Dissonance in Climate Disclosure:
the SEC, EU, California, and ISSB Regimes

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ABSTRACT: In the last few years, most major financial centers adopted rules on climate disclosure. But for all the swift action taken by policymakers, their approach has been far from uniform. A particularly thorny question relates to mandatory disclosure of greenhouse gas emissions, especially indirect Scope 3 emissions occurring throughout a company's value chain. The EU forged ahead by requiring Scope 3 disclosures in 2021. The SEC followed with a related proposal in 2022, receiving an overwhelming wave of commentary both for and against the proposal, with many negative views focusing on the Scope 3 mandate. While the SEC pondered its reaction, California moved ahead in late 2023 by introducing a Scope 3 mandate, effectively capturing many U.S. companies doing business in the state. Finally, the SEC axed the Scope 3 mandate from the final rule it adopted in 2024. Scope 3 disclosure mandates are absent from the ISSB framework, a private set of standards used by many companies voluntarily and adopted or considered as a template in many other jurisdictions, such as Brazil, Canada, Japan, and Australia.

To better understand the controversy, this essay begins by exploring the challenges associated with Scope 3 disclosure. The difficulties of obtaining accurate measurements are compounded by the lack of standardized methodologies. Various stakeholders have raised concerns regarding the costs of compliance, the reliability of data, and the potential for misaligned incentives that may divert resources from actual emissions reductions. The essay then analyzes the key differences among different regulatory approaches, such as the SEC's decision to remove Scope 3 emissions from its final rule, the EU's more comprehensive framework, California's ambitious laws, and the ISSB's focus on financial materiality.

The comparative analysis reveals the tradeoffs associated with mandatory Scope 3 disclosures. While companies may disclose Scope 3 emissions as broad indications of their footprint, these are based on estimates and methodologies generally regarded as inconsistent and leaving a lot of discretion to the reporting company. As a result, it is not clear whether mandatory disclosure alone would succeed in producing data that is comparable among companies and industries. European policymakers have set up an institutional infrastructure designed to support companies as they are developing their Scope 3 disclosures by issuing guidance and streamlining reporting quandaries. In the U.S., where this institutional infrastructure is lacking and the risk of securities litigation looming over reporting companies is heightened, the stakes of getting reports right would be much higher.

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This research was commissioned by the Committee on Capital Markets Regulation, but it does not necessarily reflect the views of the Committee or its members. I would like to thank Silvia Fregoni for excellent research assistance. All errors and omissions remain my own.

Electronic copy available at: https://ssrn.com/abstract=4828188

I. Introduction

In early March 2024, the Securities and Exchange Commission announced its anxiously awaited Final Rule on Mandatory Climate Disclosure. It had been a long and turbulent gestation period. In the two years since the SEC circulated its proposal, many criticized the financial centrality of climate disclosure and raised concerns about the agency exceeding its congressional authorization. It is little surprise that the SEC's final rule retreated from some of the most controversial aspects of the proposal, most notably the obligation to disclose GHG emissions from a company's value chain, known as Scope 3 emissions. But as the SEC moved away from these disclosures, some states, like California, are embracing them, raising questions as to how they will support enforcement of this endeavor. Moreover, the EU's corporate sustainability regime demands Scope 3 disclosures, capturing many U.S. companies active there. This misalignment among major regulatory regimes underlines the difficulties of addressing climate change through disclosure and the demanding task of transitioning the global economy toward more sustainable production models.

Below, we explore the challenges of disclosing emissions information, the gaps in current methodology, and the divergent solutions by different regulatory regimes. There is little doubt that, under all regimes discussed below, climate disclosures will require companies to build a costly compliance infrastructure, as many of them have come to realize. Grounding climate disclosure on materiality, as the SEC has done, may represent a setback for progressive agendas, but can help companies focus on information gathering at the pace that markets demand and technologies allow. At this moment, the methodology for calculating Scope 3 emissions appears to allow wide latitude to reporting companies, making it hard to discern whether a company is on track to meet its net-zero commitments or whether there is greenwashing. Without the guidance necessary to build a consistent emissions accounting framework, and the institutional resources for enforcing it, disclosure alone cannot make much headway.

As concerns about climate change continue to rise, many jurisdictions around the world are instituting or considering disclosure requirements that report a company's environmental footprint. Interest in companies' environmental outcomes as predictors of stock market returns or long-term potential has grown significantly. Some investors consider a company's emissions as indicators of its progress toward more sustainable production models, expecting a higher cost of capital for companies falling behind as environmental regulations are ramping up. Other investors might show a preference toward companies that, in their view, are actively working to minimize harmful activities to society. Mandatory disclosure, policymakers are hoping, can induce corporations to look harder at their business models and set up internal monitoring systems that can better track environmental impact. Moreover, disclosure will invite market scrutiny, thus distinguishing among companies that are making significant commitments and others making only superficial efforts. For regulators, addressing concerns about "greenwashing" or misleading marketing around sustainability strategies is a crucial step in maintaining the integrity of the capital markets.

Nevertheless, whether disclosure-based strategies will succeed in incentivizing companies to act against climate change is not a foregone conclusion. Data limitations suggest that disclosures will have to rely heavily on estimates of companies' footprint rather than

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actual measurements, at least initially. Thus, it is unclear how comparable companies' disclosures will be to one another, thus blunting the force of disclosure and hampering market scrutiny. Concerned about potential liability, companies are investing heavily on building a reporting infrastructure that provides reports as accurate as the company can defend. The financial burden and diverted attention required for establishing and staffing a new disclosure bureaucracy will, many fear, detract from the main goal of fighting climate change on the ground. At the same time, uncertainty about foundational concepts, including the materiality threshold, is likely to lead to divergent approaches among companies and jurisdictions.

This report explores how these concerns arise in the context of GHG emissions disclosure, and in particular Scope 3 emissions - indirect emissions that occur across a company's value chain. The GHG protocol was designed to gauge a company's total emissions as a helpful decision-making tool for managers seeking some guidance about their company's total footprint. Soon, investors demanded information about Scope 3 data not as an accurate measurement of emissions but as a broader indication of a company's progress toward more sustainable production methods. Policymakers then relied on Scope 3 emissions measures as a cornerstone of their mandatory climate disclosure rules, calling for rigorousness that current methodologies are ill-placed to provide. We discuss major policy initiatives on climate disclosure such as the SEC proposal, EU's Corporate Sustainability Reporting Directive, California laws, and ISSB standards. Many comments submitted on these policies urge flexibility on GHG emission disclosures through focusing only on significant emissions categories, allowing reasonable assumptions and proxy data, longer transition periods, safe harbor provisions, and more guidance on calculations and materiality determinations.

Overall, this comparative effort brings to light the unavoidable tension arising from transforming a categorization developed to offer a broad gauge into a company's emissions into a disclosure-based measurement system utilized to assess progress quarter-to-quarter or year-to-year. Policymakers globally are grappling with finding the right balance. Getting it right will enable stakeholders to accurately assess the full climate impact of corporate activity. Getting it wrong will mire industry in ineffectual box-checking that does little for sustainability while diverting focus from the urgent task of decarbonization. While Scope 3 emissions reporting helps provide an overview of the company's efforts, it is a measure ill-fitted to some industries, like finance, where fears of double-counting and the difficulty of aligning disclosure with risk supervision complicate the regulatory effort. Even European regulators, who have spent years crafting frameworks and standards, conceded the need to include a materiality opt-out clause in Scope 3 emissions. At the moment, we lack a carbon accounting system that can help realize the benefits of transparency while minimizing unintended consequences.

This report is structured as follows. Part II includes a general discussion of the Greenhouse Gas Protocol and the challenges it presents for mandatory disclosure. Part III analyzes how key regulatory efforts are responding to these challenges. It offers an overview of the SEC's Mandatory Climate Disclosure Proposal, the EU's emissions reporting rules under the CSRD, the recently adopted California Climate Disclosure Laws, and the ISSB framework. It also discusses criticisms raised against each framework separately. Part IV concludes by highlighting the challenges regulatory efforts are facing.

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II. The Policy Puzzle: The Greenhouse Gas Protocol and the Challenge of a Reporting Framework

The Greenhouse Gas Protocol has become an internationally recognized standard for measuring and reporting corporate greenhouse gas emissions. While the Protocol provides guidelines, its voluntary framework lacks consistent methodologies and emission factors for calculating emissions, especially indirect Scope 3. Thus, regulators, policymakers, and corporations have a huge role to play in the push towards disclosure regimes targeting emissions. In the paragraphs below, the report discusses the Greenhouse Gas Protocol categorization, the rationale for demanding disclosure, as well as the challenges of implementing it.

a. The Greenhouse Gas Protocol

The steppingstone in policymakers' initiatives consists in an effort to standardize disclosures around Greenhouse Gas (GHG) emissions, which help trap heat within the planet's atmosphere and thus increase its temperature. Most policymaking efforts have endorsed a categorization established in the 2001 GHG Protocol, a non-binding international instrument agreed upon by World Resources Institute, a widely respected sustainability non-profit, and the World Business Council for Sustainable Development, a CEO-led organization, with the support of the United Nations. Under the GHG Protocol, companies' emissions fall under three categories:

- Scope 1 emissions: these are direct emissions that occur from sources owned or controlled by the company (such as from furnaces, vehicles, chemical production, or livestock);
- Scope 2 emissions: these are indirect emissions associated with the purchase of electricity, steam, heat, or cooling (which typically occur at the facility where they are generated);
- Scope 3 emissions: these are indirect emissions that occur in the value chain of the reporting company, either upstream or downstream. Emissions that occurred for the extraction or manufacturing of materials and fuels purchased by the company, or for company-related transport activity are included in Scope 3. Also, emissions occurring during the life of the product, or emissions at waste disposal activities would also be included.

b. The Policy Debate Around Emissions Disclosure: Why Mandatory?

Scope 3 emissions play key role in a company's environmental impact. According to the CDP (formerly the Carbon Disclosure Project), Scope 3 emissions typically account for 75% of a company's GHG emissions and can reach close to 100% for certain industries (e.g. financial services and capital goods). For industries utilizing raw materials (e.g. real estate, construction, metals and mining, agriculture commodities), Scope 3 encompasses 90-95% of a company's value chain.[1] If upcoming mandatory disclosure rules entirely omitted any

[1] https://www.unravelcarbon.com/blog/companies-struggle-scope-3-measurement

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obligation to disclose Scope 3 emissions, certain companies might only be required to provide minimal information. Large banks, for example, which are major financiers of fossil fuel projects, would be practically exempt from revealing any meaningful climate data to investors, as their Scope 1 and 2 emissions are very low. It is worth mentioning the example of Apple, which has reduced its Scope 1 and Scope 2 emissions significantly by relying on renewable energy for all its facilities. Thus, 99% of its emissions would be categorized under Scope 3, with 71% coming from manufacturing.

From a business perspective, tracking Scope 3 emissions can assist companies in assessing risks in their business model and organize transition to sustainable production methods more effectively. By mapping their Scope 3 emissions, companies can understand what parts of their value chain are more vulnerable to risks from an evolving energy and regulatory landscape. Moreover, investors can better understand what steps the company must make for an effective transition, and how to assess its progress toward that goal. These pressures, it is hoped, will incentivize companies to pursue business opportunities in a low carbon economy more aggressively and spur innovation, in an effort to achieve progress in a more cost-effective manner.

The importance of Scope 3 emissions for companies' footprint and the benefits associated with tracking have led policy advocates and regulators around the world to support proposals for mandating disclosure by companies. As a policy tool, mandatory disclosure has certain key features that could reinforce the policy goals from tracking Scope 3 emissions analyzed above. Generally, mandatory disclosure helps increase transparency and market monitoring, because it allows market participants to compare figures among different companies and thus evaluate performance more accurately. To help investors better understand disclosures and achieve comparability across companies, mandatory disclosure regimes standardize disclosure format, so that the information can be readily absorbed by readers. Moreover, the liability risk associated with any mandatory disclosure items, policymakers hope, will put pressure on executives to beef up their measurement and data collection efforts, thus boosting the accuracy of company provided figures.

