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Via electronic mail: rule-comments@sec.gov

Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: SEC File No. S7-10-22

Comments: Proposed Rule on Climate-Related Disclosures for Investors

Dear Office of the Secretary:

Reed Smith LLP appreciates the opportunity to provide the US Securities and Exchange Commission (the "Commission") with our views on certain limited aspects of the Commission's March 21, 2022 proposed rule regarding "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (the "Proposed Rule). We offer these comments as counsel to numerous Commission-regulated "registrants" as well as other business entities who: (a) rely on and/or provide public disclosures relating to material climate change risks; and/or (b) are not regulated by the Commission but are engaged in businesses that are impacted by greenhouse gas emissions ("GHG").

As an overview, we:

- agree with the Commission that climate change is one of the most important issues of our lifetimes;

- recognize that appropriate management of climate change risk requires uniform definitions and predictability so that such risk can be identified and measured as a step towards mitigation; and

- understand that environmental, social, and governance ("ESG") considerations and climate-related risks have become a top-priority for investors as well as registrants, and

- acknowledge that transparency for investors is a vital public policy goal.

For the above reasons, we applaud the Commission's efforts to address this topic so as to better assist investors in a manner that may ultimately reduce GHGs.

Nevertheless, one facet of the Proposed Rule presents "material challenges" as related to "Scope 3"[1] GHG emission disclosures that are so broad in scope and difficult to estimate that they detract from the Commission's ultimate goal of providing *reliable* quantitative as well as qualitative information to investors. The Commission already acknowledges that estimation of Scope 3 emissions "may pose difficulties compared to Scopes 1 and 2 emissions"[2] For that reason, we suggest registrants not be required to submit Scope 3 emissions data.

In this letter, we explain why registrants should not have to disclose Scope 3 emissions due to the inherent unreliability of such disclosures and the confusion around whether such emissions are material in the traditional sense of that word (*i.e.*, under the Commission's current regulations and February 8, 2010 Commission Guidance Regarding Disclosure Related to Climate Change).

1. **The Proposed Rule will not lead to reliable Scope 3 emission disclosures**

The Commission's goal to introduce certainty on a complicated topic that is prone to greenwashing[3] claims is laudable. However, when the information sought comes from companies not regulated by the Commission, it increases the likelihood that: a) the "non-public" company (many of which are more likely to be small and medium-sized enterprises) will not be in an economic position to provide "quality" information to the registrant at all, let alone cost effectively. While the Commission is focused on protecting investors, there should be some consideration given to the accuracy of the information considered by the investor, as well as the equities of what is in essence requiring a non-regulated party to comply with the obligations of a registrant.

We also appreciate the Commission's flexibility in providing certain exemptions to Scope 3 disclosures for Small Reporting Companies ("SRC"). However, whether the registrant is an SRC or not, the weak link in this chain is the small companies that: a) are not regulated by the Commission; and b) are challenged technically and economically in producing high quality, reliable data to registrants – which may still turn out *not* to be "material" in the registrant's ultimate reporting.[4]

Our clients' primary concern with requiring disclosure of Scope 3 emissions is that while some economically larger registrants may be able to reliably estimate their Scope 3 emissions on a quarterly basis, many non-registrant companies are not able to estimate their actual Scope 3 emissions with

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[1] By Scope 3 emissions, we refer to that portion of the Proposed Rule obligating certain registrants to identify, measure/estimate and report on indirect greenhouse gas emissions not covered under Scope 2. Proposed Rule at 39.

[2] Proposed Rule at 208.

[3] See Commissioner Allison Herren Lee's May 25, 2022 Statement, "It's Not Easy Being Green: Bringing Transparency and Accountability to Sustainable Investing (noting that "[g]reenwashing can mislead investors as to the true risks, rewards, and pricing of investment assets.")

[4] In this last point, we note that Scope 3 information may not be "material" to an investor's business decisions, but could still be required if the registrant chooses to set an emission reduction target for Scope 3 emissions – no matter how small they may be.

reasonable reliability or economic efficiency– so that the likely downside risks from providing investors with poor quality information outweighs the less likely chance of producing accurate and timely information upon which investors can make educated investment decisions.

Because Scope 3 emissions measure activities from assets not owned or controlled by the registrant, they can be subject to significant variation due to assumptions about any given registrant's value chain. Registrants will more likely than not need to rely more heavily on estimates for Scope 3 emissions rather than precise data, and such estimates will vary greatly, depending upon how each registrant is independently defining, among other things:

- what constitutes a reasonably related relationship to their supply chain;
- short, medium and long-term risk periods; and
- what each registrant considers to be acute and chronic risks.

Collectively, this multitude of variables will not result in data output that a typical investor can reasonably compare, defeating the purpose of this facet of the Proposed Rule.

