

# Shifting Conversations:

## Updates on SEC Climate Disclosures Rule, NEPA, and the Equator Principles



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### INTRODUCTION

The ESG space has no shortage of voluntary standards, suggested metrics, and frameworks to identify and monitor ESG performance indicators. ESG stands for Environmental, Social and Governance (corporate governance), and the way it's typically been used is to give companies a "score" on how well they perform on various aspects, but scoring can be subjective and oversimplified, and comparing the scores of different types of businesses can be tricky and veer away from the underlying purpose of ESG.

During the past two years there has been a narrowing down of various methodologies alongside the formation of the SEC Climate-related Disclosures Rule, and efforts by the SEC to make these mandatory. In March 2022, E3 issued a podcast called The Latest Developments in ESG that discussed the proposed SEC disclosures rule. The proposed rule was finalized in March 2024 – and subsequently stayed – nonetheless, this article will start by looking at the highlights of the Final rule.

The Inflation Reduction Act has spurred the energy transition, but to take advantage of federal incentives such as loans or loan guarantees, NEPA review can be triggered, adding a level of review by federal agencies that can impact the schedule of projects. In June 2023, NEPA was amended by the Fiscal Responsibility Act to make NEPA more efficient, and those amendments have since been incorporated into the regulations.

**In this article, Carol Ho, P.E., E3's Executive Director of Environmental Services, discusses the ever-changing ESG (Environmental, Social, and Governance) landscape, which is filled with voluntary standards and metrics for evaluating risks and outcomes.**

**Carol initially discussed ESG in a "Top 3 by E3" podcast, several years ago, highlighting a consolidation of methodologies around the standards.**

**In this article, and a subsequent podcast, she provides an update on three key policies that impact investment decisions and project development.**

Since most of E3's business involves consulting with parties to financial transactions, we will also touch on the Equator Principles. The Equator Principles are not a regulation but were created by Financial Institutions to provide a global standard for environmental and social due diligence during project finance, encompassing climate change, human rights, and biodiversity. An Equator Principles review can help investors to identify risks that might not be identified by the host country's own regulations.

The SEC Rule focuses on business activities and financial impacts regarding climate, while NEPA and Equator Principles are tools for evaluating specific activities or projects and include climate and other impacts. All these approaches try to produce comparable ESG metrics.

*"The new SEC Climate Disclosures Rule - if implemented, NEPA, and Equator Principles are three different ways that ESG standards and values are being plugged into our economy, or another way to describe them is as real-world examples of incorporating sustainability into business decisions."*



## SECURITIES AND EXCHANGE COMMISSION CLIMATE-RELATED DISCLOSURES FOR INVESTORS

The purpose of the SEC Climate Disclosure Rule is to provide investors with "consistent, comparable, and decision-useful information."<sup>3</sup> The Final Rule was adopted on March 6, 2024.

In a nutshell, the rule requires publicly traded companies to report greenhouse gas (GHG) emissions and material climate-related business risks, and disclose climate-related risks that could have a material impact on strategy, operations or financial conditions; the actual and potential impacts of those risks; costs incurred due to severe weather events; mitigation or adaptation activities and their financial requirements; how the risks are being managed; and quantifying Scope 1 and Scope 2 emissions (although some smaller and emerging growth filers are exempt from the GHG emissions requirements).

E3's previous podcast done in March 2022 discussed some of the key contentious issues of the rule, the most controversial being whether Scope 3 emissions would need to be accounted for and reported. Scope 3 emissions are those associated up and down the value chain and are very difficult to quantify. The Final Rule did not include Scope 3 emissions. Other items to be disclosed, if applicable, are a transition plan, scenario analysis, internal carbon pricing, targets, and goals. These are covered by a safe harbor protection from private liability.

However, the Rule is currently stayed pending judicial review - multiple requests for a stay were filed by challengers of the rule. Opponents to the rule say that these reporting requirements are not within the SEC's purview to protect investors, maintain orderly markets, and facilitate capital formation, among other arguments. The SEC's main position is that investors need this information to make informed decisions.

## NATIONAL ENVIRONMENTAL POLICY ACT

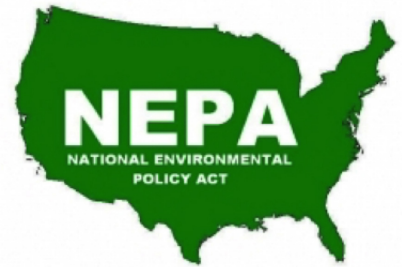
NEPA is a well-known foundational environmental law that was signed into law in 1970 and requires federal agencies to assess the environmental impacts of major Federal actions or decisions. The process is overseen by the Council on Environmental Quality (CEQ), which prepares guidance documents for the agencies and project proponents on how to comply with NEPA. As administrations have changed, so have the expectations and guidance documents issued by CEQ.

The CEQ issued guidance for climate change reviews in 2016, then rescinded in 2017 and replaced in 2019, and then replaced again in 2023. The latest guidance has a list of what an agency should do, stating “NEPA reviews should quantify proposed actions’ GHG emissions, place GHG emissions in appropriate context and disclose relevant GHG emissions and relevant climate impacts and identify alternatives and mitigation measures to avoid or reduce GHG emissions.”

