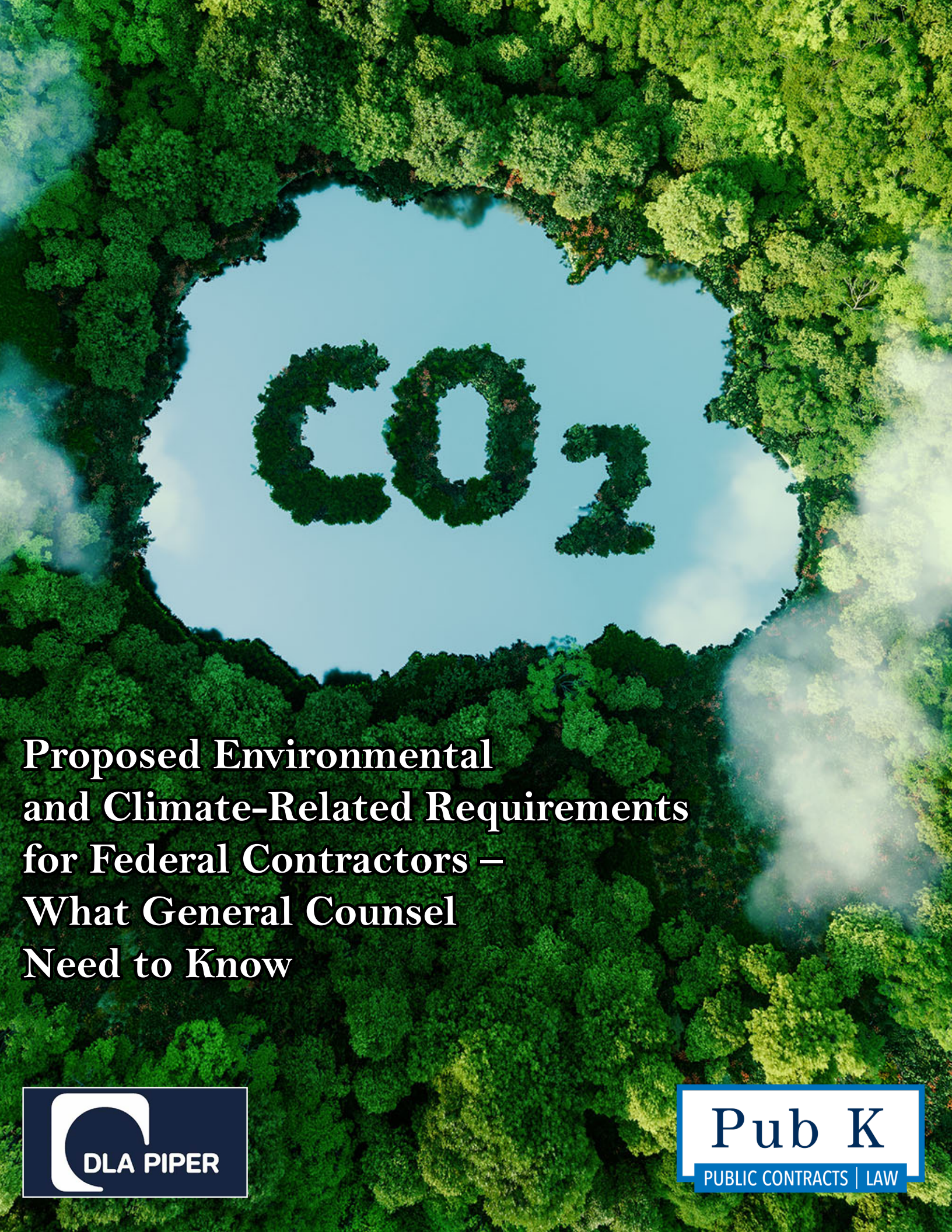


# Proposed Environmental and Climate-Related Requirements for Federal Contractors – What General Counsel Need to Know

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# Proposed Environmental and Climate-Related Requirements for Federal Contractors – What General Counsel Need to Know

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In November 2022, the Federal Acquisition Regulatory ("FAR") Council published a proposed rule that seeks to place significant environmental and climate-change related requirements on contractors that annually receive more than $7.5 million in federal contract obligations. The proposed rule would impose costly requirements on contractors and appears to be just the first step in federal efforts to incorporate environmental and climate-change considerations into the federal procurement process.

