

710 Sansome Street  
San Francisco, CA 94111

T 628.251.1222  
E info@engine1.com



June 17, 2022

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: Comments to Proposed Rule on Enhancement and Standardization of Climate-Related Disclosures for Investors (File No. S7-10-22).**

Dear Ms. Countryman:

Engine No. 1 is pleased to submit this letter in support of the rules proposed in the Enhancement and Standardization of Climate-Related Disclosures for Investors (the “Proposed Rules”) issued by the Securities and Exchange Commission (the “Commission”). We recognize the time and effort the Commission and the Staff of the Division of Corporation Finance (the “Staff”) invested in formulating the Proposed Rules and appreciate the opportunity to provide our perspective. We submit this letter to express our support and share our insight as to why the disclosures required by the Proposed Rules are important to investors and how they will be used by Engine No. 1.

We are an investment firm built on the belief that sustainable businesses are the most durable and profitable enterprises. Engine No. 1 believes that one of the most pressing and complex externalities threatening our global economy today is greenhouse gas emissions (“GHG”) and its effect on climate.<sup>1</sup> As an investor, Engine No. 1 relies on climate and GHG data to understand not just a company’s environmental impacts, but its financial prospects and risks. In this regard, climate data is financial data and climate risk is business risk. For Engine No. 1, this is not about advancing a social agenda or political stance. This is about maximizing our ability to create value for investors.

This is why we use environmental, social and governance data to identify investment opportunities in the market and transform how businesses create value over time. Since its formation, Engine No. 1 set out to demonstrate that investors can use the capitalist system to maximize value and achieve superior returns by directly addressing the world’s biggest problems. We built Engine No. 1 on two core beliefs: (i) that a company’s societal impacts should be accounted for just like other economic fundamentals and integrated into long-term business models

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<sup>1</sup> <https://www.imf.org/external/pubs/ft/fandd/basics/38-externalities.htm#:~:text=Today%2C%20the%20most%20pressing%20and,major%20cause%20of%20global%20warming>

and (ii) that by working with large companies as constructive and active owners, we can help drive long-term economic value.

Engine No. 1 proved the power of our thesis through a proxy campaign with ExxonMobil last year. We successfully spearheaded a campaign to elect three new independent directors with critical energy and corporate leadership experience to ExxonMobil's board. We won the campaign because we made an economic case, free of ideology, and brought the biggest asset owners and managers with us. Subsequently, we have been able to engage with the leadership of other major companies on their long-term strategies. For example, we are collaborating with General Motors to refine how it creates value over time—helping position its business on the right side of the transition towards sustainability and positive societal impact. We firmly believe that this will result in better growth prospects and expansion of multiples.

Disclosures such as those in the Proposed Rules would be a positive step toward closing information gaps in the market and enabling investors to engage in a more meaningful analysis of companies' financial performance over time. The Proposed Rules would provide a new and important level of transparency and reporting standardization.

Therefore, we respectfully submit this letter to:

- i. Express our view that the Proposed Rules will provide the transparency investors need to assess the financial impacts of corporate externalities and make informed, data-driven investment and voting decisions that generate long term economic value and promote a well-functioning capitalist system;
- ii. Convey our support for the Commission's effort to address the scarcity of consistent, reliable and comparable GHG emissions data that has manifested under the current voluntary reporting regime;
- iii. Defend the Commission's authority to promulgate the Proposed Rules in the interest of fulfilling its mission to maintain efficiency, promote competition and protect investor interests;
- iv. Proffer our recommendations for enhancing the reliability and availability of Scope 3 and carbon offset data; and
- v. Respond to specific questions by the Commission regarding executive remuneration, reporting periods, location data and units of measurement.

## **I. Climate Related Disclosures are Necessary for Investors to Make Informed, Data-Driven Investment Decisions**

Standardization of disclosure through the Proposed Rules will create a level playing field, arming investors with the information needed not only to allocate dollars to the companies with the greatest potential to yield long term economic value, but also to hold companies accountable for meeting stated emissions targets and mitigating climate-related business risks. In July 2021, Commission Chair Gary Gensler noted that “[t]oday, investors increasingly want to understand the climate risks of the companies whose stock they own or might buy. Large and small investors,

representing literally tens of trillions of dollars, are looking for this information to determine whether to invest, sell, or make a voting decision one way or another.”<sup>2</sup> The Proposed Rules would require the disclosure of information that is critical to helping investors make informed, data-driven investment decisions.