In addition to these general features of mandatory disclosure, policymakers are pointing to specific reasons why Scope 3 emissions should be part of mandatory disclosure requirements. First, investors and governments are concerned about the potential for "greenwashing." As companies are striving to present their environmental credentials positively gain favor with an increasingly environmentally conscious consumer and investor base, many are wondering whether company efforts are achieving any results on the ground. Some are skeptical that corporations are committing to any actions besides releasing vague rhetorical statements. Second, policymakers are hoping that, through Scope 3 emissions disclosure, their efforts will resonate throughout the supply chain. To reduce their footprint, companies will need to exert pressure on suppliers to adopt more sustainable production methods, even when suppliers are not required to disclose these figures themselves or are not directly subject to stricter regulation. Thus, policy advocates see Scope 3 emissions are seen as a vehicle to effect broader change toward a more sustainable future.

c. The Challenges of Mandating Disclosure for GHG Emissions

i. Costs of Setting Up and Managing Compliance Infrastructure

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For companies, the main challenges with mandatory emissions disclosure are associated with the difficulty of obtaining accurate measurements. Calculating emissions is far from straightforward. Companies must rely on other sources to determine how to calculate emissions from these activities, and there is no universally accepted set of standards to achieve this goal. Even for Scope 1 and Scope 2 emissions, which firms can more readily monitor, coming up with reliable figures is a complicated task. Gathering accurate data on all direct emissions sources can be complex, especially for larger organizations with multiple operations or facilities. This includes measuring fuel consumption, understanding the emissions factors of different fuels, and keeping accurate records of all emissions-producing activities. Some emission sources might require sophisticated equipment to measure emissions directly, which can be expensive and technically challenging to operate. [2]

For most companies, this requires developing a compliance infrastructure, which includes hiring and training new staff, investing in new software and IT data management systems, instituting new internal procedures and protocols, and involving senior management. [3] Moreover, as technology advances or business models evolve, the compliance infrastructure must also adapt. Especially upfront, compliance will involve significant costs in setting up reporting systems for gathering and verifying data. [4] Some investors expect these costs to diminish over time,[5] while others are concerned that ultimately the cost will be born by investors, who will see a drop in stock prices as compliance costs burden profitability.[6] As many companies are already providing voluntary disclosures of certain emissions, policymakers are hoping that they are not demanding a new compliance infrastructure to be built from the ground up, but companies can take advantage of existing reporting mechanisms.

Estimates of compliance costs vary widely. To better understand the expected costs of compliance, a helpful first step would be to inquire what companies are currently spending when disclosing their GHG emissions voluntarily. These voluntary disclosures are not as detailed as these envisaged by regulation, as only about 1 in 10 companies include fully measured Scope 3 emissions throughout their business and value chain, as a BCG survey points out.[7] According to surveys of compliance costs for corporate issuers that are disclosing their GHG emissions voluntarily, the average U.S. issuer is spending $533,000 to $677,000 annually on climate-related disclosures.[8] The SEC has estimated that the average firm will pay an additional $864,000 for the mandated disclosures. Similarly, institutional investors are spending an average of $1,372,000 annually to collect, analyze, and report climate data to

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[2] Verónica H. Villena & Suvrat Dhanorkar, *How Institutional Pressures and Managerial Incentives Elicit Carbon Transparency in Global Supply Chains*, 66 JOURNAL OF OPERATIONS MANAGEMENT 697 (2020). Ozgur Isil & Rose Sebastianelli, Arcs of Carbon Awareness in the Value Chain and Their Antecedents, 29 BUSINESS STRATEGY AND THE ENVIRONMENT 503 (2020).

[3] Maximilian Hettler & Lorenz Graf-Vlachy, *Corporate Scope 3 Carbon Emission Reporting as an Enabler of Supply Chain Decarbonization: A Systematic Review and Comprehensive Research Agenda*, n/a BUSINESS STRATEGY AND THE ENVIRONMENT, https://onlinelibrary.wiley.com/doi/abs/10.1002/bse.3486 (last visited Feb 2, 2024).

[4] https://efrag.sharefile.com/share/view/sfee944fc553c401396e7dffc23314dc2/fob6a1ba-4237-4c96-baf6-baa166d0f8b6

[5] Impax, https://www.sec.gov/comments/s7-10-22/s71022-20128633-292831.pdf

[6] Dimensional, https://www.sec.gov/comments/s7-10-22/s71022-20128689-293923.pdf

[7] https://hbr.org/2023/08/demystifying-emissions-reporting

[8] https://www.erm.com/news/survey-reveals-costs-and-benefits-of-climate-related-disclosure-for-companies-and-investors/

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inform their decisions. Moreover, these figures do not include either the costs of initially setting up the compliance infrastructure, or obtaining third party verification.

Other surveys expect the costs of compliance to be significantly higher. PWC surveyed executives in U.S. public companies with at least $500 million in annual revenue.[9] The majority of these executives expected additional compliance costs around $1M for the first year, higher than prior estimates. Commenting on the overall requirements of the SEC proposal, HP says that the Commission "has drastically underestimated the likely costs to registrants of complying with the Proposal, both initially and on an ongoing or annual basis."[10] "Registrants, including HP, will need to enhance or implement new policies, processes, controls, and systems solutions to comply with the rule, which will take time to establish and implement. In our view, the Proposal's cost estimate does not adequately take into account these time demands or costs."[11] Moreover, complying with mandatory disclosure will also entail significant costs for many suppliers and small businesses, which will be required to provide emissions data to any public companies with which they collaborate. As a result, compliance costs will encompass a much broader swath of companies than before.

Many are wondering whether the high costs of compliance with mandatory disclosure will push firms away from public markets and toward other forms of financing or other jurisdictions, where no similar requirements exist.[12] Others are worried that it will push registered firms to exit the public market and become private. By delaying entry or accelerating exit from public markets, companies are placing themselves outside the reach of disclosure, thus undermining any positive effects that disclosure ought to be bringing.

ii. Challenges of Calculating Scope 3 Emissions Throughout the Value Chain

Calculating Scope 3 emissions presents an additional set of challenges, largely because companies must rely on others to provide that data to them. Information on the amount of goods or services purchased by suppliers, the distance traveled, or the waste generated by operations is not easy to gather. Often, the data itself is not available. If all suppliers were gathering Scope 1, 2, and product life cycle emissions, then it would have been much easier to collect data about a company's upstream value chain emissions. Some suppliers are simply too small or too unsophisticated to engage into the data gathering exercise such disclosures would require. Other suppliers may be located in jurisdictions where such data gathering is not mandatory, or where measuring rules and requirements are different. There is significant variability in emission sources among industries, which tend to follow different approaches in collecting and reporting them. Overall, the transaction costs associated with collecting data from sources outside the company, the need to allocate responsibility upstream and downstream for collecting the data, and the sheer costs of measuring them,[13] helps explain

[9] https://www.workiva.com/sites/workiva/files/pdfs/change_in_the_climate_report_02.24.23.pdf
[10] https://www.sec.gov/comments/s7-10-22/s71022-20132241-302682.pdf
[11] Id.
[12] Davis Polk, https://www.sec.gov/comments/s7-10-22/s71022-20130934-300028.pdf
[13] A state-of-art literature review reflecting 15 years of focus on sustainable supply chain management - ScienceDirect, https://www.sciencedirect.com/science/article/pii/S0959652616318613 (last visited Feb 5, 2024).

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why companies are finding it harder to report Scope 3 emissions compared to Scope 1 and Scope 2 emissions.[14]

While compliance costs for measuring Scope 1 and 2 emissions fall mostly on larger companies, Scope 3 emissions disclosure requires smaller companies to set up compliance systems too, so that they can report their figures to their larger collaborators subject to the requirements. Associations representing small businesses and farms are, not surprisingly, especially vocal about this issue. The National Association of Home Builders articulates that the Scope 3 rule will "impose the regulatory burden of SEC regulations on small businesses that are not regulated by SEC and are not familiar with SEC requirements."[15] The American Farm Bureau Federation says that Scope 3 would have "devastating consequences for farmers and ranchers," as public companies that are required to report emissions from agricultural production will inevitably require farmers and ranchers to track and report their emissions information to those companies.[16] The Confederation of European Business, shortened as BusinessEurope, expressed concerns about costs when commenting on ESRS rules. The organization says that "the added value of the proposed disclosures must be considered, as well as the lack of available data (especially across supply chain/value chain)."[17] For national agricultural associations in the US, reporting climate data at the local level would be "wildly burdensome and expensive if not altogether impossible for many small and mid-sized farmers to comply with."[18]

Many small business groups fear that disclosure obligations will push public companies to either vertically integrate their supply chains, or to outsource activities to larger suppliers with greater resources and more sophisticated data-gathering and reporting systems. The American Trucking Associations note how "[s]mall trucking companies have neither the expertise nor the resources to conduct Phase 3 assessments or estimates, accumulate and enter data, or contract with third parties." The National Federation of Independent Business is worried that small businesses, not equipped to calculate emissions, may have to contract with consultants to provide accurate estimates or risk losing business. "Not every small business will be able to afford these services and this requirement can act as a new market barrier for small businesses."[19]

Major companies also expressed this concern. The Bank of America acknowledges this in its comments to the SEC proposal: "Suppliers are often small and medium-sized enterprises (SMEs)—unsurprisingly, as SMEs represent the vast majority of global businesses—and many of those companies will not be covered under the Proposal's reporting requirements." The data provider Sustainable Fitch says that mandatory Scope 3 "will create pressure on private companies to monitor and report emissions data to the public companies they service, given the former's increasing requirements to report on these."[20] Several commentators also call into question the fact that these rules, especially the SEC proposal,

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[14] Patchell, *supra* note [].

[15] https://www.sec.gov/comments/s7-10-22/s71022-20131106-301159.pdf

[16] https://www.sec.gov/comments/s7-10-22/s71022-20164335-334160.pdf

[17] https://efrag.sharefile.com/share/view/s2fcacc016dcf48ce85a943870c6dccc7/fo8ee61f-d3a3-4463-8629-a524256322e9

[18] https://www.fb.org/files/National_Ag_Associations_-_Comment_Letter_re_SEC_Proposed_Rules_on_Climate-related_Risks_-_File_Number_S7-10-22.pdf

[19] https://www.sec.gov/comments/s7-17-22/s71722-20134158-303963.pdf

[20] https://www.sec.gov/comments/s7-10-22/s71022-20124108-280363.pdf

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affect private companies. The American Securities Association says that the proposal implies "monumental changes that will impose enormous financial costs on companies of all sizes, including private businesses that the Commission has no authority to regulate." [21] The International Dairy Foods Association highlights that the SEC proposal "will place the market burden of measuring, reporting and verifying that data on private companies not within the SEC's jurisdiction." [22] It mentions that most of its members are privately held companies.

iii. Methodological Limitations for Providing Scope 3 Disclosures

While primary data, obtained directly from vendors related to specific activity in the reporting firm's value chain, is deemed more specific and accurate, they place new burdens and responsibilities on reporting firms. To address these concerns, the GHG protocol allows for the possibility of using secondary data for calculating Scope 3 emissions. These would include "industry-average data (e.g., from published databases, government statistics, literature studies, and industry associations), financial data, proxy data, and other generic data." About proxy data, the GHG Protocol explains: "In certain cases, companies may use specific data from one activity in the value chain to estimate emissions for another activity in the value chain. This type of data (i.e., proxy data) is considered secondary data, since it is not specific to the activity whose emissions are being calculated."

As a result, currently available Scope 3 emissions figures reflect a lot of discretion and represent estimations rather than measurements. Some companies and industries have raised this concern. Chevron highlights to the SEC that most Scope 3 calculations are currently based on the use of estimated third-party data whereby an emissions or activity factor is multiplied by an emission-generating activity. The accuracy of data available in some international databases has been called into question. Some described currently available Scope 3 emissions as "ill-defined guesses."[23] While they may offer a general sense of the company's environmental footprint, they involve calculations which may vary significantly in accuracy. Some believe that the uncertainties surrounding these figures could rise to "well over +/-50% for industry average factors, and +/-100-150% for spend factors." Of course, companies could describe how they arrived at the estimate, thus limiting their exposure to liability to some extent and letting investors draw their own conclusions. But by allowing for wide discretion and reverting to investors for conclusion, the rationale for mandatory disclosure weakens.

Numerous researchers have pointed to data quality as a significant concern in Scope 3 disclosure. A comprehensive study assessing the data quality of Scopes 1, 2, and 3 reporting revealed persistent issues with the availability, comparability, and consistency of data, particularly for Scope 3. These researchers found that data on direct emissions are more consistent than data on indirect emissions, and they are especially inconsistent for Scope 3. Among Scope 3 disclosures, those based on third-party estimations are less consistent compared to those based on data stemming directly from corporate reports. Another study

[21] https://www.sec.gov/comments/s7-10-22/s71022-20131037-300856.pdf
[22] https://www.sec.gov/comments/s7-10-22/s71022-20131470-301732.pdf
[23] https://www.sec.gov/comments/s7-10-22/s71022-20131777-302211.pdf.

