

# Locke Lord QuickStudy: SEC Signals Heightened ESG Focus

Locke Lord LLP

## WRITTEN BY

[Gerald J. Pels](#) | [Gislar Donnenberg](#) | [Michelle Earley](#)

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On September 22, 2021, the SEC released its Sample Letter to Companies Regarding Climate Change Disclosure (“[Letter](#)”). The Letter is not only important for what it will seek, but for what it portends. The Letter invokes the 2010 Climate Change Guidance<sup>[1]</sup> (“[Guidance](#)”) which provided an overview of potential disclosure obligations related to climate change, including the impact of climate change legislation and rulemaking, business trends, and physical impacts. The SEC’s release of the Letter is a preview of coming attractions, namely, a heightened focus on disclosures relating to climate change and likely more broadly, ESG matters. The Letter’s text also makes clear that the SEC will take a much greater interest in reviewing publicly available documentation apart from SEC filings for potential enforcement.

The Letter makes three main points. First, the SEC will closely review corporate sustainability/ESG reports (“[Reports](#)”) often found on corporate websites, regardless of whether linked or incorporated by reference into an SEC filing. Where a Report is more detailed than formal disclosures, the SEC may seek explanation as to the reasoning behind the differentiation. This could not only lead to heightened enforcement, but also compel additional disclosures to conform to the Report. In the alternative, issuers may seek to revise their Reports keeping in mind the same liability standards as an SEC filing would entail.

Second, regarding a company’s risk factors disclosure, the Letter makes clear companies should make a materiality determination regarding climate change risk. Upon a finding of materiality, disclosures should contemplate financial and operational impacts on business, as well as regulatory risks that could affect compliance, business operations, and credit risk, as well as litigation and transaction risks. In pointing to international accords, which presumably include the United Nations convention adopted in 2015 known as the “Paris Agreement,”<sup>[2]</sup> the SEC staff expresses the view that international accords are to be considered in a materiality determination.

Third, the same general disclosure principles will apply to the Management’s Discussion and Analysis section. The Letter may require revisions to disclosures to identify and quantify material climate related capital projects, compliance costs, and carbon credits/offsets. The Letter also indicates an expectation, that where material, a discussion should include the effect of climate related legislation/regulation, including international accords, as well as indirect physical consequences. Importantly, the SEC seeks a quantification as well as an analysis of

compliance costs and identification of past and/or future compliance costs.

## **Analysis**

The Letter is important for several reasons. First, the SEC appears to be signaling that neither separate legislation nor rulemaking is needed to require disclosures regarding climate change and potentially other ESG matters – so long as the traditional securities materiality standard is at issue.

Second, the SEC is looking beyond formal filings for evidence that could lead to enforcement. While the Letter speaks in terms of corporate social responsibility reports, it is reasonable to expect potential reviews of webpage materials and investor presentations.

Third, the Letter's express statement seeking quantification of compliance costs relating to climate change may very well require more than a broad brush analysis. For example, for industries with significant methane emissions, an analysis of applicable air emissions regulatory frameworks will likely be necessary.

## **Risk Mitigation**

Given the SEC's movement on these disclosure issues, Companies should review all current "postings" including website statements and Reports for, among other things, disclosures exceeding those conveyed in SEC filings. Issues to consider include statements of "materiality" that are not tied to SEC materiality standards, such as those associated with ESG reporting regimes. Further, statements about GHG emissions and climate change that tie to objective standards, such as time frames to reduce emissions and similar statements should be reviewed. Disclosures should be harmonized and unless necessary for SEC reporting, Reports should try to avoid using "materiality" terminology, unless it is material under SEC standards. In all events, disclaimers should be utilized where necessary, and should be nuanced to take into account those matters that may be ESG-specific. Where corporate efforts are articulated Companies should consider framing the goals as aspirational, not defined with objective targets, which ultimately may not be met.

To mitigate risk from an operational standpoint, Companies should consider making an applicability determination regarding methane and other "climate based" regulations to operations, because these regulations are in part based on the potential effects of climate change. Regulatory applicability can be a moving target. For example, on June 30, 2021, Congress repealed a Trump administration rule that removed methane from certain regulatory frameworks governing "new sources" in the oil and natural gas sector, including the New Source Performance Standard known as Reg. OOOOa. The reintegration of methane into Reg. OOOOa and the likelihood of technical amendments to it could lead to the need for increased source identification, emissions quantification, permitting, control requirements, as well as leak detection, and equipment repair. Both the cost and effect on business operations may need to be analyzed for materiality. And that is just one industry sector. At this time, Companies should expect revisions not only to the air emissions rules cited above, but new and/or enhanced air regulation and permitting of new and perhaps existing sources of methane. Industries that may be more acutely affected include those conducting certain fossil fuel operations, such as upstream and midstream companies, as well as those in the agricultural sector.

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[1] [Commission Guidance Regarding Disclosure Related to Climate Change](#)

[2] [Paris Agreement](#) Further, On September 24, 2021 the International Organization for Standardization (ISO) issued the [London Declaration](#) to accelerate a successful achievement of the Paris Agreement.

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