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Via Electronic Submission

The Honorable Gary Gensler
Chair
United States Securities Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: **File No. S7-10-22 - Comments on The Enhancement and Standardization of Climate-Related Disclosures for Investors.**

Dear Chair Gensler,

On behalf of the North American rail industry, the Association of American Railroads ("AAR") appreciates the opportunity to comment on the Commission's April 11, 2022, proposal on the Enhancement and Standardization of Climate-Related Disclosures for Investors ("the Proposal").[1]

AAR and its members recognize that the climate is changing, and the industry is committed to mitigating the potential repercussions for the planet, our economies, our society, and day-to-day railroad operations. Railroads are the most fuel-efficient way to move freight over land, moving one ton of freight more than 500 miles per gallon of fuel, on average. On average, railroads are three to four times more fuel-efficient than trucks and are critical to the global supply chain. A single freight

[1] AAR is a non-profit industry association whose membership includes freight railroads that operate 83 percent of the line haul mileage, employ 95 percent of the workers, and account for 97 percent of the freight revenues of all railroads in the United States. AAR also represents passenger railroads that operate intercity passenger trains and provide commuter rail service.

train can replace several hundred trucks – reducing both greenhouse gas emissions and highway congestion.

Each of the Class I railroads have established targets to reduce their greenhouse gas emissions as part of their participation in the Science Based Targets Initiative ("SBTi"). To achieve those established goals, research into low- and zero-emission technology for locomotives and other industrial equipment used in rail yards (such as the diesel fueled cranes and trucks that move containers around our railyards) is well underway across the United States, as are investments in operational changes that improve fuel efficiency (and thus reduce greenhouse gas emissions). The rail industry is committed to reducing its impact on the environment.

While AAR agrees that investors should have access to climate risk information when making investment decisions, our comments highlight several concerns we have regarding the Proposal.

At a very high level, AAR asks the Commission to consider whether this Proposal is necessary. AAR agrees with the Commission's goal to disclose material information to enable investors to make informed judgments about the impact of climate-related risks, but we believe the existing rules adequately accomplish this goal. As Commissioner Peirce correctly noted, existing "disclosure requirements already capture material risks relating to climate change."[2] These existing rules have the benefit of allowing individual registrants the opportunity to consider and disclose risks that are material to their organization rather than simply reporting information, regardless of materiality, based on a pre-established, generic checklist.[3] By departing from the long established materiality standard, the Proposal is likely to mislead and confuse investors by requiring detailed analysis of a single area of

[2] https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321.

[3] *See, e.g.*, 17 C.F.R. §§ 229.303(a), 229.101(c)(1), 229.101(c)(1)(xii), 229.103(c)(3), 229.101(c)(5).

risk, regardless of materiality, giving asymmetrical prominence to climate factors over risks that may be more material to the registrant and the investing community.

The rail industry is exposed to extreme weather conditions on a daily basis and, pursuant to the Commission's 2010 guidance on climate change disclosures, our members disclose resulting material impacts to our financial results. The same goals proffered by the Proposal can be accomplished, while avoiding this information distortion and with lower costs to registrants, by providing additional guidance around how to interpret the existing rules in light of climate-related risks.

The remainder of this Comment highlights more specific concerns regarding the Proposal.

I. The Commission's Proposal Marks a Clear Departure from its Established Materiality Standard.

Regulations S-K and S-X, which govern the narrative and financial content of registration statements and periodic reports, limit many of their disclosure requirements to "material" information.[4] Rules 408 and 12b-20 require companies to disclose, in addition to the information expressly required to be included in SEC filings, "such further *material* information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."[5] Similarly, the liability provisions within the federal securities laws are limited to misstatements of *material* fact, or the omission of *material* facts necessary to render statements not misleading.[6] This is a well established standard, one that companies are familiar with and that should be maintained.

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4 *See, e.g.*, 17 C.F.R. § 229.303(a)(1); 17 C.F.R. § 210.02(c)(2).

5 17 C.F.R. §§ 230.408, 240.12b-20 (emphasis added).

6 17 C.F.R. § 240.10b-5 (rendering it unlawful to "make any untrue statement of a *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.") (emphasis added).