While the last decade has seen growth of money flows into investment funds that claim to incorporate environmental, social and governance criteria into their strategies, Engine No. 1 strongly believes that investments based primarily on environmental, social and governance criteria are not an optimal asset class for purposes of making investment decisions. Rather, Engine No. 1 believes that environmental, social and governance data are components of financial data that account for stakeholder costs and benefits. Incorporating this data into investment analysis—including the information that is the subject of the Proposed Rules—helps us better assess a company’s true financial condition and identify opportunities to generate long-term economic value. Data empowers active owners like us to propel companies toward sustainability and improved financial performance. While some view the goals of sustainability and improved financial performance as mutually exclusive, we see them as intrinsically linked. Specifically:

**SUSTAINABILITY = PROFITS GREATER THAN YOUR COST  
OF CAPITAL AFTER INTERNALIZING ALL EXTERNALITIES™**

What does that mean? To understand whether a business is sustainable, Engine No. 1 evaluates whether a business is profitable after taking into account the dollar value of negative and positive externalities, which are the uncompensated consequences of production or consumption that impact third parties and are not reflected in market prices. Externalities account for the value that companies create or destroy for stakeholders (employees, customers, communities and environment) and we believe that they are strongly correlated to future financial outcomes. Examples of externalities include the cost of respiratory disease or the costs of lost biodiversity during the production of certain products. The backlash of environmental externalities can include capital destruction, operational disruptions, regulatory penalties, litigation, lower agricultural productivity and associated price volatility. These are all factors that erode economic value and responsible investing requires that these factors be assessed, quantified and internalized.

Rather than use a performance ranking based on a set of subjective criteria, Engine No. 1 developed a data-driven approach that helps to calculate the value of externalities that we call Total Value Framework (“TVF”). TVF methodology integrates shareholder and stakeholder data into mainstream financial valuation analysis and attempts to understand and accurately predict how externalities affect future valuations. This analysis informs our decisions as investors, both the investments that we make as well as what we subsequently do as active owners. GHG data is crucial to TVF analysis.

We believe transparency is key to a well functioning capitalist system. When costs produced by market activities are borne outside the market, the market will fail to stimulate behavior and technology that reduces those costs which is ultimately detrimental to both economic and social welfare. At Engine No. 1, we measure these costs through our TVF methodology to encourage the market to internalize the impacts of its activities. However, our TVF methodology

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<sup>2</sup> <https://www.sec.gov/news/speech/gensler-pri-2021-07-28>.

is data dependent. While some climate data exists and is becoming more transparent, it remains difficult to both aggregate and analyze. The information investors need to stimulate efficient market behavior is disparate, widely dispersed and, sometimes, simply unavailable. The Proposed Rules provide a disclosure framework that promotes much needed transparency in both qualitative and quantitative climate risk data and addresses the current scarcity of material Scope 3 data.<sup>3</sup> We see the Proposed Rules as a necessary policy intervention to help correct a market failure that has persisted for far too long.

## II. Why Engine No. 1 Supports The Proposed Rules

Engine No. 1 supports the full breadth of climate risk disclosures required by the Proposed Rules, particularly with respect to GHG emissions. Voluntary GHG emissions reporting has led to an information landscape that lacks broad participation, comparability and reliability. Engine No. 1 believes that the Proposed Rules would resolve many of these issues because they would require participation, lead to the disclosure of information that is more comparable and provide investors with more consistent and reliable information.

### A. *The Proposed Rules Will Rectify Data Scarcity and Asymmetry Issues*

The Proposed Rules will vastly increase participation in reporting GHG data. Currently, only approximately 20% of publicly listed U.S. companies voluntarily disclose emissions data.<sup>4</sup> In the absence of voluntary participation, shareholders must seek to obtain the information through other means. For example, Engine No. 1 employs analysts who perform individual outreach to companies which is a time-consuming process.

We also attempt to aggregate data ourselves through publicly available sources. This requires us to spend time searching for and identifying credible data through numerous sources because there is no centralized repository. Additionally, we subscribe to paid, third-party GHG data providers, which can be costly. Once we aggregate the data, we then spend hours converting this patchwork of information into a useful framework that facilitates analysis. Despite our best efforts, we find that the information oftentimes is either unreliable or has gaps that must be filled with statistical estimates, which have limitations. Indeed, estimated emissions data models are much less effective than reported data in identifying both the greenest companies and the worst emitters.<sup>5</sup>

In addition to being time consuming, burdensome, and expensive, the data aggregation and estimation process leads to information asymmetries—and the risk of proliferation of

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<sup>3</sup> <https://www.msci.com/www/blog-posts/reported-emission-footprints/03060866159> (Finding that “In the case of Scope 3 emissions, ... data quality and quantity were particularly low. We observed that 69% of the companies reporting to CDP did not disclose Scope 3 emissions, indicating a large reporting gap.”)

<sup>4</sup> <https://www.forbes.com/sites/shivaramrajgopal/2021/06/01/the-how-of-carbon-reporting-in-the-us/?sh=3295e385fecd>.

<sup>5</sup> See [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3722973](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3722973)

misinformation from using unreliable data sources—among investors. This leads to differing, and oftentimes incorrect, conclusions regarding the climate risks of a particular company.

