if not consistent with SEC disclosures
   - Recognize those climate related risks on which the SEC is focused, and either address or "shoot down"
   - Have in place a means to proactively review proposed and adopted laws/ rules for material business impacts
   - Develop company specific data
   - Be prepared to have a "statement of basis" for climate related decisions

VI. Questions & Answers