Regarding estimates for GHGs and associated risks in the upstream value chains, the proposed rules specify that registrants can choose their own GHGs calculation approach and may use "reasonable estimates" as long as they disclose their assumptions.[5] That sounds reasonable when reviewed from a high elevation. However, the likely wide disparity in disclosed assumptions will still undermine an investor's ability to compare "apples to apples," or in this case, CO_2e to CO_2e[6] between various GHGs. Registrants also will need to determine how far across the value chain to report. These uncertainties could affect the quality of the reported information and the ability of investors to compare the information meaningfully across registrants and over time.

Further, commercially "upstream" vendors and suppliers who are not registrants frequently sell to multiple customers. If each of their registrant customers are using different GHG emissions calculation approaches and assumptions, this places an inordinate burden on the non-regulated supplier to "mix and match" their data and estimates using a plethora of assumptions so as to satisfy multiple registrants. This is both unfair to the upstream vendor / supplier and candidly, unrealistic to expect meaningful output from them – particularly if their downstream registrant customers are requiring updates from them on a quarterly basis to enable the registrants to meet their reporting obligations to the Commission and ultimately, the investor public.

Thus, requiring registrants to provide Scope 3 analyses on a quarterly basis in official filings may in fact inadvertently mislead and confuse investors due to the significant probability that the input information from non-registrants may be inaccurate or filled with estimates upon estimates based upon differing underlying assumptions, rendering the collective information unhelpful in making investment decisions. This Scope 3 information would actually distract investors, when compared with the registrant's Scope 1 and 2 data which can be more efficiently collected on a quarterly basis solely by each registrant and is comparable to other registrants on the "apples to apples" basis referenced above.

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5 See https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors#p-2353

6 "CO_2e" meaning, tons of carbon dioxide or its equivalent in terms of other regulated GHGs.

2. **The Proposed Rule introduces confusion around materiality as applied to Scope 3 emission disclosures.**

Under the Proposed Rule, registrants will have to disclose their Scope 3 emissions: a) if they are "material;" or b) if the registrant has set an emissions reduction target that includes Scope 3 emissions – unless they are SRCs.

The above Scope 3 reporting obligation creates several conflicts which detract from the Commission's core goal of providing investors with reliable information when investing.

First, as drafted in the Proposed Rule, the materiality limitation for Scope 3 emissions is confusing. Traditionally, the Commission has relied upon a concept of materiality that is either more clearly focused on the registrant itself or at least information that the registrant can estimate (itself) without relying upon (if not imposing upon) third parties. We see this "materiality" concept play out in multiple well-trod examples:

- Regulation S-K:
  - Item 101 (Description of Business);
  - Item 103 (Description of Legal Proceedings);
  - Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations); and
- Regulation S-X (Regulating Annual Reports and Financial Statements).

The common thread with all of the above is the registrant, the party over whom the Commission has authority to regulate, can meet these obligations with information it already possesses.

Conversely, Scope 3 emissions under the Proposed Rule will require the registrant to engage in significantly more effort to force non-registrants to produce relevant information. This is not only burdensome, but it creates a concerning precedent; if the Commission is empowering itself to seek such "indirect information" on climate change issues, what other types of ESG-related issues and information will the Commission seek in the future?

Second, as written, the Commission desires that a registrant report on Scope 3 emissions if they are the subject of future emissions reductions targets – even if those emissions are <u>not</u> otherwise material. As written, a typical investor will not be able to perceive whether information being reported is actually material to the business (in the more traditional sense of "materiality," referenced above), or if it is not material but simply the topic of a well-intentioned sustainability program to advance an ESG initiative.

Finally, the Commission discusses and ultimately rejects a quantitative metric (*e.g.*, 40% of a company's total GHG emissions) at which Scope 3 emissions might be material because it believes "a quantitative analysis alone would not suffice for purposes of determining whether Scope 3 emissions are material."[7] We agree with the Commission's decision not to impose a quantitative threshold for determining materiality. However, to the extent an individual registrant deems it material to their own business operations and sufficient information exists, then we believe the registrant would have ample opportunities to assess and share this information through the traditional reporting methods (Regulation S-K and S-X) cited above, as further guided by the Commission's 2010 Climate Change Guidance referenced above.

3. **"Chilling" effect by requiring Scope 3 disclosure for registrants whose GHG emission reduction target includes Scope 3 emissions**

To the extent a registrant attempts to proactively set Scope 3 mitigation goals for the future, the Proposed Rules require that registrant report additional information about the activities and emissions the registrant includes in setting the target, the relevant time periods for achieving those goals, and annual data about the registrant's progress toward the targets it has set.[8] While a registrant that publicly sets Scope 3 goals impliedly will be monitoring its progress so that it can determine whether its goals are met, the Commission's added reporting obligations are more likely than not going to dissuade registrants from making proactive public statements about such goals. That outcome goes against a secondary but related public policy goal of encouraging registrants to reduce GHGs. On balance, it would be better to encourage registrants to work voluntarily with their upstream suppliers and vendors (many of whom may not be registrants themselves) to reduce Scope 3 emissions, than to "penalize the proactive" with additional regulatory reporting obligations for a subject that is difficult to meaningfully estimate with a high degree of certainty.