To resolve, among other things, the lack of participation and information asymmetries, there has been a growing trend among shareholders to use active engagement and submit shareholder proposals at the annual meetings of shareholders to obtain climate-related information. Indeed, climate change was the dominant theme among environmental resolutions last year.<sup>6</sup> While these proxy proposals are on the rise and have enjoyed some success, the vast majority fail and are incredibly burdensome for shareholder proponents from both a time and expense standpoint.<sup>7</sup>

Nonetheless, Engine No. 1 firmly believes that it is the right and responsibility of shareholders to vote and, in doing so, harness their power to encourage greater corporate transparency and accountability on climate risk. This is not only our belief, it is our practice. We vote to create and protect long-term shareholder value by holding companies accountable not only for managing risks related to climate change but for providing the material disclosures necessary for investors to properly assess their investments. Put simply, good voting is dependent on useful data. Our Proxy Voting Guidelines encourage the dissemination of useful data by dictating that we "support shareholder proposals that seek additional disclosure on the impacts of climate change, approaches to energy efficiency, and renewable energy" and "...[hold] boards accountable when they have failed in...providing adequate disclosure on material [climate-related] issues."<sup>8</sup> The Proposed Rules will resolve the data gaps due to lack of participation and much of the information asymmetry issues that we and other shareholders have long sought to remedy through the power of our votes.

*B. The GHG Protocol Reporting Standard Will Enhance Comparability While Easing Compliance Burdens for Certain Companies*

The Proposed Rules will enhance the comparability of data, which is crucial to investment decision making.<sup>9</sup> In the absence of mandatory reporting standards and disclosures of methodologies and assumptions, the companies that choose to make climate-related disclosures

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<sup>6</sup> <https://corpgov.law.harvard.edu/2021/08/05/2021-proxy-season-review/>

<sup>7</sup> <https://hbr.org/2021/04/shareholders-are-pressing-for-climate-risk-disclosures-thats-good-for-everyone>

<sup>8</sup> [Microsoft Word - E1-Proxy Guidelines-210813.docx \(issgovernance.com\)](#)

<sup>9</sup> [https://dspace.mit.edu/bitstream/handle/1721.1/65076/Verdi\\_The%20benefits.pdf?sequence=1&isAllowed=y](https://dspace.mit.edu/bitstream/handle/1721.1/65076/Verdi_The%20benefits.pdf?sequence=1&isAllowed=y) Specifically, the FASB [1980, p. 40] states that “investing and lending decisions essentially involve evaluations of alternative opportunities, *and they cannot be made rationally if comparative information is not available*” (our emphasis). As an additional example of the importance of comparability in a regulatory context, comparability is one of three qualitative characteristics of accounting information included in the accounting conceptual framework (along with relevance and reliability). Further, according to the FASB [1980, p. 40], “The difficulty in making financial comparisons among enterprises because of the different accounting methods has been accepted for many years as the principal reason for the development of accounting standards.” Here, the FASB argues that users’ demand for comparable information drives accounting regulation. *See, for example, Libby, Libby, and Short [2004, p. 707]*

report vastly different and often incomparable information.<sup>10</sup> For example, an analysis of the largest GHG emitters in the United States utilities sector’s voluntary disclosures to the Carbon Disclosure Project (“CDP”) revealed that those firms use different boundaries and accounting methodologies, leading to the conclusion that the reported data is not comparable.<sup>11</sup> The Proposed Rules’ requirement to base Scope 1, 2 and 3 emissions reporting on the widely accepted GHG protocol will enhance data comparability while minimizing compliance burdens for the companies that already use this methodology.<sup>12</sup>

C. *Assurance Requirements Will Improve Reporting Accuracy and Bolster Investor Confidence in Reported Data*

The assurance requirements in the Proposed Rules for Scope 1 and 2 will ensure that the information disclosed is more reliable.<sup>13</sup> In the absence of mandated third-party assurances, many of the companies who voluntarily report Scope 1 and 2 emissions do not have the reported data verified by third parties<sup>14</sup> or are simply incapable of measuring their emissions accurately on their own.<sup>15</sup> Without accurate emissions data, investors cannot evaluate emissions baselines or track progress toward meeting stated targets. Third-party assurance requirements will promote the

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<sup>10</sup> <https://ihsmarkit.com/research-analysis/lost-in-translation-inconsistencies-continue-to-limit-the-usef.html> (Showing inconsistencies in how oil and gas companies report emissions: “Some reported emissions shown include Scope 1 emissions, while others include Scope 1 and 2. These represent different emissions and thus are not comparable. There are also different choices in the organizational boundary being deployed, with some reporting emissions based on their share of operations and others reporting on assets they operate. Still, others include different operations or report emissions from different operations separately, further complicating comparisons.”)

<sup>11</sup> [https://www.researchgate.net/publication/324180108\\_Reliability\\_and\\_Comparability\\_of\\_GHG\\_Disclosures\\_to\\_the\\_CDP\\_by\\_US\\_Electric\\_Utilities](https://www.researchgate.net/publication/324180108_Reliability_and_Comparability_of_GHG_Disclosures_to_the_CDP_by_US_Electric_Utilities) (GHG protocol is one of 57 accounting methodologies CDP reporting companies use and many companies use multiple methods which deters comparability.)

