SEC'S PROPOSED CLIMATE-RELATED DISCLOSURE RULE: COMMENT ANALYSIS AND RECOMMENDATION FOR SCOPE 3 EMISSIONS

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INTRODUCTION

The Securities and Exchange Commission ("SEC") has been more active than ever under new Chair Gary Gensler, issuing over twenty-six proposed rules in about nine months.[1] This recent shift in increased rulemaking activity has been met with mixed responses. Some critics call his aggressive rulemaking an assault on U.S. capital markets, while other stakeholders generally support his fast-paced, yet ambitious rulemaking.[2]

This paper focuses on one of the most controversial rules recently proposed by the SEC: *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (hereinafter "Proposed Rule")—a proposed set of rules designed to protect investors by requiring public companies to disclose their material climate-related risks. Stakeholders submitted over 16,000 comment letters urging the SEC to either keep the rule as is, strengthen the rule, or completely get rid of it.[3] Within the Proposed Rule, this paper will focus on the highly debated disclosure requirement for Scope 3 emissions data, which includes emissions that occur in a company's supply chain.

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[1] Thom Tillis et al., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (Nov. 4, 2022), https://www.sec.gov/comments/s7-18-21/s71821-20150214-319440.pdf [https://perma.cc/3S2X-AYEA].

[2] Hal Scott & John Gulliver, *Gary Gensler's Assault on U.S. Capital Markets*, WALL ST. J. (July 17, 2022), https://www.wsj.com/articles/gary-genslers-assault-on-u-s-capital-markets-partisan-activist-sec-shareholders-investors-funds-executive-office-11658077526 [https://perma.cc/2H7Z-DWRA]; Soyoung Ho, *Updated SEC Agenda Continues to Show Ambitious Rulemaking Efforts, Including Climate Disclosure*, THOMPSON REUTERS (July 1, 2022), https://tax.thomsonreuters.com/news/updated-sec-agenda-continues-to-show-ambitious-rulemaking-efforts-including-climate-disclosure/ [https://perma.cc/3X75-M5R6].

[3] To provide context for this large number of comment letters, other proposed rules submitted around the same time received comment letters in the low hundreds. *See Comments on Special Purpose Acquisition Companies, Shell Companies, and Projections*, SEC (Mar. 28, 2023), https://www.sec.gov/comments/s7-13-22/s71322.htm [https://perma.cc/W4UE-9TPY] & https://www.sec.gov/comments/s7-09-22/s70922.htm [https://perma.cc/7MRE-C8TG]; *Comments on Notice of Shortening the Securities Transaction Settlement Cycle*, SEC (Mar. 15, 2023), https://www.sec.gov/comments/s7-05-22/s70522.htm [https://perma.cc/2GBJ-WUKE].

I. THE PROPOSED RULE

The Proposed Rule is composed of several changes that will revolutionize reporting and disclosure requirements for registrants. These changes are briefly explained in the SEC's Press release:

> The Securities and Exchange Commission today proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. The required information about climate-related risks also would include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks.[4]

While the rule provides many new disclosure requirements, including the impact of climate-related events, risk posed on the business resulting from a transition to a lower carbon economy, and governance disclosures regarding the board's oversight on climate-related risks, this paper will focus on the new disclosure rule for greenhouse gas ("GHG") emissions—specifically Scope 3 emissions.[5]

A. The SEC's Rulemaking Authority and Motivation for the Proposed Rule

The SEC explicitly stated that its motivation for proposing this rule is to design an effective and efficient disclosure regime for climate-related risks given investor demand.[6] The SEC also made clear that it "carefully considered how to craft this proposal to best advance investor protection and the public interest, consistent with the Commission's disclosure authority and regulatory mission."[7]

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[4] *See* Press Release, Sec. and Exch. Comm'n, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 21, 2022), https://www.sec.gov/news/press-release/2022-46 [https://perma.cc/FN7R-3DGD].

[5] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334, 21345, 21366 (proposed Apr. 11, 2022) [hereinafter, Proposed Rule].

[6] *Id.* at 21337.

[7] *Id.*

This is especially important because the SEC only has authority under the Securities Act of 1933 and the Securities Exchange Act of 1934 to create rules and regulations that are necessary or appropriate for public interest or the protection of investors.[8] In line with this authority from Congress, Gensler stated that this rule would "provide investors with consistent, comparable, and decision-useful information for making their investment decisions, and it would provide consistent and clear reporting obligations for issuers."[9]

Chair Gensler explained that, in the past, the SEC routinely created rules to improve disclosure requirements to meet the needs of investors, and the Proposed Rule is no different.[10] He clarified that, more generally, investors decide what risk they wish to take when investing; disclosure of certain information can inform investors to companies' risk levels. With this in mind, he went on to describe that since disclosure requirements were first introduced in the 1930s, the SEC tailored these requirements to investor demand.[11] This originally began with disclosure requirements of basic financial performance.[12] Disclosures later evolved to encompass information regarding who runs the company and executive pay, all of which was prompted by investor demand.[13] Now, Gensler is stating that investors representing trillions of dollars want consistent and comparable data on climate risk, to help them decide where to place their money.[14]

The Proposed Rule provides extensive support for the SEC's claim that investors demand disclosures of companies' climate risk.[15] For instance, the SEC stated that in 2019, 630 investors managing more than $37 trillion "signed the Global Investor Statement to Governments on Climate Change urging governments to require climate-related financial reporting."[16] Additionally, a similar statement was signed in 2021 by 733 global institutional investors managing over $52 trillion.[17] Further, in 2021, 4,000 investors with over $120

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[8] Scott Hirst, *Saving Climate Disclosure*, 28 STAN. J.L. BUS. & FIN. 91, 102 (2023).

[9] Press Release, Sec. and Exch. Comm'n, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 21, 2022), https://www.sec.gov/news/press-release/2022-46 [https://perma.cc/YV2R-G6LM].

[10] SEC, *The SEC & Climate Risk Disclosure | Office Hours with Gary Gensler*, YOUTUBE (July 28, 2021), https://www.youtube.com/watch?v=xjSk7wWJG6o [https://perma.cc/3Q6N-MEZS].

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *See* Proposed Rule, *supra* note 5, at 21340.

[16] *Id.*

[17] *Id.*

trillion in assets under management signed the UN Principles for Responsible Investment.[18] The Proposed Rule goes on to cite additional initiatives signed by hundreds of investors, which make up trillions of dollars. These investors are demanding transparent climate-related reporting.[19]

Despite the SEC explicitly stating its reason for proposing this rule and providing statistics to support its claim, stakeholders and media sources are skeptical. Some stakeholders argue that Gensler's goal in proposing this rule is to further Joe Biden's "war on fossil fuels" and the Proposed Rule is a "back-door means to push a climate change agenda."[20] Others think that during his time as the SEC's Chair, Gensler is trying to send a message in his Rulemaking because of the aggressive number of rules being proposed and the subject matter that the SEC is trying to regulate.[21]

However, these viewpoints fail to understand that the Proposed Rule is not oriented toward lessening the use of fossil fuels or pushing a climate change agenda. Gensler stated, "The SEC has no role as to climate risk itself. But we do have an important role with regard to ensuring for public companies' full, fair, and truthful disclosure about material risks."[22] He also recognized that many companies already disclose this information, and he is "simply trying to build order out of chaos."[23] This paper agrees with Chair Gensler and rejects the arguments that the SEC is attempting to address climate change. First, this Proposed Rule is simply a *disclosure* requirement. The SEC is not specifically targeting the oil and gas industry. Rather, companies in this industry will be treated even handedly with other sectors. The SEC also does not require investors to sell shares of companies with high emissions. Rather, it is equipping investors with more information to base their investments decisions off of. It is possible that the oil and gas industry

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[18] *Id.*

[19] *See id.*

[20] The Editorial Board, *Gary Gensler Stages a Climate Coup*, WALL ST. J. (Mar. 21, 2022), https://www.wsj.com/articles/gary-gensler-stages-a-climate-coup-securities-and-exchange-commission-blackrock-11647899043 [https://perma.cc/MZ2U-TFLQ]; Bob Pisani, *SEC's Gensler in Congressional Hot Seat Today Over Climate Change and Crypto*, CNBC (Apr. 18, 2023), https://www.cnbc.com/2023/04/18/secs-gensler-set-for-congressional-grilling-on-climate-change-crypto.html [https://perma.cc/8DR9-7C9X].

[21] Tillis, *supra* note 1.

[22] Bob Pisani, *SEC's Gensler in Congressional Hot Seat Today Over Climate Change and Crypto*, CNBC (Apr. 18, 2023), https://www.cnbc.com/2023/04/18/secs-gensler-set-for-congressional-grilling-on-climate-change-crypto.html [https://perma.cc/9Q5X-KPHS].

[23] *Id.*

will receive more investor demand after this rule is implemented. After all, investors ultimately choose securities that they believe will be profitable.

Even though the SEC has a clear motivation for proposing this rule, and the SEC believes it is acting under its authority granted by Congress, the SEC will face an uphill battle given the Supreme Court's recent decision in *West Virginia v. EPA*. In *West Virginia*, the Court questioned the EPA's rulemaking authority, striking down the agency's regulation of coal-based generation.[24] In doing so, the Court applied the major questions doctrine, which states that an agency must point to "clear congressional authority" when it claims power to make decisions of vast political and economic significance.[25] Here, the Court noted that "it is not plausible that Congress gave EPA the authority to adopt on its own such a regulatory scheme in Section 111(d). A decision of such magnitude and consequence rests with Congress itself, or an agency acting pursuant to a clear delegation from that representative body."[26]

This case is significant because the Court departed from traditional *Chevron* deference. *Chevron* deference states that "a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency" when reviewing implicit legislative delegation.[27] The SEC's Proposed Rule will inevitably be challenged in court similarly to the EPA's rule in *West Virginia* because of the Court's willingness to stray from traditional *Chevron* deference, question agencies' rulemaking authority, and strike down rules that are not clearly authorized by Congress .