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investigating specifically Scope 3 data found a "considerable divergence" in emissions values from the largest data providers. It also revealed that firms generally report incomplete composition of Scope 3 emissions, although they are reporting more categories over time. "There is a persistent contrast between relevance and completeness in the composition of Scope 3 emissions across sectors, with low materiality categories such as travel emissions being reported more frequently than typically high materiality ones, such as the use of products and processing of sold products."

The data and methodology limitations in gathering industry data vary significantly by industry. In their comments to the SEC Mandatory Disclosure Proposal, the Food Industry Association suggested that "[a]s it stands, data confidence around the collection of Scope 3 data would likely rank low in the food industry." More complicated companies complained that they would have to collect data from hundreds of suppliers, which would place a significant burden on the company. The Association of Equipment Manufacturers says, in its comments to the SEC climate proposal, that manufacturers deal with a multi-tiered supply chain, which poses significant challenges when reporting upstream and downstream emissions.[24] The fossil fuel sector, which is central for the transition to a sustainable economy, also highlighted problems with data collection. The National Fuel Corporation wrote to the SEC: "Because any one company's Scope 3 emissions permeate among potentially many hundreds or even thousands of companies and millions of consumers, they are nearly impossible to accurately measure, calculate, or otherwise estimate." Chevron highlights that "it is important for the Commission to recognize the substantial effort and uncertainty that many companies will face to implement or expand" emissions reporting, and Eversource Energy refers to "the level of complexity and impracticability of verifying Scope 3 disclosure requirements."

On the other hand, companies whose Scope 3 emissions make up almost their entire carbon footprint, like financial services, face different challenges when reporting GHG emissions. Third-party level data are usually not available to this companies, and approaches to estimation are still insufficiently developed. Some banks, like BBVA, have suggested making disclosures for only a subset of their emissions, focusing on parts of their value chain that they believe are going to have the greatest impact. The Independent Community Bankers of America comments that banks "do not have a trove of climate data readily at their disposal to collect, examine, or disclose" and that their "finite resources and inexperience with the onerous disclosure framework" may result in substantial compliance costs.

As many companies have been disclosing some Scope 3 emissions data voluntarily, they have had to grapple with these concerns. Discussing the lack of downstream reporting, Isil and Sebastianelli say that assessing the carbon footprint of the downstream activities, especially accounting for emissions during product use and end-of-life stages, requires sophisticated, in-house lifecycle analysis capabilities specific to each product.[25] According to Tang and Demeritt, the level of additional organizational effort required depends on the sector and a firm's previous experiences.[26] For example, highly energy-intensive firms have an advantage as their operational units are already accustomed to managing similar energy-

[24] https://www.sec.gov/comments/s7-10-22/s71022-20148507-314793.pdf

[25] Ozgur Isil & Rose Sebastianelli, *Arcs of Carbon Awareness in the Value Chain and Their Antecedents*, 29 BUSINESS STRATEGY AND THE ENVIRONMENT 503 (2020).

[26] Samuel Tang & David Demeritt, *Climate Change and Mandatory Carbon Reporting: Impacts on Business Process and Performance*, 27 BUSINESS STRATEGY AND THE ENVIRONMENT 437 (2018).

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related information, allowing for a smoother transfer of reporting structures. On the other hand, non-energy-intensive firms often find it necessary to establish entirely new processes and departments from the ground up.

These challenges raise important questions about whether disclosure, as a regulatory strategy to inform investors and enlist corporations in the fight against climate change, can achieve its desired effects. To start, the lack of comprehensive methodological guidelines and the variability in emission factors used in estimations can lead to inaccuracies and misrepresentations, which may undermine the credibility of the disclosure exercise. While the market is expecting information that will increase scrutiny and comparability, inconsistent methodology will hamper comparisons among companies. Without comparability, it will be hard for investors to rely on these reports to make informed choices about their investments. Yet, companies, executives, and directors may be held liable for these inaccuracies under general securities laws, a prospect particularly alarming for high-enforcement jurisdictions like the U.S.

Scholars have also highlighted the undesirable potential consequences of low-quality data. Through a case study of a major oil and gas firm, an empirical article suggests that information with low quality can reduce the comparability of Scope 3 reports.[27] Another study analyzed Carbon Disclosure Project (CDP) responses from 2003 to 2010, focusing on the extent to which firms account for indirect emissions and exhibit convergence in carbon reporting. The authors found that as the amount of companies' disclosure increases, the comparability between reporting expands in Scopes 1 and 2, but not in Scope 3.[28]

Other studies indicate the issue of double counting, which could affect consistency and accuracy. This is an inherent part of the process, according to the GHG Protocol.[29] By definition, Scope 3 emissions occur from sources owned or controlled by other entities in the value chain, so Scope 3 emissions for the reporting company constitute direct emissions of another entity. "In certain cases, two or more companies may account for the same emission within Scope 3. For example, the Scope 1 emissions of a power generator are the Scope 2 emissions of an electrical appliance user, which are in turn the Scope 3 emissions of both the appliance manufacturer and the appliance retailer. Each of these four companies has different and often mutually exclusive opportunities to reduce emissions."[30] Double counting is justified because by understanding all its emissions, a company can more readily take some responsibility for reducing them. But as far as drawing conclusions about economic sectors as a whole, double counting raises serious concerns.[31] Other studies indicate the risk of emission reductions also being double counted –in this situation, global emissions could be higher than the sum of what individual companies or countries report.[32]

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[27] Matthew Wegener, Réal Labelle & Lambert Jerman, *Unpacking Carbon Accounting Numbers: A Study of the Commensurability and Comparability of Corporate Greenhouse Gas Emission Disclosures*, 211 JOURNAL OF CLEANER PRODUCTION 652 (2019).

[28] Daniel C. Matisoff, Douglas S. Noonan & John J. O'Brien, *Convergence in Environmental Reporting: Assessing the Carbon Disclosure Project*, 22 BUS STRAT ENV 285 (2013).

[29] https://ghgprotocol.org/sites/default/files/2022-12/Scope%203%20Detailed%20FAQ.pdf, p 20-21

[30] https://ghgprotocol.org/sites/default/files/2022-12/Scope%203%20Detailed%20FAQ.pdf, p 20

[31] Oliver J. Robinson et al., *Towards a Universal Carbon Footprint Standard: A Case Study of Carbon Management at Universities*, 172 JOURNAL OF CLEANER PRODUCTION 4435 (2018).

[32] Lambert Schneider, Anja Kollmuss & Michael Lazarus, *Addressing the Risk of Double Counting Emission Reductions under the UNFCCC*, 131 CLIMATIC CHANGE 473 (2015).

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iv. Lack of Standardized Approach to Calculating Emissions

Although the GHG Protocol provides some guidance, it does not constitute a comprehensive set of rules for accounting for these emissions. Government regulatory agencies like the SEC lack the capacity to develop these rules themselves; with regard to accounting standards, for example, the SEC has relied on FASB to establish and update US GAAP. However, no similar standard-setter of wide acceptance has yet emerged with regard to GHG emissions and other sustainability metrics.

There are at least two major sets of standards that could provide guidance to companies in calculating GHG emissions: the European Sustainability Reporting Standards (ESRS), which are mandatory within the EU, and the International Sustainability Board Standards, which companies can voluntarily adopt. The European Financial Reporting Advisory Group (EFRAG) and the International Sustainability Standards Board (ISSB) have been working on aligning their respective climate-related disclosure standards to reduce complexity and duplication for entities wishing to apply both sets of standards. EFRAG has released draft standards, and the ISSB has issued proposed standards aiming to create a global baseline for investor-focused sustainability reporting. While there is common ground between these standards, there are also areas where they are not aligned. For example, both sets of standards rely on internal governance mechanisms aligned with the TCFD framework, and both emphasize engagement with stakeholders. However, while the ISSB standards require disclosures only if the issues are material for the company, the ESRS mandate does not depend on materiality. Thus, companies that may find themselves subject to both sets of standards might be faced with duplicative efforts, additional costs, and inconsistent perspectives.

v. Diverting Company Resources from Sustainability to Compliance

To provide emissions figures and other sustainability reporting, companies are investing resources in building up their reporting infrastructure to improve the accuracy of their measures and oversee their emissions more closely. In doing so, however, they are diverting attention and resources from the underlying goal of transforming their production and operation toward a more sustainable model. Instead of focusing on fighting climate change, companies are focusing on enhancing accurate reporting. Many fear that, rather than the promised innovation in sustainable operation and production, the imposition of disclosure requirements is aggrandizing corporate bureaucracies.

Sustainability officers, in particular, have been clear about the effect new disclosure rules are having on their scope of work. The core of their job, to devise investment strategies and production methods that would help the company transition to a more sustainable future, is currently taking backstage. Instead, they are spending the time designing and setting up compliance infrastructures, training new hires, and integrating climate risk in existing risk management frameworks. According to the PWC survey discussed above, executives many executives did not feel confident that their companies are staffed appropriately, or that they would be able to source the right technology to respond to regulatory requirements.[33] 40% of surveyed executives believed that their companies are not fully prepared to meet these

[33] https://www.workiva.com/sites/workiva/files/pdfs/change_in_the_climate_report_02.24.23.pdf

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requirements, while 70% believe that, to reach that point, they will need at least two years since new rules come into effect. Preparing disclosures and reports can involve significant effort writing, designing, and negotiating with the company's experts.

vi. Methodological Discrepancies and Double Counting in the Financial Industry

The methodological limitations discussed above, such as lack of a standardized carbon accounting system or reliance on industry averages and gross estimates, hit the financial industry the hardest. On the one hand, Scope 3 emissions typically constitute over 90% of a financial firm's total emissions, thus raising the stakes for a financial firm to get them right. On the other hand, financial firms are farther removed from the companies generating these emissions than in most industries, and thus have little say or control over their calculation, while they need to assess how they can be attributed to their financing. These emissions are tied to activities such as financing, investment ("financed emissions"), and underwriting ("facilitated emissions"). In essence, the emissions are generated by companies that financial institutions lend to, invest in, insure, or assist with IPOs. The critical question is whether financial firms should bear responsibility and risk for these emissions due to their involvement, and if so, how they should account for it.

Some argue that financial institutions, as the gatekeepers of capital flows, are uniquely positioned to pressure companies to disclose and manage their emissions, as they have a vested interest in mitigating potential risks to their portfolios. By focusing financial institutions' attention to lowering emissions, policymakers hope, they can divert resources to firms that facilitate decarbonization and jumpstart transition to sustainability. Moreover, banks committed to achieving net-zero emissions by 2050 will almost certainly need to set ambitious targets to reduce their Scope 3 emissions and meticulously account for them. Under the Net Zero Banking Alliance (NZBA), over 70 banks have already set bold interim decarbonization targets for 2030. Finally, advocates argue that banks can harness their extensive compliance departments, which navigate complex regulations such as anti-money laundering rules, to streamline data collection from corporate clients for reporting. This could also present a significant business opportunity for banks to offer additional products and services to support clients in their energy transition.

But to successfully prod banks towards sustainability in their portfolio and benchmark their progress toward that goal, Scope 3 data must represent a reliable measurement of emissions in those portfolios. As broadly acknowledged, current Scope 3 measurement efforts are falling short. The Bank Policy Institute (BPI), a banking industry trade group, argues that absolute emissions metrics are often "simply a crude indicator of the size of a firm's business and the sector in which it operates." This is because financial institutions' own emissions represent a subset of the Scope 3 emissions reported by the underlying companies they finance, which in turn rely on estimates based on industry average metrics. But by aggregating emissions by multiple companies in the same industry, financial institutions are de facto using different estimates of the industry average. Therefore, the value of collecting this data compared to its cost remains highly questionable.

A particularly thorny issue for financial institutions with multiple borrowers and projects in each industry concerns avoiding counting the same emissions twice. For example,

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if a bank offers auto loans to retail clients, as well as a credit line to an auto manufacturer, assessing emissions represents a problem. Since the auto manufacturer will have to report Scope 3 emissions from the operation of the cars it produces, and the auto-loan-financed cars also result in Scope 3 emissions, the bank is faced with the possibility of counting these emissions twice. Similarly, a bank that has a lending relationship both with an airline company and with a manufacturing company may be faced with the challenge of double counting emissions by the manufacturer's employees that are traveling with the airline. Double counting can easily turn into triple counting or multiple counting, if the bank in the above examples has relationships with, say, a steel or glass supplier to the auto-manufacturer, or a fuel provider to the airline.

For now, there are no generally accepted methodologies around double counting, and financial institutions rely on internal efforts to catch duplicative reports while disclosing their respective approaches. However, these ad hoc approaches undermine the goals of disclosure, which calls for standardized and comparable information. Moreover, the vagueness around double counting introduces uncertainty as to whether a company has reached its decarbonization goals, and may invite litigation, particularly in the company has to provide these numbers in mandated disclosures.