This alert provides an overview of the FAR Council's proposed rule, the greenhouse gas ("GHG") inventories that certain contractors will need to perform, the projected timeline for implementation, and the penalties for non-compliance. The alert also discusses the federal government's broader efforts to increase environmental and climate-change related requirements on federal contractors, compares the proposed rule to a disclosure rule proposed by the U.S. Securities and Exchange ("SEC"), outlines environmental and climate-change related considerations beyond the FAR Council's proposed rule, and identifies steps that contractors should consider taking in anticipation of these changes.

## Background

In 2021, the Biden Administration issued Executive Orders 13990 ("Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis"), 14008 ("Tackling the Climate Crisis at Home and Abroad"), 14030 ("Climate-Related Financial Risk"), and 14057 ("Catalyzing Clean Energy Industries and Jobs Through Federal Sustainability"). The Executive Orders directed federal agencies to take a variety of actions in connection with those items, including amending the FAR to require contractors to publicly disclose GHG emissions and climate-related financial risk as well as to set science-based reduction targets. Additionally, the FAR Council was instructed to consider amending the regulations to ensure that federal procurements minimize the risk of climate change by having agencies consider GHG emissions when making procurement decisions. Federal agencies were also directed to pursue procurement strategies that were designed to reduce contractor emissions and embodied emissions in federal projects.

## Proposed Rule

On November 14, 2022, the FAR Council issued a proposed rule that seeks to implment requirements in Executive Order 14030 relating to, among other things, contractor disclosure of GHG emissions and climate-related financial risks, as well as the establishment of science-based reduction targets. The proposed rule creates two categories of contractors: "significant contractors," which are those contractors that received between $7.5 million and $50 million in federal contract obligations in the prior federal fiscal year, and "major contractors," which are those contractors that received in excess of $50 million in federal contract obligations in the prior federal fiscal year. The obligations that the proposed rule places on a contractor generally depend on whether a contractor is classified as a significant or major contractor.[1]

The proposed rule contemplates that significant contractors will perform annual GHG inventories of their Scope 1 and Scope 2 GHG emissions, which are defined in greater detail below, and will disclose their total Scope 1 and Scope 2 emissions in SAM.gov. A significant contractor's GHG inventory must reflect its emissions for a continuous twelve-month period that ends not more than twelve months before the inventory is completed.

Major contractors must comply with all requirements applicable to significant contractors, as well as additional requirements. Specifically, a major contractor must complete an annual climate disclosure within its current or previous fiscal year, which must include Scope 1, Scope 2, and Scope 3 emissions and describe the major contractor's climate risk assessment process and any identified risks. A major contractor is required to post its annual climate disclosure on a publicly available website.

Additionally, a major contractor must develop science-based targets that provide the contractor with a pathway for reducing GHG emissions.[2] The targets must aim to reduce GHG in line with reductions as necessary to meet the goals of the Paris Agreement to limit global warming to well below 2 °C above pre-industrial levels and pursue efforts to limit warming to 1.5 °C. The targets also must be validated by the Science Based Targets Initiative ("SBTi")[3] within the previous five years and be made available on a publicly accessible website. Obtaining SBTi validation can be an onerous task, as it involves setting a target; undergoing an initial screen-

ing by SBTi; signing a target validation service contract; and undergoing an assessment by the SBTi, which typically provides a decision within thirty to sixty business days of when the contract is signed. It will be prudent for major contractors to build additional time into strategies for meeting this proposed requirement, as there may be delays and SBTi has the discretion to not approve targets.

Notably, the proposed rule contains only limited exceptions for significant and major contractors. At a high-level, the exceptions apply to Alaska Native Corporations, non-profit research entities, higher education institutions, state and local governments, and certain management and operating contractors. A small business contractor (as governed by the Small Business Administration's regulations) that exceeds the thresholds for being a significant or major contractor must comply with the requirements applicable to significant contractors for Scope 1 and Scope 2 emissions. However, a small business contractor that qualifies as a major contractor is not required to inventory its Scope 3 emissions, complete an annual climate disclosure, or set science-based targets, provided that the contractor is small under its primary North American Industry Classification System code. Additionally, the requirements discussed above will apply to commercial item and commercial-off-the-shelf contractors.

