Environmental & Government Contracts Update

February 2023

Latest Federal Procurement Proposed Rule Turns Up Heat on Federal Contractors and Suppliers by Requiring Greenhouse Gas Emission and Climate-Related Reporting

On November 14, 2022, the Department of Defense, National Aeronautics and Space Administration, and General Services Administration issued a proposed rule entitled, "Federal Acquisition Regulation: Disclosure of Greenhouse Gas Emissions and Climate-Related Financial Risk" (hereafter, the "Proposed Rule"), requiring contractors who receive at least $7.5 million in annual contracts ("Significant Contractors") to disclose greenhouse gas ("GHG") emissions in the System for Award Management ("SAM"). Additionally, the Proposed Rule requires contractors who received at least $50 million in total federal contract obligations in the prior fiscal year ("Major Contractors") to file *annual* disclosures for GHG emissions ***and*** to set science-based emissions reduction targets for public view on the companies' websites. If issued as set forth, beginning one year after final publication of the Proposed Rule, both Significant and Major Contractors must have completed their GHG inventory and disclosed total Scope 1[1] and 2[2] GHG emissions in the SAM. The remaining requirements, applicable only to Major Contractors, would need to be satisfied beginning two years after final publication of the Proposed Rule.

Failure to comply with the Proposed Rule's requirements would result in a determination that the contractor is nonresponsible on project solicitations and requests for proposals. Accordingly, contractors that fall within the definitions of Major or Significant Contractors (or those that are nearing these thresholds) should:

1. ensure that their voices are heard as the FAR Council considers and solidifies the Proposed Rule;
2. start to review their own GHG emissions; and
3. familiarize themselves with the Proposed Rule's potential disclosure obligations and standards so they don't jeopardize their status as responsible contractors and lose their ability to contract with the federal government.

Background

The Proposed Rule complies with President Biden's Executive Order 14030, Climate-Related Financial Risk, which directed the Federal Acquisition Regulation ("FAR") Council to amend the FAR to "require major Federal suppliers to publicly disclose greenhouse gas emissions and climate-related financial risk and to set science-based reduction targets" and to lower GHG effects. The Proposed Rule would revise the FAR to create further requirements for certain contractors to report and disclose GHG emissions, as well as create emission targets. The Proposed Rule is intended to allow the federal government to

[1] Scope 1 emissions include GHG emissions from sources that are owned or controlled by the reporting company.
[2] Scope 2 emissions include GHG emissions associated with the generation of electricity, heating and cooling, or steam, when these are purchased or acquired for the reporting company's own consumption but occur at sources owned or controlled by another entity.

strengthen its supply chain by requiring major suppliers to set Paris Agreement-aligned emissions reduction goals.

Applicability of Proposed Rule

The Proposed Rule creates a new subpart titled "Public Disclosure of Climate Information" in FAR Part 23, which sets forth environmental policies applicable to federal contractors, to expand climate-related representations and establish new responsibility standards for certain federal contractors.

As described in more detail below, these new requirements would be implemented based on contractor size and used as criteria for contractor responsibility under FAR Part 9, meaning that an offeror for a federal procurement may be ineligible for an award if it has not made the required disclosures. Significant and Major Contractors, as defined in the Proposed Rule, would be required to publicly disclose their GHG emissions and climate-related financial risks, and Major Contractors would be required to set science-based emissions reduction targets.

Requirements of the Proposed Rule

The Proposed Rule requires new climate-related disclosures and targets for contractors depending on a contractor's status as either a Significant or Major Contractor:

GHG Emissions Inventory and Annual Disclosure

Both Major and Significant Contractors would need to complete GHG inventories of their annual Scope 1 and Scope 2 GHG emissions and disclose the total annual amounts of such emissions in SAM. As currently defined by FAR 23.001, GHGs include:

- carbon dioxide,
- methane,
- nitrous oxide,
- hydrofluorocarbons,
- perfluorocarbons,
- nitrogen trifluoride, and
- sulfur hexafluoride.

Scope 1 emissions are those directly from sources owned or controlled by the reporting entity, while Scope 2 emissions include indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling. The Proposed Rule contemplates that contractors may calculate emissions "using the calculation tool of their choice, as long as it is in alignment with the GHG Protocol Corporate Accounting and Reporting Standard."

Major Contractors' inventories would also include Scope 3 emissions – emissions that are a consequence of the operations of the reporting entities but are produced or occur at sources not owned or controlled by the entities. According to the Greenhouse Gas Protocol Corporate Standard referenced in the Proposed Rule, Major Contractors may need to analyze emissions that occur both upstream and downstream from their activities to calculate their Scope 3 emissions. Upstream emissions include those generated by materials suppliers, third-party logistics providers, and employees that are related to their operations, while downstream emissions include those generated by customers' use of products and services. The FAR Council expects that Major Contractors would use a combination of disclosed and modeled data to calculate their Scope 3 emissions from these sources.