<sup>12</sup> <https://ghgprotocol.org/companies-and-organizations#:~:text=GHG%20Protocol%20standards%20and%20guidance,program%20based%20on%20GHG%20Protocol>. (In 2016, at least 92% of Fortune 500 companies responding to CDP used GHG Protocol directly or indirectly through a program based on GHG Protocol.)

<sup>13</sup> *Id.* (Sample of 20 US electric utilities that disclosed their 2013 and 2014 emissions amounts to the CDP and are subject to GHGRP reporting requirements. We find that the amounts for some firms exceed the amounts that they report to the CDP. This finding suggests that the CDP amounts are not reliable.)

<sup>14</sup> <https://www.epa.gov/sites/default/files/2020-04/documents/appendix-corporate-ghg-inventorying-and-target-setting-self-assessment.pdf>. (Dataset of 565 companies within the S&P500 and Fortune 500 that voluntarily report GHG emissions data shows that only half receive third-party verification of reported Scope 1 and Scope 2 GHG emissions.)

<sup>15</sup> <https://www.bcg.com/publications/2021/measuring-emissions-accurately>. (Survey of 1,290 organizations across nine major industries around the globe shows that only 9% are able to measure their emissions comprehensively and overall, respondents estimated a 30% to 40% average error rate in their emissions measurements.)

accuracy of available data, increase investor confidence in reported data and will enable investors to make more impactful investment and voting decisions.

*D. The Availability and Reliability of Decision Useful Data Promotes Market Efficiency*

The benefits of providing more comparable, consistent and reliable information outweigh the cost considerations that Engine No. 1 anticipates companies subject to disclosure will emphasize in arguing against the Proposed Rules. Perhaps the most important benefit of the Proposed Rules, consistent with the Commission’s goals, is that increasing the quality of information disclosed to investors increases the efficiency of the markets. As described above, it is currently difficult for investors to obtain useful information, so their investment and voting decisions are misguided, opportunities to drive value are missed, “greenwashing” thrives and markets simply do not work efficiently.<sup>16</sup>

To the contrary, when information is widely shared, capitalism works at its best and value is created, not destroyed. Indeed, requiring Scope 1, 2 and 3 disclosures will require companies to evaluate the true costs of their environmental externalities, meaning these disclosures will stimulate companies to internalize their externalities, and drive value by making adjustments for those costs.

*E. The Proposed Rules Would Preserve the United States' Leading Economic and Reputational Position on the Financial World Stage*

Finally, addressing climate change is an imperative that is being pursued globally by companies as well as governments. Yet, despite being both the largest per capita GHG emitter in the world<sup>17</sup> and the leading financial system globally,<sup>18</sup> the United States lags behind much of the rest of the world in implementing mandatory financial disclosures relating to climate risk. The Proposed Rules would bring the United States more in line with other countries and international entities that have already implemented mandatory climate risk reporting, including Brazil, the European Union, Hong Kong, Japan, New Zealand, Singapore, Switzerland, and the United Kingdom. Engine No. 1 firmly believes that mandatory climate risk disclosures will stimulate companies to voluntarily address climate change’s economic threat to their businesses, which will, in turn, have an aggregate impact on the economy as a whole. The Proposed Rules are thus critical

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<sup>16</sup> <https://www.energyenvironmentallawadviser.com/2017/06/shareholders-demand-more-disclosure-of-climate-change-risks/> (Inadequate information can lead to mispricing of assets and misallocation of capital, both of which can lead to economic instability.)

<sup>17</sup> <https://www.c2es.org/content/international-emissions/>

<sup>18</sup> <https://www.bloomberg.com/news/newsletters/2022-03-04/what-s-happening-in-the-world-economy-u-s-flexes-its-financial-dominance>

to the United States maintaining its relative economic strength and global reputation as the financial capital of the world.

### **III. The Proposed Rules Align With The Commission’s Mission To Protect Investors And Improve Access to Material Financial Data**

The Commission’s tripartite mission is: (i) to protect investors; (ii) maintain fair, orderly and efficient markets; and (iii) facilitate capital formation.<sup>19</sup> To further the Commission’s mission, the Securities Act of 1933 and the Securities Exchange Act of 1934 authorize it to promulgate rules or regulations requiring the disclosure of information that it believes is “necessary or appropriate in the public interest or for the protection of investors.”<sup>20</sup> In determining whether an action is necessary or appropriate in the public interest, Congress has directed the SEC to consider, in addition to the protection of investors, “whether the action will promote efficiency, competition, and capital formation.”<sup>21</sup>

We anticipate that some critics of the Proposed Rules will suggest that the Commission may mandate disclosure requirements only if it determines that the information would be material to investors. While we disagree with this standard, as “materiality” appears nowhere in the statutes or regulations, it is inapposite because the information that would be required under the Proposed Rules is material to Engine No. 1 and other investors.

