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SEC Faces Backlash over Scope 3 Removal

By ESG Investor
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Experts have welcomed the release of the much-awaited US climate disclosure requirements, but criticise divergence from other reporting regimes.

The decision from the US Securities and Exchange Commission (SEC) to drop Scope 3 emissions from its much-awaited climate disclosure rules will create uncertainty around climate risks posed by US companies, industry pundits have warned.

In a landmark decision yesterday, three of the five SEC commissioners **voted in favour** of adopting rules to enhance and standardise climate-related disclosures for investors in the US, putting an end to nearly a year of market speculation.

But the requirement for compliant firms to disclose greenhouse gas (GHG) emissions from upstream and downstream activities in their value chains – also known as Scope 3 emissions – was dropped from the **final text**, drawing criticism from industry participants, who deplored a "watered-down" version of the regime.

"Without Scope 3 requirements, this rule is anemic," Charles Slidders, Senior Attorney for Financial Strategies at the Center for International Environmental Law (CIEL), told *ESG Investor*. "It is far weaker than what is needed to protect investors, and ultimately the public, from climate risk. Such disclosures of are critical to assessing investments – from the value of a company to its exposure to climate risks and its transition to net zero."

Scope 3 emissions typically represent the majority of a corporation's carbon footprint – and up to 90% of oil and gas majors' GHG emissions.

"We welcome the new disclosures adopted by the SEC, as enhanced transparency certainly benefits investors, but the scaling back on Scope 3 is disappointing," said Hannah Simons, Head of Sustainability at Lloyds Bank Corporate Markets. "By not requiring companies to disclose value-chain emissions, the rule allows companies to continue to be silent on core factors that contribute to climate pollution, leaving investors in the dark about critical information needed to make informed choices about financial risk."

The SEC regime built off recommendations from the **Task Force on Climate-related Financial Disclosure** and the **GHG Protocol**, aiming to help investors seeking to compare Commission registrants and foreign companies not registered under US federal securities laws and making disclosures under those frameworks. However, the final rules also diverged from those.

"The SEC took an important and long overdue step to protect investors, the integrity of our markets, and the retirements of everyday Americans," said Hana Vizcarra, Senior Attorney at environmental law nonprofit Earthjustice. "But it is condoning misleading and incomplete disclosures that open investors to risk. They deserve better than where the SEC has landed with this."

Long, arduous road

Originally proposed in **2022**, the US climate disclosure rules have been the subject of heated debate. Their goal is to mandate material climate risk disclosures by public companies and in public offerings, providing investors with consistent and comparable information for their decision-making, and issuers with clear reporting requirements.

Although the final version of the rules was due in April last year, the SEC delayed their publication multiple times, largely due to the sheer volume of industry feedback it received, but also to the highly controversial nature of the discussion – especially in the US, where anti-ESG rhetoric has been mounting ahead of the **elections later this year**.

“Transparency is the bedrock of our financial system,” said Danielle Fugere, President and Chief Counsel at US shareholder advocacy group As You Sow. “The old business maxim – what gets measured gets managed – is as relevant as ever. The corollary, of course, is that risk that doesn’t get measured doesn’t get managed.”

The Scope 3 requirements included in the initial proposal had sparked the most backlash and pushback from the market, leading to suspicions that they could eventually be removed. According to estimates from investor network Ceres, **97% of the investors** it surveyed in 2022 were in favour of mandating those emissions.

“Disregarding Scope 3 emissions creates a significant hole in shareholders’ understanding of climate risk [and] investor decision-making will be impaired by this critical omission,” Fugere added. “Only **29%** of listed US companies have disclosed at least partial Scope 3 emissions, leaving the bulk of emissions insufficiently addressed.”

Entities covered by the new regime will begin disclosures next year, with large public companies required to disclose material climate-related risks and impacts – including transition plans, scenario analysis and internal carbon prices. The rules also require disclosure of material Scope 1 and 2 emissions, which respectively cover direct GHG emissions, and indirect emissions from purchased electricity or other forms of energy.