The Supreme Court has clarified what it means for a fact to be "material." In *TSC Industries v. Northway*, the Court explained that the question of materiality

> is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor. . . . An omitted fact is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote . . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.[7]

More than a decade later, the Court reiterated the *TSC Industries* standard of materiality, stating that something is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[8] The Court stated that materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the [registrant's] activity."[9]

The Proposal claims to recognize this body of law, citing to *TSC Industries* and making assurances that the long-established understanding of materiality has not changed. However, this claim either ignores or distorts the actual contents of the Proposal which deviates in numerous – and significant – ways. Instead, the Commission appears to employ one of the arguments explicitly rejected in *TSC Industries.* The Commission states in the Proposing Release that it is "proposing to require disclosures about climate-related risks and metrics reflecting those risks because this information *can* have an impact on public companies' financial performance or position and *may* be

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7 426, U.S. 438, 445, 449 (1976).
8 *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).
9 *Id.* at 238.

material to investors in making investment or voting decisions."[10] In *TSC Industries,* the Court rejected "the definition of a material fact [as] a fact which a reasonable shareholder *might* consider important" and held that "the 'might' formulation is too suggestive of mere possibility, however unlikely."[11] On its face, the Proposal uses a standard, "may be material" that was specifically rejected by the Supreme Court in *TSC Industries*.

a. <u>The Proposal Requires Disclosure of Climate-Related Risks Without Regard to Materiality.</u>

As currently proposed, "climate-related risks" are defined as "the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole."[12] These risks, the Proposal explains, can be physical or transitional in nature. Nowhere in this definition or the rest of the Proposal does the Commission limit climate-related risks solely to material risks. Further, risks must be identified in a breathtaking level of detail – for example the Proposal would require disclosure of the zip code in which at risk assets are located and what percentage of square footage lies within the flood zone.[13] These requirements are a dramatic departure from the concept of "materiality" as it is currently understood.

Moreover, the Proposal requires disclosure of not only *actual* risks, but also risks that may manifest over the "short, medium, and long term" - a feat that, at least as of today, is not possible with any degree of certainty and requires increasing levels of speculation the further into the future the Company looks.[14]

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[10] Proposing Release at 7 (emphasis added).
[11] 426 U.S. at 449 (internal citations and quotations omitted) (emphasis in original).
[12] *See* Proposed 17 C.F.R. 229.1500(c).
[13] *Id.* at. 229.1502(a)(1)(i).
[14] *Id.* at 240.12b-2 (definition of "material").

Risks associated with climate-change are difficult for even climate scientists to predict beyond a few years into the future. We have seen the impacts of climate change come to fruition years sooner than originally anticipated, while other expected impacts have not yet materialized.[15] To ask for such speculative disclosure by registrants, who are not climate scientists, considering mid- to long-term projections years to decades in advance amounts to little more than speculation, which is not helpful to investors and could be misunderstood by them as reliable. Moreover, speculation of this sort in disclosures has the potential to subject a company to liability as a result of providing the mandated disclosures that later turn out to be inaccurate.

In an effort to avoid this gap between the Proposal and established practice, the Commission states that the "materiality determination that a registrant would be required to make regarding climate-related risks under [the Proposal] is *similar* to what is required when preparing the [Management Disclosure and Analysis, or "MD&A"] section in a registration statement or annual report."[16] Given the number of significant differences between requirements under the Proposal and the MD&A, this analogy is severely misplaced.

First, climate science and climate-risks are nowhere near as developed and established as traditional trends and uncertainties required to be reported in the MD&A. As such, the established requirements for MD&A do not require the same level of speculation as the Proposal. Second, in the context of the MD&A, companies are instructed to "focus on material information and eliminate immaterial information that does not promote the understanding of companies' financial condition,

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15 *See, e.g,* USGCRP, 2017: *Climate Science Special Report Fourth National Climate Assessment, Volume 1*, Wuebbles, D.J., D.W. Fahey, K.A. Hibbard, D.J. Dokken, B.C. Steward, and T.K. Maycock (eds.), U.S. Global Change Research Program, Washington, D.C., USA (https://science2017.globalchange.gov/).

16 Proposing Release at 74 (emphasis added).

liquidity, and capital resources, changes in financial condition, and results of operations."[17] The Proposal diverges significantly from these basic rules, and the abandonment of materiality in the climate-risk disclosure context is not in the interest of investors and may actually work against "the public interest or [] the protection of investors."[18] For example, as currently drafted, the Proposal may require such a high degree of speculation with respect to climate-risks that the true, foreseeable risks faced by a registrant may get lost in a sea of unlikely, speculative risks. Or they may lead an investor to overestimate or underestimate the true risk associated with a particular organization as a result of the deluge of information the Proposal seeks to require – basically watering down the disclosures to the point that they are no longer practically useful to a reasonable investor. This outcome is counterproductive when protection of investors is the primary goal of the Commission.