Putting measurement inaccuracies aside, Scope 3 emissions data may prove misleading even if taken simply as a broad indication of transition efforts. Typically, the highest gains from transition to sustainability come from sectors that have the longest path toward that direction, often because transition is currently difficult to achieve due to lack of available technologies. For example, sustainable aviation fuel is currently available only in small quantities and at high cost, and the airline industry must invest heavily in research and development funding to move in that direction. Yet, this investment will require high Scope 3 emissions in the short term. The BPI summarizes this conundrum as follows: "relating to climate-related characteristics alone, in some industries, a borrower with a higher starting level of GHG emissions and a credible transition plan may be less exposed to transition risk over the medium-to-long term than a borrower with lower starting GHG emissions and no transition plan."

Due to the complexity of Scope 3 accounting for financial institutions, whose activities are diverse and vastly different in nature from those of other industries, a standardized methodology would be essential in supporting a successful disclosure regime. Although various frameworks for assessing, categorizing, and disclosing financial institutions' exposures to climate risk are under development, none has yet reached the requisite level of maturity or emerged as the industry leader. The most significant effort in this direction consists in the creation of the Partnership for Carbon Accounting Financials (PCAF), a global organization of more than 450 financial institutions aiming to develop emissions accounting standards, has been issuing standards to help banks calculate their Scope 3 emissions. Their first standard for "financed emissions" was released in 2019 and updated in 2022, with endorsement by the GHG Protocol. The second standard, released in 2022, focused on insurance-associated emissions, while the third and most controversial one, released in December 2023, addressed "facilitated emissions" related to capital market issuances.

But while many banks are lining behind the PCAF standards, they are also recognizing their limitations. The methodologies for calculating financed emissions vary significantly across asset classes and sectors, thus making it hard to apply consistently. The most controversial aspect of the methodology, which consists in attributing emissions to the

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financier's respective contribution, remains challenging and invites discretion. As a result, there are worries that PCAF standards are vulnerable to greenwashing.

The challenges associated with disclosing facilitated emissions are even more daunting than those associated with financed emissions and are amplified by the novelty of measurement approaches in this area and an even more tenuous link to banks' credit risk exposure. Due to these risks, many banks had been excluding these emissions from their voluntary disclosures, despite the fact that they represent significant financing channels for many industries, including fossil fuel. Reporting facilitated emissions associated with capital market instruments is currently "optional" under the GHG Protocol and has therefore been excluded by many current disclosure regimes, such as the EU and the ISSB. Other financial activities, such as sovereign bonds, securitized products (including asset-backed securities), covered bonds, derivatives, and M&A advisory services, do not yet have their own standards. Treasury securities present an extreme example, as banks will have to estimate the emissions associated with the activities of the U.S. government, which is a herculean task. Ultimately, the costs and effort associated with this type of measurement might yield minimal payoff; the figures are bound to be, at least in the short term, largely a calculated guess, and the U.S. government is unlikely to alter its operations just to help the banking sector reduce its Scope 3 emissions.

Overall, in reporting Scope 3 emissions, the financial industry's challenges are compounded by the lack of generally acceptable and standardized methodologies for attributing emissions, the risk of double-counting, and the vagueness of the underlying data. Under the current voluntary disclosure regime, many banks provide this information as a broad indication of their efforts and portfolio makeup. But mandatory disclosure will require rigorousness and invite judicial scrutiny in ways that current methodologies are unlikely to support.

III. Comparing Key Regulatory Efforts: SEC's Proposal, EU's CSRD, California's Climate Laws, and the ISSB's Framework

The challenges of creating a sustainability reporting infrastructure and overcoming the lack of data on Scope 3 emissions are well known to policymakers, climate advocates, corporations, and professional consultants and experts around the world. Until recently, the disclosure of GHG emissions, including Scope 3 ones, was a voluntary initiative many companies undertook to burnish their sustainability credentials and respond to investor requests for information. However, policymakers around the world are currently considering or are in the process of establishing mandatory emission disclosure regimes. While recognizing the challenges associated with these disclosures, supporters of these initiatives argue that the represent a necessary first step in the effort to monitor and discipline corporate emissions. Acknowledging that the data may leave a lot to be desired, supporters hope that, if corporations are required to disclose their emissions, they will take their role as emitters more seriously. Combined with market pressure, disclosure obligation will spearhead an internal transformation that within corporate leadership that will reorient production toward more sustainable methods. This report will explore how key jurisdictions considering or enacting mandatory emissions disclosure are planning to address these challenges.

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a. SEC Mandatory Climate Disclosure Rule

On March 6, 2024, the Securities and Exchange Commission (SEC) adopted and released its final rules on "The Enhancement and Standardization of Climate Risk Disclosure," after a vote of 3-2 with the two Republican commissioners opposing.[34] The final rule gives shape to the agency's efforts to establish the first federal sustainability disclosure requirements in the U.S. But in contrast with the proposed rule, released almost two years earlier, the disclosure requirements in the final rule are generally subject to a materiality requirement. As far as GHG emissions are concerned, issuers will be required to provide material information on Scope 1 and Scope 2 greenhouse gas emissions. There is no explicit requirement to provide disclosure on Scope 3 emissions. Moreover, issuers will provide disclosure on severe weather-related financial statement impact, and climate-related governance, risks, and targets information to the extend they consider material.

The rules represent the first step toward bringing climate information to the forefront of the federal disclosure regime in the U.S., recognizing the financial and systemic implications of climate-related activities and events for companies' overall outlook. As the agency stated, "[t]he final rules reflect the Commission's efforts to respond to investors' demand for more consistent, comparable, and reliable information about the financial effects of climate-related risks on a registrant's operations and how it manages those risks while balancing concerns about mitigating the associated costs of the rules."[35] At the same time, the SEC made a pragmatic choice to remove some of the most cumbersome requirements of the proposed role, and most notably the requirement to report Scope 3 emissions figures, and to ground its climate disclosure on materiality. In scaling back its rule, the Commission responded to concerns about the feasibility of producing accurate Scope 3 emission figures, the difficulties this posed for certain industries, such as finance, and the costs of building compliance infrastructures that would be up to the task within the timeframe required by the rules.

The SEC's pivot came after an onslaught of commentary following the proposing release, suggesting that the difficulties in implementing the disclosure mandate as initially drafted would be far higher than the agency had anticipated. While many companies have begun to announce Scope 3 figures voluntarily, there is much uncertainty about the underlying informational value of these figures. Other companies have chosen to avoid this disclosure due to the difficulty of collecting data in their industry or their supply network and the high scrutiny associated with mandatory disclosure. But while removing these requirements may have averted an immediate increase in compliance costs, it also places greater burden on companies to assess their exposure to transition risks. Under the final rule, the company must decide for itself the actual and potential impacts of identified climate-related risks on its business. This discretion may invite additional litigation.

The controversial character of the disclosure regime has been exposed since the beginning. The SEC proposal was released on March 21, 2022, and the comment period for the 490-page document was originally set to end on May 20, 2022, but was pushed to June

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[34] SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors, https://www.sec.gov/news/press-release/2024-31 (last visited Mar. 12, 2024).
[35] *Id.*

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17, 2022, after the Commission received numerous requests for an extension. Since then, the SEC has been reviewing the comments, that summed up more than 24,000[36] letters, including more than 4,500 unique letters, from issuers, shareholders, interest groups and others—significantly more than any other past piece of SEC rulemaking. By comparison, 37 rules mandated by the Dodd-Frank Act and promulgated by the SEC before the end of 2014 received, on average, just 92 comments per rule.[37] Because of the new requirements it seeks to impose, the Mandatory Climate Disclosure is one of the most anticipated and more highly contested rulemakings in the history of the SEC.

Below, we illustrate the shift in the SEC's position on GHG emissions by first discussing the Proposed Rule and then illustrating the changes in the Final Rule.

b. SEC Proposed Mandatory Climate Disclosure

i. Target Companies

The SEC's proposed rule would cover all reporting companies. There are no special provisions for new filers conducting an IPO or seasoned issuers, nor any distinction between domestic or foreign issuers. However, Smaller Reporting Companies ("SRCs")[38] benefit from relaxed requirements in certain cases; most importantly, SRCs are not subject to Scope 3 emissions disclosure requirements. According to some estimates, about half of publicly traded companies are SRCs. Moreover, the proposed rule had envisaged different phase-in periods for large accelerated filers (starting reporting in 2024 for year 2023), other filers (starting reporting in 2025 for year 2024), and SRCs (starting reporting in 2026 for year 2025). However, the phase-in period dates are likely to be revised, given the delay in adopting the rulemaking.

ii. Mandated Disclosures

The Mandatory Climate Disclosure Proposal requires all reporting companies to disclose their Scope 1 and Scope 2 emissions, arguing that gathering data on these emissions falls under the control of the company, and that the EPA has issued substantial guidance on methodologies. In contrast, it requires companies to provide disclosure of Scope 3 emissions only if those emissions are material, or if the registrant has set a GHG emissions reduction target or a goal that includes these emissions (such as a net-zero goal). To determine materiality, the proposal refers to the standard definition of materiality under the federal securities laws, as data that "alters the mix of information available to investors." This is a famously vague standard, developed to allow courts flexibility to discuss not only the overall financial impact of the company's revealed misstatements, but also the qualitative characteristics it betrays about its management and operations. Thus, it places on companies the burden to make the materiality determination.

[36] *Id.*
[37] Pamela Ban & Hye Young You, *Presence and Influence in Lobbying: Evidence from Dodd-Frank*, BUSINESS AND POLITICS 21(2): 267–295 (2019).
[38] The Commission's rules define a smaller reporting company to mean an issuer that: (1) Had a public float of less than $250 million; or (2) had annual revenues of less than $100 million and either: (i) No public float; or (ii) a public float of less than $700 million.

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They must also describe the key activities generating those emissions, thus helping investors understand their sources. To help alleviate some concerns associated with these calculations, the Proposal calls for companies to disclose their methodology, assumptions, and data sources. By explaining how they arrived at their reported figures, companies can be more transparent and better defend themselves against claims of misleading investors.

iii. Safe Harbor

The Proposal also includes a dedicated safe harbor for Scope 3 disclosures, which will be deemed not to be fraudulent unless shown to be made or reaffirmed "*without a reasonable basis*" or disclosed other than in "*good faith*." The main function of the safe harbor is to insulate companies from liability arising out of figures they have received from third parties, which they may have otherwise had to go into great lengths to confirm. Rather, companies will only require to make "reasonable" inquiries about the reliability of the data provided to them. The proposal itself does not define reasonableness in this context, thus leaving it to courts to determine how to balance firm efforts against investor interest. Still, the safe harbor suggests that companies should not be expected to guarantee the accuracy of these figures but may rely on the information provided to them unless they are aware of red flags regarding data quality.

iv. Concerns and Criticisms

The SEC Proposal has generated significant controversy, as discussed above. Some are doubting whether mandating climate disclosure rules, especially as described above, falls within the SEC's statutory mandate, or whether aspects of the proposal require companies to make disclosures that do not involve material risks to investors. This report focuses on criticisms relating to the choices the SEC has made with regard to GHG emissions disclosure. Among those who submitted comments to the SEC's rulemaking proposal, many reference both the justifications in favor of including Scope 3 emissions outlined above, as well as the challenges identified. Below, we discuss main views and criticisms.

The decision to include Scope 3 emissions, if material, is one of the signature moves of the SEC's Proposal. It is likely to raise reporting costs significantly for public companies. According to data by the MSCI,[39] in March 2022 (at the time the SEC make its proposal), out of 2,565 public companies in the MSCI USA IMI Index, only 28% disclosed both Scope 1 and Scope 2 emissions, and only 15% disclosed any Scope 3 emissions. Most voluntary Scope 3 emissions disclosures would not meet the requirements of the rule, as they mostly represented value chain disclosures that were readily available. While disclosure rates were somewhat higher in some of the most emission-intensive sectors, like utilities (55%) and energy (47%), the survey concluded that companies would face an "uphill battle" in complying with the disclosure requirements.

Currently, market participants seem quite divided as to whether including Scope 3 emissions in mandatory disclosure is a good idea. Some asset managers and climate activist NGOs support the SEC's choice. This camp would include funds like CalSTRS, Engine No.1, As You Sow, Green Century Capital Management, Inc., and Oxfam America. Some, like the U.S. Impact Investing Alliance, suggested that companies should disclose Scope 3 emissions

[39] https://www.msci.com/www/blog-posts/companies-may-not-be-ready-for/03092675115

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on the same basis as their Scope 1 and 2 emissions, i.e. regardless of whether they consider them material.

