



# Comment in Response to SEC Proposed Rule: The Enhancement and Standardization of Climate- Related Disclosures for Investors

## ClientEarth US Response

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ClientEarth is an international non-profit organization dedicated to using the law to protect all life on Earth. Its team of over 200 people works to create systemic change in over 50 countries. ClientEarth addresses the most pressing environmental challenges of today, including climate change, air pollution, deforestation, and species destruction. It offers practical solutions to the world's toughest environmental challenges, and works with people, campaigners, governments, and industry to make those solutions a reality. ClientEarth's newly-formed U.S. operations specialize in the intersection of finance, securities laws, and climate.

### Executive Summary

The SEC, in proposing certain climate-related disclosures, states that the purpose of such disclosures is to “provide consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments.”<sup>1</sup> While the SEC’s proposed rule is an important step forward, several elements of the current proposal would impede the SEC’s stated purpose in requiring such disclosures. In sum, ClientEarth proposes the following recommendations to ensure adequate and enforceable climate disclosures that provide decision-useful information to investors:

1. Require the disclosure of Scope 3 emissions without any limitations or qualifiers.
2. Remove the safe harbor for Scope 3 emissions disclosures.
3. Remove the Scope 3 disclosure exemption for SRCs.

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<sup>1</sup> Securities and Exchange Commission, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 FR 21334, 7.

4. Afford SRCs the same timeframe for disclosure as accelerated and non-accelerated filers.
5. Do not afford registrants one additional year to comply with Scope 3 disclosure requirements.
6. Clarify the one percent threshold materiality requirement and do not allow offsets to be used as an accounting mechanism.
7. Require companies to disclose whether they have a transition plan, what such a transition plan consists of, or, alternatively, why they have chosen not to implement a transition plan.

In the sections below, we will discuss the proposal and our proposed potential solutions in detail.

## **Recommendations for Changes to Specific Proposed Provisions**

### **I. Clarify Scope 3 Emissions Provisions**

As written, the provisions involving Scope 3 emissions are likely to discourage meaningful disclosure. Specifically, we have identified three key issues: (1) the language qualifiers, (2) the litigation safe harbor provision, and (3) the exemption for smaller reporting companies (SRCs). Addressing each of these three key issues is necessary for meaningful disclosure and will further the SEC's aims of providing decision-useful information to investors.

**First**, the current proposal requires disclosure of “Scope 3 GHG emissions and intensity, *if material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.*”<sup>2</sup>

#### *Materiality*

Traditional materiality concepts necessitate the disclosure of Scope 3 emissions because this information is essential to the reasonable investor.<sup>3</sup> Scope 3 emissions typically account for *more than 70 percent* of a business' carbon footprint,<sup>4</sup> and these “indirect emissions are substantial and growing.”<sup>5</sup> Moreover, “because scope 3 emissions sources may represent the majority of an organization's

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<sup>2</sup> 87 FR 21334, 43.

<sup>3</sup> See Hana V. Vizcarra, *The Reasonable Investor and Climate-Related Information: Changing Expectations For Financial Disclosures*, 50 ELR 10106, available at [Eelp.law.harvard.edu/wp-content/uploads/50.10106.pdf](https://eelp.law.harvard.edu/wp-content/uploads/50.10106.pdf), (Arguing that recent trends lean in favor of findings that climate-related information is material). Note also that Scope 3 emissions information cannot be obtained without inside information regarding a company's suppliers and customers.

<sup>4</sup> Scope 3 Emissions, Global Compact Network UN, available at <https://www.unglobalcompact.org.uk/scope-3-emissions/>. See also, Scope 3 Inventory Guidance, US EPA, available at <https://www.epa.gov/climateleadership/scope-3-inventory-guidance>, (“Scope 3 emissions, also referred to as value chain emissions, often represent the majority of an organization's total GHG emissions.”)

<sup>5</sup> Edgar G Hertwich & Richard Wood, *The growing importance of scope 3 greenhouse gas emissions from industry*, 2018 *Environ. Res. Lett.* 13 104013, at 8, available at <https://iopscience.iop.org/article/10.1088/1748-9326/aae19a>.