Consider recurring weather events – in some regions there will always be risk associated with a single hurricane or flood that, under the Proposal could require extensive disclosure as a "severe weather event." But hurricanes and floods occur annually, and rarely have an impact that would require disclosure under the traditional understanding of materiality. Further, beyond requiring disclosure of a non-material event, registrants would be required to determine when a given hurricane or flood is "severe," whether that risk is due to climate change or simply the result of naturally occurring weather patterns that have existed for thousands of years, and to quantify the degree to which the risk is attributable to that severity. The extent to which the risk of a particular year's event exceeds the typical hurricane or flood or whether the event is caused by climate change is practically

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[17] Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Rel. No. 33-8350, 68 Fed. Reg. 75056, 75057 (Dec. 29, 2003); *available at* https://www.sec.gov/rules/interp/33-8350.htm.

[18] *See* Securities Act § 2(b); Exchange Act § 23(a)(2).

unknowable by Companies. The mere fact that registrants will be required to perform this analysis and disclose to investors elements of a risk that would otherwise not be material at all illustrates the danger of departing from traditional notions of materiality.

Efforts to identify risks in this manner compound the level of pure conjecture and speculation involved in such disclosures. The Commission's effort to reassure organizations by noting that "climate consulting firms are available to assist registrants in making [materiality determinations]" falls flat – not only does this solution impose significant consulting costs on registrants, but this area of consulting is not well developed.[19] It will take years for robust and reliable metrics to be established to guide registrants in making these determinations – either in-house or with the help of costly third-party consultants. The Commission should not sanction what is, in effect, a transfer of wealth from registrants to climate consultants without at least providing an adequate explanation of the benefits to investors, as well as sufficient time for this expertise to be developed in-house. Such a requirement is clearly not in the best interests of shareholders.

The sheer volume of nonmaterial data required to be disclosed under the Proposal would also advantage large institutional investors at the expense of retail investors, who don't have the time or resources to review excessive nonmaterial information. *TSC Industries* recognized the risk that excess disclosure of nonmaterial information could "bury the shareholders in an avalanche of trivial information."[20]

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[19] Proposing Release at 75.

[20] 426 U.S. 438, 448.

b. *<u>The Proposal's 1% Threshold for Financial Statements Disclosure is Arbitrary and Abandons Consideration of Materiality.</u>*

The Proposal establishes a bright-line threshold for financial statements under which "disclosure of the financial impact on a line item [] is not required if the sum of the absolute values of all of the impacts on the line item is less than one percent of the total line item for the relevant fiscal year."[21] If the overall impact is deemed to meet this 1% bright-line threshold, details must be disclosed regardless of whether those details would be considered material to a reasonable investor. Such a requirement creates an overwhelming task for registrants that must consider what information must be disclosed and the level of detail that must accompany such a disclosure.

By requiring an impossibly low threshold of one percent for disclosure of climate-related impacts, the Proposal diverges in significant ways from the Commission's long-established "materiality" standard.

Moreover, the Proposal would require the standard for climate-related disclosures to differ significantly from the materiality standard for *every other* risk or transaction, resulting in an over-emphasis on climate relative to other financial impacts of interest to investors. A required disclosure of a 1% impact to a line item that is itself only 5% of revenue or assets would result in discussion of an impact that is only ½% of the total base. This is obviously not material and will draw attention to minor climate-related issues over more relevant issues that aren't discussed in detail. Such a low threshold could also result in requiring the disclosure of details that could be competitively sensitive or otherwise confidential, such as the costs of inputs that are purchased under confidential rates.

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[21] *Id.* at 210.14-02(b).

Although the Commission does not adhere to any quantitative "rules of thumb" when evaluating materiality, it does recognize the use of such initial quantification as an "initial step in assessing materiality."[22] AAR is aware of no such initial quantitative threshold as low as a single percentage point. Rather, registrants often use a 10% initial step in evaluating materiality with respect to balance sheets (as suggested by Item 601 of Regulation S-K) and 5% threshold with respect to income statements. Existing controls have been designed around these common thresholds. Effectively lowering the threshold for climate disclosures will require significant investment by registrants to design and implement necessary controls to ensure accurate reporting. The Commission should bring its bright-line threshold for climate-related risks into line with other commonly used thresholds.

