Navigating SEC's Proposed Scope 3 Rules:

Key Considerations for Asset Heavy Companies

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The U.S. Securities and Exchange Commission (SEC) is currently in the process of finalizing a new climate-risk disclosure rule to "Enhance and Standardize Climate-Related Disclosures for Investors."

The proposed SEC rules mandate that listed companies disclose Scope 3 emissions, which encompass greenhouse gas emissions from suppliers and vendors throughout the company's supply chain. While Scope 1 and Scope 2 emissions (direct emissions from operations and indirect emissions from purchased electricity) are also included, it is Scope 3 emissions that have stirred intense debates among companies, industries, and lawmakers. For asset heavy companies, it is crucial to understand the implications of these proposed rules and the divergent viewpoints surrounding them.

Understanding Scope 3 Emissions:

Scope 3 emissions, also referred to as value chain emissions, include indirect emissions from purchased goods and services. Scope 3 emissions, unlike Scope 1 and 2 emissions, are the results of activities from assets not owned or controlled by the organization itself. The GHG Protocol defines 15 categories of scope 3 emissions and they can come from suppliers, vendors, end-product distribution networks, and even waste disposal processes.

Asset-heavy companies that are on the path to decarbonization face significant obstacles in addressing Scope 3 emissions:

- **Complexity and Uncertainty:** Going about reducing Scope 3 emissions poses as much uncertainty as calculating them. Estimating GHG emissions beyond an organization's direct operations requires navigating complexities, making assumptions, and dealing with uncertainties. Without quantifiable clarity over the source of emissions, Scope 3 figures, if reported, could be misleading.

- **Extensive Supply Chains:** Asset-heavy industries have extensive networks of suppliers and vendors, making it more difficult to track and report emissions generated throughout the entire supply chain.

- **Misleading Reporting:** SEC doesn't provide any specific guidance on reporting methodologies or standards. While there are various standards for reporting and targeting Scope 3 emissions, the lack of consistency and transparency often renders the statistics incomparable.

- **Significant Costs:** Another matter of concern for asset-heavy companies is the cost of collecting and assembling such information throughout their value chain. Verdantix, an ESG research and advisory firm, has predicted that this mandatory SEC disclosure of Scope 3 emissions will have companies spending US$6.7 billion across the next three years to gather this data, verify it and report it over the next three years.

- **Unclear Categorization Frameworks:** Sharing emissions data across supply chains is still uncommon, raising valid concerns for auditors regarding the categorization of these emissions.

- **Lack of Guidance:** Players in the heavy industry space that do not have the internal and external experts to implement a reliable, accurate management system for SEC disclosures will face an additional challenge in the defining, collection, and reporting of the right data.

Opposing Perspectives:

Detractors of Scope 3 emissions disclosures contend that the lack of a standardized universal methodology for supply-chain reporting may result in unreliable guesstimates, that could lead to inaccurate disclosures, potentially misleading investors. Republican lawmakers have even introduced a bill seeking to block the disclosure of value-chain emissions.

Advocating for Enhanced Disclosures:

Supporters of the proposed rules emphasize the importance of reporting Scope 3 emissions in today's investment landscape, where climate change risks pose significant financial implications. They argue that investors require reliable information on climate risks to make informed investment decisions. Environmental organizations, such as Earthjustice and Greenpeace, strongly support Scope 3 disclosures but seek clarification regarding the responsibilities of suppliers and downstream partners.

A Guide for Asset-Heavy Companies: Making Scope 3 Emissions Accessible, Accurate, and Verifiable

With the first mandatory Scope 3 disclosure rule likely to take effect within the next 24 months, asset-heavy companies can take several steps to proactively prepare themselves to adhere to it, demonstrate environmental responsibility, and align with the growing demand for climate-related disclosures.

Making Scope 3 data accessible, accurate, and verifiable requires careful consideration and implementation of various practices. Here are some approaches to achieve these objectives:

- **Assess Emissions Across the Value Chain:** Conduct a comprehensive assessment of emissions from both direct operations (Scope 1) and indirect sources like purchased energy (Scope 2), as well as upstream and downstream activities (Scope 3). This assessment will provide a baseline for future reporting.

- **Data Collection and Management:** Develop robust data collection systems and processes to gather Scope 3 data effectively. Implement tools such as supplier questionnaires, surveys, and data sharing platforms to streamline the data collection process. Ensure data quality by verifying the accuracy and completeness of the reported information.

- **Supplier Engagement:** Collaborate with suppliers and partners to collect accurate data on their emissions. Establish clear guidelines and reporting requirements for suppliers, encouraging them to disclose their emissions information. Encourage suppliers to adopt their own sustainability initiatives and reporting practices.

- **Standardized Reporting Frameworks:** Adopt internationally recognized reporting frameworks such as the Global Reporting Initiative (GRI) or the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. These frameworks provide guidelines for Scope 3 emissions reporting, ensuring consistency and comparability.

- **Standardized Protocols:** Follow recognized and standardized protocols for calculating Scope 3 emissions, such as the Greenhouse Gas Protocol (GHGP) developed by the World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD).

- **Robust Emission Reduction Strategies:** Identify emission hotspots and areas for improvement within the value chain. Develop and implement strategies to reduce emissions, such as energy efficiency measures, renewable energy adoption, supply chain optimization, and product lifecycle analysis.

- **Verification and Assurance:** Engage third-party auditors or independent verifiers to assess the accuracy and completeness of Scope 3 data. Verification provides an objective assessment of the reported emissions and enhances credibility. Verification can be conducted using recognized standards like ISO 14064 or by engaging specialized verification firms.

- **Technology Solutions:** Leverage technology to automate data collection, analysis, and reporting processes. Use digital platforms or software solutions that integrate with suppliers' systems to capture emissions data directly. These technologies can help improve data accuracy, reduce manual errors, and increase transparency.

- **Continuous Improvement:** Regularly review and improve data collection processes and methodologies to enhance accuracy and adapt to changes in the value chain.

- **Stay Informed and Seek Expertise:** Stay updated on the finalization and implementation of the SEC's proposed rule. Seek guidance from sustainability experts, industry associations, and consultants to understand best practices and ensure compliance.

In conclusion, the SEC's proposed Scope 3 emissions reduction rule has become a focal point of contention, with opposing perspectives on its feasibility and potential burden on businesses. However, the importance of disclosing Scope 3 emissions cannot be overlooked in the current investment climate, where climate-related risks have significant financial implications. For asset-heavy companies, it is crucial to navigate these proposed rules and proactively prepare for compliance with Scope 3 emissions disclosure and contribute to a more transparent and sustainable business environment.

Get In Touch

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