EPSA

Submitted via email: *rule-comments@sec.gov*

June 17, 2022

Ms. Vanessa Countryman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Rule Regarding "*The Enhancement and Standardization of Climate-Related Disclosures for Investors"* (File Number S7-10-22)

Dear Ms. Countryman:

The Electric Power Supply Association ("EPSA")[1] respectfully submits the following comments in response to the U.S. Securities and Exchange Commission's (the "Commission" or "SEC") March 21, 2022 proposed rule to require companies to include certain climate change-related disclosures in their registration statements and periodic reports ("Proposed Rule").[2] The recommendations outlined below are offered to establish an efficient and informative reporting process to provide climate-related transparency to the public, investors, and government. EPSA's comments, examples, and suggested modifications are focused on the key provisions of the Proposed Rule that pose the greatest concern and are not necessarily inclusive of all concerns that EPSA or its member companies may have with the Proposed Rule.

EPSA is the national trade association that advocates for well-functioning competitive wholesale electricity markets and represents America's competitive power suppliers. Healthy competitive markets provide the best foundation to reliably power the nation's homes and businesses at the lowest cost—as well as to foster the innovation and sustainable environmental progress needed to meet the future. EPSA members provide approximately 150,000 MW of reliable and competitively priced electricity from environmentally responsible generation facilities using a diverse mix of fuels and technologies, including natural gas, wind, solar, hydropower, nuclear, and coal. EPSA member companies also own and operate battery storage facilities throughout competitive markets. EPSA seeks to bring the benefits of competition to all power customers.

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[1] These comments represent the position of EPSA as an organization, but not necessarily the view of any particular member with respect to any issue. Certain EPSA member companies are not subject to the U.S. Securities and Exchange Commission jurisdiction.

[2] *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (March 21, 2022), available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf (conformed to Federal Register version) (hereinafter, "Proposed Rule").

EPSA and its members are at the forefront of the clean energy transition and have advocated for more comprehensive, coordinated, and market-based approaches to addressing climate change. EPSA member companies voluntarily report and/or disclose climate change-related and environmental, social and governance ("ESG") information pursuant to company policies[3] and are undertaking investments that reduce greenhouse gas ("GHG") and other emissions to facilitate emissions reductions while maintaining electric grid reliability and resilience.

I. Overview Of SEC Proposal

Over the last several years, the Commission has increasingly focused on climate change issues, including seeking public input in March 2021 on the need for climate change disclosure requirements. This effort culminated with issuance of the Proposed Rule, which as outlined in extensive detail in the proposal would mandate disclosure of a significant level of information from public companies in registration statements and periodic reports, such as on Form 10-K, related to climate-related risks, GHG emissions, climate-related targets and goals, and certain climate-related financial statement metrics and related disclosures in a note to audited financial statements. The proposed disclosures are based in part on existing frameworks, such as the Task Force on Climate-Related Financial Disclosures ("TCFD") and the GHG Protocol, and includes amendments to both Regulation S-K and Regulation S-X. The Proposed Rule would include a phased-in compliance period and certain exemptions and/or safe harbors based on filer status, likely commencing with reports filed in 2024 containing 2023 financials (assuming a Final Rule is adopted with a December 2022 or earlier effective date).

II. Comments And Recommendations

EPSA recognizes the SEC's intention through the Proposed Rule to provide investors with climate change disclosures. Many companies, including EPSA member companies, have been voluntarily providing climate change and sustainability disclosures for some time, and practices continue to evolve and improve as companies take into account market feedback and build on their capabilities and resources. However, EPSA believes certain aspects of the SEC's proposed rules would not provide investors with decision-useful information, and at the same time create significant, undue burdens on companies. The comments below discuss key provisions that are of concern, along with specific examples. EPSA urges the SEC to make targeted revisions in these areas and in so doing, develop a Final Rule that would facilitate more efficient and effective disclosures, benefitting both companies and investors.

[3] Specifically, EPSA members' sustainability and ESG practices include voluntary disclosure and reporting of information, pursuant to respective company policies, regarding climate-related risk and other climate-related business information to ensure investors and other stakeholders have information regarding material risks available to facilitate informed investment decisions, as well as to provide other non-material climate information of interest. Competitive power suppliers' individual business circumstances vary based on region, operations, and other factors that affect requirements.

A. The Proposed Regulation S-X Amendment Requirements Are Unworkable For Companies, Would Not Provide The Intended Benefits For Investors, And Therefore Should Not Be Included In The Final Rule

The proposed Regulation S-X amendments would require companies to provide certain climate-related financial statement metrics by financial statement line item and related disclosures in a separate note to annual audited financial statements. The expansive and prescriptive disclosure requirements regarding the financial statement impacts of both realized and potential *(i.e.,* as yet unrealized) severe weather events and transition activities would create a significant burden for energy companies to comply with given methodological complexities involved. At the same time, the proposed disclosure would yield inconsistent, non-comparable information that would therefore not be useful to investors.

Specifically, as it relates to the proposed financial statement footnote disclosure requirement to provide quantitative disclosures about the impacts of severe weather events and other natural conditions and transition activities if they have an impact of greater than 1% (on an absolute value basis) on any financial statement line item,[4] EPSA is concerned the bright-line nature and expansive calculation of this requirement would require a level of disclosure that is not material to an understanding of a company's financial position, is not practical to comply with, and would not provide decision-useful information to investors. This requirement goes well beyond any voluntary disclosure regime in practice today and would be very difficult for EPSA member companies to ascertain or sufficiently report. In addition, this requirement is not in line with other SEC requirements under Regulation S-X, which are all governed by a standard of materiality.[5] We believe this requirement would not provide decision-useful information for investors because it would skew the focus of investors from the overall financial position of a company to an extreme focus on climate impacts, even when not material.

