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ALERT

FAR Council Proposes to Create a New Standard of Contractor Responsibility: Requiring Contractors to Disclose Greenhouse Gas Emissions and Climate-Related Financial Risk

November 16, 2022

WHAT: The Federal Acquisition Regulatory Council (FAR Council) issued a proposed rule requiring certain contractors to make representations regarding greenhouse gas (GHG) emissions and climate-related financial risk, leveraging existing third-party standards and systems. The proposed rule would implement portions of President Biden's 2021 Executive Orders 13990, 14008, 14030, and 14057 on the climate crisis and climate-related financial risk. The proposed rule would amend FAR Part 23 and the related contractor representations and certifications clauses to require certain contractors to:

- Complete an inventory of GHG emissions;
- Complete an annual climate disclosure including a climate risk assessment process and any risks identified and make those disclosures available on a publicly-available website; and
- Develop science-based targets for reducing GHG emissions to meet the goals of the Paris Agreement.

Contracting Officers would then review and assess contractors' representations regarding compliance with these requirements as part of the responsibility determination under revised FAR Part 9.

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Environment & Product Regulation
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WHEN: The FAR Council issued the proposed rule on November 14, 2022. Comments on the proposed rule are due by January 13, 2023.

WHO: The proposed rule affects two categories of contractors registered in the System for Award Management (SAM) (although there are some proposed exceptions within these categories):

- "Significant contractors," which are defined as those that received between $7.5 and $50 million in federal contract obligations in the prior fiscal year; and
- "Major contractors," which are defined as those that received more than $50 million in federal contract obligations in the prior fiscal year.

Each category has specific representation and disclosure requirements. Specifically, the proposed rule would require "significant" contractors to inventory GHG emissions from sources within the contractors' control or electricity sources supporting the contractors' own consumption (Scope 1 and 2 emissions as discussed in OMB Memorandum M-22-06 and defined in the proposed rule), and complete an annual climate disclosure in SAM.gov. In addition to the obligations that apply to "significant" contractors, "major" contractors would also be required to inventory and report GHG emissions at other facilities that result from the contractors' operations (Scope 3 emissions), publicly report climate emissions through responses to a third-party questionnaire, develop science-based targets for reducing GHG emissions, and have the targets validated by the Science Based Targets Initiative (SBTi). Contractors' compliance obligations would commence one or two years after enactment of a final rule, depending on the obligation and whether the contractor is considered "significant" or "major."

Although the responsibility determination and related representations would apply to the offeror bidding on a particular federal government contract, contractors could rely on inventories and disclosures performed by their immediate or highest-level owners, as defined in FAR 52.204-17, for a larger organization that includes the offeror.

WHAT DOES IT MEAN FOR INDUSTRY: This proposed rule would use contracting officer responsibility determinations under FAR Part 9 to create a new element of contractor responsibility – compliance with GHG inventory and climate disclosures – and a prospective contractor covered by the rule would be *presumed to be nonresponsible* unless the contractor can make certain showings. The proposed rule is expected to impact more than 6,000 federal government contractors, with a total estimated cost of compliance of over $600 million in the first year and over $442 million annually thereafter.

Emissions Inventory

"Significant" and "major" contractors would be required to post an inventory on SAM including:

- **Scope 1** emissions (which include GHG emissions from sources that are owned or controlled by the reporting company); and

- **Scope 2** emissions (which 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).

In conducting the GHG emissions inventory, covered contractors would be required to follow the GHG Protocol Corporate Accounting and Reporting Standard (GHG Reporting Protocol); they could use the emissions calculation tool of their choice, however, so long as that tool aligns with the GHG Reporting Protocol. The inventory would represent emissions during a continuous period of 12 months, no more than 12 months before the inventory is completed.

"Major" contractors' inventory would also include **Scope 3** emissions—these are "all other indirect emissions" from the contractor's operations. The proposed rule defines Scope 3 emissions as GHG emissions not captured under Scopes 1 and 2 that occur as a consequence of the operations of the reporting entity but at sources not owned or controlled by the entity. 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 of 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 the contractor's operations; downstream emissions include those generated by customer 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 Disclosures and Science-Based Target Development

In addition to the inventory and disclosure obligations described above, "major" contractors would have three additional requirements:

- Post on a public website an annual climate disclosure using portions of the CDP (formerly Carbon Disclosure Project) Climate Questionnaire that align with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations and address the company's climate risk assessment process and any associated risks. The preamble to the proposed rule also states that "[n]either the CDP climate scores, nor the answers to questions beyond those necessary to provide a complete annual climate disclosure, will be used to evaluate compliance with this FAR rule";
- Develop and post on a public website a science-based target for reducing their GHG emissions; and
- Have that target validated by SBTi criteria.