Overall, the FAR Council estimates that the proposed rule will cover 86% of "supply chain GHG impacts" and asserts that the proposed rule will "provide a better understanding of the Federal supply chain impacts, including Scope 3 emissions reported by major contractors."

## GHG Inventories

A GHG inventory consists of a list of emission sources and their associated emissions as quantified using standardized methods during a particular time period. In other words, a GHG inventory is an accounting of GHG emissions, listed by source, during a given time period. GHG inventories can be used to establish a baseline for tracking emissions, develop reduction strategies or policies, and measure progress. The proposed rule identifies carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, nitrogen trifluoride, and sulfur hexafluoride as GHGs.

GHG emissions are classified into different "scopes." Scope 1 emissions are direct GHG emissions or emissions from sources that are owned or controlled by a contractor. Examples include emissions from combustion in contractor-owned or contractor-controlled boilers, furnaces, and vehicles. Scope 2 emissions are indirect emissions or emissions that are associated with the generation of purchased electricity, heating, and cooling when acquired for the contractor's own consumption. Scope 2 emissions physically occur outside of the contractor's facilities but are acquired for use by the contractor within its facilities. As discussed above, under the proposed rule, significant and major contractors must inventory Scope 1 and Scope 2 emissions.

Major contractors also must inventory Scope 3 emissions or "other indirect" GHG emissions, which are emissions that are a consequence of the major contractor's operations but occur at sources other than those owned or controlled by the contractor. Examples of Scope 3 emissions include transportation of purchased fuels, business travel by means not owned or controlled by the contractor, and the use of sold products and goods. Calculating Scope 3 emissions can be complex, and major contractors may need to utilize a hybrid approach of disclosed and modeled

data to calculate their Scope 3 emissions.

The proposed rule requires that GHG inventories be completed in accordance with the GHG Protocol Corporate Accounting and Reporting Standard. Contractors have flexibility in selecting their emissions calculation tool, provided that the tool aligns with the GHG Protocol Corporate Accounting and Reporting Standard. The FAR Council stated that it anticipated that significant and major contractors would "use a mix of internal personnel and external consultants to complete" the annual GHG inventories.

## Potential Timeline and Penalties for Non-Compliance

The proposed rule provides that a significant or major contractor must complete a GHG inventory and disclose its total annual Scope 1 and Scope 2 emissions from its most recent inventory in SAM.gov within one year of when the final rule is published. A major contractor must comply with the additional requirements for major contractors (i.e., Scope 3 emissions, annual climate disclosure, science-based targets) within two years of when the final rule is published.

Comments regarding the proposed rule are due on February 13, 2023, and we expect that the FAR Council will receive a significant number of them.[4] The FAR Council will then review the comments, develop responses, and consider whether to modify the final rule as a result. The final rule may not be published until late 2023 or early 2024, with the requirements likely becoming effective one or two years thereafter, as discussed above. Moreover, the final rule likely will be challenged in federal court soon after publication. This means the final rule, or portions thereof, could be temporarily or permanently enjoined from taking effect, as has occurred with other rules that were based on executive orders (e.g., the COVID vaccine mandate, portions of the Fair Pay and Safe Workplaces final rule in 2016).

Additionally, the proposed rule faces opposition from Republican members of Congress. On December 19, 2022, Senator John Hoeven and a group of Republican senators sent a letter to Secretary of Defense Lloyd Austin requesting that the proposed rule be rescinded. According to the senators, the proposed rule is not in the best interests of the Department of Defense because it will impose significant regulatory burdens on defense contractors; result in additional costs being passed onto the Department of Defense; and "puts environmentalism over national security." Senator Hoeven also authored and introduced the Focus on the Mission Act (S.5269), which seeks to block the proposed rule.