B. Scope 1, 2, and 3 Emissions: Definition and Reporting Requirements

The SEC adopts similar definitions for Scope 1, 2, and 3 emissions as the GHG Protocol—a partnership between the World Business Council for Sustainable Development and the World Resources Institute to "create a standardized GHG accounting methodology."[28] The GHG Protocol created a standardized accounting methodology as a way to measure and manage climate-warming emissions.[29] The SEC adopted a similar methodology not to manage climate-warming emissions, but rather as a way to provide investors with

[24] *See* West Virginia v. EPA, 142 S. Ct. 2587 (2022).

[25] *See id.* at 2613.

[26] *Id.* at 2616.

[27] Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 843–44 (1984).

[28] Proposed Rule, *supra* note 5, at 21344, 21374.

[29] *About Us*, GREENHOUSE GAS PROTOCOL, https://ghgprotocol.org/about-us.

consistent, reliable, and comparable information.[30] Scope 1 emissions are defined as direct GHG emissions "from operations that are owned or controlled by a registrant."[31] Scope 2 emissions are defined as "indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a registrant."[32] Scope 3 emissions are defined 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 products, transportation of products (for example, to the registrant's customers), end of life treatment of sold products, and investments made by the registrant.[33]

Moreover, Scope 3 emissions are made up of fifteen non-exhaustive categories, which include:

1. A registrant's purchased goods and services;
2. A registrant's capital goods;
3. A registrant's fuel and energy related activities not included in Scope 1 or Scope 2 emissions;
4. Transportation and distribution of purchased goods, raw materials, and other inputs;
5. Waste generated in a registrant's operations;
6. Business travel by a registrant's employees;
7. Employee commuting by a registrant's employees;

[30] Proposed Rule, *supra* note 5, at 21428.
[31] *Id.* at 21374.
[32] *Id.*
[33] *Id.*

8. A registrant's leased assets related principally to purchased or acquired goods or services.

9. Transportation and distribution of a registrant's sold products, goods or other outputs;

10. Processing by a third party of a registrant's sold products;

11. Use by a third party of a registrant's sold products;

12. End-of-life treatment by a third party of a registrant's sold products;

13. A registrant's leased assets related principally to the sale or disposition of goods or services;

14. A registrant's franchises;

15. Investments by a registrant.[34]

Under the Proposed Rule, registrants are required to disclose Scope 1 and Scope 2 emissions. Additionally, there are two ways for a registrant to trigger Scope 3 reporting. Registrants will be required to disclose Scope 3 emissions "if material or if the registrant has a target or goal related to Scope 3."[35]

The first prong of satisfying this disclosure requirement hinges on whether Scope 3 emissions are material. Importantly, materiality has a specific meaning within securities law. The court in *TSC Industries* determined that information is material if there is a "substantial likelihood that the disclosure…would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[36] While *TSC Industries* applied only to whether a fact is material in reference to section 14 of the Securities Exchange Act of 1934, a later Court decision applied the *TSC Industries* materiality standard to all statutory provisions in securities law, including this Proposed Rule.[37] Commenters who oppose Scope 3 emissions disclosure argue against using this standard because it requires companies to make the difficult determination of whether a reasonable investor would view the company's Scope 3 emissions as significantly altering the total mix of information. This will be discussed in further detail below.

[34] *Id.* at 21380.
[35] *Id.* at 21435.
[36] TSC Industries, Inc. v. Northway, 426 U.S. 438, 449 (1976).
[37] *See* Basic v. Levinson, 485 U.S. 224, 231–32 (1988).

It is easier for registrants to determine if the second prong, whether the registrant has a goal related to Scope 3 emissions, is satisfied. Essentially, a registrant will have to disclose its Scope 3 emissions data if it has a goal or target relating to Scope 3 emissions. While this is an easier inquiry than the first prong, most comment letters believe that this second prong is imprudent.[38] The individuals and entities behind these comment letters believe that making disclosure contingent on goals or targets will have a chilling effect and disincentivize companies from setting goals. It will have a chilling effect because setting goals will expose them to greater disclosure requirements and potentially greater liability. Given the potential for this unintended consequence, and the consensus among stakeholders, the analysis and recommendation will be directed to the materiality prong.

C. The Comment Period and Agency Rulemaking Background

Under section 553 of the Administrative Procedure Act ("APA"), agencies are required to give notice of proposed rulemaking in the Federal Register.[39] In this notice, the agency must include (1) the time, place, and nature of the proceedings; (2) the legal authority that the agency has for proposing the rule; and (3) the substance of the proposed rule.[40] After giving notice, agencies shall give interested parties an opportunity to comment on the proposed rule through "submission of written data, views, or arguments with or without opportunity for oral presentation."[41] When an agency releases its final rule, it shall respond to these comments and explain the changes it made.[42] Following the notice and comment period, agencies must have an effective date for their rule that is at least 30 days after the publication of the final rule.[43]

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[38] *See* Amazon, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132266-302794.pdf [https://perma.cc/SH24-ST4H]; *see also* California State Teachers' Retirement System, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132337-302902.pdf [https://perma.cc/63N7-Z5UH].

[39] *See* 5 U.S.C. § 553(a).

[40] *Id.*

[41] 5 U.S.C. § 553(c).

[42] *Id.*

[43] 5 U.S.C. § 553(d).

As with all agency rulemaking, the SEC welcomed and encouraged parties to submit comments on the Proposed Rule.[44] Originally, this period began when the Proposed Rule was submitted on March 21, 2022, and ended on May 20, 2022. However, given the complex nature of this 490 page proposed rule,[45] the SEC extended the deadline for comments until June 17, 2022.[46] The SEC did this partly because of numerous complaints from stakeholders that two months was insufficient for meaningful contributions to the agency's rulemaking process.[47] In making this decision, SEC Chair Gensler reasoned that the SEC benefits greatly from public comments on proposed regulatory changes. Additionally, given the significant interest from various stakeholders, the SEC will provide additional time for thoughtful feedback from diverse perspectives.[48] This comment period was further extended because of a technological error.[49] For several months, the Commission did not receive comments submitted directly through the SEC's internet comment form.[50] As a result, on October 7, 2022, the SEC reopened the comment period until November 1, 2022 for several proposed rules, including *The Enhancement and Standardization of Climate-Related Disclosures for Investors*.[51]

During this comment period, the SEC received 4,419 individualized comments and 11,595 form letters.[52] These individualized comments take many different forms, from extremely detailed expert arguments and substantial legal arguments to misconceptions like the following:

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[44] *See* Proposed Rule, *supra* note 5.

[45] The Enhancement and Standardization of Climate-Related Disclosures for Investors, Release Nos. 33-11042; 34-94478; File No. S7-10-22 (proposed Mar. 21, 2021).

[46] The Enhancement and Standardization of Climate-Related Disclosures for Investors, Release Nos. 33-11061; 34-94867; File No. S7-10-22, 1 (May 9, 2022).

[47] *See id.*

[48] *See* Press Release, Sec. and Exch. Comm'n, SEC Extends Comment Period for Proposed Rules on Climate-Related Disclosures, Reopens Comment Periods for Proposed Rules Regarding Private Fund Advisers and Regulation ATS (May 9, 2022), https://www.sec.gov/news/press-release/2022-82 [https://perma.cc/JX73-5VE4].

[49] Resubmission of Comments and Reopening of Comment Periods for Several Rulemaking Releases Due to a Technological Error in Receiving Certain Comments, 87 Fed. Reg. 63016, 63016 (Oct. 18, 2022).

[50] *Id.*

[51] *See id.*

[52] *Comments for The Enhancement and Standardization of Climate-Related Disclosures for Investors*, SEC. AND EXCH. COMM'N, https://www.sec.gov/comments/s7-10-22/s71022.htm [https://perma.cc/CH8V-DQDK].

> Upon hearing about S7-10-22, I would like you to know I and many others stand against the proposed rule for the Enhancement and Standardization of Climate-Related Disclosures for Investors. Please, do not move this forward, which will hurt small Mom and Pop businesses, and will most likely do nothing for the climate and environment.[53]

Comments like the one above will not influence the SEC's final rule. This is because (1) small Mom and Pop businesses are non-exchange act reporting and therefore not subject to the proposed disclosure requirement, (2) the SEC's goal is not centered around the climate and environment, and (3) the comment fails to provide any evidence for its claims. However, one thing this comment *does* do is signal to the SEC what the general public may think of the rule. In reading comments like this, the SEC may consider strengthening its messaging around the proposal to better inform the general public. For instance, the SEC may consider providing key information in a more suitable manner for people to digest. Media such as an infographic or short video can dispel misconceptions, create more informed general investors, and foster more support for the proposal.

Similarly, in a paper exploring whether administrative rulemakings are democratic, legal scholars Edward H. Stiglitz and John M. de Figueiredo addressed the role of comments like the one above and offered an alternative for these individuals to take in lieu of submitting comment letters.[54] They highlighted the fact that Congress—comprised of elected officials—produced only 72 public laws in 2013 whereas administrative agencies with no elected officials finalized over 2,800 rules.[55] While the comment period used by agencies apparently allows democratic input from everyone, studies find that meaningful comments come almost exclusively from a small subset of interest groups.[56] The majority of individuals submitting comments were "tremendously unsophisticated," and most comments failed to recognize the difference between regulations and statutes.[57] As a result, even the most engaged citizens that submitted comment letters arguably

[53] Brandon Maddox, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (Apr. 22, 2022), https://www.sec.gov/comments/s7-10-22/s71022-286510.htm. [https://perma.cc/Q9T6-QSTT].