On the other hand, many commentators expressed concerns that, as proposed, Scope 3 disclosures would overburden companies without being particularly informative for investors. Major asset management firms have reservations about requiring Scope 3 emissions disclosure due to the difficulties in accessing this data and questions about its value. State Street indicated that Scope 3 reporting should remain voluntary. BlackRock stated that companies should only have to disclose Scope 3 emissions from any of the 15 categories that are relevant to their operations. BlackRock also worried that the proposed Scope 3 rules could pressure public companies to take responsibility for emission reductions in areas beyond their influence. The Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association, while generally supportive of the proposal, recommended the extent of Scope 3 disclosures should be limited to more easily quantifiable or estimable categories.

Of particular concern is the lack of clarity as to what constitutes "material" Scope 3 emissions. Determining materiality would be a responsibility of the company, according to the SEC's proposal. But assessing materiality is famously complicated, particularly for a new type of disclosure. It calls for considering not only quantitative factors (e.g., what percentage of the company's total emissions fall under Scope 3) but also qualitative ones (e.g., an otherwise small percentage of Scope 3 emissions might hint to potential future increases or include particularly hazardous ones). Thus, many commentators are calling on the SEC to set a bright-line threshold to determine materiality, by determining for example that Scope 3 emissions are material if they exceed 40% of the company's total emissions. According to the SEC, the materiality determination for climate-related risks would be in line with currently required determinations of materiality in the MD&A Section. However, this only raises the question why a company discloses climate-related risks for the first time and had not disclosed it previously.

From a regulatory design perspective, requiring companies to make the materiality determination for themselves might result in outcomes that are neither comparable nor particularly informative. MSCI explored whether companies that are currently collecting and reporting Scope 3 emissions data voluntarily consider them material.[40] The results indicate divergent approaches across industries and companies. For example, financial companies report Scope 3 emissions that amount to over 90% of their aggregate carbon footprint on average, mostly due to purchased services. But only one of the 54 financial companies included in MSCI's survey considered these emissions material. On the other hand, companies in the consumer sector regarded certain categories of Scope 3 emissions material, even though they reached lower levels than other categories of Scope 3 emissions. In other words, some companies might underreport, while others might overreport.

Although the SEC has sought to address the uncertainties associated with Scope 3 emissions disclosure through the safe harbor, there remains a significant risk of liability. Because the safe harbor conditions its protection on a finding of good faith or reasonableness, plaintiffs are likely to contest the company's decision on those bases. However, asking the court to determine good faith or reasonableness typically involves an inquiry into the facts, which is unlikely to be resolved in an early motion in the lawsuit. Moreover, the safe harbor

[40] https://www.msci.com/www/blog-posts/which-scope-3-emissions-will/03153333292

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does not extend over disclosures provided due to state law or due to obligations arising from other jurisdictions.

c. SEC Final Rule on Mandatory Climate Disclosure

The most significant change between the SEC's proposal release and its final rules consists in the complete removal of the disclosure requirement for material Scope 3 emissions. Unlike Europe and California, described below, the SEC has decided that no company will have to provide investors with information about emissions in its value chain. The SEC also scaled back its proposed Scope 1 and Scope 2 disclosures by exempting smaller reporting companies and requiring large companies (accelerated filers or large accelerated filers) to only disclose material emissions. The agency has also agreed to give companies more time to report their emissions, saying they could do so by the second fiscal quarter rather than in their annual reports, as proposed.[41] To accommodate the numerous requests for reconsideration, the assurance requirements for emissions data are subject to an extended phase-in period, and reasonable assurance will eventually be required only for large accelerated filers.[42] No issuer will be required to provide GHG intensity data.[43]

For companies, the biggest challenge will be the requirement to disclose climate-related risks that are reasonably likely to have a material impact on their strategy, profits, or financial condition. These can be either physical risks, due to their geography or industry, or transition risks, that arise from regulatory developments, market changes, or technological advances. This requirement leaves significant latitude on companies to determine the extent and scope of their disclosures. However, it encompasses a broad array of factors, ranging from changing consumer preferences to evolving transition strategies and costs. Thus, it may invite more scrutiny and result in higher litigation risk.

The final rule also includes a series of more streamlined requirements with regard to governance. For example, while companies have to describe their boards' climate oversight efforts, they do not need to report climate experience for individual board members, as required in the rules. The safe harbor for forward-looking statements under the Private Securities Litigation Reform Act is explicitly extended to cover disclosure of targets and goals, transition plans, scenario analysis, and internal carbon pricing.[44] The SEC's new rules mandate the inclusion of climate-related disclosures in many registration statement Forms and in periodic filings under Forms 10-K3 and 20-F. The disclosure would be treated as "filed" with the SEC rather than "furnished" and would be subject to potential liability under Section 18 of the Exchange Act or Section 11 of the Securities Act, as applicable.

The SEC's decision to stop short of demanding Scope 3 emissions figures avoids some of the thorniest disclosure problems in its proposal and lowers demands for the sustainability reporting infrastructure. Companies will no longer need to implement a large compliance

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[41] Jessica Corso, *Divided SEC Adopts Scaled-Back Climate Reporting Regs - Law360*, https://www.law360.com/articles/1809533/divided-sec-adopts-scaled-back-climate-reporting-regs (last visited Mar 14, 2024).

[42] *SEC Finalizes Landmark Climate-Related Disclosure Rules,* Simpson Thacher, https://www.stblaw.com/docs/default-source/publications/esg-alert_03_07_24.pdf (last visited Mar 14, 2024).

[43] *Id.*

[44] *Id.*

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infrastructure to gather and consolidate data from vendors throughout multiple layers in their supply chain. More importantly, concerns about the quality of supply chain information or the need to resort to estimations based on potentially unreliable industry data are also mute. If they had been enacted, these disclosures were highly likely to invite securities litigation over inaccuracies that seem hard to avoid given the lack of clarity in the underlying data and the lack of control over their production. Finally, the decision to focus disclosure requirements on larger companies makes sense, since their climate footprint tends to be significantly more impactful. On the other hand, small and medium-sized businesses that are not directly under the authority of the SEC are now free from the worries of having to calculate their emissions at the request of their trading partners.

By yielding to pressure from many corners of the market, the SEC recognized that enacting the rules as initially proposed would represent a huge lift that many companies were unprepared to make in the timeline envisaged. Given the high intensity of securities litigation in the U.S., many companies were unwilling to embark in a disclosure effort fraught with many uncertainties that would need to be worked out on the go. Clarifying and implementing Scope 3 disclosure requirements would represent a herculean task that U.S. companies would have to accomplish unassisted by much regulatory guidance and under the scrutiny of the courts. In contrast, the EU is forging ahead with these requirements while also devoting more regulatory resources to the task. As discussed below, the EU's regime puts in place ongoing regulatory structures for consultation and guidance that are significantly more comprehensive than a simple disclosure mandate. Moreover, the risk of securities litigation in the E.U. remains substantially lower compared to the U.S.

Despite the SEC's decision to relax the rule, litigation has already begun, mainly challenging the agency's statutory authority to regulate climate disclosure. Legal challenges to the final rule were always expected, whether or not Scope 3 reporting was included. On the same day that the SEC approved the regulation, ten Republican-led states, led by West Virginia and Georgia, petitioned the Eleventh Circuit to review the rule on the premise that the SEC lacks the authority to enact climate regulation because it is a financial regulator. West Virginia Attorney General Patrick Morrisey said that, while it scraps a controversial proposal to mandate Scope 3 disclosures, the new rule "is still wildly in defect, illegal and unconstitutional."[45] Louisiana, Texas and Mississippi announced on March 7th that they have brought their own legal challenge to the SEC's rule in the Fifth Circuit.[46] The states want to overturn the disclosure rule, which Louisiana Attorney General Liz Murrill said threatens to "drive up business costs, which will then be passed on to the consumers."[47] On March 12th, another complaint was filed by nine more Republican-leaning states –Arkansas, Iowa, Idaho, Missouri, Montana, Nebraska, North Dakota, South Dakota and Utah– in the Eighth U.S.

[45] Lauren Berg, Red State AGs Sue SEC Over 'Illegal' Climate Disclosure Regs, Law360 (Mar. 6, 2024, 11:34 PM), https://www.law360.com/articles/1810913/red-state-ags-sue-sec-over-illegal-climate-disclosure-regs.
[46] Andrew Ramonas, Three More Red States Sue SEC Over Climate Reporting Rules (1) , Bloomberg Law (Mar. 8, 2024, 8:36 AM), https://news.bloomberglaw.com/esg/louisiana-texas-mississippi-sue-sec-over-climate-regulations.
[47] Louisiana Attorney General Liz Murrill's Office Files Lawsuit Against Securities and Exchange Commission, Fighting & Winning for Louisiana, https://www.ag.state.la.us/Article/13199 (last visited Mar 14, 2024).

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Circuit Court of Appeals. It states that the final rule exceeds the agency's statutory authority and "is arbitrary, capricious, an abuse of discretion, and not in accordance with law."[48]

The private initiative has also gone to court. A lawsuit was brought by energy industry suppliers Liberty Energy Inc. and Nomad Proppant Services LLC, also in the Fifth Circuit. Another one was filed by the Texas Alliance of Energy Producers and the Domestic Energy Producers Alliance. During the comment time of the climate proposal, the Domestic Energy Producers Alliance urged the SEC to withdraw the rules in their entirety and the Texas Alliance of Energy Producers pushed for final regulations without emissions reporting requirements.[49] Jerry Simmons, Domestic Energy Producers Alliance's CEO, said in a June 2022 letter to the SEC: "The rule is designed to achieve the political goal of abolishing the fossil fuel industry without going through the democratic process."[50] Another lawsuit filed within a week of the SEC's final rule is from the U.S. Chamber of Commerce, also in the Fifth Circuit, and says that the final regime "seriously erodes the reasonable investor standard of materiality and micromanages how companies make key determinations about materiality."[51]

At the same time, environmental organizations are gearing up to sue the SEC saying the final rules are insufficient. The Sierra Club, a grassroots environmental advocacy group, and the Sierra Club Foundation, represented by Earthjustice, have already brought a lawsuit against the SEC in the U.S. Circuit Court of Appeals for the District of Columbia. They believe that "[b]y allowing companies to selectively report their emissions, the SEC has fallen short of its statutory mandate to protect investors, maintain fair, orderly, and efficient markets, and promote capital formation."[52] The organizations state that the SEC has a fundamental legal authority to require climate-based disclosures and call on the agency to fulfill its obligation to protect investors. [53]

d. <u>The European Framework for Emissions' Disclosure</u>

The Corporate Sustainability Reporting Directive (CSRD) is a European Union legislative act that entered into force in January 2023, expanding sustainability reporting requirements for companies in the EU. The CSRD significantly extends the scope from around 11,700 companies to over 50,000 companies that will need to provide more sustainability disclosures related to their environmental and social impacts. The CSRD aims to accelerate the EU's transition to a more sustainable economic system by increasing corporate transparency and accountability on sustainability matters. Detailed disclosure

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[48] Andrew Ramonas, <u>Nine More States Target SEC Climate Reporting Rules in Court (2)</u>, Bloomberg Law (Mar. 12, 2024, 12:28 PM), https://news.bloomberglaw.com/esg/nine-more-states-join-republican-lawsuits-over-sec-climate-rules.
[49] Letter from Texas Alliance of Energy Producers to the SEC (Jun. 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132308-302842.pdf.
[50] Letter from Domestic Energy Producers Alliance to the SEC (Jun. 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131593-301961.pdf.
[51] Chamber of Commerce v. SEC, https://www.uschamber.com/cases/capital-markets-and-corporate-law/sec-climate-disclosure-rule (last visited Mar 14, 2024).
[52] Sierra Club, Earthjustice Challenge SEC's Weakened Climate Risk Disclosure Rule, EARTHJUSTICE, https://earthjustice.org/press/2024/sierra-club-earthjustice-challenge-secs-weakened-climate-risk-disclosure-rule (last visited Mar 14, 2024).
[53] *Id.*

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requirements will be provided in the European Sustainability Reporting Standards (ESRS) which were issued in July 2023.

v. Target Companies

In contrast to the SEC's proposal, which would apply only over companies whose shares are trading on the stock exchange, the CSRD applies over a much broader swath of companies, encompassing over 50,000 companies according to some estimates. Four categories of companies will be subject to sustainability requirements:

1. **<u>Public Interest Entities (PIEs):</u>** According to the Statutory Audit Directive, these are companies whose shares are traded in EU-regulated markets, as well as banks, insurance companies, and other entities designated by member states, regardless of listing status. Only PIEs with more than 500 employees are subject to the CSRD.