GHG emissions, they often offer emissions reduction opportunities.”<sup>6</sup> Scope 3 emissions are therefore integral for a reasonable investor to determine the climate impact of specific businesses and how climate change may impact businesses’ long-term financial sustainability. This information is *per se* qualitatively and qualitatively material, and its disclosure should be mandated by the rulemaking.

Further, the high investor demand for climate change information<sup>7</sup> renders it both quantitatively and qualitatively material. Such investor demand is driven largely by the recognition that climate risk and practices are crucial to the long-term health and viability of not only our natural ecosystems, but also our financial ones. Addressing Scope 3 emissions is a crucial component of meeting the aims of the Paris Agreement and limiting global warming to 1.5°C.<sup>8</sup> Failure to mandate Scope 3 disclosure only opens the door to “boilerplate discussions that provide limited information as to the registrants’ assessment of their climate-related risks or their impact on the companies’ business” by registrants that often already track “significantly more extensive information”, including in their “sustainability reports and other locations such as their websites as compared with their reports filed with the Commission.”<sup>9</sup>

Failure to require robust and enforceable Scope 3 disclosures will also place the U.S. at odds with the global trend of peer financial regulators. This inconsistency will create increased regulatory burden for filers, as well as asymmetries of information between domestic and foreign corporations that will hinder efficient investment. Indeed, given the increased investor demand for climate-related corporate information, the SEC’s failure to adopt robust disclosure requirements on par with peer jurisdictions may actually create a domestic competitive disadvantage in key sectors such as energy and renewables.

Additionally, requiring Scope 3 emissions disclosure will reduce the administrative burden and strain on judicial resources. The SEC is already asking companies to justify the lack of information in their disclosures compared to their sustainability reports,<sup>10</sup> and leaving the Scope 3 emissions materiality question open is bound to result in burdensome SEC follow up. This open question will also

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<sup>6</sup> Scope 3 Inventory Guidance, US EPA.

<sup>7</sup> See Jason Halper, Sara Bussiere & Timbre Shriver, *Investors and Regulators Turning up the Heat on Climate-Change Disclosures*, Harvard Law School Forum on Corporate Governance (October 4, 2021), available at <https://corpgov.law.harvard.edu/2021/10/04/investors-and-regulators-turning-up-the-heat-on-climate-change-disclosures/>, (“[I]nvestors are increasingly demanding that companies change their approach to managing climate-related risks and more thoroughly disclosing those efforts.”) For example, “Morgan Stanley studies have shown that 86 percent of Millennials – broadly defined as those born between the early 1980s and 2000 – say they are interested in socially responsible investing.” *Morgan Stanley Launches Morgan Stanley Access Investing*, Morgan Stanley (Dec. 4, 2017), available at <https://www.morganstanley.com/press-releases/morgan-stanley-launches-morgan-stanley-access-investing>.

<sup>8</sup> Scope 3 Emissions, Global Compact Network UN.

<sup>9</sup> 87 FR 21334, 21. This SEC statement responding to commenters who argued that disclosure rules are not necessary for *any* type of emissions because registrants are already required to disclose material climate risks is just as applicable to Scope 3 emissions as it is to Scope 1 and 2.

<sup>10</sup> Halper, *supra* note 7.

likely result in a wave of litigation regarding the definition of materiality in the climate change context.

### *Registrant-Initiated Emissions Reduction Targets*

The second qualifier—which requires disclosure if the registrant has set a GHG emissions reduction target or goal that includes Scope 3 emissions—may deter companies from putting such targets in place in order to avoid mandatory disclosure. It is also likely to skew investor perception, as it may mislead investors into believing that disclosing companies are riskier investments than non-disclosing companies—when the very opposite may be true.

In sum, requiring the disclosure of Scope 3 emissions without any materiality or registrant-initiated reductions target qualifiers is consistent with the SEC’s objective of providing decision-useful information to investors. While some may argue that it could be difficult to obtain the necessary data from third parties or that methodological uncertainties may arise, such positioning is belied by the fact that many companies are already quantifying their Scope 3 emissions<sup>11</sup> and much guidance already exists on how to report Scope 3 emissions.<sup>12</sup> And as discussed, the importance to investors of being able to understand organizations’ full environmental impact outweighs such contentions.