That said, although compliance with the final rule may not be required until 2024 or 2025, contractors should begin contemplating how they would comply with the proposed disclosure and environmental requirements. A contractor completing a GHG inventory for the first time will need to dedicate significant time and resources to reviewing and understanding the relevant accounting standards and methods; determining organizational and operational boundaries; choosing a reporting and base year; collecting data aligned to that year from across the business; likely developing a GHG Inventory Management Plan to formalize and standardize data collection procedures; and utilizing a GHG calculator to determine the associated GHG emissions. Indeed, the FAR Council suggests in the proposed rule that the delayed effective date (of one year after the final rule is published) provides affected contractors with sufficient

time to become familiar with the GHG Protocol Corporate Accounting and Reporting Standard, to survey GHG emissions, and report the Scope 1 and Scope 2 emissions in SAM.gov. As discussed above, taking these steps may require that a contractor engage with legal counsel and consultants who are familiar and experienced with these requirements and calculations.

The importance of planning for compliance is heightened by the proposed requirement that a contracting officer generally must presume that a significant or major contractor is non-responsible under FAR subpart 9.1 if the contractor cannot represent that it has complied with the applicable requirements after the effective date of the final rule.[5] Thus, there are potentially severe consequences for non-compliance with the final rule, including ineligibility for new work that is awarded after the effective date.

## Overlap with the SEC Proposed Rule

On March 21, 2022, the SEC published a proposed rule that requires SEC registrants, including publicly listed/traded companies, to disclose certain climate-related information and GHG emissions in registration statements and annual reports. Among other requirements, a registrant would be required to disclose its process for identifying, assessing, and managing climate-related risks; Scope 1 and 2 emissions; Scope 3 emissions, if material or if the registrant has adopted a goal relating to Scope 3 emissions; and the impact of climate-related events and transition activities on the line items in the registrant's consolidated financial statement and related expenditures. The SEC proposed a phased approach to the required disclosures, with the earliest start date occurring in 2024. Significant and major contractors will not need to comply with the requirements in the SEC's proposed rule unless those contractors are SEC registrants or seek to become registrants.

There is some overlap between the SEC's proposed rule and the FAR Council's proposed rule. Both the SEC's proposed rule and the Council's proposed rule contemplate an entity performing a GHG inventory and publicly disclosing Scope 1 and Scope 2 emissions and, in certain circumstances, Scope 3 emissions. The SEC's proposed rule also utilizes certain standards (e.g., the GHG Protocol Corporate Accounting and Reporting Standard) that are utilized in the FAR Council's proposed rule.

There are, however, significant differences between the two rules. Under the FAR Council's proposed rule, major contractors are required to disclose Scope 3 emissions regardless of whether the emissions are material or tied to a reduction target or goal. Additionally, unlike the SEC's proposed rule, the FAR Council's proposed rule requires that major contractors set science-based goals to reduce emissions and that the goals be validated by the SBTi. Thus, a major or significant contractor that is subject to both the SEC's final rule and the FAR Council's final rule will need to ensure that it is satisfying the requirements of both.

The SEC initially anticipated finalizing its proposed rule by October 2022, but, due to a technical issue that may have prevented certain comments from being received, as well as the large volume of comments that the SEC received (more than 4,000 comments), the SEC appears likely to publish its final rule in 2023. The final rule likely will be challenged in court, which could further delay implementation.

## Additional Environmental and Climate-Change Related Considerations

The FAR Council's proposed rule is just one part of the federal government's efforts to incorporate environmental and climate-change considerations into the federal procurement process. As discussed above, the Executive Orders issued last year indicate that agencies will begin to consider contractor emissions when making procurement decisions. Although no FAR changes have yet been proposed in this area, such changes may be coming.

In particular, Executive Order 14030 requires the FAR Council to consider amending the FAR to ensure that agencies consider the social cost of GHG emissions when evaluating proposals and, when appropriate, give preference to proposals from suppliers with a lower social cost of GHG emissions. In 2021, the FAR Council issued an advanced notice of proposed rulemaking that asked for feedback regarding, among other climate-focused topics, how GHG emissions could "best be qualitatively and quantitatively considered in Federal procurement decisions" and how agencies could "consider and minimize climate-related financial risks through procurement decisions." After the final rule becomes effective and significant and major contractors begin to disclose their GHG emissions, agencies, in certain procurements, will have information that could be used to decide which offerors have the lower social cost of GHG emissions. Thus, agencies may begin including environmental and climate-change related considerations as evaluation factors in the next few years and may utilize disclosed GHG emissions when evaluating proposals.