2. **<u>Other Large Companies:</u>** Regardless of listing or PIE status, this category includes companies that meet at least two of the following three criteria:
   a. A total balance sheet of more than €20 million.
   b. A net turnover of more than €40 million.
   c. More than 250 employees on average during the financial year.

   This category would include many European subsidiaries of foreign companies that fulfill two of the above criteria.

3. **<u>Listed SMEs:</u>** Small and medium-sized enterprises (SMEs) that have securities listed on EU-regulated markets. However, these companies can benefit from simplified reporting standards to reduce the administrative burden.

4. **<u>Non-EU Companies:</u>** The CSRD also applies to non-EU companies that generate a net turnover of €150 million or more in the EU, provided they have at least one subsidiary or branch within the EU.

vi. Mandated Disclosures

While the CSRD sets general disclosure requirements, it delegates the task of developing the technical standards for sustainability reporting to the European Financial Reporting Advisory Group (EFRAG). Technically a private entity, EFRAG is in fact a self-regulatory organization, whose membership comprises industry wide-bodies like the European Banking Federation and the European Federation of Accountants and Auditors, national accounting standard-setters, as well as civil society organizations such as the WWF or Environmental Defense Fund Europe, and consumer organizations like Better Finance. But official European institutions also play a role in standard-setting. EFRAG's Sustainability Reporting Board includes representatives from all these member categories, is led by a Chair appointed by the European Commission after having heard the European Parliament and the Council and includes observers from key European public institutions and agencies, including the European Securities Markets Authority and the European Banking Authority.

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EFRAG's Sustainability Reporting Board has the final responsibility for the standards, known as European Sustainability Reporting Standards (ESRS). It relies heavily on a Technical Expert Group, comprised of international recognized law and accounting experts that specialize on environmental and social issues. The first set of ESRS standards published on December 22, 2023 encompasses two cross-cutting standards (ESRS 1 and 2), providing general reporting concepts, and ten topical standards (ESRS E1-E10) covering specific environmental, social, and governance subjects. As this report focuses on the rules for emissions disclosure, specifically for Scope 3, the analysis below involves the two general provisions and the ESRS E1, related to climate change.

These rules mandate target companies to disclose detailed Scope 1, 2 and 3 emissions, as well as aggregate ones. Companies should screen their total Scope 3 emissions based on the 15 categories identified by the GHG Protocol, in line with what was mandated by the California legislature and the ISSB (see below) and suggested by the SEC. The firms must identify and disclose only their significant Scope 3 categories based on the magnitude of their estimated emissions and other criteria, such as financial spending, influence, related transition risks and opportunities, or stakeholder views. Like the SEC and California, Europe gave more time for companies to prepare for Scope 3 – the mandatory reporting starts a year later than Scopes 1 and 2.

Companies can opt-out of Scope 3 emissions disclosure if they conclude their impact is not material, but reaching that conclusion relies on a significantly stricter standard than that put forward by the SEC and the ISSB. The ESRS adopts a "double materiality" definition, which requires companies to report both "on the impacts of the activities of the undertaking on people and the environment [impact materiality]," and "on how sustainability matters affect the undertaking [financial materiality]."[54] Both the SEC and the ISSB rely only on financial materiality, which transposes on sustainability reporting the well-known disclosure threshold established in securities regulation. Material impacts, under ESRS 1, Section 3.4, could include those connected with "the undertaking's own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships."[55] These two concepts can be interrelated, such as when a company's impact on the environment generates a financial risk. Sustainability information meets the criteria of double materiality if it is material from the impact perspective, the financial perspective, or both perspectives.[56]

Utilizing the materiality opt-out is far from straightforward. First, it requires companies to conclude that their Scope 3 emissions fail both the financial materiality threshold (e.g., they do not affect stock price) and the impact materiality threshold (e.g. they do not affect the environment materially). To convince regulators and investors about their materiality opt-out, companies must "disclose a detailed explanation of the conclusions of its materiality assessment about climate change, including a forward-looking analysis of the conditions that could lead the company to conclude that climate change is material in the future." To present analysis concluding that its Scope 3 emissions are immaterial, companies

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[54] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=PI_COM:C(2023)5303
[55] Id.
[56] Heads Up — #DeloitteESGNow — Frequently Asked Questions About the E.U. Corporate Sustainability Reporting Directive (August 17, 2023) | DART – Deloitte Accounting Research Tool, https://dart.deloitte.com/USDART/home/publications/deloitte/heads-up/2023/csrd-corporate-sustainability-reporting-directive-faqs (last visited Feb 8, 2024).

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have to engage into gathering data and evidence, as well as involve professional advisers. For all other topics, a simple explanation is enough.

This difference in approaches shows that the concept of double materially in ESRS is broader than the definitions of materiality used by the SEC and the ISSB, and will require management to apply additional judgment to determine which matters should be reported from an impact perspective. If climate information meets any of the materiality concepts, the company will need to disclose it, which will result in almost all companies being required to report Scope 3. Because double materiality is a new concept for companies, the European Commission has instructed EFRAG to issue interpretive guidance on how to evaluate double materiality.[57]

vii. Safe Harbor

Unlike the SEC proposal and the California law, the ESRS rules do not explicitly provide safe harbor to reduce or exclude liability from companies that fail to make accurate Scope 3 disclosure. As there are not many security lawsuits in Europe, exclusion of liability is not a concern articulated as frequently by companies commenting on the new set of rules.

viii. Concerns and Criticisms

The already published ESRS standards are more expansive in scope than the SEC climate proposal, the California climate law and the first set of ISSB provisions, as they cover a wider range of environmental topics and some social topics, in addition to climate information. The comments and criticisms of the rules, therefore, refer to a dispersed spectrum of subjects. Among comments of the general ESRS standards, some doubt whether the rules are too comprehensive, whether some aspects should be voluntary rather than mandatory, or whether the materiality assessments will provide the results expected by regulators and market participants. This report focuses on criticisms relating to the choices European authorities have made regarding to Scope 3 disclosure.

The inclusion of Scope 3 in the first ESRS standards was already expected, in line with the CSRD directive, which aims to hold companies more accountable and accelerate the E.U.'s transition to a more sustainable economic and financial system. This, however, is not without concerns. In its comments to the rules, BASF brought up its complex value chain, spread across 120 countries, to suggest restricting the value chain to first-tier suppliers and direct customers, since "smaller suppliers are not equipped to deliver the required information with the respective level of robustness."[58] Also commenting on the ESRS draft, Mondelez International acknowledges the burden of getting emissions information. "If companies were required to report on Scope 3 emissions at the present time, they would have to rely on collecting this data from third parties, who may: (1) refuse to provide data, (2) fail to provide

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[57] https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/assurance/accountinglink/ey-tl16626-221us-09-20-2023.pdf

[58] https://efrag.sharefile.com/share/view/s2fcacc016dcf48ce85a943870c6dccc7/fo8ee61f-d3a3-4463-8629-a524256322e9

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it on a timely basis, or (3) furnish data that is flawed, inconsistent, and not comparable."[59] The accounting services provider KPMG states it is especially concerned about the "high volume of required disclosures and the vast amount of data points that companies will have to collect and report on."[60]

Apprehension has also been voiced by companies whose Scope 3 makes up almost their entire carbon footprint, such as financial services. Deutsche Bank openly refused value chain disclosure requirements in both the environmental and social ESRSs, stating that they "are excessive and not currently feasible."[61] It claims that third-party-level data is not sufficiently available and that banks "would struggle to comply with several of the disclosure requirements if they were applicable to the whole value chain."[62] Allianz Group asks ESRS to clarify how financial companies shall cover their value chain, highlighting that "reasonable boundaries as regards look-through provisions to cover indirect impacts need to be defined to ensure both feasibility and reliability." [63] Acknowledging the data limitations, BBVA suggests to the European authorities that firms should be able to decide which part of the value chain is significant for their industry and, therefore, included in the disclosures.[64] It articulates that focusing on the part of the value chain that is considered to have the greatest impact "would be more efficient."[65]

On top of that, the materiality regime adopted by the standards raised many concerns. The most critical part was considered the principle that all information prescribed in the standards should be considered material for the companies unless demonstrated otherwise (the so-called "rebuttable presumption"), which was later removed by EFRAG from the rules.[66] Critics generally claimed that applying the rebuttable presumption to every disclosure would be impractical and onerous, and lead to reports containing a significant level of information about non-material matters, which would be confusing and reduce the clarity on the significant material matters.[67] Although the principle was removed, the authorities still require companies to give a detailed explanation of their materiality assessment of climate change (ESRS E1), including a forward-looking analysis, if they conclude that the related provision is not material. "This requirement is included in recognition of the widespread and

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[59] EFRAG, https://efrag.sharefile.com/share/view/sfee944fc553c401396e7dffc23314dc2/fob6a1ba-4237-4c96-baf6-baa166d0f8b6 (last visited Jan 31, 2024).

[60] https://efrag.sharefile.com/share/view/sfee944fc553c401396e7dffc23314dc2/fob6a1ba-4237-4c96-baf6-baa166d0f8b6

[61] https://efrag.sharefile.com/share/view/s2fcacc016dcf48ce85a943870c6dccc7/fo8ee61f-d3a3-4463-8629-a524256322e9

[62] https://efrag.sharefile.com/share/view/s2fcacc016dcf48ce85a943870c6dccc7/fo8ee61f-d3a3-4463-8629-a524256322e9

[63] https://efrag.sharefile.com/share/view/sfee944fc553c401396e7dffc23314dc2/fob6a1ba-4237-4c96-baf6-baa166d0f8b6

[64] https://efrag.sharefile.com/share/view/sfee944fc553c401396e7dffc23314dc2/fob6a1ba-4237-4c96-baf6-baa166d0f8b6

[65] Id.

[66] See generally Introducing the European Sustainability Reporting Standards - KPMG Global, KPMG (2023), https://kpmg.com/xx/en/home/insights/2023/04/introducing-the-european-sustainability-reporting-standards.html (last visited Feb 8, 2024).

[67] Rebuttable presumptions rebutted in comment letters to EFRAG, CORPORATE DISCLOSURES, https://www.corporatedisclosures.org/content/top-stories/rebuttable-presumptions-rebutted-in-comment-letters-to-efrag.html (last visited Feb 8, 2024).

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systemic effects of climate change on the economy as a whole," the European Commission says. It is like keeping the rebuttable presumption for climate issues.

The materiality of emissions disclosure received many comments from market participants. Unsurprisingly, of particular concern is the lack of clarity as to how to apply the new double materiality approach. In addition to the fact that assessing materiality is famously complicated, particularly for a new type of disclosure, the double materiality concept adopted by the European authorities is particularly challenging. As discussed above, it calls for considering not only the impact of business activities on people and the environment (impact materiality) but also how the emissions and climate change affect the company (financial materiality). In both cases, companies should consider the positive and the negative effects, and not just those happening now but also those that may happen in the future.

Although several commentators support the double materiality approach to measure a broader range of climate change effects,[68] others point to the problem of misalignment with the ISSB, SEC and European Accounting Directive, which only apply financial materiality. Different materiality concepts will likely hamper comparability among reporting between European and non-European companies. For example, the Deutsche Bank strongly opposes the double materiality and urges a "consistent approach for information included in the Management Report and to create connectivity between sustainability and financial reporting."[69] Munich Re highlights that there are well-established processes with the auditors regarding materiality stemming from financial accounting, which should also be applied to sustainability reporting. Otherwise, it says, an unreasonable amount of work and coordination would be required, "which is only balanced by a very small benefit." Other market participants complain about the detailed explanation that companies will have to provide for a non-material provision –a requirement now applied just for the climate part of the rules. Prescribing companies to present the counterevidence to be able to consider something as non-material is not proportionate, BusinessEurope says. As a result, many entities will be led to conclude that they should comply with the provision, it claims.

b. The ISSB Framework

On June 26, 2023, the International Sustainability Standards Board (ISSB), established by the IFRS Foundation to develop a comprehensive set of standards to serve as a global baseline for sustainability reporting, issued its inaugural standards. IFRS S1 General Requirements for Disclosure of Sustainability-Related Financial Information requires companies to disclose general information about their sustainability-related risks and opportunities. IFRS S2 Climate-related Disclosures sets out specific climate-related disclosures. The ISSB has set the implementation date for annual reporting periods beginning on or after January 1, 2024. However, the effective date in each jurisdiction will depend on the local authorities. The standards require adoption by authorities in local jurisdictions before compliance would be mandatory, similar to other International Financial Reporting Standards (IFRS). On July 25, 2023, the International Organization of Securities Commissions (IOSCO) endorsed the ISSB standards and called on its members to consider

[68] See BMW, BusinessEurope,
[69]

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how they might adopt, apply, or otherwise be informed by the ISSB Standards.[70] Several jurisdictions, including the United Kingdom, Canada and Australia, have indicated they expect to require the adoption of the ISSB standards. Brazil was the first country worldwide to announce the adoption of the ISSB standards, setting out a roadmap for voluntary use starting in 2024 and mandatory use starting in 2026.[71]

i. Target Companies

IFRS S1 and S2 will likely apply to registered public companies, in line with IFRS financial standards, which aim at providing information to investors, lenders and other creditors. However, the exact scope of target companies will be defined by each jurisdiction that opts to use the new standards. For example, Brazil, which has already announced the adoption, will make the rules mandatory for all publicly traded companies.[72]

ii. Mandated Disclosures

The rules mandating Scope 3 emissions disclosure, which is the focus of this report, are in the IFRS S2. Specifically, it requires companies to report information about their gross Scopes 1, 2 and 3 to enable users of general-purpose financial reports to understand the source of these emissions.[73] The firms must consider their entire value chain (upstream and downstream) and all 15 categories of Scope 3 defined by the GHG Protocol. The ISSB confirmed Scope 3 in the standard final text, as set out in its draft, "given feedback from investors that they cannot fully understand a company's transition risk without information about its absolute gross Scope 1, 2 and 3 emissions."[74] The ISSB considered and rejected the alternative of limiting Scope 3 emission disclosure requirements to Tier 1 suppliers only.