Annual Climate Disclosure

Major Contractors would also be required to complete annual climate disclosures within their current or previous fiscal years. This annual disclosure would be composed of a set of disclosures by an entity that aligns with the recommendations of the Task Force on Climate-Related Disclosures ("TCFD") – a voluntary third-party framework for the disclosure of climate-related risks and opportunities delineated along four major pillars: governance, strategy, risk management, and metrics and targets – including aligned portions of the CDP (formerly the Carbon Disclosure Project) Climate Change Questionnaire. The annual climate disclosure would include a GHG inventory of Scope 1 and Scope 2 GHG emissions (as discussed above), as well as relevant Scope 3 GHG emissions. The disclosure would also describe the contractor's climate-related risk assessment process and any risks identified. These would include risks associated with the transition to a lower-carbon global economy, as well as physical risks from climate-related hazards.

It is estimated that 31% of Major Contractors already disclose their GHG emissions through SAM. The annual climate disclosure would be made available on a publicly accessible website, such as the company's environmental, social and governance (ESG)/sustainability webpage or on CDP's website. The total annual emissions information would be included in SAM.

Science-Based Targets

Major Contractors would also need to set science-based emissions reductions targets and list this information publicly on the Science-Based Targets initiative's ("SBTi") website or on their companies' webpages. The Proposed Rule would specifically require development of science-based targets consistent with the goals of the 2015 Paris Agreement of limiting global warming to well below two degrees Celsius above pre-industrial levels and pursuing efforts to limit warming to 1.5 degrees Celsius. These targets must be validated by the SBTi within the past five calendar years. On this point, the Proposed Rule is more onerous than the current draft of the Securities and Exchange Commission's ("SEC") climate disclosure rule. The SEC's March 2022 draft rule only requires that registrants disclose their SBTi targets if already established.

Exceptions and Waivers from Climate-Related Risk Disclosures and SBTi Targets

Major and Significant Contractors that fall within the following categories would be exempt from the Proposed Rule's new requirements:

- An Alaska Native Corporation, a Community Development Corporation, an Indian tribe, a Native Hawaiian Organization, or a Tribally owned concern;
- A higher education institution;
- A nonprofit research entity;
- A state or local government;
- An entity deriving 80% or more of its annual revenue from federal management and operating ("M&O") contracts that are subject to agency annual site sustainability reporting requirements; and
- Certain Major Contractors that are also considered small businesses for purposes of their primary North American Industry Classification System ("NAICS") codes identified in SAM, or where the Major Contractor is a nonprofit organization. Such Major Contractors are not required to complete annual climate disclosures and associated SAM reporting requirements, but would still be required to complete GHG inventories of Scope 1 and 2 emissions and report them in SAM.

The Proposed Rule would provide limited waiver authority to federal agency senior procurement executives, who could waive the inventory and reporting requirements for facilities, business units, or other entities for national security purposes, as well as emergencies and other mission essential purposes. Waivers of up to one year also would be available to allow Significant or Major Contractors to achieve compliance with their obligations, and those waivers would be posted on the agency's public website.

Enforcement of Climate-Related Risk Disclosures

Under the Proposed Rule, a Contracting Officer ("CO") is required to treat a Significant or Major Contractor as nonresponsible unless it has inventoried its annual GHG emissions and disclosed its total annual emissions in SAM. The Proposal Rule also treats a Major Contractor as nonresponsible unless it has publicized an annual climate disclosure and set targets to reduce its emissions.

Contractors found nonresponsible would be ineligible to receive federal government contracts or subcontracts. The Proposed Rule allows a contractor to rebut this determination only where the CO has decided that the noncompliance resulted from circumstances beyond the contractor's control; the contractor provided sufficient documentation to demonstrate substantial efforts to comply with its requirements; and the contractor has made a public commitment on a publicly available website to comply as soon as possible. In reaching this determination, the Proposed Rule directs COs to gather information on the offeror's compliance efforts. If a contractor is exempt, as discussed above, the revised FAR Part 9 provides that this responsibility element would not apply.

Conclusion

This Proposed Rule is reflective of the Biden administration's federal procurement initiatives. The U.S. federal government is the largest purchasing organization in the world and this Proposed Rule would have a significant effect on supply chain operations. Contractors and suppliers should also understand that climate-related risk disclosures may be an important component of future responsibility determinations. Accordingly, federal contractors should begin determining whether they would be considered a "Significant" or "Major" Contractor and take steps to compile data that would be collected under the Proposed Rule. Additionally, federal contractors and suppliers should consider submitting comments on the Proposed Rule. The comment period has been extended until February 13, 2023.

FOR MORE INFORMATION

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