The Commission estimates that this proposed additional disclosure for financial statements would increase audit costs by just $15,000.[23] However, this estimate woefully underestimates the cost and complexity of what is being proposed. Recent Commenters have noted that the true cost of this complex and novel requirement will increase audit costs by several orders of magnitude beyond what the Commission has estimated.[24] AAR agrees with this assessment and notes that this is just the cost for *external* auditors. Internally there would also be a substantial internal cost of creating the internal structures and frameworks needed to collect the required data and the potential need to hire new employees. AAR's members, like most Companies, do not currently track data at the level of

[22] *See* Staff Accounting Bulletin No. 99, Aug. 12, 1999.

[23] Proposing Release ("We are conservatively estimating that auditing the note pertaining to the climate-related financial statement metrics and associated disclosures would add audit fees of $15,000 to the overall costs associated with the audit of the registrant's financial statements.").

[24] *See, e.g.,* National Association of Manufacturers Comment letter, p. 31.

granularity required to comply with the Proposal. Doing so would require drafting and implementing entirely new accounting policies, internal controls, and potentially purchasing new software.

Another challenge that filers will face is determining how to identify when financial impacts are climate-related. For example, if new rail is installed as part of the Company's planned capital expenditures, but that rail also contains features that will mitigate climate-related impacts such as flooding risk, how should the Company determine how much of the total expenditure is climate-related? It's not clear in the Proposal whether an incremental value related to certain features should be reported as a climate-related cost or whether the entire cost of the new rail must be reported as such.

Similarly, AAR's members may make investments in certain areas of their rights-of-way to raise the elevation of track. The Proposal does not explain how a Company should quantify what percentage of that cost is attributable to routine maintenance, localized changes unrelated to climate change (for example, new housing or industrial development nearby that replaced a field), or the effects of global climate change. The Proposal also requires aggregating positive and negative costs on a per line-item basis rather than allowing for them to be netted against each other. This would be a substantial departure from standard practice.

As another example, the rail industry installs and maintains snow sheds in mountainous areas that have protected against avalanches on our rights-of-ways since the 1800s. To the extent a particular railroad adds a new shed or maintains an older shed, it would be impossible to calculate the percentage attributable to climate change versus routine investment. The Proposal appears to assume that financial impacts are either related to climate or unrelated, but in reality, there may be a variety of reasons for any particular business decision that cannot be clearly described under the Proposal.

On the revenue side, it will be challenging to determine what percentage of an increase or decrease in any given business segment is attributable to climate change versus other market and economic factors such as changes in global demand for a given product the rail industry ships, competition among railroads and other modes of freight or public transportation, regulatory impacts, competing products and services, and inflation.

AAR believes that investors should have access to disclosures on *material* climate-related metrics, risks, and opportunities and supports a principles-based framework that enables publicly traded companies to efficiently report them. The Commission should reconsider its proposed climate-related disclosure requirement, and instead focus on climate change metrics that are *financially material* to the investors in a specific business. The current materiality standard's emphasis on the *reasonable* investor focuses disclosures on metrics that *actually drive* value creation and long-term shareholder return. The Commission should not abandon the established materiality standard.

II. The Proposal Disproportionately Impacts the Railroad Industry in Comparison to Competing Modes of Freight Transportation.

AAR's members own most of the rights-of-way upon which their trains travel. As such, the rail industry will have a far greater burden to analyze, quantify, and disclose potential impacts and risks across a rail network that spans more than 140,000 route miles, the cost of which will be significant. No such requirement will be imposed on competing modes of freight and public transportation and, as a result, registrants in the truck, air, and water transportation industries will have a comparatively lower regulatory burden and less disclosure of climate risks and impacts in their filings.

This impact is unwarranted and is likely to mislead the investing public. The rail industry is significantly more fuel efficient and less carbon intensive than alternative modes of freight and public transportation. The disparity created by the Proposal may mislead the investing public as to the relative environmental and climate risks and benefits among these competing modes of transportation. In her statement in support of the Proposal, Commissioner Lee stated, "[c]limate change thus poses a pressing and urgent risk – for investors, companies, capital markets, and the economy."[25] If responding to climate change is truly the goal of the Commission, such disparities imposed upon the most carbon efficient method of ground transportation are counterproductive.