**Second**, the current proposal provides a new and unnecessary safe harbor for Scope 3 emissions disclosure from certain forms of liability under the Federal securities laws. “The proposed safe harbor would provide that disclosure of scope 3 emissions by or on behalf of the registrant would be deemed not to be a fraudulent statement unless it is shown that such a statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.”<sup>13</sup> This safe harbor provision is duplicative and unwarranted for several reasons.

First and foremost, the Private Securities Litigation Reform Act (“PSLRA”) already provides a heightened pleading standard for establishing liability for misstatements and omissions. The language of the proposed safe harbor is identical to that found in the PSLRA’s safe harbor provision for forward-looking statements.<sup>14</sup> That provision is the statutory codification of the common law bespeaks caution doctrine, which applies in cases where forward-looking statements such as estimates or projections are accompanied by meaningful cautionary language.

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<sup>11</sup> For example, 90% of the 400 companies who have joined the Science Based Targets Initiative (SBTi) have set Scope 3 reduction targets. Nicole Labutong & Vincent Hoen, *How can companies address their scope 3 greenhouse gas emissions?*, Science Based Targets (May 25, 2018), available at <https://sciencebasedtargets.org/blog/how-can-companies-address-their-scope-3-greenhouse-gas-emissions>.

<sup>12</sup> Scope 3 Inventory Guidance, US EPA (referring to the GHG protocol).

<sup>13</sup> 87 FR 21334, 211.

<sup>14</sup> 17 C.F.R. 230.175(a).

Companies already routinely make disclosures of all types of historical facts and operating statistics. Many of these are based on difficult, subjective, or unstandardized methodologies. Liability for the material misstatement or omission of such facts is already well-covered by existing federal securities laws and the judicial doctrines surrounding them. For these reasons, it is unnecessary, and indeed illogical, to create a new litigation safe harbor provision for Scope 3 emissions. Such an addition would only muddy the waters surrounding the standards of liability applicable to potential misstatements regarding Scope 3 emissions, and undermine the confidence of investors that companies are fully and accurately reporting these emissions.

The logic and structure of the PSLRA's safe harbor provision is also fundamentally inapplicable to Scope 3 emissions. While such disclosures may be methodologically onerous, this does not render those statements inherently prospective in nature. Although it is true that Scope 3 emissions often incorporate information about future emissions, this is more akin to a company booking revenue at the time that it is earned, rather than when it is collected. As in revenue recognition, Scope 3 emissions reporting determines, at the time of the disclosure, the total impact attributed to a specific project or asset. Accordingly, these Scope 3 emissions are not forward-looking, and the misapplication of the PSLRA safe harbor to these disclosures raises thorny questions such as whether these emissions disclosures must include cautionary language, whether the current facets of judicial interpretation of the PSLRA safe harbor would apply to these emissions disclosures, and whether the use of this proposed safe harbor would constitute a new affirmative defense.

**Finally**, the current proposal exempts smaller reporting companies ("SRCs") from the Scope 3 emissions disclosure provision.<sup>15</sup> Allowing such an exemption for SRCs may incentivize companies to use smaller spin-off entities as disclosure havens and is superfluous. The phase-in periods we suggest below and the many already existing resources regarding Scope 3 emissions disclosure available to organizations renders this exemption unnecessary. The SEC need not exempt SRCs from Scope 3 emissions disclosure, especially in light of the importance of Scope 3 emissions disclosure to reduction opportunities as discussed above.

## II. Modify Phase-In Periods

The phase-in periods for the proposed climate-related disclosure requirements also impede the SEC's stated goals for disclosure, primarily because the periods are overly delayed. As written, the compliance dates for disclosure depend on an organization's registration status: for large accelerated filers,

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<sup>15</sup> Note that there is what seems to be a drafting error on page 44 of the proposed rule. The current language reads: "The proposed rules would require an accelerated filer or a large accelerated filer to include, in the relevant filing, an attestation report covering, at a minimum, the disclosure of its Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider." As written, this language would seem to exclude non-accelerated filers and SRCs, but it is our understanding that this is not the SEC's intent.

disclosure begins in fiscal year 2023 (filed in 2024); for accelerated and non-accelerated filers, disclosure begins in fiscal year 2024 (filed in 2025); and for SRCs, disclosure begins in fiscal year 2025 (filed in 2026). Further, registrants subject to the proposed Scope 3 disclosure obligations would have one additional year to comply with those disclosure requirements. With such phase-in periods in place, companies may not be required to file certain climate-related disclosures until 2027.