4. **Disclosure of Scope 3 involves relying on third party data to make significant previously unrequired disclosure which presents an unacceptable risk to registrants**

Verifying third party GHG emissions and related risk issues information with a sufficient degree of certainty to provide meaningful information to investors will be more difficult and costly than verifying the information about GHG emissions produced by the registrant itself or its direct energy suppliers (*i.e.*, Scope 1 and Scope 2 emissions). Registrants also will vary in their ability to influence their suppliers and other third parties to reduce Scope 3 emissions to meet emissions targets or goal.

Even if a registrant's suppliers disclose their emissions information, a registrant may not be confident in the accuracy of such information to include it in its SEC filings due to the inherent difficulty in calculating the information. The Commission itself admits that it "may be difficult to obtain activity data from suppliers and other third parties in a registrant's value chain, or to verify the accuracy of that information. It may also be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data."[9] We agree, and go so far as to submit that the Commission's comment is likely an understatement - and for that very reason, recommend such information should not be relied upon by investors.

[7] Proposed Rule at 165-66.
[8] *Id.* at 268.
[9] *Id.* at 208.

5. Business disruption effect of requiring Scope 3 reporting

Requiring Scope 3 emissions reporting from registrants will almost certainly induce a “reshuffling” of supply-chain relationships. Registrants looking to shrink their Scope 3 emissions will want to source their inputs from less carbon-intensive suppliers. Less carbon-intensive inputs will, therefore, be preferentially allocated to firms with Scope 3 disclosure requirements. Highly carbon-intensive inputs may then be reallocated or “shuffled” to firms that are not subject to Scope 3 reporting obligations.

The above outcome will lead to business disruption, a temporary “supply shortage” of vendors and suppliers that are able to comply with these demands, resulting in increased costs to consumers – many of whom are also the Commission’s “investors.” While the Commission wants to arm investors with more accurate data, it likely also does not want to concurrently “disarm” investors with spurring inflation further (resulting in less disposable income to invest).

Counting reductions in disclosed Scope 3 emissions could also result in “leakage,” which negates the value of the Commission’s goal in counting such emissions. By leakage, we mean that registrants may have an increased preference for entering into contracts with private companies that are not subject to GHG reporting at all.

6. GHG Intensity re Scope 3

The Commission’s Proposed Rule also requires registrants to report on their “Scope 3 GHG intensity,” which means emissions per unit of economic value (such as total revenue) or per unit of commodity produced. The stated reason for this is that such a requirement for Scope 3 will facilitate the comparability of the disclosure across the sector, to provide investors with standardized method for presenting such measure of efficiency across registrants, which should facilitate comparability of the registrant’s emissions efficiency over time.

With regard to Scope 3 emissions, this is problematic because registrants do not control how the raw materials they produce are transformed into other products or consumed; registrants vary in their ability to influence their suppliers and other third parties to reduce Scope 3 emissions to meet emissions targets or goals. Bigger registrants tend to have more influence over suppliers. This would skew the GHG intensity determinations for Scope 3 towards bigger companies. Therefore, basing an investor’s determination of a registrant’s efficiency on GHG intensity regarding Scope 3 is an inherently misleading analysis and in fact skews determinations or perceptions of efficiency toward larger registrants that have the ability to influence their suppliers. Such a calculation would in fact <u>mislead</u> investors.

7. Conclusion

Ensuring investors have access to “material” information about their investment options is already the law and has never been at issue. However, the concept of conveying material information implies accurate information as well as information reasonably related to the registrant’s core business. The Proposed Rule’s current Scope 3 disclosure requirements are laudable in their aspirational goals, but fall short in reasonably producing consistently accurate information upon which investors can rely. Further, by requiring registrants to trace their entire supply chain brings into question at what point are the upstream GHG emissions outside of the registrant's core business.

For the reasons set forth in the body of this letter, we respectfully recommend that the Commission not require registrants to disclose Scope 3 emissions at this time. However, we believe companies should still seek to undertake the process of assessing their indirect emissions as this may be helpful for evaluating its climate risk exposure, but not as a requirement under this Proposed Rule.

Again, thank you for the opportunity to provide feedback on the Proposed Rule. We welcome any follow up questions or communications regarding our thoughts on these issues.

Very truly yours,

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