

## Statement

Thank you for offering me the opportunity to testify about the SEC Climate Disclosure Rule. I am an associate professor of supply chain management at the University of Tennessee-Knoxville, and I specialize in supply chain management, sustainability reporting, and understanding how such reporting rules affect companies across the entire supply chain.

As with any complex rule or regulation, there are pros and cons to each. This rule has several potential drawbacks associated with it. First, climate reporting will impose significant costs on businesses to collect, compile, and verify. These costs come in several forms. Companies will need to implement measuring and monitoring systems that, in many cases, do not currently exist. For example, consider a company that manufactures a product, distributes it through their supply chain, and delivers it to their end customer, be it a retail outlet or an individual e-commerce consumer. The company will need to estimate emissions on the inbound side into the plant, the emissions associated with manufacturing the product, the emissions associated with loading the product and delivering it to the distribution center, if it is on their truck (but not if they outsource it, because these are Scope 3 emissions and outside the scope of the SEC rule). They will be required to measure the emissions as the product passes through their distribution center, including all of the touch points along the way. Finally, if the product is delivered on the company's truck to the final delivery point, they will have to estimate the emissions associated with that delivery, but not if they outsource to another company, which creates potentially undesirable incentives which I will expound upon shortly.

For many of the activities throughout the supply chain, there is not a standard technology or method to measure the emissions. For example, a leading organization for logistics emissions reporting known as the Global Logistics Emissions Council (GLEC), stated in their most recent reporting framework that “the development of default emission intensities for logistics hubs is still at a relatively early stage.”<sup>1</sup> “Logistics hubs” are also known as distribution centers that can be found in every major supply chain, and we do not have good basic data on the emissions associated with them. Yet, companies are required by this rule to measure their emissions when leading emissions organizations have difficulty generating default values on an industry-wide basis. And distribution centers are relatively simple operations; the problem is trickier when considering multi-stage, globalized production settings, where plants can have different energy sources and production methods.

Second, there are several competing standards and a lack of clear guidance on the exact procedures that companies should follow when reporting emissions. For example, there are reporting standards provided by the: Institute for Financial Reporting Standards (IFRS) Foundation under the direction of the International Sustainability Standards Board (ISSB); the Greenhouse Gas Protocol; GLEC and the International Standards Organization (ISO) 14083; the European Union; the state of California and California Air Resources Board (CARB); and

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<sup>1</sup> [https://smart-freight-centre-media.s3.amazonaws.com/documents/GLEC\\_FRAMEWORK\\_v3\\_UPDATED\\_13\\_12\\_23.pdf](https://smart-freight-centre-media.s3.amazonaws.com/documents/GLEC_FRAMEWORK_v3_UPDATED_13_12_23.pdf), page 87.

perhaps others. The IFRS, ISSB, and GLEC standards do not prescribe exactly how to report emissions but leave room for interpretation. For example, the ISSB standards use the words “reasonable”, “without undue cost and effort”, and “faithful representation” throughout their guidelines. This leaves room for flexibility but can create confusion for businesses when determining what is “reasonable” or a “faithful representation.” Moreover, it invites potential lawsuits over these vague definitions.

A third potential drawback of the rule is that it is not clear the exact value that the data will provide. While there is some truth to the statement that you cannot improve what you do not measure, there are few examples that I am aware of that demonstrate how governmental emissions reporting requirements result in significantly reduced emissions. Moreover, vague reporting requirements, which could ultimately be the subject of lawsuits, will require companies to devote resources to reporting as opposed to action, such as investing in cleaner equipment or funding environmental projects.

Fourth, the SEC rule requires companies to report Scope 1 and Scope 2 emissions – i.e., emissions that come from assets owned by the company (Scope 1) or purchased energy (Scope 2) – but not Scope 3 emissions. Scope 3 emissions are those that are generated by suppliers and service providers for a focal company. These are often the largest source of emissions across a supply chain. I have seen estimates that Scope 3 emissions account for as much as 80 or 90 percent of the emissions in the entire supply chain of a product. This provides a direct incentive for a company to outsource their production and distribution to other companies (suppliers) because doing so immediately reduces the Scope 1 and 2 emissions of the focal company. However, this does not mean that the emissions were reduced, but merely recategorized into Scope 3 emissions. If the production or distribution method of the supplier is more pollution intensive than that of the focal company (for example, perhaps a for-hire trucking company with dirtier trucks), then not only did emissions not decrease, but they could potentially increase. The SEC’s rule, however, would show a reduction in Scope 1 and 2 emissions in this example. Thus, the rules would alter the “make or buy” calculation, and result in companies buying more goods and services from third parties as opposed to providing their goods and services using their own assets.

A further potential unintended consequence of the increased incentive to outsource is that many of the operations that companies currently control – large, public companies that can often be influenced by consumers and government policy – will likely be shifted to companies that are not consumer facing, more likely to be private, and possibly less influenced by government policy. Thus, the SEC rule could actually push emissions into places that are harder to observe and measure, because they will become Scope 3 emissions of the large public companies.

Lastly, as with any additional reporting burden placed on public companies, these rules are likely to shift the calculus associated with the decision to go public or remain/transition to private. If these reporting costs are not faced by private companies, then the option to go or remain public is

less attractive. A potential consequence of this rule, therefore, could be that there are fewer companies that are subject to the SEC's rules than there would be in the absence of the rule.

In summary, there are pros and cons associated with the SEC's Climate Disclosure Rule. The cons are that these rules will impose significant costs on public companies, many of which do not have expertise in climate reporting. These costs include hiring additional employees and hiring consulting and legal firms, among others. The reporting rules are unclear, frequently changing, and leave significant room for interpretation and confusion. There is little evidence of the direct value that the collection and aggregation of this data will provide. The rule will increase the incentive for companies to outsource their production and distribution to reduce their Scope 1 and 2 emissions, which in turn can reduce the influence that the government and the public has on those emissions. Lastly, the rule could alter the calculus that companies make when going public. In short, an increased reporting burden on public companies could result in fewer companies going public. Thank you for the opportunity to present this testimony.

A handwritten signature in cursive script, appearing to read "Frank Scott".

Frank Alexander Scott III