The United States Supreme Court held that information is material to investors when there is “a substantial likelihood that a reasonable investor would consider it important to deciding how to vote or make an investment decision, or put another way, if the information would alter the total mix of available information.”<sup>22</sup> Indeed, “[u]nder our federal securities laws, public companies are required to disclose certain financial and other information to investors. The basic premise of this disclosure-based regulatory regime is that if investors have timely, accurate, and complete financial and other information, they can make informed, rational investment decisions.”<sup>23</sup> As further described in this letter, the climate data identified in the Proposed Rules is material to an

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<sup>19</sup> <https://www.sec.gov/about.shtml>; *Id.* §§ 77b(b), 78c(f); see also *id.* § 78w(a)(2). The Commission has interpreted its authority as cabined by its “core mission to promote investor protection, market efficiency and competition, and capital formation.” Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,917, 23,922 & n.6 & n.55 (Apr. 22, 2016)

<sup>20</sup> Securities Act Section 7(a) and Exchange Act Section 12(b).

<sup>21</sup> See 15 U.S.C. § 77b(b). The Commission also should promulgate rules or regulations as necessary or appropriate for the proper protection of investors to insure fair dealing in a security. 15 U.S.C. §§ 77g(a)(1), 78l(b)(1); see also *id.* § 78m(a) (“as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security”).

<sup>22</sup> *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976); see also *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) (as the Supreme Court has noted, determinations of materiality require “delicate assessments of the inferences a ‘reasonable shareholder’ would draw from a given set of facts and the significance of those inferences to him....” citing *TSC Industries*, 426 U.S. at 450).

<sup>23</sup> “Assessing Materiality: Focusing on the Reasonable Investor When Evaluating Errors,” Munter, Paul, Acting Chief Accountant of the Commission (March 9, 2022).

[https://www.sec.gov/news/statement/munter-statement-assessing-materiality-030922#\\_edn4](https://www.sec.gov/news/statement/munter-statement-assessing-materiality-030922#_edn4)

investor and promotes efficiency and competition because it helps investors both evaluate the long-term financial value of the companies in which they are considering investing and make decisions regarding how to vote as a shareholder.

This is not the first time the Commission has issued guidance with respect to climate-related disclosures. In 2010, the Commission issued the Commission Guidance Regarding Disclosure Related to Climate Change (17 CFR Parts 211, 231 and 241), which discussed companies' obligations to disclose climate change related information under the existing disclosure requirements. Twelve years later, it is apparent that disclosures under the existing requirements do not provide sufficient information to investors.

The Proposed Rules will help provide a single, consistent and accessible source for reported emissions, which investors will use to: (a) quantify climate risk; (b) assess the impact of that risk on a company's business performance; (c) identify companies who are leading and who are lagging behind in an industry; (d) make decisions on which issues to address with companies based on an assessment of their externalities; and (e) hold companies accountable if they are missing targets. Importantly, this information is incredibly valuable to investors from a financial perspective, regardless of their political or ideological affiliations.

As an investor, Engine No. 1's investment processes and analyses are dependent upon the information mandated by the Proposed Rules. For example, disclosure of Scope 3 data by companies in the consumer automotive industry with respect to upstream and downstream vendors will allow Engine No. 1 to enhance models, consider whether those companies' plans to reduce emissions are aggressive enough, and compare targets to results. For businesses that have set GHG targets, the data will help to analyze evidence of whether progress is being made and whether those targets remain viable. Reporting also will discourage greenwashing for those who identify GHG targets without a viable plan and allow investors to identify those companies without viable plans. In this regard, the Proposed Rules would protect Engine No. 1 and other investors from corporate attempts to obscure or conceal their underperformance in managing climate risk.

For these reasons, the Proposed Rules are well within the Commission's rulemaking authority.

#### **IV. Engine No. 1's Recommendations**

Consistent with our reasoning for supporting the Proposed Rules, Engine No. 1 respectfully posits recommendations for the Commission to consider relating to Scope 3 and carbon offset reporting requirements and the requirement to file rather than furnish environmental disclosures. Specifically, Engine No. 1 respectfully suggests that the Commission consider requiring those reporting Scope 3 data to provide good faith assurances as to their process and methodology in the short term and consider phasing in data assurances for certain industries over time as calculation, estimation and data gathering processes for Scope 3 data mature. Assurances will promote the data quality and reliability that investors need to have productive engagements with companies on strategies to manage climate related risks. Additionally, Engine No.1 also recommends: (i) additional guidance relating to Scope 3 materiality assessments, (ii) the enhancement of

disclosures concerning carbon offsets, and (iii) the retention of the proposed requirement that certain climate disclosures be filed and not furnished.