[54] John M. de Figueiredo & Edward H. Stiglitz, *Democratic Rulemaking* 18 (Nat'l Bureau of Econ. Rsch., Working Paper No. w21765, 2015).

[55] *Id.* at 18.

[56] *Id.*

[57] *Id.*

have little influence over regulations due to a lack of knowledge of the rulemaking process.[58] This is not surprising considering the high-level knowledge needed to understand the rulemaking process. Additionally, the rules are typically hundreds of pages of complex subject matter.

Given these setbacks to individuals' impact on agency rulemaking, citizens can direct general complaints about rules to members of Congress instead of submitting comments on proposed rules. Members of Congress are directly elected by individual citizens and have more influence over independent agencies for several reasons. First, they likely have a strong understanding of the rule and can therefore advocate for the best interests of citizens in their district. Second, the SEC derives its rulemaking authority from statutes enacted by Congress. Members of Congress can then analyze whether agencies have overstepped their delegated rulemaking authority and pass new federal statutes to better address their constituency's concerns. Rather than having their comments disregarded by agencies like the SEC, these citizens have an alternative route to have their voices meaningfully heard.

This paper will focus on individualized, fully developed comments from key stakeholders supporting or opposing the Proposed Rule. Developed, thoughtful comments will be the focus of this analysis because the SEC will likely address them in the final rule, as agencies are required to respond to all material comments.[59] Furthermore, well-documented comments also successfully preserve issues for future litigation against the SEC. The SEC will watch these comments closely, as the Commission wants to avoid litigation and does not want the rule to be struck down as invalid.[60] On the other hand, agencies may ignore insubstantial comments because some commenters have not successfully exhausted their administrative remedies and, therefore, have not preserved their claims.[61] This principle was demonstrated in *Portland Cement Association v. Ruckelshaus*, where the court said "challenges to [the rule] must be limited to points made by petitioners in agency proceedings. To entertain comments made for the first time before this court would be destructive of a meaningful administrative process."[62]

Commentary on administrative law and the rulemaking process has argued that the "squeaky wheel gets the grease" during agency rulemaking, which has led commenters on proposed rules to overwhelm the agency with "more information

[58] *See id.*

[59] Wendy E. Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321, 1371 (2010).

[60] *Id.* at 1364–65.

[61] *Id.* at 1364.

[62] Portland Cement Ass'n v. Ruckelshaus, 486 F.2d 375, 394 (D.C. Cir. 1973).

than it can absorb."[63] Additionally, without regulation on what information may be filed, commenters can strategically include only those facts most beneficial to their arguments.[64] Unlike legal disputes between two parties, commenters have no duty to present unfavorable facts or distinguish counterpoints. This flaw is particularly important to consider while analyzing comments from stakeholders with varying interests, which is why this paper will synthesize arguments from both sides and recommend how the SEC should proceed in its final rule.

II. ANALYSIS OF COMMENTS

A. Analysis of Comments in Favor of Scope 3 Emissions Disclosure

To begin, it is not surprising that many comments in support of Scope 3 emissions disclosure requirements come from nonprofits, environmental organizations, and environmental investment funds rather than companies subject to the disclosure requirements.

i. Disclosure of Scope 3 Emissions Is Essential to Understanding the Full Picture of a Company's Emissions Data

Many comments in support of Scope 3 emissions disclosure argue that it is essential to understand a company's total climate risk. Investment advisors of the environmentally-focused mutual fund Green Century argued this in their comment letter, which stated that investors need the full picture of a company's climate risk to make informed investment decisions.[65] In support, Green Century stated that Scope 3 emissions can make up 90% or more of a company's total emissions.[66] With only Scope 1 and Scope 2 emissions data, investors are left without insights into a significant portion of a company's climate risk because it resides in the company's supply chain. With only Scope 1 and Scope 2 emissions disclosure,

[63] Wagner, *supra* note 59 at 1398–1400. (citing Rosemary O'Leary, The Impact of Federal Court Decisions on the Policies and Administration of the U.S. Environmental Protection Agency, 41 ADMIN. L. REV. 549, 566 (1989)).

[64] *Id.* at 1364, 1399–1400.

[65] Green Century, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132101-302584.pdf [https://perma.cc/VW3J-C6VH].

[66] *Id.*

money managers like Green Century are therefore unable to accurately predict where climate risk resides in their portfolio.[67]

This concern is also recognized by other organizations, including Americans for Financial Reform Education Fund, Public Citizen, Sierra Club, The Sunrise Project, and Ocean Conservancy.[68] These organizations submitted a detailed comment letter in support of mandatory Scope 3 emissions disclosure, which stated that "Scope 3 emissions dwarf Scope 1 and Scope 2 in many industries, including outside of fossil-fuel-heavy sectors. With more than 80% of companies not yet reporting Scope 3, it's no wonder the market cannot assess — or price — risks associated with the low-carbon transition."[69] This data aligns with the statistics the SEC provided in its Proposed Rule, which stated that in some cases, Scope 3 emissions can be as high as 85% –95% of a company's carbon footprint.[70]

A comment by Oxfam America, an organization that acts as an advisor for ESG investing strategies, noted in its comment that the Task Force on Climate-Related Financial Disclosures ("TCFD") similarly views Scope 3 disclosure as an "essential component" to a company's climate risk analysis.[71] Notably, the SEC modeled part of the Proposed Rule after the TCFD's framework.[72] Oxfam America also mentions that the Financial Stability Oversight Council ("FSOC"), a federal organization that helps identify threats to U.S. financial stability, thinks Scope 3 disclosure is essential because it "provides a more complete picture" of a company's transition risks.[73] In 2021, FSOC concluded that climate risks can increase company costs and impact a company's value chain, and therefore, companies should track all emissions to stay ahead of these issues.[74] While it is understandable that without Scope 3 emissions disclosure, investors may not

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[67] *Id.*

[68] Ams. for Fin. Reform Educ. Fund et al., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131579-301946.pdf [https://perma.cc/HY6R-].

[69] *Id.* at 105. (citing Erika Murphy, *Has Climate Transition Risk Been Priced Into Equities?*, WELLINGTON MGMT. (2021) (https://www.wellington.com/en-gb/intermediary/insights/green-equities-climate-change-stocks-funds).

[70] Proposed Rule, *supra* note 5, at 21435.

[71] Oxfam Am., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20133143-303346.pdf [https://perma.cc/7UYU-Y87Z].

[72] *See* Proposed Rule, *supra* note 5, at 21343.

[73] Oxfam Am., *supra* note 71.

[74] *Id.*

understand the total climate risk of each company, it is unclear whether a company's total climate risk is something investors should care about given the fact these emissions are outside the registrant's control. However, while these emissions are not *directly* controlled by the registrant, the registrant still makes important decisions over business relationships to form its supply chain.

ii. Current Voluntary Scope 3 Reporting Is Misleading and Incomplete

Several comment letters acknowledge flaws in only having voluntary disclosures of Scope 3 emissions. For instance, Public Citizen and other nonprofit organizations found that:

> Partial reporting of Scope 3 emissions, which we are seeing today, can also be misleading to investors. Without rules requiring reporting on all 15 Scope 3 categories, investors may assume that a company reporting its Scope 3 emissions is reporting in full, while in reality, it is reporting only a fraction of such emissions.[75]

Without regulations, companies are free to choose how to report their emissions as they like if the reports do not violate other securities laws.

Americans for Financial Reform Education Fund and other commenters argue that these voluntary disclosures are a form of greenwashing that can mislead investors.[76] Greenwashing is when a company presents deceiving statements about the company's climate-related activities through half-truths that make the company appear environmentally responsible.[77] This practice conceals a company's actual climate-related risk and inevitably misleads investors. While greenwashing statements are incomplete and misleading as to a company's actual climate risk, legal action will likely fail because courts may view greenwashing statements as puffery, a statement that reasonable investors would not rely on when making investment decisions.[78]

Friends of the Earth's comment letter cited a study by research and consulting firm Ernst & Young ("EY").[79] EY's study analyzed over 970 companies

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[75] Ams. for Fin. Reform Educ. Fund et al., *supra* note 68.

[76] *See id.*

[77] *See id.*

[78] *See* Longman v. Food Lion, Inc., 197 F.3d 675, 685 (4th Cir. 1999).

[79] Friends of the Earth, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132243-302684.pdf.

in 34 countries. Each company evaluated was given a score on its climate-related (1) coverage and (2) quality.[80] To determine these scores, EY looked to each company's climate-related information and assessed how much it adhered to TCFD recommendations.[81] This study found that 54% of companies voluntarily disclosed some climate-related risks, but the overall quality of the disclosure was around 27%.[82] This survey is particularly insightful because the Proposed Rule was modeled after several TCFD recommendations.[83]

While the overall data showed only a 27% quality rating, Friends of the Earth failed to look deeper into the study, which stated that "[c]ompanies based in the US presented the highest score on quality of disclosures with an average of 63% (vs. 27% on average) and showed the biggest year-on-year improvement with an increase of over 21 points compared with 2018."[84] It is interesting that Friends of the Earth chose to cite the global statistic when less than 10% of companies registered with the SEC are non-US companies;[85] however, that may be a feature, rather than a bug, of this comment letter, given the flaws in rulemaking as discussed earlier.