Before reporting on any of the requirements of the new standards, companies must undertake a materiality assessment. The ISSB's definition of materiality aligns with the definition of materiality in IFRS accounting standards. It focuses on what is financial material to the primary users of the general-purpose financial report (i.e., existing and potential investors, lenders and other creditors). This means that companies must disclose information related to a specific requirement when it concludes that the information is material to the users in assessing the entity's enterprise value and making decisions about whether to provide economic resources to them. That is, if a point is not material, no disclosure would be

[70] IFRS - IFRS Sustainability Disclosure Standards endorsed by international securities regulators, https://www.ifrs.org/news-and-events/news/2023/07/issb-standards-endorsed-by-iosco/ (last visited Feb 8, 2024).

[71] IFRS - Brazil adopts ISSB global baseline, as IFRS Foundation Trustees meet in Latin America, https://www.ifrs.org/news-and-events/news/2023/10/brazil-adopts-issb-global-baseline/ (last visited Feb 8, 2024).

[72] Brazil Sets Global Precedent: First Nation to Embrace ISSB Sustainability Financial Reports | Insights | Mayer Brown, https://www.mayerbrown.com/en/insights/blogs/2023/10/brazil-sets-global-precedent-first-nation-to-embrace-issb-sustainability-financial-reports (last visited Feb 8, 2024).

[73] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards-issb/english/2023/issued/part-a/issb-2023-a-ifrs-s2-climate-related-disclosures.pdf?bypass=on

[74] https://www.ifrs.org/news-and-events/news/2022/12/issb-announces-guidance-and-reliefs-to-support-scope-3-ghg-emiss/

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required.[75] Although it places on companies the burden to make the materiality determination, this definition of materiality is familiar to companies, auditing firms and regulators worldwide and did not raise so many concerns.

Both IFRS S1 and IFRS S2 are structured around four core elements: governance, strategy, risk management and metrics and targets.[76] When reporting Scope 3, companies must also detail their measurement approach, inputs and assumptions used.

iii. Safe Harbor

IFRS S2 does not include a dedicated, explicit safe harbor for Scope 3 disclosures, as does the SEC's climate proposal and the California law. However, its wording may be used by companies seeking protection from liability. For example, it says that in preparing disclosures to meet the requirements in paragraph 29(b)–(d), a company "shall use all *reasonable* and supportable information that is available to the entity at the reporting date without undue cost or effort."[77] It also talks about faithful representation. "In measuring Scope 3 greenhouse gas emissions an entity shall use a measurement approach, inputs and assumptions that result in a faithful representation of this measurement."[78]

Moreover, the ISSB team notes that in discussions with jurisdictions adopting IFRS sustainability standards, it may consider whether providing safe harbor provisions would be necessary or helpful to facilitate Scope 3 disclosure.[79] Its idea is to provide companies with some protection from litigation risks, for a limited period, to resolve some of the data availability and data quality challenges. Ultimately, however, this is a decision for jurisdictions and local securities regulators. [80]

iv. Concerns and Criticisms

Comments from market participants on IFRS S1 and S2 include a mix of support and concerns. Supporters mainly point out that the ISSB's efforts to promote an internationally consistent standard for climate disclosure are welcome, given concerns around a fragmented system and the resulting financial impact on companies, especially multinationals, that would have to comply with different regimes. As an international standard-setting body, ISSB is considered the natural organization to lead the movement toward a global standard for

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[75] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards-issb/english/2023/issued/part-a/issb-2023-a-ifrs-s2-climate-related-disclosures.pdf?bypass=on

[76] What you need to know about new ISSB standard IFRS S2, https://www.ey.com/en_us/ifrs/what-you-need-to-know-about-new-issb-standard-ifrs-s2 (last visited Feb 8, 2024).

[77] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards-issb/english/2023/issued/part-a/issb-2023-a-ifrs-s2-climate-related-disclosures.pdf?bypass=on page 16

[78] Id page 33

[79] IFRS - ISSB unanimously confirms Scope 3 GHG emissions disclosure requirements with strong application support, among key decisions, https://www.ifrs.org/news-and-events/news/2022/10/issb-unanimously-confirms-scope-3-ghg-emissions-disclosure-requirements-with-strong-application-support-among-key-decisions/#2 (last visited Feb 9, 2024).

[80] https://www.ifrs.org/content/dam/ifrs/meetings/2022/october/issb/ap4b-climate-related-disclosures-scope-3-greenhouse-gas-emissions.pdf

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corporate sustainability disclosure to facilitate comparable and reliable information on sustainability performance.[81] The Australian Institute of Company Directors says it strongly endorses the principle of "harmonized" international sustainability standards under the ISSB umbrella and urges a consistent approach across jurisdictions.[82] The Hong Kong Chartered Governance Institute voiced the opinion of many others that ISSB took an appropriate approach to building on the work of other organizations, including TCFD and SASB.

While the ISSB is considered the best-positioned player to drive this global framework, there are concerns about the organization's ability to maintain standards' consistency across jurisdictions. As countries will have to choose to incorporate the standards, they will also be able to tailor the application according to their challenges and interests, reducing global comparability. The bank UBS, for example, highlights the importance of efforts to ensure the interoperability of the ISSB standards with national standards that may be developed under its umbrella. Thus, the bank suggests the formation of a working group of jurisdictional representatives to establish dialogue for enhanced compatibility.[83] Another point voiced by commentators is the need for more alignment with the SEC climate proposal, with, for example, the adoption of clear safe harbor provisions for Scope 3 emissions disclosure, as stated by Lloyds Banking Group.[84] As a standard setter of an EU country, the Swedish Financial Reporting Board demonstrated concern that the development of two separate sustainability reporting standards (from ISSB and EU) may not only create an unnecessary high administrative burden on European entities but also reduce the usefulness of corporate reports. Therefore, it recommends that ISSB continue its joint efforts with European authorities to reduce the differences between the two standards.

Similar comments were provided about the ISSB's materiality approach. Market participants in general celebrate the adoption of the well-known financial materiality concept, as discussed above, in contrast to the EU's double materiality approach. However, many comments show that this still raises doubts, mainly on how to apply the concept in terms of what sits within the new sustainability scope. Shell International considers challenging the interpretation of the term "enterprise value" and how to assess and apply both the terms "significant" and "materiality," which could be interpreted as having similar meanings. The firm, therefore, urges ISSB to clearly define the term "significant," distinguishing it from "material," and develop disclosure requirements on the judgments and assumptions used by preparers when assessing materiality in the context of sustainable-related matters, especially Scope 3.

As in the other regulatory regimes, many criticisms are about the onerous and complex process involved in reporting Scope 3. As discussed above, these are related to the need for a data governance framework for gathering and reporting value chain emission data. Despite

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[81] USB https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65713_ubs--issb-consultation-endorsement-letter-final.pdf

[82] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65719_australian-institute-of-company-directors-aicd-submission---issb-s1-and-s2---july-2022.pdf

[83] USB https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65713_ubs--issb-consultation-endorsement-letter-final.pdf

[84] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65786_lloyds-banking-group-climate-lloyds-banking-group-plc.pdf

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supporting the ISSB initiative, the Australian Institute of Company Directors points to current "data and workforce skills gaps" that, in the short term, will make comprehensive and consistent adoption of the standards very difficult to achieve.[85] It also highlights that there is a lack of clear, well-accepted methodologies for measuring key metrics like Scope 3.

The University of Sao Paulo claims that carbon disclosure "is a difficult issue for all organizations (mainly industry) in countries like Brazil" given the data limitation.[86] The Thailand Securities and Exchange Commission refers to the numerous data and methodology challenges for preparers,[87] and the Lloyds Banking Group claims that real economy disclosure needs to mature, particularly in less developed sectors, for financial services firms' Scope 3 disclosures to improve fully.[88] The Hong Kong Chartered Governance Institute recognizes that there are aspects of the standards that only companies that are "mature in their reporting approaches, for example, those financial and non-financial sectors where TCFD has provided guidance, would be in a good position to report on".[89] So, it calls on ISSB to issue practical guidance to assist the less experienced companies and to provide practical examples of best reporting practices from the standpoint of beginner, intermediate, to advanced reporters.

Commentators also articulate ways that ISSB could address the Scope 3 data limitation issues. Some suggest that the only possibility would be to make Scope 3 voluntary at the first moment. Lloyds recommends "consistency with the TCFD for Scope 3 disclosures where this is strongly encouraged rather than mandated," recognizing the data availability and quality improvements required across firms. The Thailand SEC also suggests optional disclosure for Scope 3, although mandatory reporting for Scopes 1 and 2. Many others urge a flexible timeline for approaching Scope 3. The Australian Institute of Company Directors claims that the data problem would require an "appropriate transition period" to enable the creation of systems to capture reliable and accurate Scope 3 information.[90] The Life Insurance Association of Japan believes that, compared to Scope 1 and Scope 2, Scope 3 should not require the same level of information regarding completeness, reliability, and comparability.[91]

c. California Climate Disclosure Laws

On October 7, 2023, California Governor Gavin Newsom signed two comprehensive climate disclosure bills into law, making California the first U.S. state to impose requirements on emissions disclosure (SB 253) and mandate reporting on climate-related financial risk (SB

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[85] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65719_australian-institute-of-company-directors-aicd-submission---issb-s1-and-s2---july-2022.pdf

[86] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65853_universidade-federal-de-s-o-paulo-ifrs-climate-change-27-jul-22-heloisahollnagel-brazil.pdf

[87] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65734_securities-and-exchange-commission--sec---thailand--sec-thailand--s2-climate-related-disclosures.pdf

[88] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65786_lloyds-banking-group-climate-lloyds-banking-group-plc.pdf

[89] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65761_the-hong-kong-chartered-governance-institute-issb-exposure-drafts-submission.pdf

[90] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65719_australian-institute-of-company-directors-aicd-submission---issb-s1-and-s2---july-2022.pdf

[91] https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=611_65717_the-life-insurance-association-of-japan-liaj-comments-on-the-ed-ifrs-sustainability-disclosure-standard-s2.pdf

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261). The legislature's stated goal is to address the impact of climate change on California's residents and economy, as the state already faces devastating wildfires, rising sea levels, droughts, and other extreme-impacting events.[92] The laws aim to increase transparency and corporate accountability in an effort to move California towards a net-zero carbon economy.[93] California is a well-known leader in climate action in the U.S. and this climate package will likely boost similar efforts in other states, such as New York.[94]

i. Target Companies

Senate Bill No. 253, Climate Corporate Data Accountability Act, requires public and private companies organized in the U.S., doing business in California and with more than $1 billion in total annual revenue to report direct emissions from operations and indirect emissions from energy use starting in 2026. Reporting on emissions from a company's value chain (Scope 3) starts in 2027. The law is expected to impact over 5,300 companies.[95] Senate Bill No. 261 Greenhouse Gases: Climate-Related Financial Risk, applies to public and private companies doing business in California with more than $500 million in annual revenue.[96] They must report climate-related financial risks biennially starting in 2026. The law will impact over 10,000 companies.[97] It is worth noting that "doing business" in California, although not explicitly defined in the current language, was previously defined in existing tax code prevision as "engaging in any transaction for the purpose of financial gain within California, being organized or commercially domiciled in California, or having California sales, property or payroll exceed specified amounts: as of 2020 being $610,395, $61,040, and $61,040, respectively."[98]

ii. Mandated Disclosures

The published California reporting law, specifically SB 253, requires the California Air Resources Board (CARB) to adopt, by January 1, 2025, regulations to require the reporting

[92] Bill Text - SB-253 Climate Corporate Data Accountability Act., https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240SB253 (last visited Feb 7, 2024).
[93] *Id.*
[94] NY State Senate Bill 2023-S897A, NYSENATE.GOV, https://www.nysenate.gov/legislation/bills/2023/S897/amendment/A (last visited Feb 7, 2024).
[95] California's first-in-the-nation climate disclosure legislation sets new standard for corporate transparency, CERES, https://www.ceres.org/news-center/press-releases/californias-first-nation-climate-disclosure-legislation-sets-new (last visited Feb 7, 2024).
[96] Bill Text - SB-261 Greenhouse gases: climate-related financial risk., https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240SB261 (last visited Feb 7, 2024).
[97] Companies call for climate disclosure legislation as California lawmakers return to session, CERES, https://www.ceres.org/news-center/press-releases/companies-call-climate-disclosure-legislation-california-lawmakers (last visited Feb 7, 2024).
[98] Coming Soon: "Doing Business" in California Will Require Companies to Disclose Climate Risk and Emissions Reports – American University Business Law Review, https://aublr.org/2023/10/coming-soon-doing-business-in-california-will-require-companies-to-disclose-climate-risk-and-emissions-reports/ (last visited Feb 8, 2024).