*A. Recommendation for Assurances with Scope 3 Data*

Engine No. 1 recommends that registrants provide good faith assurances regarding the completeness and accuracy of their Scope 3 reporting. Scope 3 reporting is essential for investors to meaningfully understand the financial consequences of climate related risks existing up and down a registrant’s supply chain.<sup>24</sup> Some reports estimate that for the average company Scope 3 emissions are 5.5 times higher than the direct emissions from its own assets and operations.<sup>25</sup> For example, technology, retail, insurance, and health care companies may not report Scope 1 data, but because of their large physical footprints and heavy energy uses, those companies will have significant impacts that would be largely unaccounted for without the Scope 3 metric. Indeed, Scope 3 applies to many modern industries engaged in consumer product manufacturing and retail that are, in reality, giant assemblers of products manufactured by third-party vendors. For example:

- An automobile is made of thousands of parts, most of which are purchased from component parts manufacturers and then assembled. Ford reports that it has “around 1,200 Tier 1 production suppliers providing vehicle parts comprised of 1,000 different materials...”<sup>26</sup>
- Intel, the world’s largest semiconductor chip manufacturer by revenue and the developer of the series of microprocessors found in most personal computers, “works with more than 9,000 tier 1 suppliers in 89 countries” to provide direct materials for production processes, intellectual property, tools and machines for factories, logistics and packaging services, software, office materials, and travel services.<sup>27</sup>
- H&M, a clothing retailer, does business with over 602 commercial product suppliers who manufacture products for their brands in over 1,519 Tier 1 factories

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<sup>24</sup> <https://www.americanprogress.org/article/why-companies-should-be-required-to-disclose-their-scope-3-emissions/#:~:text=Reporting%20of%20Scope%203%20emissions%20protects%20investors&text=For%20instance%2C%20federal%2C%20state%2C,use%20down%20the%20supply%20chain>

<sup>25</sup> <https://hbr.org/2022/04/we-need-better-carbon-accounting-heres-how-to-get-there>

<sup>26</sup> <https://corporate.ford.com/social-impact/sustainability/responsible-material-sourcing.html>

<sup>27</sup> <https://www.intel.com/content/www/us/en/corporate-responsibility/supply-chain.html>

in Europe, Asia and Africa.<sup>28</sup> And retailing giant Walmart counts over 100,000 suppliers.<sup>29</sup>

For these and many other industries, Scope 3 emissions are typically the largest part of a company's carbon footprint, sometimes accounting for up to 95% of their total emissions.<sup>30</sup> The only way to fully understand a company's exposure to certain climate related financial risks such as the impacts of rising carbon prices and more stringent national emissions policies, is to have a complete and accurate picture of their Scope 3 emissions. And the only way for an investor to understand the completeness and accuracy of the Scope 3 reporting are registrants' good faith assurances as to their processes and methodologies.

Indeed, as important as it is, Scope 3 reporting is challenging and complex. For instance, for the oil and gas industry, Scope 3 emissions from the use of the oil itself account for approximately 88% of total emissions but reporting on those Scope 3 emissions is particularly dependent on data from their downstream customers<sup>31</sup>. Thus, for oil and gas companies, accurate data on the customer side is extraordinarily difficult to obtain but necessary to reducing overall emissions. On the other hand, consumer products companies like Walmart can engage with and exert pressure on their supplier base to reduce Scope 3 emissions. Given the challenges that Scope 3 presents for some industries, the Commission recognizes—and we agree—that “a one size fits all” approach to Scope 3 disclosures is difficult to achieve and Engine No. 1 does not advocate for that.<sup>32</sup> However, if the Commission is not going to require standards for Scope 3 data, assurances are necessary, particularly because a registrant's Scope 3 data often is based on information it receives from suppliers and other third parties that they do not control. Thus, requiring companies who report on Scope 3 to provide assurances as to their processes and methodologies will motivate those companies to exert pressure on their vendors and suppliers to provide better data on their direct emissions. This trickle-down effect will also stimulate investment in technologies and innovative solutions to make Scope 3 measurements more streamlined and accurate. Additionally, mandated Scope 3 assurances will likely lead to the development of industry reporting standards over time, as it will enhance how competitors gather, calculate and report data and enhance their own methodologies. Thus, while Scope 3 may be difficult now, it will get easier over time.<sup>33</sup>

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<sup>28</sup> <https://hmggroup.com/sustainability/leading-the-change/transparency/supply-chain/>

<sup>29</sup> <https://www.investopedia.com/articles/insights/050116/walmart-stock-analyzing-5-key-suppliers-wmt.asp>

<sup>30</sup> <https://www.cnbc.com/2021/08/18/apple-amazon-exxon-and-the-toughest-carbon-emissions-to-capture.html>

<sup>31</sup> [Oil, gas companies under pressure to manage Scope 3 emissions to reach net-zero goals: analysts | IHS Markit](#)

<sup>32</sup> [https://www.wsj.com/articles/companies-are-tallying-their-carbon-emissions-but-the-data-can-be-tricky-11630661401?mod=hp\\_lead\\_pos4](https://www.wsj.com/articles/companies-are-tallying-their-carbon-emissions-but-the-data-can-be-tricky-11630661401?mod=hp_lead_pos4) (“The measurement, target-setting, and management of Scope 3 is a mess...[t]here is a wide range of uncertainty in Scope 3 emissions measurement ... to the point that numbers can be absurdly off.”)