Despite this data, comments recognize gaps and inconsistencies in voluntary disclosures that need to be addressed. The SEC further addresses these concerns, stating that while climate-related disclosures generally increased, there is substantial variation in the detail, content, and location of the disclosures.[86] Public Citizen and others note the lack of comparable data and frameworks across voluntary disclosures.[87] These organizations found that company data is spread over survey responses, websites, and databases—each with varying assurances of accuracy.[88] This leaves investors to scavenge across various sources, only to be left guessing as to whether information is accurate.

[https://perma.cc/39J6-KZPC].

[80] Mathew Nelson, *How Can Climate Change Disclosures Protect Reputation and Value?*, EY (Apr. 27, 2020), https://www.ey.com/en_us/climate-change-sustainability-services/how-can-climate-change-disclosures-protect-reputation-and-value#methodology [https://perma.cc/2MXA-74KB].

[81] *Id.*

[82] Friends of the Earth, *supra* note 79.

[83] *See* Proposed Rule, *supra* note 5, at 21346.

[84] Nelson, *supra* note 80.

[85] Deloitte, *US Securities and Exchange Commission (SEC)*, IAS PLUS, https://www.iasplus.com/en/resources/regional/sec [https://perma.cc/ZZE4-SSAM].

[86] Proposed Rule, *supra* note 5, at 21339.

[87] Ams. for Fin. Reform Educ. Fund et al., s*upra* note 68.

[88] *Id.*

A review of voluntary climate disclosures from two well-known companies—Apple and Tesla—confirms the comment letters' findings that data is inconsistent and misleading. Apple discloses Scope 3 emissions in five separate categories: (1) business travel and commute, (2) product manufacturing, (3) product use, (4) product transport, and (5) end-of-life product processing.[89] On the other hand, Tesla only discloses Scope 3 emissions from downstream use of their products.[90] Because neither company's voluntary disclosures fully encompass all 15 Scope 3 emissions, investors will face challenges when comparing these firms' climate disclosures to make meaningful investment decisions. Making disclosure mandatory will resolve this issue because disclosures will be in uniform categories that investors can easily use to compare data.

iii. Without a Mandatory Reporting Requirement, Scope 3 Emissions Will Be Underreported

It may be easy to think that if a company's Scope 3 emissions are greater than 80% of the company's total emissions, the company will consider these emissions to be material and report them. However, several comments in favor of reporting Scope 3 emissions express dissatisfaction with the SEC's proposal of registrants disclosing Scope 3 emissions only if the emissions are material or if the registrant has a goal related to Scope 3. Various commenters propose strengthening Scope 3 reporting standards by making reporting mandatory—and even extending disclosure requirements to all registrants.

77 organizations, composed of nonprofits and social welfare organizations like Evergreen Action and People's Action, submitted a joint comment letter expressing this concern.[91] They believe that "allowing registrants to determine whether their Scope 3 emissions are material will lead to underreporting." To support their claim, these organizations point to the outcome of the 2010 climate risk guidance, which used this same approach and "led to significant

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[89] APPLE, INC., ENVIRONMENTAL PROGRESS REPORT 13 (2022), https://www.apple.com/environment/pdf/Apple_Environmental_Progress_Report_2022.pdf [https://perma.cc/K49H-95PC].

[90] *See* TESLA, INC., IMPACT REPORT 123 (2021), https://www.tesla.com/ns_videos/2021-tesla-impact-report.pdf [https://perma.cc/9VRW-5AEH].

[91] Evergreen Action et al., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131703-302113.pdf [https://perma.cc/BST8-WKFU].

underreporting."[92] These organizations believe that the same will happen unless climate disclosure is mandatory.[93] Friends of the Earth also noted that companies will try to skirt disclosure of Scope 3 emissions by arguing that their emissions are not material.[94]

Commenters propose that Scope 3 emissions reports be mandatory. The SEC has required disclosure for other important disclosures that further its goal to protect investors and ensure fair and efficient markets.[95] These commenters bolster their argument by quoting SEC Commissioner Lee, who stated that the SEC has *previously* required disclosures by all registrants, even in instances where the information may not be material to every company making the disclosure.[96] Commissioner Lee stated that the SEC has made this common practice for parts of Regulation S-K, environmental proceedings, executive compensation, share repurchases, and disclosures of related-party transactions.[97] These commenters believe that using clear parameters is a better alternative than allowing companies to apply the materiality test to determine disclosure requirements. Additionally, as explained below in Part III(B)(i), it appears that Scope 3 emissions data are inherently material because a reasonable investor will always find Scope 3 data to significantly alter the total mix of information made available, regardless of whether the emissions are small, large, increasing, or decreasing.

B. Analysis of Comments in Opposition of Scope 3 Emissions Disclosure

It is no surprise that a large portion of comments against the Proposed Rule come from entities who would be subject to new disclosure requirements.[98] Furthermore, members of Congress, institutional investors, and even former members of the SEC expressed concern over the new rule, specifically as it relates to Scope 3. Their arguments are analyzed below.

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[92] *Id.*

[93] *Id.*

[94] Friends of the Earth, *supra* note 79.

[95] Evergreen Action et al., *supra* note 91.

[96] *Id.*

[97] *Id.*

[98] *See Comments for The Enhancement and Standardization of Climate-Related Disclosures for Investors*, *supra* note 52.

i. Without Standard Practices and Guidance on Collecting Scope 3 Emissions, Data Will Be Inconsistent, and, Therefore, Not Useful to Investors

Several comment letters argue that without guidance on how to report Scope 3 emissions, information will not be helpful to reasonable investors because methods of collection are inconsistent. As explained by investment management company Blackrock:

> Requiring companies to create disclosures before standards and methodologies are sufficiently mature, and before companies can develop mechanisms necessary to produce robust climate-related disclosures, will result in climate-related disclosures across companies and industries that are costly, inconsistent, unreliable, and difficult to compare.[99]

Because the SEC requires only a "reasonable estimate" of a company's GHG emissions when actual data is not reasonably available,[100] companies may have inconsistent methods of arriving at a reasonable estimate. For example, Company A may hire a third-party service provider to research the company's supply chain, analyze each individual supplier, distribution channel, transportation method, and compute a highly detailed estimate into all 15 Scope 3 categories. Company B may look to comparable companies in the industry to disclose their Scope 3 emissions. Finally, Company C may use actual data for its Scope 3 emissions. A reasonable investor will have difficulty making sound investment decisions based on this data. The investor may decide to invest in Company A because, among other reasons, it is less prone to climate risk than its competitors B and C. However, it turns out that Company A's reasonable estimate was inaccurate. In reality, Company A's Scope 3 emissions were 11% and 15% higher than Company B and Company C respectively.

This example also illustrates that there is uncertainty in whether Company B's method of reviewing comparable companies produces a reasonable estimate. There is no clear answer because the SEC has not provided guidance on what constitutes a reasonable estimate. To further highlight this point, what is reasonable given the circumstances of one company's highly complex supply chain, which

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[99] Blackrock, Inc., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132288-302820.pdf [https://perma.cc/U3RM-HDAY].

[100] Proposed Rule, *supra* note 5, at 21469.

may be made up of 83 different companies spanning 30 countries, may be different from what is reasonable for a company that only has five suppliers that are all based in the United States. Differences between companies computing their Scope 3 emissions may vary greatly and will be left to interpretation by courts on whether it was in fact a reasonable estimate. However, courts may not have the opportunity to answer this question because the Proposed Rule has a safe harbor provision for Scope 3 emissions data.[101] A registrant's statements on its Scope 3 emissions will not be fraudulent unless the statements were made without a reasonable basis or were not disclosed in good faith.[102]

The SEC concedes in the Proposed Rule that methods and measurements of GHG emissions continue to evolve with new assumptions, substantial estimates, and different methodologies for reporting.[103] Of course, this provides little assurance for companies who may be exposed to potential antifraud liability claims under the rule when it is adopted. However, Blackrock is not completely against climate disclosures. It recognizes that investments are impacted by climate risk, and that mandatory disclosure showcasing this risk can benefit investing clients.[104] Nevertheless, given inconsistencies in measuring Scope 3 emissions and a lack of standardization, Blackrock's comment letter advises the SEC to implement a comply or explain basis for Scope 3 emissions.[105]

A comment letter by financial services company State Street Global Advisors echoes this point and expressed concern that there are too many uncertainties with disclosing Scope 3 emissions.[106] State Street's letter argues that Scope 3 emissions disclosures should remain voluntary until definitional ambiguities are clarified.[107] Without clarification, these untested, unreliable, and inconsistent disclosures are not useful to investors.[108]

Fidelity Investments argues the same but provides two additional points: (1) current Scope 3 emissions disclosures will be inherently immaterial and (2) current Scope 3 emissions disclosures will only overwhelm investors with insignificant

[101] *Id.* at 21391.
[102] *Id.*
[103] *Id.*
[104] *Id.*
[105] *Id.*
[106] State Street Corp., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131965-302424.pdf [https://perma.cc/7PR5-FYD9].
[107] *Id.*
[108] *Id.*

information and will distract investors from meaningful company data when making investment decisions.[109]

Fidelity, citing *Basic* in its comment letter, does not believe that "Scope 3 emissions—by definition—meet the materiality threshold for disclosure."[110] Fidelity states that simply because investors started assigning value to GHG emissions does not make that information *de facto* material.[111] Rather, this information can become material in the future when guidelines are implemented and industry reporting standards are standardized. Inconsistent, speculative, and standardless Scope 3 emissions disclosures will not significantly alter the total mix of information made available to reasonable investors.[112] Like many other commenters, Fidelity believes that Scope 3 emissions will be ripe for disclosure in the future, but now, in its early stage of development, does not meet the materiality requirement.[113]

Materiality, as it relates to Scope 3 emissions, is a fuzzy concept because the SEC offers no guidance for when the data would be material. Determining when a company's emissions are or are not material proves difficult. Is a company's Scope 3 emissions material only if its emissions reach a certain threshold? Or should materiality of Scope 3 emissions hinge on whether there is a noticeable increase or decrease from the previous year? Arguably, a reasonable investor would find that the emissions would significantly alter the total mix of information made available, no matter what. On the other hand, a larger amount shows that a company has a high climate risk, which is also material. Additionally, whether emissions remained constant, decreased, or increased are all situations that a reasonable investor would want to know. This is because investors need the full picture of a company's emissions data to make informed investment decisions, as pointed out by comments in favor of the rule.

