KILPATRICK TOWNSEND

My Company is Considering Disclosing ESG Information. What Should I Consider?

By Todd Roessler

In addition to regulations outside the United States, a number of proposed and current federal regulations address ESG disclosure requirements. Disclosures refer to the release of information by a company that can influence an investor or consumer's decision about whether to invest in a company or purchase company products or services and at what price. Disclosures can be mandatory or voluntary.

If your company is public, it is required to disclose "material" information, which includes ESG-related information, to investors. The Securities and Exchange Commission (the "SEC"), through its interpretive guidance dated February 8, 2010, provides recommendations for publicly traded companies on how to disclose information related to the impact of climate change on their business. The guidance emphasizes the importance of providing material information to investors, such as the potential financial impact of climate change-related regulations, the impact of climate change on the company's operations and supply chain, and the company's efforts to address climate change.

The guidance also encourages companies to use existing SEC disclosure requirements, such as the requirements for risk factors and management discussion and analysis, to provide this information to investors. The guidance is intended to provide investors with a more complete understanding of a company's exposure to climate-related risks and opportunities and to increase transparency in the marketplace.

More recently, on March 21, 2022, the SEC proposed regulations that would require publicly-traded companies to disclose information about climate-related risks that are likely to have an impact on their business and climate goals or planning processes that the company has developed in response to these risks and to report their greenhouse gas ("GHG") emissions. In promulgating this rule, the SEC intends to provide "consistent, comparable, and reliable – and therefore decision-useful – information to investors."

In addition to the SEC, on November 14, 2022, the Federal Acquisition Regulation ("FAR") Council has proposed to require significant and major contractors[1] to disclose their GHG emissions and climate-related financial risks. Major contractors would additionally be required to submit an annual climate disclosure that aligns with the Task Force on Climate-related Financial Disclosures ("TCFD") recommendations.[2] Major contractors would also be required to develop and validate science-based emissions reduction targets via the Science-Based Targets initiative ("SBTi").

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[1] "Significant" contractors are those that receive at least $7.5 million in annual contracts, but less than $50 million. "Major" contractors are those that receive more than $50 million in annual contracts. The proposal exempts higher education institutions, nonprofit research entities, and state and local governments.

[2] The TCFD is one of many voluntary ESG disclosure frameworks used to provide ESG reporting standards. The TCFD's four core elements encourage entities to disclose their climate change governance, strategy, risk management, as well as metrics and targets to assess climate-related risks and opportunities. Other popular frameworks include the Global Reporting Initiative (GRI), the Global Real Estate Sustainability Benchmark (GRESB), the Carbon Disclosure Project (CDP), the International Sustainability Standards Board (ISSB), and the Sustainability Accounting Standards Board (SASB). While no one standard is ubiquitously adopted, these frameworks seek the disclosure of climate-related data in order to compare with other companies within an industry or investment portfolio.

Following the Biden's administration's directive to "assess climate-related financial risk to the U.S. financial system," on October 21, 2021, the Financial Stability Oversight Council (the "FSOC") recommended U.S. companies that issue securities, financial institutions, and U.S.

U.S. financial system," on October 21, 2021, the Financial Stability Oversight Council (the "FSOC") recommended U.S. companies that issue securities, financial institutions, and U.S. insurance providers follow the framework developed by the TCFD. The report also recommends implementing mandatory disclosures of GHG emissions metrics.

In addition to mandatory disclosure requirements, chances are your company is already voluntarily disclosing ESG information and this does not come without legal risks. Moving forward, your company will also likely face increasing pressure to disclose ESG information.

Many companies—both public and private—voluntarily provide disclosures beyond what is required by regulations, including on their websites as well as in sustainability, corporate social responsibility and ESG reports. Despite this growing trend, voluntary disclosures are often inconsistent, incomplete and fragmented. The Governance and Accountability Institute reported that 70% of companies in the Russell 1000 published sustainability reports in 2020, but 86% of institutional investors surveyed in 2021 were skeptical about companies' capability of attaining their sustainability goals.

Demand—both from the public and investors—is the primary factor driving the growing trend of voluntary ESG disclosures. Consumers are increasingly demanding more sustainable products and services and ethical and transparent behavior, and public scrutiny influences decisions made by institutional investors. Companies understand the importance and value of their brand and often respond to this public scrutiny by disclosing the measures they have taken to respond to these concerns. With growing scrutiny, however, ESG disclosures—whether mandatory or voluntary—do not come without legal risks, including:

- False or misleading ESG disclosures, including material gaps or misstatements, which could result in an SEC enforcement action and/or a civil shareholder or stakeholder class action suit;

- "Greenwashing", which occurs when a company makes false or misleading—whether intentional or accidental—that can cause a customer or investor to believe its products, services, or mission are more environmentally friendly than is true (i.e., making public climate pledges or committing to a net-zero strategy, while providing limited or no information on how those pledges will be achieved);

- Lack of board or management oversight.

Not only does voluntarily disclosing ESG information present legal risks, your company might be required to disclose such information in the near future. Private companies serving as suppliers, customers or partners within a public company's value chain—e.g., food and agriculture suppliers, component manufacturers, equipment suppliers, professional service companies—may be required to provide ESG information. For example, if a public company is reporting its Scope 3 emissions (greenhouse gas (GHG) emissions from upstream and downstream activities), it will need to obtain Scope 1 (direct GHG emissions that occur from sources that are controlled or owned by an organization) and Scope 2 emissions (indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling) data from companies within its value chain.

In addition, new proposed rules that address climate-related disclosures and climate-related risks in procurement decisions will likely result in increased obligations for federal contractors to disclose ESG information. Finally, as discussed previously, investors and consumers are increasingly focused on transparency and disclosure of ESG information. This scrutiny is not limited to public companies.

In response to these growing trends, companies should:

- Ensure that they have measures in place to review ESG information provided to the public and implement measures to mitigate legal risks.

- Ensure that any disclosures comply with the Federal Trade Commission's ("FTC") "Green Guides for the Use of Environmental Marketing Claims." On December 14, 2022, the FTC expressed that it is seeking comments to potentially revise disclosures and marketing materials related to climate change, carbon offset, net zero, carbon neutral, and low carbon claims.

- Evaluate relationships with other companies, the federal government, and investors and customers to determine whether it is likely that they will be required to disclose ESG information, including emissions data, in the future.

- Evaluate whether your company has the resources and knowledge to conduct an assessment of ESG information, including at a minimum Scope 1 and Scope 2 emissions data.

- Determine whether your company needs to retain outside help to gather, track, monitor and disclose ESG information.

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Kilpatrick Townsend partner Todd Roessler focuses his practice on a wide range of matters related to environmental litigation, regulatory counseling, and transactions. Mr. Roessler has nearly 30 years of diverse environmental experience.

Raleigh Partner Todd Roessler has created a multi-part series to help you navigate complex issues to start or enhance your ESG journey.

Read the fourth installment "My Company is Considering Disclosing ESG Information. What Should I Consider?" below, or "Download PDF."

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