The proposed rule leverages third-party standards referenced in the Securities and Exchange Commission's (SEC) March 2022 proposed rule, which would require publicly-traded companies and other SEC registrants to disclose climate-related financial risk and related metrics, including GHG emissions, but the SEC's proposed rule does not include requirements for science-based targets for reducing GHG emissions.

Exceptions and Waivers

"Significant" or "major" contractors that fall under the following categories would be exempt from the new requirements:

1. An Alaska Native Corporation, a Community Development Corporation, an Indian tribe, a Native Hawaiian Organization, or a Tribally owned concern;
2. A higher education institution;
3. A nonprofit research entity;
4. A state or local government;
5. An entity deriving 80 percent 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
6. Small business contractors may be excepted from the requirements specific to "major" contractors (only) if the contractor is considered a small business for the North American Industry Classification System (NAICS) code it has identified in its SAM registration as its primary NAICS code, or if it is a nonprofit organization. A small business "major" contractor would still be required to complete a GHG inventory of Scope 1 and 2 emissions and report them in SAM.

The proposed rule would provide limited waiver authority to agency senior procurement executives. Those individuals 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. They could also provide waivers of up to one year to allow a "significant" or "major" contractor to come into compliance with its obligations, and those waivers would be posted on the agency's public website.

Notably, the proposed rule omits any reference to the rule's impact on subcontractors, the use of "flow down" clauses, or FAR 9.104-4, Subcontractor responsibility. Entities that do not meet the threshold of a "significant" contractor—or even hold any prime contracts with the Government—could still be affected by this proposed rule because "major" contractors are required to analyze impacts upstream and downstream of their operations. To comply with those obligations, "major" contractors may request information from their subcontractors and suppliers and incorporate disclosure obligations into their standard supplier agreements.

Timing

"Significant" and "major" contractors must comply with the Scope 1 and Scope 2 GHG inventory requirements within one year after publication of the final rule. Requirements specific to "major" contractors must be completed within two years after publication of the final rule.

Enforcement

The proposed rule would use FAR Part 9 affirmative responsibility requirements to enforce the reporting and disclosure obligations. The proposed rule includes instructions in the new proposed Subpart 23.XX05 and tables to illustrate the specific offeror responses that show an offeror is in compliance. If a contractor fails to comply with these requirements, the contractor would be presumed to be "nonresponsible." A contractor could rebut this presumption only if the Contracting Officer determines 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, Contracting Officers would be directed to gather information on the offeror's compliance efforts. If a contractor is exempt, as discussed above, the revised FAR Part 9 would provide that this responsibility element would not apply.

Public Comment

Public comments are due by January 13, 2023. Among other things, the FAR Council is seeking comments specifically on (i) the standards used in the proposed rule and any potential alternatives; (ii) the exceptions included in the proposed rule and any potential alternatives; and (iii) whether the rule requires more specificity about those portions of the CDP Questionnaire that "major" contractors must complete.

Conclusion

The FAR Council's proposed rule is the federal government's latest attempt to shift away from carbon-intensive energy sources and industrial processes towards decarbonized, climate-resilient solutions. The proposed rule would be a significant expansion of government contractors' role in this effort. The proposed rule includes an extensive discussion of the expected impact of the rule, which includes not only anticipated benefits such as identifying areas for increased efficiency and risk reduction, understanding of supply chain vulnerability, aligning of targets to address climate change, increased transparency, and disclosure standardization, but also public costs and government costs. In light of the voluminous comments submitted on the SEC's proposed climate-related disclosure rules, it is likely that the FAR Council will also receive significant comment, and perhaps take cues from the SEC's proceedings, in reaching a final rule. Wiley's Government Contracts and Environment & Product Regulation practice groups will continue to monitor developments in this area and provide additional alerts as the rulemaking process continues.