Fidelity also believes that the requirement for companies to disclose immaterial information will overwhelm investors and lead to poor investment decisions.[114] For instance, an investor deciding whether to invest money into Tesla may analyze Tesla's financial documents. In doing so, this investor may give less

[109] Fidelity Invs., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132177-302674.pdf [https://perma.cc/Q4ZB-JB5U].

[110] *Id.*

[111] *Id.*

[112] *See id.*; Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988).

[113] Fidelity Invs., *supra* note 109.

[114] *Id.*

weight to typically fundamental indicators of a strong investment, such as high earnings per share and a low price to earnings ratio, and instead assign more weight to the newly-required Scope 3 emissions disclosure. This investor, who previously viewed Tesla as a green company, may be shocked to see Tesla's Scope 3 emissions from electric vehicle charging alone created 1,954,000 tons of carbon dioxide.[115] The full 15 categories of Scope 3 emissions is considerably higher. As a result, this investor will overly rely on an inaccurate, immaterial Scope 3 emissions disclosure and decide not to invest in Tesla despite other 10-K indicators showing that it is a sound investment. Fidelity does not want this situation to occur and thus urged the Commission to reconsider its Scope 3 emissions disclosure requirement.

ii. Scope 3 Emissions Disclosures Are Inherently Misleading

Several comment letters bring up an interesting point: an increase or decrease in a company's Scope 3 emissions is not always correlated to climate risk and can thus mislead investors looking at this metric. Exxon Mobil and State Street argue this point in their comment letters.

Exxon Mobil uses an example of a reporting natural gas producer.[116] In its letter, Exxon explains that Scope 3 emissions for the natural gas producer will rise when its production increases. Investors will see an increase in Scope 3 emissions on the natural gas producer's financial documents and assume that the increased emissions are harmful and, as a result, will negatively impact overall climate risk.[117] However, the reason this natural gas producer's 2026 10-K showed increased Scope 3 emissions could have been from energy demands shifting away from coal.[118] In this situation, an increase in natural gas production is overall better for society, as it results in a net decrease for climate risk.

State Street provides a similar example to demonstrate this inherent flaw in Scope 3 disclosures:

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[115] *Impact Report 68*, TESLA (2021), https://www.tesla.com/ns_videos/2021-tesla-impact-report.pdf [https://perma.cc/PT69-PBKS].

[116] Exxon Mobil, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132323-302882.pdf [https://perma.cc/3M2B-M35H].

[117] *Id.*

[118] *Id.*

> [W]e urge the Commission to further consider the context in which Scope 3 data is presented, and the challenges in drawing useful conclusions from the data. For example, the introduction of new liquefied natural gas ("LNG") facilities by an energy supplier would, by definition, increase the supplier's Scope 3 emissions. To the extent such action was part of a supplier's business strategy to transition away from other, more carbon-intensive energy sources, however, the increase in Scope 3 reported emissions would be misleading, if not properly considered.[119]

Investors will also be misled when companies use biofuels as opposed to traditional fossil fuels.[120] The United States Energy Information Administration describes biofuel as fuel derived from feedstocks, which are biomass materials.[121] This fuel, also known as ethanol or biodiesel, is typically used in transportation and comes with a tax credit to incentivize its use.[122] However, Exxon notes that biofuel is treated no differently than fossil fuels for purposes of disclosing Scope 3 emissions.[123] As demonstrated by State Street and Exxon, company-level Scope 3 emissions can be inversely correlated when looking at the bigger picture of climate risk, and can thus mislead investors.[124]

Companies could easily solve this issue, however, by conveying this information to investors through other means. For instance, if a company is concerned that its climate risk is not accurately depicted, it can submit a press release letting the public know that 20% of its energy derives from biofuel, or that the company's increase in energy demand is due to a shift away from coal. Investors can then factor this information into their analysis when looking at the company's emissions data.

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[119] State Street Corp., *supra* note 106.

[120] Exxon Mobil, *supra* note 116.

[121] *Biofuels explained*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/energyexplained/biofuels/ [https://perma.cc/C3VB-5WFB].

[122] *Id.*

[123] Exxon Mobil, *supra* note 116.

[124] *Id.*

iii. Requiring Scope 3 Emissions Disclosure Will Result in Registrants Policing Smaller, Private Companies Outside the Scope of the Proposed Rule to Produce Their Emissions

This argument against Scope 3 emissions disclosure was largely raised by members of Congress from both houses. Notably, bipartisan comment letters address the potential problem of policing smaller non-reporting companies. Their concern is that reporting companies subject to this disclosure requirement will put undue pressure on smaller companies in the reporting company's supply chain to provide emissions data.[125]

August Pfluger, a Republican Congressman from Texas, opposed Scope 3 GHG emissions disclosure due to concerns that monitoring and reporting will inevitably be pushed on the private companies that do business with these publicly-traded companies.[126] Congressman Pfluger believes this will significantly increase the cost of production for smaller private companies who lack the financial resources and technology to complete this task.[127] Therefore, he contends that the rule will only exacerbate inflation, harm America's ability to compete in global markets, and lead to consolidated supply chains.[128] While not directly stated by Congressman Pfluger, if these claims turn out to be true, they point out that the SEC does not have the power to enact such a rule because the Securities Act of 1933 and Securities Exchange Act of 1934 require rules to be "in the public interest."[129] Higher rates of inflation and harming the United States economy is undeniably against the public interest.

Jon Tester, a Democratic Senator from Montana, submitted a comment letter expressing the same concern.[130] Much like Congressman Pfluger's letter, Senator Tester focused on the negative impacts to agricultural companies and farmers.[131]

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[125] Jon Tester, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (Nov. 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20150961-319959.pdf [https://perma.cc/KR5M-EDHK].

[126] August Pfluger, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (Oct. 11, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20150519-319579.pdf [https://perma.cc/34CM-ZX6W].

[127] *Id.*

[128] *Id.*

[129] Hirst, *supra* note 8, at 102.

[130] Tester, *supra* note 125.

[131] *Id.*

However, unlike Congressman Pfluger, Senator Tester recognized that the SEC "does not intend for public companies to have an obligation to ask producers for information to estimate these emissions," which was made clear in the Proposed Rule and in discussions between the SEC and Sen. Tester.[132] As a result, the SEC will likely argue that Congressman Pfluger's concern has no merit because Scope 3 reporting companies are not required to acquire data from companies in their supply chain.[133] Rather, these companies can make reasonable estimates themselves without involving farmers or agricultural companies.

Blackrock's comment letter recognizes this potential problem with Scope 3 reporting and purports that mandatory reporting needs to be consistent among private and public companies to avoid inadvertent consequences.[134] Like the members of Congress, Blackrock thinks public companies can use their power to police companies in their value chain and use the power to negotiate measurement systems of emissions for their own benefit.[135] Without standardized reporting obligations from both private and public markets, Blackrock believes that there will continue to be unintended outcomes with companies transferring assets to private companies to avoid regulation.[136] Another overarching consequence of treating public and private companies differently is that more companies remain private to avoid disclosures like the ones in the Proposed Rule.[137] As a result, there will be fewer choices in public markets for investors.[138]

iv. Emissions Will Be Double Counted in Scope 3 Reporting with One Company's Scope 1 and 2 Emissions Counted Twice in Another Company's Scope 3 Emissions

Many comment letters argue that Scope 3 emissions will be overstated because of double counting. Double counting occurs when two reporting companies—within the same value chain—report emissions from the same source because "the scope 3 emissions for one organization are the scope 1 and 2

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[132] *Id.*
[133] Proposed Rule, *supra* note 5, at 21469.
[134] Blackrock, Inc., *supra* note 99.
[135] *Id.*
[136] *Id.*
[137] *Id.*
[138] *Id.*

emissions of another organization."[139] To better explain this concept, take for instance Goodyear Tire & Rubber Company and Ford. Goodyear provides tires for Ford vehicles.[140] Therefore, because both companies are publicly traded, Goodyear's Scope 1 and 2 emissions will be double counted. The emissions for Goodyear tires on Ford cars will count as part of Ford's Scope 3 emissions as well as Goodyear's Scope 1 and 2 emissions. If the energy required to manufacture four new tires is around 124 kg CO2,[141] then this single activity will be reported as 248 kg CO2 when looking at both Ford and Goodyear's disclosures. State Street and Exxon highlighted this serious flaw to Scope 3 reporting in their comment letters.[142]

However, while overstated emissions can deceive investors into believing that climate risk is worse than it actually is, the European Union's Technical Expert Group on Sustainable Finance ("TEG") considered this problem in its 2019 final report on climate benchmarks and ESG disclosures.[143] In its report, the TEG first explained that double counting is not a company-level issue but is only a problem when considering many companies across various sectors in the aggregate.[144] Next, the TEG provided an example of how this issue can occur, much like the Goodyear and Ford example, and gave a complex solution to double counting.[145] The solution involves companies in the value chain splitting the emissions according to the added value of each participant.[146] This subjective value adding method of allocating emissions will be a difficult task for companies within a value chain to agree on due to each company's incentive to argue for a low emissions level. The

[139] US EPA, *Scope 3 Inventory Guidance*, EPA (Feb. 14, 2023), https://www.epa.gov/climateleadership/scope-3-inventory-guidance [https://perma.cc/FZV5-HXRP].