<sup>33</sup> <https://www.ft.com/content/0c6aa679-7061-4ddd-b9d8-a6b01c0c979a>

With respect to the type of assurances for Scope 3 emissions disclosures, Engine No. 1 recommends registrants be subject to self-assurances that methodologies and assumptions used are reasonable and made in good faith. We recommend assurances be in the form of a certification that the reporting entity has developed a formal process to gather Scope 3 data, which includes engaging with their upstream and downstream vendors. Requiring companies and industries to disclose and provide assurances for processes for identifying data and their reporting methodologies will encourage those processes and methodologies to conform toward an evolving industry standard. This is valuable to investors to facilitate understanding the information disclosed, to allow comparisons among industry participants, and to influence the consistency and reliability of disclosures.

With respect to who should be subject to mandatory disclosure and self-assurances, Engine No. 1 recommends a phase-in approach by size of registrant and industry. For example, the transportation and agriculture industries, as two of the largest contributors to GHG emissions, should be among the first to be required to provide assurances on Scope 3 data processes and methodologies.<sup>34</sup> The oil and gas industry also should be subject to such assurances given that Scope 3 emissions are the overwhelming majority of those associated with the industry.<sup>35</sup> We believe that requiring Scope 3 reporting and methodology disclosure will accelerate the development of best practices for identifying sector level material categories in these industries. And, of course, many companies, such as upstream product suppliers, also will be incentivized to provide emissions data as a competitive advantage, thereby furthering disclosures.

#### *B. Recommendation on Scope 3 Materiality Assessments*

Engine No. 1 supports the Commission's proposal to require disclosure of Scope 3 emissions when an issuer's Scope 3 emissions are material or where the issuer has set an emissions reduction target that includes its Scope 3 emissions. However, for companies that have not set reduction targets relating to their Scope 3 emissions, the Commission has not promulgated any factors that must be considered in determining whether Scope 3 emissions are material and must be disclosed. We are concerned this uncertainty could be creatively exploited to support findings of immateriality. Therefore, we recommend that the Commission consider providing additional guidance on the factors that a company must consider when assessing materiality for Scope 3 reporting. We recommend that such elements include: (i) where available, relevant materiality standards by industry; (ii) whether the issuer has performed an assessment of its Scope 3 emissions, (iii) whether the issuer presents a particular or unique position from other similarly situated issuers, and (iv) where an issuer's GHG emissions are 40% or more of their total Scope 1, 2 and 3 emissions.

#### *C. Recommendation on Carbon Offsets*

Engine No. 1 supports the standardization of disclosures concerning existing targets, transition plans, scenario analysis, and carbon offset use. We often are unable to find that

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<sup>34</sup> <https://www.epa.gov/ghgemissions/sources-greenhouse-gas-emissions> (The agriculture and transportation industries collectively accounted for 38% of GHG emissions in 2020.)

<sup>35</sup> <https://www.weforum.org/agenda/2021/08/oil-gas-industry-lifecycle-approach-reducing-emissions/>

information in sustainability reports such that we are left to seek to fill in the gaps. However, we respectfully recommend that the Commission enhance the information required with respect to carbon offsets. Specifically, Engine No. 1 believes that the Commission should require additional disclosure on climate-related financial instruments and any key performance metrics tied to such instruments. This information would help investors better evaluate companies' transition risk management and help measure the credibility of their climate targets and whether companies are meeting those targets. For example, it is useful for investors to understand whether a company is truly reducing its GHG emissions or, instead, relying on offsetting with carbon credits to reduce emissions.

Thus, companies should be required to distinguish between carbon credits generated from carbon dioxide removals and emission reductions, by disclosing the amount of carbon credits from carbon dioxide removals purchased to neutralize residual emissions (emissions that are unfeasible to abate) and the amount of carbon credits from carbon dioxide removals or reductions, purchased to counterbalance GHG emissions. This distinction is crucial to Engine No. 1 in forecasting companies' emissions reduction paths and in properly assessing future environmental externalities that are internalized in the economic valuation process.

#### *D. Recommendation on Filing Requirements*

Engine No. 1 understands that there has been some industry push-back regarding the Commission's requirement that companies 'file' their environmental-related disclosures with the Commission rather than merely 'furnishing' this information to the Commission. The requirement to file, as currently written, impacts Form S-1, Form F-1, Form S-4, Form F-4, Form S-11, Form 10, Form 10-K, and Form 10-Q and subjects the disclosures to the private right of action granted by Section 18(a) of the Exchange Act for those who rely on a false or misleading statement/omission and then buy or sell a security at a price affected by such statement/omission. We strongly believe that this provision is essential to the Proposed Rules, as it places necessary pressure on corporate boards and management to give greater scrutiny to ensure that their disclosures are accurate for the investing public.