There is not a quantitative threshold for GHG emissions as there is in air permitting for criteria pollutants such as NO<sub>x</sub>, for example. Having a threshold would help the proponent know whether an agency will consider an activity to be significant. Right now, this is still discretionary and to be reviewed in context. The guidance lists the climate risks that could be most relevant to an activity and a location such as sea-level rise, temperature changes, ocean acidity, wildfires, drought, and human health effects (including to underserved populations). These broad climate change impacts cannot be attributed to individual projects.

When a project is required to go through NEPA, there will be a Lead Agency who is responsible for the overall NEPA review; for our work in power generation, this is usually the Department of Energy, the Bureau of Land Management, or Federal Energy Regulatory Commission. The agencies usually rely on the applicants and their consultants to study the existing environment and the potential impacts of the activity under consideration. NEPA may require an Environmental Assessment (EA) or a more involved Environmental Impact Statement (EIS), followed by an Agency Decision along with a potentially very long list of prevention and mitigation measures. Since NEPA is such a broad framework, the EAs and EISs can be quite involved, but they may not provide an opinion about GHG impact significance. For example, the FERC has stated in recent EAs that “there currently are no accepted tools or methods for the Commission to use to determine significance, therefore the Commission is not herein characterizing these emissions as significant or insignificant.”<sup>2</sup>

Back to the NEPA rule itself though - it has had very few revisions since 1970. In June 2023, the Fiscal Responsibility Act (FRA) amended NEPA. These include some specific changes that are intended to make NEPA faster and more focused: page limits of 75 and 150 pages for EAs and EISs, as well as deadlines of one and two years for EAs and EISs, respectively. While there may be workarounds to these limits, at least they convey that NEPA reviews should stay focused and be done in a reasonable timeframe.



There is a third category for actions or projects that would not typically have a significant impact: called a Categorical Exclusion (CatEx). If a project meets specific criteria, it can be issued a CatEx determination (and not need an EA or an EIS). Recently, the DOE finalized some changes to a CatEx for upgrading and rebuilding power lines and for certain energy storage systems and solar PV systems. DOE removed the acreage limit for solar PV Categorical Exclusion for solar projects on buildings or previously disturbed or developed land. This is another way that NEPA is being streamlined.

## EQUATOR PRINCIPLES

The Equator Principles is a framework for reviewing environmental and social impacts when financing projects. It was created by a group of Financial Institutions to screen projects for significant issues that may not be identified through regulations, and it has evolved over the years. The most recent version of Equator Principles is EP4, and EP4 has clear requirements for Assessment Documentation. For projects being financed by an EPFI, all borrowers are expected to assess potential adverse Human Rights impacts (this is relevant to projects using batteries where there are concerns about supply chain human rights issues), climate change risks, and biodiversity.

A consultant can reference the efforts for other permit applications to validate EP4 compliance, while gaps in information may necessitate further study. For example, in the United States, current air permitting requirements typically will not cover the full scope of a Climate Change Risk Assessment, which can include not only the project's GHG emissions (if any), but also how climate change could impact the project when it comes to more variable or extreme weather events. If it is not done through NEPA, this would be something that Equator Principles adds on to a project's due diligence.

There are currently 131 EP Signatories although four large long-time members withdrew from EP earlier this year (2024). Two former members cited a restructuring of the EP organization as a reason, and another wished to maintain autonomy rather than be reviewed by a third-party organization. All four stated that the EP objectives remain a part of their internal risk assessment.<sup>3</sup>



**Carol Ho** is an environmental engineer with over 23 years of diverse experience in evaluating all aspects of environmental requirements associated with energy projects. Carol focuses on environmental risk assessment and permitting compliance issues. Her reviews of projects include all aspects of local, state, and federal level environmental permitting and regulatory compliance. Her work includes reviews of permit conditions and technical compliance issues at a variety of facilities, including renewable and traditional power plants, pipeline routes, and transmission projects. The investigations typically require independent research, documentation requests, and discussions with the local, state or federal agency, reviewing the applicable regulations, permit conditions, notices of violation and compliance orders. Her experience in navigating permitting requirements provides clients with valuable guidance in interpreting common regulatory issues and maintaining compliance. Carol has a B.S. in Environmental Engineering from the University of Guelph, located in Ontario, and a M.S. Sustainability Leadership from Arizona State University. She is a registered environmental engineer in the State of Colorado.



Finally, it is worth mentioning that the European Union (EU) is moving ahead with sustainability metrics reporting requirements. The EU's Corporate Sustainability Due Diligence Directive, CSDDD, was adopted in April this year and applies to EU and non-EU companies with activities in the EU that meet certain thresholds. In general, the rule requires companies to identify and assess environmental and human rights issues across their value chain. As far as GHG emissions, the CSDDD includes ensuring that their business model and strategy are compatible with the Paris Agreement.

We at E3 understand that the ESG field has been through some controversy, but to be honest, the people we work with every day as colleagues and clients share the underlying values of a sustainable society. The "how" remains a challenge - and an open door for new ideas.

<sup>1</sup> <https://www.sec.gov/newsroom/press-releases/2024-31>

<sup>2</sup> Driftwood Pipeline LLC, 183 FERC ¶ 61,049, at P 63 (2023)

<sup>3</sup> <https://www.reuters.com/business/finance/jpmorgan-citi-wells-boe-are-no-longer-signatories-equator-principles-website-2024-03-05/>