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Cooley: SEC's Climate Proposal - SCOOP!

According to exclusive reporting from Bloomberg, the SEC's new proposal for climate disclosure regulation—scheduled for a vote and release on Monday—will include a requirement to disclose some Scope 3 *emissions*, that is "greenhouse gases that are generated by other firms in [a company's] supply chain or by customers using [its] products." It's widely believed that Scope 3 emissions "make up the bulk" of most companies' emissions. It's unclear whether the proposed requirement would apply to all public companies or just larger ones, or whether the requirement might be phased in. As discussed below, whether or not to require disclosure of Scope 3 emissions has been a subject of heated internal debate at the SEC, and, the article suggests, the proposal appears to reflect some compromise.

The article indicates that the rules will require companies to discuss "indirect emissions that are 'material' to their operations. Because of the legal uncertainty surrounding the term, the proposal is likely to provide examples for companies to follow, [sources said]. The commissioners also compromised on whether the new corporate filings will need to be audited, another flashpoint. The regulation is likely to require expert review, but it will be phased in over time, the people said." Note that the frequently mentioned framework of the Task Force on Climate-Related Financial Disclosures provides for disclosure of Scope 3 emissions "if appropriate," which could suggest a materiality test.

As noted above, the wrangling over whether to require disclosure regarding Scope 3 emissions has been fierce—including among the commissioners. Back in January, Reuters reported that environmentalist and some activist investors were strongly advocating that the SEC require companies to make broad disclosure about GHG emissions, while business groups were "pushing for a narrower rule that will make it easier and less expensive to gather and report emissions data, and which will protect them from being sued over potential mistakes." The article reported that a "major issue staff are struggling with is whether and how some or all companies should disclose the broadest measure of greenhouse-gas emissions, also known as 'Scope 3' emissions, according to the sources and company and investor advocates." Another "big challenge" that the article highlighted was "identifying which Scope 3 metrics help investors gauge a company's financial prospects, and ensuring the rule is flexible enough to generate specific, rather than generic information." While activists may view Scope 3 emissions disclosure as "critical," some companies contended that "there is no agreed methodology for calculating Scope 3 emissions and providing that level of detail would be burdensome." In addition, they maintained, this information was not necessarily within each company's control and exposed companies to potential litigation.

The Reuters article discussed some compromises the staff was considering at the time, including whether to create a new safe harbor or to rely on the current safe harbor for forward-looking statements. One alternative under consideration was reportedly to require some information about Scope 3 emissions to be filed as part of companies' financial reports and other Scope 3 data to be submitted separately. The article reported that the staff had reached out to advocacy groups such as Ceres and Public Citizen for feedback on Scope 3 issues, including phase-ins and safe harbors. A Ceres representative indicated that the SEC had solicited his views on "whether it should include Scope 3 for large, high-revenue companies, then phase in medium and small-sized companies a year or two later." Time will tell whether any of these compromises will be included in the ultimate proposal. (See this PubCo post.)

And in February, Bloomberg reported that one of the reasons for the delay in the release of the SEC's climate disclosure proposal was internal conflict about the proposal—conflicts not between the Dems and the one Republican remaining on the SEC; rather, they were reportedly between SEC Chair Gary Gensler and the two other Democratic commissioners, Allison Herren Lee and Caroline Crenshaw, about how far to push the proposed new disclosure requirements, especially in light of the near certainty of litigation, and whether to require that the disclosures be audited. The article painted the SEC's dilemma about the rulemaking this way: "If its rule lacks teeth, progressives will be outraged. On the flip side, an aggressive stance makes it more likely the regulation will be shot down by the courts, leaving the Biden administration with nothing. Either way, someone is going to be disappointed."

According to the Bloomberg article, the issues centered around "how much information the agency can force companies to divulge without losing an almost certain legal challenge brought by Washington's business lobby or a Republican-led state. Fundamental to the debate, Bloomberg indicated, was the question of "materiality." (See this PubCo post for a discussion of the some of the commissioners' views of "materiality.") The authors reported that Gensler had "caution[ed] agency staff to make sure the climate proposal adheres to a legally defensible definition of materiality. He contend[ed] that only this approach can survive a legal challenge." According to the reporters' sources, "[t]ensions over the divergent approaches have reached a tipping point.…At one meeting,… Gensler told SEC lawyers that their work must conform with the interpretation of materiality that has been laid out by the U.S. Supreme Court—a standard that underpins the SEC's guidance. Gensler made clear that, as far as he was concerned, there would be no more debate on the issue," the sources told Bloomberg. (See this PubCo post.)

Some contend that litigation is inevitable, regardless of what the proposal requires, and Bloomberg has reported that "[m]ost Republicans insist that regulating global warming is outside the agency's jurisdiction, and business groups have already been discussing a litigation strategy." The WSJ has also reported that some Republicans argue that "it isn't the SEC's job to mandate nonfinancial disclosures." In addition, the article continues, some industry organizations "told the SEC it didn't have legal authority to compel disclosures and impose its value judgments." One Republican state attorney general "wrote that 'West Virginia will not permit the unconstitutional politicization of the Securities and Exchange Commission. If you choose to pursue this course we will defeat it in court.'"

SideBar
According to a 2021 report from Deloitte of a 2021 survey of audit committee members globally, not that many companies had planned to disclose Scope 3 emissions. In the Americas, only 26% of respondents said they were reporting or planning to report Scope 3 emissions as part of their TCFD disclosures. Companies that were planning to report Scope 3 identified as the biggest challenges the ambiguity of measurement standards (92%), lack of robust information from the value chain (85%), lack of clear parameters to define Scope 3 emissions (77%), lack of understanding of the perceived value of this information (62%) and lack of co-operation from the parties in the value chain (46%). Deloitte observed that, while the entire task of addressing climate is enormous, "Scope 3 GHG emissions are significantly more difficult to quantify than those in Scope 1 or 2." However, Deloitte asserted, given that "Scope 3 emissions are likely to be the most material part of a company's carbon footprint, companies need to get more comfortable with preparing and exchanging information to facilitate greenhouse gas reporting in the value chain." (See this PubCo post.)

Of course, the SEC still has a few days before the meeting—time enough to make further changes in the proposal. How the proposal will ultimately shake out remains to be seen.

Cydney Posner on March 18, 2022

Cooley LLP