If companies are merely required to 'furnish' this information, the disclosures would be exempt from this liability regime and would only be subject to general liability provisions such as Section 10(b) and Rule 10(b)(5), rendering the Proposed Rules toothless and incentivizing companies to not take the Proposed Rules seriously. Liability under Section 10(b) and Rule 10(b)(5) (and in enforcement actions by the Commission) requires knowing and intentional conduct, otherwise known as "scienter," which the Supreme Court has defined as "a mental state embracing intent to deceive, manipulate, or defraud."<sup>36</sup> The Private Securities Litigation Reform Act of 1995 makes clear that the required state of mind must be with respect to the act or omission alleged to violate securities laws.<sup>37</sup> Thus, if investors are left with only Section 10(b) and Rule 10(b)(5) claims, reporting companies may feel emboldened that they can evade liability if the

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<sup>36</sup> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 192, 193 n.12 (1976); see also *Aaron v. SEC*, 446 U.S. 680, 689-95 (1980) (quoting *Ernst*, 425 U.S. at 197)

<sup>37</sup> 15 U.S.C. § 78u-4(b)(2)(A)

information furnished is wildly incorrect simply because they did not intend to report false information.

We anticipate that reporting companies will argue that the liability regime for filed documents applied to Scope 3 disclosures is unfair, especially given the more uncertain nature of these types of disclosures. We disagree. The Proposed Rules provide a "safe harbor" for Scope 3 emissions disclosures—the most difficult emissions to estimate. The safe harbor would insulate a company from liabilities associated with reporting its Scope 3 emissions, so long as the statements are made with a “reasonable basis” and are disclosed in “good faith.” Thus, the Commission already strikes a balance of compliance and fairness through both the filing requirement and the safe harbor, and the Commission need not alter these provisions to appease industry interests. We are heartened by the Commission’s commitment to encourage compliance with these climate disclosures, and we strongly believe that this filing requirement should remain in the final rule.

## **V. Responses To Specific Questions From The Commission**

Finally, we appreciate the opportunity to answer certain questions that the Commission posed with respect to the Proposed Rules and provide the below answers for your consideration.

Executive Remuneration. The Commission asked whether it should require a registrant to disclose any connection between executive remuneration and the achievement of climate-related targets and goals. Engine No. 1 supports the Commission’s integration of the recommendations of the Task Force On Climate-Related Financial Disclosures (“TCFD”) into the Proposed Rules. Because many companies, investors and regulators already have experience with the TCFD framework, adoption of disclosure rules that are consistent with the TCFD recommendations will mitigate the compliance burden for companies and provide information that is familiar and useful to investors. TCFD guidance recommends that companies disclose whether and how executive remuneration policies take into consideration climate-related risks and opportunities. Engine No. 1 believes that, particularly for companies that face material climate-related risks, this may be a material governance issue. Consequently, we recommend that the Commission consider including a similar disclosure requirement consistent with TCFD recommendations and guidance.

Reporting Period. The Commission asked whether it should require the calculation of a registrant’s Scope 1, Scope 2, and/or Scope 3 emissions to be as of its fiscal year-end, as proposed, or another methodology. Engine No. 1 respectfully suggests that calendar year reporting would be preferable to fiscal year-end. Because companies have differing fiscal years, comparing data relating to fiscal years among companies in a given industry would require investors to make assumptions. Calendar year reporting would therefore enhance consistency, particularly in a given industry. In addition, calendar year information would facilitate scenario-based analyses, as well as modeling based upon goals for an industry in a given calendar year.

Location Data. The Commission asked how data should be presented if it were to require a registrant to provide location data for its GHG emissions. Engine No. 1 respectfully suggests that, to the extent possible, geographic coordinates, which are more granular than zip code, would be most useful, particularly for NOx/Sox, which have localized effects. When geographic coordinates are not available, Engine No. 1 believes that zip codes would be useful. With respect to the format, zip codes and geographic coordinates are more useful to investors than heat maps

for data extraction purposes. Finally, if the Commission requires a registrant to provide location data for its GHG emissions, Engine No. 1 is in favor of also requiring disclosure about the source of the emissions because the source of emissions provides a more accurate means to assess, measure and monitor Scope 1 emissions, which also helps identify, assess, measure and attribute downstream Scope 3 emissions.

Units of Measurement. The Commission asked whether it is important to designate a common unit of measurement for GHG emissions data, as proposed, or should it permit registrants to select and disclose their own unit of measurement. Engine No. 1 believes that having a common unit of measurement is preferable because it allows for comparability across companies and across molecules.

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We would be pleased to respond to any inquiries you may have regarding our letter or our views on the Proposed Rules more generally. Please feel free to direct any inquiries to [info@engine1.com](mailto:info@engine1.com).

Respectfully submitted,

*Jennifer Grancio*

Jennifer Grancio  
Chief Executive Officer  
Engine No. 1

cc: The Honorable Gary Gensler  
The Honorable Caroline Crenshaw  
The Honorable Allison Herren Lee  
The Honorable Hester Peirce  
Renee Jones, Director, Division of Corporation Finance