Such delayed disclosures impede the ability of investors to make informed judgments about the impact of climate-related risks on current and potential investments in a manner calculated to meet the urgent goal of worldwide emissions reductions. According to the Intergovernmental Panel on Climate Change (IPCC), “[w]ithout immediate and deep emissions reductions across all sectors, limiting global warming to 1.5°C is beyond reach.”<sup>16</sup> Specifically, “limiting warming to around 1.5°C (2.7°F) requires global greenhouse gas emissions to peak before 2025 at the latest, and be reduced by 43% by 2030.”<sup>17</sup> For these reasons, many countries and companies have set major emission reduction goals for 2030.<sup>18</sup> If the current phase-in periods stay in place, investors will struggle to make timely decisions in light of such reduction goals.

Moreover, while the SEC presumably proposed phase-in periods to allow organizations to acquire the necessary resources to comply, the delays are needless as such disclosures are not new for the vast bulk of companies. As the SEC acknowledges, “[t]his proposal builds on the Commission’s previous rules and guidance on climate-related disclosures, which date back to the 1970s.”<sup>19</sup> Most importantly, the 2010 Guidance provided registrants with detailed information about climate-related disclosure and the potential impacts of climate change on a registrant’s business and finances. Due to previous rules and guidance, many businesses have taken steps to prepare for mandatory climate-related disclosures.<sup>20</sup> Therefore, the proposed phase-in periods not only undercut the

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<sup>16</sup> *The evidence is clear: the time for action is now. We can halve emissions by 2030.*, IPCC (April 4, 2022), available at <https://www.ipcc.ch/2022/04/04/ipcc-ar6-wgiii-pressrelease/>.

<sup>17</sup> *Id.*

<sup>18</sup> See *Halving Emissions by 2030 is New Normal - Race to Zero Anniversary*, United Nations Climate Press (June 15, 2021), available at <https://unfccc.int/news/halving-emissions-by-2030-is-new-normal-race-to-zero-anniversary>. See also Brad Plummer, Blacki Migliozi & Nadja Popovich, *How much are countries pledging to reduce emissions?*, The New York Times (Nov. 1, 2021), available at <https://www.nytimes.com/interactive/2021/11/01/climate/paris-pledges-tracker-cop-26.html>.

<sup>19</sup> 87 FR 21334, 13.

<sup>20</sup> See *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures*, SEC (March 21, 2022), available at <https://www.sec.gov/news/press-release/2022-46>, (“The proposed disclosures are similar to those that many companies already provide based on broadly accepted disclosure frameworks, such as the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol.”). See also *Report: Gap in Climate Disclosures Between Large, Small Cos Stark Gap in Climate Disclosures Exists Between Large & Small Public Companies*, The Conference Board (Jan. 20, 2022), available at <https://www.conference-board.org/press/climate-disclosures-gap>, (“More than half of S&P 500 companies disclose climate risks in annual reports; 71 percent disclose GHG emissions in their annual reports, sustainability reports, or company websites.”).

“decision-usefulness” of these disclosures by sidestepping the urgency of climate change, they are in fact unnecessary.

For the foregoing reasons, we recommend that the additional year to comply with Scope 3 disclosure requirements be eliminated, and that SRCs be bound to the same timeframe as accelerated and non-accelerated filers. These suggestions would result in all companies disclosing Scope 1-3 emissions by 2025: large accelerated filers would file in fiscal year 2023 (filed in 2024), and accelerated and non-accelerated filers/SRCs would file in 2024 (filed in 2025). While it is true that SRCs may have fewer resources to allocate to the new engineering, regulatory, and legal compliance requirements for these disclosures, the proposed timeframe for compliance still provides ample time for all filers to reach compliance, especially since the SEC has already provided significant guidance around climate disclosures.

### III. Eliminate the Potential for Greenwashing

Several features of the proposal could also lead to financial greenwashing by corporations. Specifically, the one percent quantitative materiality disclosure threshold and the impact of carbon offsets should be carefully considered.