[140] *Goodyear Tires Outfit Top Vehicles at Auto Show*, GOODYEAR (Jan. 14, 2013), https://corporate.goodyear.com/us/en/media/news/goodyear-tires-outfit-top-vehicles-at-auto-show-1426100343156.html#:~:text=Goodyear%20tires%20are%20original%20equipment,%2C%20Nissan%2C%20Ram%20and%20Toyota [https://perma.cc/BA3B-MFS4].

[141] *See New Study Looks at Carbon Footprints of Tires, Retreads*, VEHICLE SERVICE PROS, (Dec. 31, 2019), https://www.vehicleservicepros.com/shop-operations/collision-repair/business-and-finance/article/21171888/new-study-looks-at-carbon-footprints-of-tires-retreads [https://perma.cc/7WUU-UZ9P].

[142] *See* State Street Corp., *supra* note 106; Exxon Mobil, *supra* note 116.

[143] EU TECH. EXPERT GRP. ON SUSTAINABLE FIN., TEG INTERIM REPORT ON CLIMATE BENCHMARKS AND BENCHMARKS' ESG DISCLOSURES 42 (June 2019).

[144] *Id.*

[145] *Id.*

[146] *Id.*

TEG notes that solving this issue is not easy, and "in the case of diversified investment strategies across almost all sectors of the company, double counting happens everywhere, especially with a continuous integration of Scope 3 emissions over time – which will lead to triple counting."[147] This point was also mentioned in State Street's comment letter, which expressed concern over category 15 of Scope 3 emissions—investments by a registrant.[148]

Given the complexity around double counting, the TEG recommended that companies let double counting occur and do not attempt to correct it.[149] The TEG reasoned that emissions data, even if imperfect, serves as a useful proxy for financial risks related to the climate. [150] More importantly, double counting is only an issue when looking at the emissions data in the aggregate. The SEC's motivation for this rule is to give investors consistent, comparable GHG emissions data on a company-level. The rule did not intend for investors to add up emissions of all public companies, which is where double counting would occur. Rather, investors will be comparing one company's emissions data to another and, therefore, double counting is not an issue that the SEC should worry about.

v. Scope 3 Emissions Disclosures Will Be Much More Costly Than the SEC Estimates and Will Be Overly Burdensome on Required Companies

Comment letters from entities subject to the disclosure requirements and former Chief Economist of the SEC criticize the Proposed Rule based on the compliance cost registrants will have to bear. To start, the SEC provided multiple analyses on annual compliance costs related to climate disclosures.[151] Some analyses relate directly to the total costs of complying with the Proposed Rule while others offer comparative compliance estimates from other countries' climate regulations.[152] The chart below depicts these analyses:

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[147] *Id.*
[148] State Street Corp., *supra* note 106.
[149] EU TECH. EXPERT GRP. ON SUSTAINABLE FIN., *supra* note 143.
[150] *Id.*
[151] *See* Proposed Rule, *supra* note 5, at 21439–447.
[152] *Id.*

	First Year Compliance Cost	Ongoing Yearly Compliance Cost	Year-over-Year Change
Non-Smaller Reporting Companies Adhering to the Proposed Rule	$640,000	$530,000	(17.2%)
Smaller Reporting Companies Adhering to the Proposed Rule	$490,000	$420,000	(14.3%)
Companies Without Preexisting Disclosure Practices in Place Adhering to UK's TCFD Disclosures	$201,800	$177,900	(11.8%)
Scope 1, 2, and 3 Emissions Estimate from 3rd Party Service Provider	$75,000 – $125,000	$40,000 without material changes $75,000 – $125,000 with material changes[153]	(68%) – 0%

While these estimates are helpful to gauge the impact on reporting companies, former Chief Economist of the SEC Craig Lewis is not satisfied with the analysis; he believes that the Proposed Rule's cost-benefit analysis does not adequately address the impact on both companies and the economy.[154] Lewis points out that these new costs would double the overall cost of producing reports to the SEC.[155] His argument relates to the opportunity costs of this rule. It is not

[153] *Id.*

[154] S.P. Kothari & Craig Lewis, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132332-302895.pdf [https://perma.cc/FZQ6-C7LR].

[155] *Id.*

just the time, money, and resources spent on compliance, but the fact that these resources are being diverted from other useful opportunities that the business could have invested in. Time spent preparing documents to comply with the Proposed Rule could instead be spent on R&D, product design, and other ways to improve business operations. The additional money can also be reinvested in the business for further growth or used as a dividend to pay shareholders. These uses of employee time and company money would arguably be a better allocation of resources, which would both protect investors and be in the public interest, than compliance with additional disclosure requirements. Further, he believes that the true cost of implementing new disclosures—including Scope 3 emissions—will likely be much higher than the SEC's provided estimates. [156]

Exxon Mobil has similar views in its comment letter and believes that "[t]he proposed requirements will cause issuers to incur enormous costs…"[157] Like Lewis, Exxon also believes that the cost of implementing disclosures is significantly higher than the Commission's estimates.[158] Notably, Exxon estimates that the one-time compliance cost to adhere to the Proposed Rule will cost tens of millions of dollars.[159] Exxon's estimation method involved using a multiple of the combined cost of two Financial Accounting Standards Board ("FASB") standards, which were "significantly simpler" than the Proposed Rule.[160]

There are several flaws with Exxon's argument: (1) assuming the SEC's estimates are accurate, Exxon's estimated cost is extremely overstated, (2) even if Exxon's estimates are correct, tens of millions of dollars for a nearly half a trillion-dollar company is not overly burdensome, and (3) Exxon fails to mention that compliance costs will significantly decrease in following years of disclosure. Assuming tens of millions of dollars is $25,000,000, Exxon's estimate is 3,806% higher than the SEC's estimate. Importantly, depending on the company's size, this compliance cost may not be that significant. In 2022, ExxonMobil had a net income of $55.74 billion.[161] Using Exxon's estimate, complying with the SEC's Proposed Rule would be a mere .045% of its 2022 net income. Exxon would still have $55.715 billion left in yearly net income. Using the SEC's compliance cost estimates instead, this "enormous cost" would be .0011% of its net income. While it is true that Exxon can use $25,000,000 or $640,000 for other purposes the

[156] *Id.*
[157] Exxon Mobil, *supra* note 116.
[158] *Id.*
[159] *See id.*
[160] *Id.*
[161] Exxon Mobil Co., Annual Report (Form 10-K) (Feb. 23, 2022).

company views as beneficial, it is a hard argument to make that these are "enormous costs."

Exxon also fails to consider that the cost in subsequent years will significantly decrease—with estimates showing a 11% to 17% decrease in the following years of disclosure. Additionally, the SEC will likely provide guidance in the years to come to help clarify reporting standards, much like it did with Sarbanes-Oxley Section 404, which will ease the burden on reporting companies. Moreover, technology and companies in the business of providing third-party climate risk assessments will continue to improve and cost less for companies like Exxon.

C. Takeaways From the Proposed Rule, Rulemaking Process, and Comment Letters

Before moving onto this paper's recommendation to the SEC on its final rule for Scope 3 emissions reporting, this section will provide takeaways on the Proposed Rule, rulemaking process, and comment letters. It goes without saying that an understanding of the Proposed Rule was necessary before moving forward with the analysis. An important takeaway is the SEC motivation for proposing this rule, which several media sources and comment letters got wrong. The SEC is simply catering to investor demand and expanding companies' disclosure obligations to provide consistent and comparable climate-risk data. This is important because this rule will be challenged in court once it is finalized and released. After *West Virginia*, agencies, like the SEC, need to be explicit by pointing to clear congressional authority. Therefore, because the SEC does not have Congressional authority to regulate the climate, it made sure to connect this rule to its authority of investor protection.

Another critical takeaway is understanding the rulemaking process, which is the sole reason why the SEC submitted a proposed rule and the reason why stakeholders are commenting on it. Without the APA, this helpful process—where the SEC can learn valuable insights from key stakeholders in comment letters—would not exist. As a result, the SEC will read through these comment letters, address them, and implement changes based on the letters in its final rule. Both sides submitted extremely compelling arguments regarding Scope 3 emissions disclosure, and this paper goes on to recommend the best course of action the SEC should take given these comment letters.

III. RECOMMENDATION ON HOW THE SEC SHOULD PROCEED

The SEC will respond to the arguments made in these comment letters when it releases its final rule for *The Enhancement and Standardization of Climate-Related Disclosures for Investors*. As a result, the SEC will likely modify the Proposed Rule for several reasons. First, and most important, the SEC will ensure that its rule expressly relates back to the statutory authority delegated to it by Congress to avoid invalidity. In previous years, the Supreme Court allowed agencies to liberally create rules broadly within the power delegated to them. All this changed after *West Virginia v. EPA*, where the Supreme Court applied the major questions doctrine and now requires agencies to point directly to clear congressional authority. For instance, an issue like climate change is such a major question that Congress needs to give explicit authority over to the SEC and as such, the SEC cannot broadly interpret "in the public interest or for the protection of investors" to encompass it.[162] Second, the SEC will ensure it checks all necessary procedural boxes to conform with the APA, which will be less of an issue because this requires notices of proposal, an opportunity for comments, and a delayed effective date, all of which the SEC has conformed with. Lastly, the SEC will ensure that its rule is not "arbitrary" or "capricious," a substantive requirement under the APA that requires the agency to adequately consider all relevant factors, including, where relevant, the costs and benefits of the rule.[163] The Supreme Court explained that an agency's rule is arbitrary and capricious—and therefore invalid—if the agency failed to consider a major part of the problem, evidence contradicts the agency's explanation, the agency relied on factors that Congress did not intend for it to consider, or the rule is implausible.[164]

This section of the paper will look past the biases of comment letters, analyze the merits of key arguments, and conclude the best course of action the SEC should take for Scope 3 emissions disclosure to ensure a constitutionally valid rule. The SEC should strengthen its Scope 3 disclosure requirement from a materiality threshold to mandatory disclosure because (A) most arguments against Scope 3 emissions disclosure are overstated; (B) Scope 3 emissions disclosure is evolutionary by nature and, by requiring disclosure sooner rather than later, standards and best practices will be expedited; and (C) not requiring Scope 3

[162] *See* West Virginia v. EPA, 142 S. Ct. 2587, 2614 (2022); 15 U.S.C. §78l(d) (Lexis).