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of greenhouse gas emissions statewide and to monitor and enforce compliance with the act. SB 253 outlines that CARB should "ensure that its emissions reporting regulations are structured in a way that 'minimizes duplication of effort' and allows companies to 'meet other national and international reporting requirements.'" According to the law, the disclosure of Scopes 1, 2 and 3 emissions will be in conformance with the GHG Protocol rules and guidance, a requirement that is in line with the European and the ISSB mandates (the SEC proposal does not impose that methodology).[99]

One notable feature of the California law is its application to private companies, distinguishing it from SEC regulations, which primarily target public companies. The California law is also considered more ambitious than other regimes in terms of materiality, or lack thereof. It requires Scope 3 emissions disclosure for all reporting entities, regardless of whether Scope 3 emissions are material. Moreover, SB 253 authorizes CARB to establish a third-party assurance requirement for Scope 3 emissions (in addition to the required assurance for Scope 1 and Scope 2), with assurance at a limited assurance level beginning in 2030. The State Board is required to review and evaluate trends in third-party assurance when deciding the requirement. Under California law, the reports will be filed with a newly established statewide reporting organization and then made publicly available.

iii. Safe Harbor

The reporting law (SB 253) authorizes administrative penalties up to $500,000 for noncompliance, including reporting late or not at all, but adopts a safe harbor for Scope 3 such that (i) penalties will not apply to any misstatements regarding Scope 3 GHG emissions that were "made with a reasonable basis and disclosed in good faith," and (ii) until 2030, penalties will only be assessed on Scope 3 reporting for non-filing. This means that companies reporting in California are more protected from liability, at least until 2030, than those disclosing under the SEC climate rules. They will be punished only if they do not disclose Scope 3 at all. Companies are only exempt from liability under the SEC's safe harbor provisions if they show to be acting in good faith or on a reasonable basis.

iv. Concerns and Criticisms

As in other emission disclosure regimes, the most controversial point in California law is the requirement for reporting on the difficult-to-track Scope 3. The challenges associated with it, both concerning the costly and difficult implementation of the disclosure and the potential for inconsistent results, were acknowledged even by Governor Newsom. In connection with the signature of the bills into law, the governor published a signing message that contains important caveats that may impact how the law is implemented. For example, it is unclear whether CARB will be able to issue the necessary regulations in the aggressive timeframe envisaged by the two bills. In his message, the Governor notes that the deadlines in the bill are "likely infeasible," and that the

[99] SEC proposal, page 148

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reporting protocol specified might result in "inconsistent reporting" among different types of businesses.[100] He asked his administration to work with the bill's author and the Legislature to "address these issues."[101]

The Governor's message is cited as evidence of the complexity of Scope 3 in the first lawsuit challenging California climate bills. The U.S. Chamber of Commerce and American Farm Bureau Federation filed the lawsuit in a Los Angeles federal court in January 2024 alongside four California business groups. They argue that the laws violate First Amendment protections against compelled speech and that California is attempting to act as a "de facto" national emissions regulator, which is precluded by the Dormant Commerce Clause and principles of federalism.[102] The laws seek to regulate an area that is outside California's jurisdiction and subject to exclusive federal control under the Clean Air Act, the lawsuit says.[103]

California's authority to regulate emissions was, indeed, among the most pronounced criticisms from those who publicly commented on the bills. The California Chamber of Commerce, the loudest critic, stated in a letter to the legislature that California should not regulate out-of-state emissions.[104] Although the reporting mandate applies only to companies doing business in the state meeting the defined revenue threshold, part of these firms' value chain can be outside of California and potentially subject to requests for data emissions by their business partners that need to comply with the laws. Another criticism exhaustively appointed is the burden for private companies, which are also directly targets of the rules, as well as small and mid-sized businesses. Joining by a broad coalition that includes agricultural and other industry groups, as well as local chambers of commerce, the CalChamber said in an opposition letter that the Scope 3 reporting will "necessarily require that large businesses stop doing business with small and medium-sized businesses." It claims that these businesses are likely under-resourced and will struggle to accurately measure their emissions, and the requirement would leave "these companies without the contracts that enable them to grow and employ more workers."

A report prepared by Encina Advisor for the California Foundation for Commerce and Education estimates that a typical upstream firm will spend from $38,500 to $123,100 on calculating and documenting its emissions, which would result in a potential loss of $1 billion to $1.3 billion in state tax revenue. These economic impacts will likely create inefficient supply chains that will further add to consumer costs, the CalChamber argues. Based on this, the Chamber-coordinated campaign to "Stop SB 253" claimed that the disclosure requirement would act as a "hidden tax on small businesses."

But while companies are expected to foot the bill for upgrading their monitoring systems, it is unclear whether the state can develop the necessary regulatory might to supervise and enforce these requirements. Compared to the SEC, California regulators' staffing and resources lag far behind; they pale in comparison to the EU. Now that the SEC has backtracked on its decision to require Scope 3 emissions, California regulators remain the

[100] https://www.gov.ca.gov/wp-content/uploads/2023/10/SB-253-Signing.pdf
[101] Id.
[102] https://www.uschamber.com/assets/documents/FILED-Chamber-v.-CARB-Complaint.pdf
[103] Id.
[104] Bill Setting Out-of-State Emissions Reporting Requirements to Be Heard in Senate Today - Advocacy - California Chamber of Commerce, https://advocacy.calchamber.com/2023/04/18/bill-setting-out-of-state-emissions-reporting-requirements-to-be-heard-in-senate-today/ (last visited Feb 8, 2024).

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only US state authority demanding this reporting and must thus take a leadership position in enforcing these rules for the whole country. The funding and staffing needs for this endeavor might have been behind CARB's initial reluctance to embrace the disclosure. In recently emerged reports, it appears that CARB, in providing feedback to the state senate, had suggested to eliminate Scope 3 emissions from the scope of mandatory disclosure. Moreover, CARB remained out of Newsom's budget proposal in January 2024, despite statements by Liane Randolph, CARB chair, that she expects the regulator to receive additional funds to implement the disclosure mandate. As a result, it remains to be seen whether the disclosure effort driven by California's laws can rise up to the task.

Despite the challenges raised, California's big tech companies and other large firms, subject to the law, supported the initiative in a letter to lawmakers. Microsoft, IKEA USA, Sierra Nevada Brewing, Patagonia, Adobe, Avocado Green Brands, Dignity Health, Grove Collaborative, REI Co-Op, Everlane, Eileen Fisher, Recology, Atlassian, and Seventh Generation sign the letter.[105] The firms acknowledge that mid-market companies and suppliers do not have the resources or the knowledge to disclose and take action on Scope 3, but still have significant emissions footprints, and need to advance. Salesforce also issued a letter of its own in favor of SB 253.[106] Apple also submitted a separate letter where it recognizes "some amount of uncertainty" in reporting Scope 3 emissions due to limited available data, which involves "making educated assumptions and complex modeling." However, Apple says that its reports "attest to the feasibility" of doing it.

IV. Conclusion

As global momentum builds behind the policy push toward mandated corporate sustainability disclosures, key questions persist regarding the optimal design and implementation of emissions reporting requirements. If thoughtfully crafted, mandatory rules on emissions measurement and disclosure could significantly advance accountability across supply chains, prevent misleading claims of sustainability, spur innovations in emissions tracking, and ultimately accelerate economy-wide decarbonization. However, sweeping disclosure mandates also threaten high compliance costs, unreliable data quality, and misaligned organizational incentives that divert resources from actual emissions reductions. As explored here through major regulatory case studies, disclosure policies exhibit wide variance in provisions around materiality determinations, safe harbors, phase-in timelines, and legal liability.

The clearest dissonance concerns mandatory reporting of Scope 3 emissions. The EU is forging ahead, albeit with extended phase-in relief for smaller companies. On the other hand, the SEC removed Scope 3 emissions from its final rule, acknowledging public feedback that the measure was insufficiently defined and relied excessively on estimations, which would heighten compliance burdens and litigation risk. California state laws, passed right

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105 https://www.ceres.org/sites/default/files/Asm%20Approps%20Major%20Companies%20and%20Institutions%20Support%20SB%20253.pdf

106 https://ceres.my.salesforce.com/sfc/p/#A0000000ZqYY/a/5c000001BxAf/a6qKtL99hJKfg9eSezyXp3v8m0Vv5P5GXpG.ziIOogE

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before the SEC's rule was finalized, require Scope 3 disclosure, in effect subjecting many companies to this mandate. But the regulatory effort to implement the state regime is still nascent, and it is unclear how intensely the state will implement this mandate in the years to come. The ISSB, the most influential private standard-setter endorsed by jurisdictions around the world, has stayed clear of explicitly requiring Scope 3 disclosures and focusing instead on materiality.

The dissonance among policymakers is due to the lack of a standardized and widely accepted methodology for measuring Scope 3 emissions that would avert criticisms of greenwashing. While some companies are voluntarily disclosing Scope 3 emissions as broad indications of their footprint, these are based on estimates and methodologies generally regarded as inconsistent and leaving a lot of discretion to the reporting company. As a result, it is not clear whether mandatory disclosure alone would succeed in producing data that is comparable among companies and industries. European policymakers have set up an institutional infrastructure designed to support companies as they are developing their Scope 3 disclosures by issuing guidance and streamlining reporting quandaries. In the U.S., with the heightened risk of securities litigation looming over reporting companies, the stakes of getting reports right would be much higher.

The methodological quandaries around Scope 3 emissions are coming to light due to the different policy objectives that rulemakers are prioritizing. While the overarching goal of aiding transition to sustainability is key, there are multiple policy objectives that disclosures were enlisted to achieve. For private standard-setters, like the ISSB, the primary goal is to produce information that is relevant and helpful for managers making choices for their businesses, as well as for investors that are monitoring them. In this way, sustainability becomes operationalized throughout corporate hierarchies and discussed in board meetings. For capital markets regulators, like the SEC, creating a level playing field among reporting companies and focusing on materiality remains a key priority. For comprehensive efforts that span multiple regulatory domains, like the European Green Deal, the credibility of the whole regime is paramount, and the emphasis on combatting greenwashing becomes central to the endeavor. While all these policy objectives contribute to aiding transition, they address distinct aspects of the effort and utilize information for in different ways.

In retracting from mandatory disclosure of Scope 3 emissions, the SEC has left it to investor demand to determine the future of these disclosures. Methodologies may continue to improve, spearheaded by market inquiries and incoming regulatory requirements in Europe. But the current dissonance among major jurisdictions underlines that, in order to tackle climate impacts, companies and regulators must address complex tradeoffs between data constrains and accountability for major emitters. The central tension remains clear – to incentivize decarbonization, disclosure rules must enhance supply chain visibility without overburdening those best positioned to drive sustainability transitions. Sweeping requirements could overwhelm regulators and industry alike, demanding data that is unreliable or inaccessible. The result would be increased costs and bureaucracy that yield minimal transparency gains while achieving no meaningful progress on the ground.

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