III. The Compliance Date of the Proposal's Required Disclosure is Unreasonable.

The Proposal would require accelerated filers to include all proposed disclosure requirements – including Scope 1 and 2 emissions, and associated intensity metrics (but excluding Scope 3 emissions) – in their filings for fiscal year 2023. From a practical perspective, this would require registrants to have all internal systems in place at the beginning of 2023 (a mere 6 months from this filing, and weeks from the potential finalization of the Proposal), for a rule finalized in late 2022, in order to provide the requisite data to the Commission in early 2024. This timeline is unreasonable.

The Proposal also contemplates three years of comparative data. Under the Proposal's 2023 implementation date, a registrant would be required to have captured the requisite data as far back as 2021. Although there is a caveat in that it only requires this disclosure "to the extent such historical GHG emissions data is reasonably available," the inclusion of this retroactive requirement would require registrants to review significant historical data to consider what data is available and will result in additional costs of compliance.

Registrants, including the railroads, need more time to put in place the internal personnel, policies, and structure to properly comply with the Proposal's disclosure requirements. Even registrants that have previously voluntarily reported some subset of the newly-required data would

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[25] https://www.sec.gov/news/statement/lee-climate-disclosure-20220321

need time to implement systems that can track the data at the microscopic level required under the Proposal. The science and standards for calculating greenhouse gas emissions are ever evolving and remain unsettled. As such, this data is not currently available at the level described, regardless of the current voluntary disclosure frameworks a registrant has adopted to date. Such a requirement will necessitate system changes as of the beginning of the year in which data will be reported. Registrants need at least one full fiscal year during which to establish the requisite protocols, hire the necessary staff, and collect the necessary data to comply with the Proposal, should it be finalized in its current form.

AAR respectfully requests that the Commission extend the implementation of the Proposal to allow a stepped-up implementation period. AAR supports the timeline proposed by the National Association of Manufacturers.[26]

IV. The Timing of the Required Disclosure on Form 10-K is Unreasonable.

The Proposal requires additional climate-related disclosures in a Company's annual Form 10-K. For accelerated filers this is filed within sixty days of the end of the fiscal year. Many companies, including AAR's members, file before this deadline, often in early- to mid-February. The Proposed changes to the disclosures would require the additional data in the 10-K to be finalized mere weeks after the fiscal year end.

Gathering emissions data can be extremely time intensive and can take up to six months to gather and validate data. This is one of the reasons why the submission deadline for CDP is not until late July and why AAR's members do not generally release their sustainability reports with their

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[26] National Association of Manufacturers Comment letter at 48.

emissions data for a particular year until the following summer. The Proposal would mandate that this timeframe shrink by two-thirds or more, while at the same time imposing assurance requirements that will almost certainly add additional timing delays. And notably, this timeline also reflects only Scope 1 and Scope 2 data, the collection of which is significantly more straight forward than Scope 3 data. The timeline for accurate Scope 3 data, which the Commission anticipates being disclosed by many companies, would be even longer.

The Proposal does make a small concession (subtly acknowledging the unreasonableness of the proposed timeline) by allowing for the use of estimates for emissions in the fourth quarter as long as any material differences between the estimate and actual emissions is promptly disclosed. However, the use of estimates in this manner will not only diminish the accuracy of numbers reported by companies – decreasing the usefulness of information to investors – it also likely imposes the burden on companies of an additional filing annually. The Proposal also ignores the potential liability exposure that a company could face from incomplete or inaccurate emissions data, even if this data is released with the caveat that it is an estimate. This exposure may have a chilling effect on the number of companies willing to release estimates.

The Commission is requiring substantially increased disclosure, with increased assurance, and is requiring it on a substantially shortened timeline. This is unreasonable. If the Commission decides to require the disclosure contained within the Proposal, it is critical that it grant companies the time required to provide accurate and useful data. AAR recommends that the timeline be extended at least six months to when this information is likely to be available. This would allow for disclosure in the second quarter 10-Q for most companies. Alternatively, the Commission could allow companies to report emissions data in the following year's 10-K – i.e., 2023 emissions data would be reported in the

10-K filed for 2024 during the first quarter of 2025. Such an extension would not negatively impact the availability of information for investors, would increase the accuracy of information, and would decrease the administrative burden on companies.