“This is an important advancement – unfortunately, the original requirement that all registrants report their Scope 1 and 2 emissions has been weakened significantly,” said Abigail Paris, Decarbonisation Lead at As You Sow. “Companies are now allowed to determine the materiality of their emissions and report only what they think is significant – reducing comparability, creating significant subjectivity, and diminishing confidence in reporting.”

Regulatory divergence

Another point of contention regarding the removal of Scope 3 emissions was the fact that US requirements will now significantly diverge from similar regimes in other jurisdictions – including in **California and Europe**. Such submissions are also required under the International Sustainability Standards Board’s **climate-related disclosures**.

“I would have hoped the SEC would take stock of existing regulations in California and the EU, which do require Scope 3 reporting, and for it to approach this in a way that’s more in line with other rules,” said Rachel Delacour, CEO at climate analytics firm Sweep. “Especially as we are already in a politically fragmented world, it would seem wise to bring more alignment – not less.”

This discrepancy could also create complexities for companies operating internationally – although sources argued that the need for them to disclose Scope 3 emissions under other regimes meant they would likely report those anyway, regardless of their omission in the SEC rules.

“The Scope 3 train already has left the station”, said Michael Littenberg, Partner at law firm Ropes & Gray. “Larger companies, in particular, are subject to mandatory Scope 3 disclosures under other regimes, and as such – are unlikely to pull back from them.”

Increasing pressure from investors for transparency over companies’ climate transition plans and carbon emissions is another contributing factor reinforcing that narrative.

“Ultimately, the divergence between US disclosure regulations and that of its trading partners has created uncertainty for investors about the climate risk US companies face, deterring investment, and increasing the cost of capital,” argued the CIEL’s Slidders, who also deplored the fact that the SEC stopped short from mandating Scope 1 and 2 disclosures across the board.

Despite such significant scale-backs, some sources maintained that the new regime was still powerful, as representing the biggest change to the SEC’s disclosures requirements for public companies in decades.

“Some of these changes will require compliant firms to start work in the near future in order to track information for their fiscal year 2025 filings,” said Elad Roisman, Partner at law firm Cravath and former acting chair at the SEC. “Companies and their advisors will need to spend considerable time combing the rules to see what they need to do now and what further resources are required to comply.”

Legal conundrum

Although the final version of the regime is a lot less radical than the original version, the SEC climate disclosure regime still faces internal objections, with Republican Commissioners Hester Peirce and Mark Uyeda having expressed their discontent during this week’s voting session.

Peirce – who has famously opposed many of the rulemakings proposed or adopted during incumbent SEC Chair Gary Gensler’s tenure – argued that despite the changes, the rule would still “spam investors with details from the Commission’s pet topic of the day”, and would likely “overwhelm” investors, rather than informing them.

Beyond criticism from its own benches, the SEC may also expose itself to external legal challenges. Environmental non-profit **Sierra Club** and the Sierra Club Foundation, for instance, are reportedly considering challenging the SEC’s removal of Scope 3 provisions from the final rules, while also taking action to defend its authority to implement them.

“It would be naïve to believe there will not be legal challenges — some of which will likely be large, especially given the current political tensions in Washington and across the US, which are unprecedented in scope and intensity,” said Harry Broadman, Chair at The ESG Exchange and former chief of staff of the US president’s Council of Economic Advisors. “I believe there are significant odds that this ferment could disrupt implementation of the rule.”

Just hours after the SEC vote, ten Republican states including Georgia, Alabama and Alaska decided to **sue the agency** over the new regime, filing a petition at the Atlanta-based 11th US Circuit Court of Appeals. If the presidential elections later this year lead to a Republican mandate, this would only increase the likelihood of legal challenges against regulations supporting the US climate transition.

“If there is a new administration next year, we can expect a Republican-led Commission to seek to suppress and limit such rules,” said Ropes & Gray’s Littenberg.

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