[163] *See* Chamber of Com. v. SEC, 412 F.3d 133, 140 (D.C. Cir. 2005).

[164] *See* Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

disclosure will result in an arbitrary and capricious rule because other emissions data is not helpful in the absence of Scope 3.

The SEC should strengthen its disclosure requirement from a materiality threshold to a mandatory one because it is hard to imagine a situation where Scope 3 emissions data is not material. The reason this data is material in all situations is because investors need the full picture of a company's emissions—whether small or large—to make informed investment decisions.[165] The SEC, in its proposed rule, stated that "[w]hen assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions."[166] Conversely, the SEC recognized that "Scope 3 emissions may make up a relatively small portion of a registrant's overall GHG emissions but still be material…"[167] Therefore, companies cannot simply look to whether their Scope 3 emissions are high or low in determining whether their data is material because in either case the data can be viewed by a reasonable investor as significantly altering the 'total mix' of information made available. Additionally, comment letters and the SEC fail to identify any situations where Scope 3 emissions data would not be material, besides certain comment letters, such as Fidelity's, that flat out believe all Scope 3 emissions data is immaterial. As a result, Scope 3 emissions data is always material, and, therefore, companies subject to the rule should be required to disclose this data.

A. Companies Are Ready for Scope 3 Emissions Reporting, and Arguments from Stakeholders Opposing Scope 3 Emissions Disclosure Are Overstated

To start, a majority of stakeholders in favor and in opposition of Scope 3 emissions disclosure both agree that climate risk will impact investors.[168] The key difference is that those against Scope 3 emissions disclosure are concerned that a mandatory disclosure requirement is being imposed too soon. It is not that these stakeholders are entirely against Scope 3 emissions disclosure, but they are instead against a *premature* disclosure requirement where data and methodologies will be rushed, inconsistent, or inaccurate. However, history and recent data indicates that

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[165] This is explained in great detail in Part III(B)(i).

[166] Proposed Rule, *supra* note 5, at 21379.

[167] *Id.*

[168] *See* Proposed Rule, supra note 5, at 21340; *see also* Blackrock, Inc., *supra* note 99. ("[C]limate risk is investment risk, we also write to express our strong support for the Commission's goal of implementing a framework for public issuers to provide investors with more comparable and consistent climate-related disclosures.").

the SEC's disclosure requirement is not premature, and many companies are ready for Scope 3 reporting.

Looking back at the history of regulations, climate risk is not new, and neither are climate-related regulations. In the international context, there have been agreements dating back to 1997 with the Kyoto Protocol where developed countries pledged to reduce GHG emissions by a certain amount. While agreements like the Kyoto Protocol and more recently the Paris Agreement are arguably different from the Proposed Rule because they are emissions reduction goals for countries rather than a company level disclosure requirement to protect investors, registrants were still on notice of upcoming disclosure requirements. The Commission has addressed environmental disclosures since 1970, and in 2010 released the *Commission Guidance Regarding Disclosure Related to Climate Change*.[169] Furthermore, state legislators have been trying to pass climate-related disclosure on companies that do business within their state. For example, in January of 2021, California introduced SB 260 Climate Corporate Accountability Act, which would have required US companies with annual revenues exceeding $1 billion that conduct business in California to report Scope 1, 2, and 3 emissions data.[170] While this bill ultimately failed to pass, it signaled to companies the direction lawmakers are headed.

Reasonably prudent companies are proactive when it comes to anticipating issues whether it is upcoming regulation, shifting consumer preferences, or increasing competition. Companies have had decades to analyze both climate and disclosure trends. Research show that registrants proactively started implementing measures to disclose climate risk data voluntarily and are ready for Scope 3 emissions disclosure in light of upcoming rules.[171] A study by World Resources Institute found that 3,317 companies reported Scope 3 emissions in 2021 and trends dating back to 2010 show that this number continues to increase each

[169] Commission Guidance Regarding Disclosure Related to Climate Change, Release Nos. 33-9106; 34-61469; FR-82 (Feb. 8, 2010).

[170] *See* Climate Corporate Accountability Act, S.B. 260 (Cal. 2022); Cydney Posner, *California's Proposed Climate Corporate Accountability Act Goes Belly Up*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 25, 2022), https://corpgov.law.harvard.edu/2022/09/25/californias-proposed-climate-corporate-accountability-act-goes-belly-up [https://perma.cc/AJ7S-XAFD].

[171] *See* Shannon M. Lloyd et al., *Trends Show Companies Are Ready for Scope 3 Reporting with US Climate Disclosure Rule*, WORLD RESOURCES INSTITUTE (June 24, 2022), https://www.wri.org/update/trends-show-companies-are-ready-scope-3-reporting-us-climate-disclosure-rule [https://perma.cc/6SER-3AT8].

year.[172] The study by EY cited in Friends of the Earth's comment letter also supports the conclusion that companies are ready for a mandatory disclosure requirement. Even more reason to require Scope 3 emissions disclosure, TCFD consultations found that "more companies estimate emissions [internally] than disclose emissions."[173] Therefore, a large number of companies that already internally measure their emissions will be required to make their data public without additional burden.

To further prove that companies are prepared for Scope 3 emissions disclosure, there are companies already taking measures to proactively reduce their Scope 3 emissions in anticipation of upcoming disclosure requirements. Take, for instance, Apple—a large, accelerated filer that would be among the first companies subject to the disclosure requirement. On October 24, 2022, Apple introduced "Clean Energy Charging" for iPhones in its iOS 16.1 software update.[174] This update automatically opted every iPhone into "Clean Energy Charging," which allows users to reduce their carbon footprint "by selectively charging when lower carbon-emissions electricity is available."[175] When cleaner energy is not available, iPhones will suspend charging. This can be overridden by disabling the setting, which notifies the user that "Clean Energy Charging helps reduce carbon footprint." Apple is already finding innovative ways to decrease their downstream Scope 3 emissions.

While this is evidence that Scope 3 emissions data collection has been around and is more developed than commentors against disclosure recognize, these commenters still raise additional arguments that have not been rebutted. Going back to the argument made in Part II(d)(ii)—how emissions data can be misleading as illustrated by a hypothetical natural gas supplier—this example is not only extremely niche to energy suppliers but can easily be mitigated with a simple disclosure or press release by the company. Even without a disclosure or press release, investors who analyze companies will likely be aware from news stories. The policing argument in Part III(B)(iii) is also overstated because the SEC explicitly stated numerous times that it did not intend for public companies to ask producers for their data. Lastly, the double counting argument is a minimal concern because it only applies in the aggregate, which investors will not look at, and the cost argument in Part III(B)(v) illustrates how de minimis the cost actually is for companies. Therefore, the SEC should proceed with a mandatory Scope 3

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[172] *Id.*

[173] *Id.*

[174] *Use Clean Energy Charging on Your iPhone*, APPLE (Oct. 24, 2022), https://support.apple.com/en-us/HT213323 [https://perma.cc/G9XD-AK5D].

[175] *Id.*

emissions disclosure requirement on the basis that companies are ready for the rule and arguments against it are weak.

B. Mandatory Scope 3 Reporting Is Warranted Even if Imperfect Because the Rule Is Evolutionary. By Requiring Disclosure Sooner Rather Than Later, Standards and Best Practices Will Be Expedited, Thereby Protecting Investors Better Than Voluntary Reporting

It is unrealistic for a brand-new disclosure requirement to be perfect when first released. Standards naturally evolve over time as best practices emerge and develop with new technology and the addition of more firms specializing in third-party emissions data collection. Imposing a mandatory rule will get the ball rolling and allow the SEC to work together with registrants to find which data collection methods work best. As stated above, companies are already prepared to disclose Scope 3 emissions and by imposing a mandatory disclosure requirement, emissions data reporting will improve at a faster rate than if the SEC loosened the standard to a voluntary basis. Later, the SEC can publish an interpretive release, similar to how the SEC handled Section 404 of the Sarbanes-Oxley Act and provide management with guidance on collection methods and standards for Scope 3 reporting.[176]

Disclosure standards evolving over time is not a new concept. United States Generally Accepted Accounting Principles ("GAAP"), a set of accounting practices for financial documents, also evolved over time. From its inception in 1932 following the Wall Street Crash of 1929, GAAP has undergone almost yearly changes.[177] For instance, in 1938 companies were permitted to use a new inventory method called LIFO.[178] In 1947, inventory methods changed again, and the American Institute of Accountants' special committee began allowing LIFO, FIFO, and average inventory methods of accounting.[179] The addition of Sarbanes-

[176] *See generally* Yoon-Ho Alex Lee, *Sarbanes-Oxley Section 404 and Its Administrative Legacy*, NW. UNIV. PRITZKER SCHOOL OF L. PUB. L. AND LEGAL THEORY SERIES, No. 23-14 (2023) (explaining how the SEC used an interpretive release to provide guidance to companies regarding Sarbanes-Oxley section 404).