V. The Proposal Should Delay Attestation and Assurance Requirements and Expand the Safe Harbor Provisions.

With respect to the Proposal's attestation requirements for climate disclosures, AAR asks the Commission to delay the requirements for third-party attestation. Under the Proposal, large accelerated filers and accelerated filers would be required to include an attestation report that covers, at minimum, the disclosure of a filer's Scope 1 and Scope 2 emissions, as well as information about the attestation service provider.[27] Although these attestation requirements would be phased-in over time under the Proposal, initially subjecting disclosures to limited assurance and eventually moving to reasonable assurance, this timeframe should be further extended to allow for the development of a robust community of consultants capable of providing quality attestation services. This third-party expertise does not exist today on a nationwide basis, and the Commission should allow sufficient time between the finalization of a climate-disclosure rule and the requirement for third-party attestation.

Further, AAR encourages the Commission to reconsider the assurance requirements in the Proposal and return to those assurances traditionally associated with financial reports. Measurement principles for climate-related data are relatively immature, particularly when compared to financial data. If the Commission were to require reasonable assurance, it would trigger significant costs and liability for registrants, with little to no benefit to shareholders or investors. Disclosures that are not subject to traditional certification, assurance, and controls, on the other hand, would more accurately

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[27] *See* Proposed 17 C.F.R. § 229.1505.

reflect the evolving nature of the climate information and assurance infrastructure and of the market's understanding of the impact of climate metrics on company performance.

Finally, AAR encourages the Commission to consider expanding the "safe harbor" provisions afforded to disclosures regarding Scope 3 emissions to cover all forms of liability for Scope 3 emissions and to the disclosure of climate-related risks, at least for an introductory period.

VI. The Proposal's Cost Benefit Analysis Fails to Adequately Reflect the True Incremental Cost of the Proposal.

The Cost Benefit Analysis prepared by the Commission for the Proposal fails to accurately reflect the associated incremental costs. The Commission sets aside the magnitude of costs the Proposal would impose on registrants by observing that some companies have already made voluntary climate-related disclosures. The problem with this line of thinking is that voluntary frameworks, by their very nature, allow companies to adjust the disclosure to fit the information they have access to and can rely upon. Put differently, not all companies universally follow the TCFD framework. This is true for a variety of reasons including data availability, costs associated with complete compliance, and lack of materiality. In addition, TCFD and other voluntary frameworks do not require registrants to report data at the level of granularity envisioned in the Proposal nor do they require attestation and assurance. And finally, not all companies have adopted voluntary frameworks, either in whole or in part, and will therefore be faced with the full implementation costs of setting such a system up from scratch. The Proposal's suggestion that implementation costs will be minimal grossly underestimates the true costs to be borne by registrants should these requirements be fully promulgated. Indeed, Commissioner Peirce recognized the likelihood of these costs being higher than anticipated and estimated by her fellow Commissioners.[28]

The Commission, in its cost benefit analysis, also ignores the obvious distinction between a voluntary sustainability report that is posted on an organization's website, and which may be referenced in its regulatory filings, with the Proposal's requirements for mandatory assurance and the potential for liability and enforcement. These are not equivalent and the distinction between the two, and costs associated with the imposition of a regulatory mandate, are not reflected in the Cost Benefit Analysis.

The Proposal, if finalized in its current form, will require registrants to invest in expanded accounting capabilities, internal controls, additional personnel, updated education and training, and potentially the addition of entire departments. In addition to these internal costs, there would also be increased costs from expanding the scope of work done by a company's accounting firm and retaining third-party consultants and legal counsel to advise and provide the necessary attestations. None of these extra costs are reflected in the Commission's cost benefit analysis. As such, the analysis is woefully inadequate and does not accurately reflect the true costs that will be imposed on all registrants by the Proposal.

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[28] https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321.

VII. Financial Statement Footnote Disclosures Should Remain in the MD&A.

The Proposal would require registrants to disclose financial impacts in the footnotes based on the absolute value of both positive and negative impacts of severe weather events, other natural conditions, and transition activities that exceed 1% of relevant financial statement line items, either individually or in the aggregate.[29] In addition, registrants would be required to disclose expenditures based on the total amount of expenses and capitalized costs related to climate events or transition activities if those amounts exceed 1% of total expenses of total capitalized costs.[30] Specifically, the Proposal would require registrants to disclose financial impact metrics if the aggregate absolute value of positive and negative impacts arising from severe weather events (and other natural conditions), transition activities, and identified climate-related risks is greater than 1% of the impacted line item.[31] The Proposal includes examples of potential impacts – including changes to revenue or costs from disruptions to business operations, impairment charges, and changes to loss contingencies.[32]