As written, “[t]he financial impact metric disclosure requirements in proposed Rules 14-02(c), (d), and (i) would require a registrant to disclose the financial impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on the consolidated financial statements included in the relevant filing *unless the aggregated impact of the severe weather events, other natural conditions, transition activities, and identified climate-related risks is less than one percent of the total line item for the relevant fiscal year.*”<sup>21</sup>

Without further clarification by the SEC, the adoption of a percentage-based quantitative materiality threshold may undermine the ability of investors to obtain precise and accurate information necessary to inform climate-conscious investing decisions. While this threshold is suitable as a bright-line quantitative rule, the SEC should clarify that disclosure is still necessary for lesser impacts if they are material. Without such clarification, this threshold may create a loophole for large companies where 1% may represent a small part of the company’s financials, but nonetheless has an incredibly significant environmental impact. The 1% threshold could hinder appropriate disclosure of high impact environmental issues and should be clarified as second to the materiality requirement.

The SEC also asks whether “[f]or purposes of determining whether the disclosure threshold has been met, should impacts on a line item from climate-related events and transition activities be permitted to offset (netting of positive and negative impacts), instead of aggregating on an absolute value basis as

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<sup>21</sup> 87 FR 21334, 120-121.

proposed?”<sup>22</sup> Climate-related events, risks, and transition activities should generally be disclosed and calculated separately if investors are to understand both the impacts a business is experiencing, as well as the potential steps the company is taking to mitigate those impacts. Therefore, offsetting instead of aggregating is a disfavored solution. Allowing for offsetting has the potential to open the “greenwashing” floodgates as little regulation or enforcement exists as to what can or should qualify as an “offset.” This lack of regulation or uniformity can be both confusing for investors and provide unscrupulous actors with the opportunity to abuse the high demand and weak regulation of carbon offsets.<sup>23</sup> Until such regulation is in place, offsets should not be employed as part of the calculation.

Due to the preceding considerations, we recommend that the 1% threshold be clarified as second to the materiality requirement. We also caution against permitting companies to “offset” instead of aggregating due to the potential for greenwashing.

#### IV. Require Further Disclosure Regarding Transition Plans

In order to provide the clearest information possible to investors, we also suggest that all companies be required to disclose whether or not they have a transition plan. In addition to those companies who have transition plans being required to disclose the plan’s substance, those who do not have transition plans should be required to explain their decision to not have such a plan in place. This approach aligns more closely with other comparable jurisdictions, like the UK, which is considering an outright requirement for all public companies to have transition plans.<sup>24</sup> Such information is incredibly important for investors to accurately determine the future viability of the companies they invest in.

### Conclusion

We believe that the recommendations set forth in this comment letter represent the minimum required changes needed to ensure that the SEC’s proposed climate change rulemaking meets its stated goals. Simply put, without these changes, the proposed disclosures will be too little, too late.

Specifically, in order to effectively provide useful climate change disclosures that allow investors to appropriately allocate capital, the SEC’s rulemaking *must* include mandatory and enforceable Scope 3 emissions disclosures. Further, these

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<sup>22</sup> 87 FR 21334, 131.

<sup>23</sup> Michael Polonsky & Romana Garma, *Are carbon offsets potentially the new "greenwash?"*, Australian and New Zealand Marketing Academy Conference 2008, available at <https://dro.deakin.edu.au/eserv/DU:30018171/polonsky-arecarbonoffsets-2008.pdf>. (“[I]t would appear that the use of carbon offsets in marketing campaigns could be misunderstood by consumers...”).

<sup>24</sup> Under the proposed Treasury rules, financial institutions and companies listed on the London Stock Exchange must come up with transition plans. Robert Pummer & Beth Timmins, *COP26: UK firms forced to show how they will hit net zero*, BBC News (Nov. 3, 2021), available at <https://www.bbc.co.uk/news/business-59136214>.



requirements *must not* be rendered ineffectual by way of unworkable qualifiers, safe harbors, exemptions, protracted timelines, or accounting issues. We also suggest that companies be required to disclose whether they have a transition plan, what such a transition plan consists of, or, alternatively, why they have chosen not to implement a transition plan.

For the outlined reasons, we respectfully request that the SEC adopt the recommendations of this comment letter.

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Respectfully Submitted,

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