In fact, the U.S. General Services Administration recently took actions indicating that it may evaluate GHG disclosures when making award decisions. On January 7, 2023, GSA issued an amendment to its draft request for proposals for the upcoming Alliant 3 procurement that added an evaluation criterion for "sustainability-related disclosures." The Alliant 3 procurement utilizes a points-based evaluation scheme for award, and the new evaluation criterion allows offerors to score points if they are publicly disclosing their Scope 1 and 2 GHG emissions, as well as additional points if they are publicly disclosing their Scope 3 GHG emissions. Offerors must identify the websites on which the disclosures are made and must provide a "self-attestation" that the GHG emissions were calculated in accordance with the GHG Protocol Corporate Accounting and Reporting Standard.

The Implementing Instructions for Executive Order 14057 (the "Implementing Instructions") also suggest that agencies will begin evaluating environmental and climate-change considerations when evaluating price. The Implementing Instructions state that agencies should procure products and services in a manner that advances energy, sustainability, and climate adaptation goals and that best-value determinations should, when possible, be based on full life-cycle costs, including measurable costs of environmental impacts in all phases of the product or service life cycle. The Implementing Instructions indicate that an agency may consider the total life-cycle costs, including measurable costs of any associated environmental impacts, when evaluating price and whether a price is unreasonably high.

The incorporation of environmental and climate-change related considerations into the procurement process will give rise to additional considerations for federal contractors. For instance, if agencies begin to consider GHG

emissions or other similar considerations when evaluating proposals, it may make business sense for a contractor to undertake efforts to reduce GHG emissions to receive more favorable consideration, even if it is not required to do so. Additionally, agencies' evaluation of environmental and climate-change related considerations likely will lead to the creation of new bid protest grounds. Depending on the terms of the solicitation, a protestor could, for example, argue that an agency improperly evaluated the protestor's or awardee's proposal under an environmental or climate-change evaluation factor; erred in finding that the awardee had a lower social cost than the protestor based on GHG emissions; or gave undue weight to the life-cycle costs of the awardee's proposal when making the best-value determination.

Additionally, the requirements in the proposed rule could potentially give rise to violations under the False Claims Act if a contractor acted with knowledge, deliberate indifference, or reckless disregard of the truth of its required environmental disclosures and representations and those disclosures or representations were material. For example, the government could potentially argue that a significant or major contractor fraudulently induced the government into awarding it a contract by intentionally or recklessly making misrepresentations relating to its GHG emissions, annual climate disclosures, or science-based targets, as applicable. The government has previously made that type of argument in other contexts, such as certifying compliance with cybersecurity requirements.

## Conclusion

The federal government is moving forward to incorporate significant environmental and climate-change considerations into the federal procurement process. Contractors should consider commenting upon and tracking the emerging rules, as well as planning for the proposed inventory and disclosure requirements. We are closely monitoring developments in this area. If you have any questions or are interested in submitting comments, please contact the authors or your DLA Piper relationship attorney.

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**Footnotes**

1 A significant or major contractor can satisfy the requirements discussed below by relying on the actions and disclosures of its immediate or highest-level owner.

2 A target is considered to be "science-based" if it is in line with what the latest climate science deems necessary to meet the goals of the Paris Agreement.

3 SBTi is a partnership between CDP (formerly the Carbon Disclosure Project), the United Nations Global Compact, the World Resources Institute, and the World Wide Fund for Nature.

4 Comments on the proposed rule were originally due on January 13, 2023, but the FAR Council extended the deadline to February 13, 2023.

5 A contractor that is not in compliance with the final rule may rebut the non-responsibility presumption by demonstrating that its non-compliance resulted from circumstances beyond the contractor's control; it has demonstrated a substantial effort to comply; and has made a commitment to comply as soon as possible on a publicly available website.

## About the Authors

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