As explained above, this list of items in the Proposal's requisite disclosures is extremely broad and will require internal process and structural changes within organizations to accurately report these values at the requisite level of detail. Moreover, registrants would be required to disclose how other estimates and assumptions in the financial statements are affected by the disclosed climate-related impacts. For example, AAR's members may need to quantify the changes in the useful lives of locomotives in each railroads' fleet and how climate-related forces may impact their depreciation and

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[29] *See* Proposed 17 C.F.R. 229.1500.
[30] *Id.*
[31] *Id*.
[32] *Id.*

asset retirement. What the Proposal fails to consider is that these impacts may be extremely hard to quantify with any confidence.

In addition, the Proposal fails to allow companies to net the negative and positive impacts on a particular registrant's assets because of efforts related to climate reduction efforts. Registrants should be allowed the flexibility to provide a complete picture of the negative impacts associated with climate-related risk in relation to the positive effects of the registrants' efforts to combat those risks. For example, although the rail industry's current emissions result primarily from the combustion of the diesel fuel that propels our locomotives and other equipment, rail remains the most fuel-efficient method of transporting freight and people over land and the Class I railroads are in the process of testing low- and zero-emission locomotives that will further reduce our dependence on diesel fuel. To only provide one half of this equation to investors fails to provide them with a full picture of the industry.

Regardless, these disclosures should remain in the MD&A section of filings to avoid the need for auditors to opine on matters that do not lend themselves to quantitative analysis. For example, the Proposal requires a level of detail that analyzes the weather patterns, costs associated with climate change outside of those related to weather events, and other "indirect effects." But the Proposal fails to provide any explanation as to how to quantify the "indirect effects" of climate-related changes. Even climate scientists are unable to predict these effects with any level of confidence. Thus, the Proposal leaves unresolved how a registrant should quantify these effects as a loss of sales versus gained sales, or higher costs due to weather that impacted our suppliers, or any detail with respect to how registrants should go about this analysis. For example, the rail industry does not currently quantify "lost sales" that could result from any number of issues – e.g., labor shortages that could be the result of low unemployment or the migration of workers from one part of the country to another or employee education and training requirements that are difficult to satisfy. It is impossible for issuers to provide a true, well-founded amount for "lost sales" that could be audited. Such a quantification, if required, would likely overestimate the impact of climate change because other factors involved in those "lost sales" would not be disclosed, even if more impactful.

Given the inherently speculative nature of these disclosures based on today's available science and understanding, AAR respectfully asks that any required disclosure remain in the MD&A rather than in the financial footnotes.

VIII. Even Considering the Proposal's Allowances with Respect to Scope 3 Emissions, the Lack of Established Norms Requires Additional Flexibility.

The Proposal defines Scope 3 emissions as

> all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain. Upstream emissions include emissions attributable to goods and services that the registrant acquires, the transportation of goods (for example, to the registrant), and employee business travel and commuting. Downstream emissions include the use of the registrant's projects, transportation of products (for example, to the registrant's customers, end life treatment of sold products, and investments made by the registrant.[33]

The Proposal states that registrants need only disclose Scope 3 emissions if (i) they are material to that organization or (ii) if the registrant has set an emissions reduction target that includes Scope 3 emissions.

There are number of problems with the Proposal's treatment of Scope 3 emissions. First, from the materiality standpoint, the Commission has already stated that Scope 3 emissions are generally

[33] *See* Proposed 17 C.F.R. § 229.1500(r).

material and tells registrants that materiality doubts should "be resolved in favor of those the statute is designed to protect, namely investors." [34] This leaves little room for a registrant to determine that its Scope 3 emissions are immaterial. The guidance on determining materiality also suffers from the flaws discussed above in seemingly ignoring the Commission's longstanding approach to materiality as established in *TSC Industries*.

The Proposing Release appears to go even further, though, indicating that if a company determines that its Scope 3 emissions are not material it must disclose the basis for that determination. AAR is unaware of any similar requirement for disclosing the basis of an immateriality determination. Even if the Commission decides to abandon long established materiality standards elsewhere in this Proposal, AAR requests that it not adopt a first ever disclosure requirement regarding the basis for a finding of immateriality.