[177] *See* Stephen A. Zeff, *Evolution of US Generally Accepted Accounting Principles (GAAP)*, RICE UNIV., https://www.icjce.es/images/pdfs/TECNICA/C03%20-%20AICPA/C311%20-%20Estudios%20y%20Varios/Evol%20US%20GAAP%20-%20Stephen%20Zeff%20%20-%20July%202004.pdf [https://perma.cc/7MXW-K8US].

[178] *Id.* at 2.

[179] *Id.*

Oxley in 2002 further added changes to GAAP standards.[180] As a result, GAAP "has gradually evolved, based on established concepts and standards, as well as on best practices that have come to be commonly accepted across different industries" and slowly became GAAP as we know it today.[181] The Financial Accounting Standards Board and SEC did not wait until GAAP was perfect to implement it; rather, companies were required to follow GAAP in its early stages and it continues to evolve with new reporting standards. In 2022, there were GAAP changes to leases, gifts, and Cloud Computing costs.[182]

The SEC should take a similar evolutionary approach with the Proposed Rule, specifically Scope 3 emissions disclosure, and keep its disclosure requirement. Slowly over time, the SEC can release guidelines to refine reporting methodologies and develop standards for companies to conform to.

Comment letter on the Proposed Rule by Professor Scott Hirst proposes an "investor-optional" rule that would allow companies to opt out of disclosure obligations if approved by a majority of equity shareholders in a vote.[183] His comment and paper, *Saving Climate Disclosure*, concludes that this approach would better meet the goal of protecting investors and satisfying their demand as well as avoiding validity arguments.[184] While Hirst's proposal has real merit, giving company boards this option to initiate an opt-out of disclosure is trivial. As explained above, thousands of companies are already voluntarily preparing emissions data. Furthermore, companies in the United States have the highest quality of emissions disclosures when scored, and trends show that this continues to improve. It would be illogical for companies that have *voluntarily* poured significant resources into a disclosure to suddenly conclude that it is not necessary for shareholders and ask them to vote against disclosing this information. If this

[180] *See id.* at 12–13.

[181] CFI Team, *GAAP A Commonly Recognized Set of Rules and Procedures Governing Corporate Accounting and Financial Reporting*, CFI (Nov. 29, 2022), https://corporatefinanceinstitute.com/resources/accounting/gaap/ [https://perma.cc/S8YV-8WZH]. *See* Brooke Tomasetti, *Generally Accepted Accounting Principles (GAAP)*, CARBON COLLECTIVE (Mar. 29, 2023), https://www.carboncollective.co/sustainable-investing/gaap [https://perma.cc/9SFV-PZRX].

[182] *See* Deby Macleod, *Short List of New GAAP Accounting Standards Effective in 2022*, CLARK NUBER (2022), https://clarknuber.com/articles/short-list-of-new-gaap-accounting-standards-effective-in-2022/ [https://perma.cc/C7UD-EXA7].

[183] Scott Hirst, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (Nov. 1, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20149097-316286.pdf [https://perma.cc/Q8HM-VLJK].

[184] *See id.*

were the case, there would not be thousands of companies continually improving their voluntary disclosures each year.

In the minority case where a company has yet to either voluntarily report emissions data or develop a measurement system, the opt-out rule would require them to do this before allowing shareholders to vote. This is because shareholders could not make an informed decision on whether it would benefit them to opt out without first having the information. As a result, these companies would have already surpassed the significant challenges and costs associated with disclosures, resulting in reduced expenses and improved accuracy over time. More generally, investors typically benefit from having access to more information rather than less, and it would be against their best interest to vote against having another metric to evaluate the company. Therefore, while this approach would meet the goals of the SEC and avoid invalidity, in practice, this option is insignificant.

C. Not Requiring Scope 3 Disclosure May Result in an Arbitrary and Capricious Rule Because Other Emissions Data is Not Helpful in the Absence of Scope 3

A mandatory Scope 3 emissions disclosure is not only the most logical approach, given its evolutionary nature, but also arguably protects the SEC from validity arguments. The SEC wants to be sure that its rule will be constitutionally valid, and an important hurdle is whether it has express statutory authority to create the rule by Congress. As mentioned above, the SEC's authority derives from the Securities Act of 1933 and the Securities Exchange Act of 1934 to create rules and regulations that are necessary or appropriate in the public interest or for the protection of investors.

Investors need Scope 3 emissions disclosure to make informed investment decisions, and without it, Scope 1 and 2 emissions data give investors only a small slice of a company's total emissions. Emissions data will likely be used as another metric by sell-side analysts at investment banks—who write reports on whether to buy, sell, or hold stocks to investors—to improve their analysis of stock trading recommendations. Likely, emissions data will be analyzed as a ratio to net income. For example, in 2021, Amazon had total emissions of 71.54 million metric tons of CO2.[185] Given Amazon's net income of $33.364 billion in the same year, Amazon's net income to GHG emissions ratio would be 466.56. Put differently,

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[185] *Our Carbon Footprint*, AMAZON SUSTAINABILITY (2021), https://sustainability.aboutamazon.com/environment/carbon-footprint [https://perma.cc/6TGF-S6MU].

for every $466.56 Amazon makes, it emits one metric ton of CO2. Then, analysts will compare this ratio to Amazon's net income to GHG emissions ratio from previous years. In 2019, this ratio was 226.46, and in 2020, it was 351.76. Therefore, from 2019 to 2021, Amazon has a trend of making more money per metric ton of CO2, which is a positive sign for investors. Lastly, sell-side analysts will compare Amazon's net income to GHG emissions ratio to its competitors. If Amazon is more environmentally efficient (making more money per metric ton of CO2) than competitors, such as Walmart, this will signal analysts to recommend a buy to investors.

With only voluntary Scope 3 reporting, this analysis is not possible. Notably, Scope 1 and Scope 2 emissions disclosure was not nearly as contested in comment letters. This is because Scope 1 and Scope 2 emissions data is much easier to produce for registrants. Furthermore, research suggests that investors care about having all emissions data from a company, including Scope 3, rather than just Scope 1 and Scope 2. Sentieo, a corporate and financial research platform for investment analysts, found that "[i]nvestors and analysts are more focused than ever on companies' Scope 3 emissions, with execs being asked more questions about this at earnings calls than anything else."[186] Research by Sustainalytics also found that investors' approach regarding climate risk data targets encompasses companies' full-value chain emissions.[187]

The SEC risks invalidity if it decides to keep a mandatory disclosure requirement for Scope 1 and Scope 2 while making Scope 3 voluntary, because drawing the line here is arbitrary and capricious. It would be arbitrary and capricious because, as illustrated in Part III(A)(i), investors are missing the central piece of emissions data and are thereby not protected. Instead, the SEC should either, as recommended by this paper, require Scope 3 emissions disclosure or not require any form for GHG emissions disclosure.

This recommendation is conditional on the SEC adopting a rule designed to mandate emissions disclosure. It is possible that a court will strike down this rule similarly to the Court in *West Virginia*. In that situation, companies will have no GHG reporting obligations while leaving investors without comparable and

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[186] Sean Ashcroft, *Execs 'Being Grilled' on Scope 3 Emissions by Investors*, SUPPLYCHAIN (Dec. 13, 2021), https://supplychaindigital.com/sustainability/execs-being-grilled-scope-3-emissions-investors [https://perma.cc/YVV4-TMSD].

[187] Jekaterina Spiridonova & Jackie Cook, *Investors Seek Meaningful Scope 3 Emissions Targets to Evaluate Climate Transition Plans*, SUSTAINALYTICS (Dec. 20, 2022), https://www.sustainalytics.com/esg-research/resource/investors-esg-blog/investors-seek-meaningful-scope-3-emissions-targets-to-evaluate-climate-transition-plans [https://perma.cc/S4WT-P24U].

consistent data. If the SEC decides to require only Scope 1 and Scope 2 data while keeping a materiality threshold for Scope 3, a court cannot command the SEC to change the rule and make Scope 3 mandatory.

However, a climate-related rule without any GHG emissions reporting seems hardly defensible because it is one of the metrics that is most discussed by stakeholders. The SEC justifying its adoption of this rule based on investor protection and demand while simultaneously not requiring any disclosure of GHG emissions would be invalid because it is an implausible rule.[188] The SEC may try to justify its decision not to mandate Scope 3 emissions disclosure based on the cost-consideration; however, that argument is weak given the relatively low cost on registrants, as discussed in Part III(D)(v). Because no GHG emissions reporting or only requiring Scope 1 and Scope 2 will result in an invalid rule, the SEC should proceed with mandatory Scope 3 emissions reporting.

CONCLUSION

This paper recommends that the SEC strengthens the Proposed Rule's Scope 3 emissions disclosure requirement from a materiality threshold to a mandatory one. Before arriving at this conclusion, this paper provided the necessary foundational information for the analysis. This started out with an overview of the Proposed Rule and the rulemaking process. Then, Part III provided a comprehensive analysis of the main arguments from key stakeholder comments to get an idea of arguments for and against Scope 3 reporting. Lastly, a recommendation was formed based on the Proposed Rule and the meritorious arguments in these comment letters.

To conclude, the SEC should require registrants to disclose Scope 3 emissions in its final rule because, as the analysis above explains, it is the best way to meet its goal of protecting investors and avoiding validity challenges. Considering that all Scope 3 emissions data is material, and the SEC and comment letters fail to establish a situation where Scope 3 data *is not* material, the rule should be required for all registrants. Later in 2024, the SEC will release its final rule and will hopefully reach the correct outcome by keeping and requiring Scope 3 emissions disclosures for registrants.

[188] *See* Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).