The Commission, through this Proposal, is also likely to create a chilling effect on voluntary commitments to reduce greenhouse gas emissions that include Scope 3 emissions, as such commitments would immediately require mandatory Scope 3 disclosure. To the extent that a registrant determines that its Scope 3 emissions are immaterial (despite the Commission's statements noted above), it may be preferable for that registrant avoid required disclosure by either opting not to enter such a voluntary commitment or extracting itself from prior commitments. This would be an unfortunate unintended consequence of the Commission's action.

A second potential unintended consequence may follow from the focus on a supplier's emissions and emissions reductions over all other aspects of their operations. For example, AAR's

[34] Proposing Release at 181.

members work with some suppliers because they are minority- or women- owned businesses. Others may be small businesses that compete with large multinational organizations and receive preferential treatment as a result. The Commission's laser focus solely on the emissions portion of ESG considerations could easily create negative effects within the global supply chain to the detriment of other social issues and overall resiliency, such as has been experienced as a result of a global pandemic and the war in Ukraine.

Finally, the proposal with respect to Scope 3 emissions is simply infeasible and impractical, at least as applied to railroads. The calculation of a single railroad's Scope 3 emissions would require the collection of emissions data from hundreds, and perhaps even thousands of suppliers. Some of these suppliers will be large, international corporations that will easily be able to provide this data to AAR's members. But other suppliers may be small, family-owned businesses with no prior experience calculating or reporting their greenhouse gas emissions. As the Commission acknowledges, "a registrant's material Scope 3 emissions is a relatively new type of metric, based largely on third-party data, that [the Commission has] not previously required."[35] There are currently no market norms established for collecting and quantifying Scope 3 emissions, and registrants have little control over third parties and the data provided by them. It will take more than a few years to establish the appropriate market norms and to put in place the necessary protocols within each organization up and down the supply chain to have accurate and reasonably comprehensive data with respect to Scope 3 emissions.

[35] *Id.* at 192.

In light of this reality, if Scope 3 disclosure is mandated, as opposed to voluntary, the Commission should further delay the timeline for implementation of its disclosure requirements and expand the proposed "safe harbor" rules to include not just liability, but also Commission enforcement actions.

IX. GHG Emissions Disclosures Should be "Furnished" Instead of "Filed."

AAR supports the Commission's alternative in its Proposal to allow registrants' climate disclosures to be considered "furnished" rather than "filed." As the Commission notes, this would limit the incremental risk of being held liable under Section 18 of the Exchange Act and Section 11. Given the developing nature of climate science and the lack of established market norms for filing greenhouse gas emission disclosures, providing this option is prudent.

X. AAR Supports the Adoption of the TFCD Standard.

As the Commission is no doubt aware, there are a variety of voluntary reporting mechanisms available, with overlapping and time-consuming requirements. AAR's member have already taken steps to voluntarily comply with third-party standard setters such as the Sustainability Accounting Standards Board ("SASB") and the Task Force on Climate-Related Financial Disclosures ("TCFD"). To the extent the Commission moves forward with this proposal, AAR supports adoption of the TCFD framework in its current state. Adopting an existing, widely used program will lessen the transition time needed to implement a framework and standard.

The TCFD framework is sufficiently flexible to adapt to changing market conditions and a wide range of industries. TCFD focuses on material sustainability issues that are likely to impact shareholder value and will continue the Commission's current principles-based disclosure framework. Many companies, including AAR's members, have already invested significant resources in adopting voluntary processes based on TCFD. Moreover, investors and other stakeholders are also already familiar with these frameworks. AAR encourages the Commission to adopt the TCFD framework as it currently exists, *without the additional requirements included in the Proposal*.

XI. Conclusion

AAR appreciates the opportunity to provide these comments. AAR's members are leading by example in addressing climate change by developing and implementing new technologies, enhancing operating practices, and working with their suppliers, customers, and supply chain partners to build a more sustainable future. AAR believes the current disclosure rules, based on the traditional materiality standard, provide investors with ample information regarding climate-related risks. As such, the Proposal is duplicative and strays from established Commission standards.

To the extent the Commission does finalize a climate-disclosure rule, a more reasonable disclosure requirement that (i) promotes consistency in climate-related reporting across industries, (ii) focuses on materiality and its well-established definition, (iii) has a compliance date providing enough time to prepare for the required disclosures, and (iv) requires disclosure in a filing other than Form 10-K to allow for sufficient time to gather emissions data, will provide reliable and comparable information for investors.

AAR appreciates the Commission's consideration of our comments.

Respectfully,

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