In addition, and equally if not more concerning, the measurements required to be included are inherently uncertain in three distinct respects: (a) it is impossible to accurately disaggregate the impacts of *realized* severe weather events and transition activities from ordinary ongoing operations of the business; (b) it is very complex to accurately estimate the potential future (*i.e*., as yet *unrealized*) impacts of severe weather events and transition activities by financial statement line item; and (c) estimating the impact of both realized and unrealized events or transition activities requires developing a counterfactual of what would have happened – but for the event or activity – and this is a very challenging undertaking from an analytical standpoint.

First, it is impossible to isolate the financial impacts of realized severe weather events and transition activities. For example, the rules would require disclosures related to a "severe weather event." It is unclear how a "severe weather event" would be defined or

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[4] Proposed Rule at 127-128.

[5] *See* Dissenting Statement of Commissioner Hester M. Peirce at 3-4 (issued March 21, 2022) ("…and the financial metrics do not have a materiality qualifier.")

applied. Specifically, a baseline definition for “severe weather event” would be needed and this baseline would need to vary by location, by industry (and within each industry, by activity), and over time among other dimensions. There is currently no accepted standard definition for either “severe weather event” or, crucially, how the baseline definition of such events should be adjusted by location, by industry, and over time (for example as the prevalence and severity of “severe weather events” changes). In other words, even within the same industry, different companies are likely to have different views on what constitutes a “severe weather event” at a given point in time, in a given location, as well as over time.

The uncertain meanings of “severe weather event” and “transition risks” in turn create significant issues which have a cascading effect throughout the rule. As previously discussed, it is not clear how a company should differentiate a severe weather event from normal weather activity. Moreover, the definitions of “severe weather events” and “transition risks” would require companies to make subjective determinations about whether an impact on the financial statements was due to a weather event (if deemed “severe”), actions taken in connection with transition-related activities, or ordinary course of business activities. For example, many of our member companies own physical generation assets. These assets often require companies to add back-end controls to mitigate emissions, and these controls are often required by law. Management would need to consider these costs and determine if they are related to ordinary course business to run the assets or climate-related costs in furtherance of a transition plan, or possibly consider how to apportion the costs among these expenditure categories. We would expect this process to lead to arbitrary determinations as to what expenditures relate to ordinary course business or climate-related activities, making the information not comparable between companies and not decision-useful to investors.

Of note, and to highlight the challenges associated with establishing workable and clear definitions, a long-established energy industry standard-setting organization, the North American Energy Standards Board (“NAESB”) was recently unable to define an “Extreme Weather Operating Condition” based on a standard for Extreme Weather following months of stakeholder deliberations.[6]

The following example outlines how the 1% line-item threshold disclosure reporting requirement is impractical to comply with, especially in isolating the impact of severe weather events, and would not provide decision-useful information:

> The electric power generation sector is exposed to fluctuations in commodity prices including, but not limited to the prices of natural gas, oil, and uranium which are used to generate electricity. To mitigate these risks, competitive power

[6] Recommendation for NAESB Executive Committee - *Approval of No Action Recommendation for Standards Request R21006*, Joint WEQ/WGQ/RMQ Quadrant of the North American Energy Standards Board, (April 26, 2022), *https://www.naesb.org/pdf4/weq_wgq_rmq_bps042622w1.docx*.

generators maintain material derivatives portfolios – such as options to buy and sell these commodities at pre-determined prices on pre-determined dates – which are marked-to-market (*i.e*., re-valued based on current market conditions) on a continuous basis. Severe weather events and other natural conditions can have material impacts on commodity prices, but they are only one factor in determining such prices. EPSA is concerned it is not practical to isolate the impacts weather-related events have on market prices when other factors including, but not limited to, geopolitical factors, seasonality of demand, fuel storage levels, energy facility outages, and transportation constraints, also factor heavily into commodity prices.

Additionally, even if it were practical to isolate impacts of weather-related events on commodity prices, EPSA does not believe this provides decision-useful information to investors. To evidence this point, it is common in the electric power generation sector to exclude changes in unrealized mark-to-market instruments from power generators' primary non-generally accepted accounting principles ("non-GAAP") measures because they are naturally offset by an opposing change in projected cash flows from plant assets which are not marked-to-market on a recurring basis.

For example, if there is an increase in forward power prices in a period, as was the case in electric power markets in the first quarter of 2022, a power generator will recognize an unrealized loss on contracted obligations/forward power sales accounted for as derivatives. This is naturally offset by increased future cash flows expected to be generated from the generating assets, but plant asset values are not marked-to-market so GAAP does not reflect this. The increase in forward power prices in the first quarter of 2022 and resulting unrealized loss likely reflects some weather/climate related factors, but we believe they are also driven by geopolitical factors, and it is not possible to discern how much relates to each factor. Further, explaining an unrealized loss from increased forward power prices without explaining the offset from future cash flows to be generated by plant assets places undue emphasis on climate impacts on this metric and could be misleading to investors.

Therefore, requiring registrants to estimate the impacts of severe weather events will result in non-consistent, non-comparable, and non-decision useful information for investors.

Second, the proposed requirement that registrants include the impact of *unrealized* climate-related risks (physical and transition, separately) on financial statement metrics by line item is even more complex than reporting the impact of *realized* climate-related events. Quantifying the impacts of risk from unrealized events implies having a 'table of probabilities' for the myriad potential risks by type, location, and time horizon, and an accurate estimate of losses from the myriad potential physical and transition climate events -- if these were realized. Neither of these types of data is readily available, much less well-accepted or even understood. In particular, the probability data are extremely subjective. Moreover, there are a multitude of methodological uncertainties and complexities associated with this type of forecast analysis. Therefore, requiring such risk quantification would not result in the consistency and comparability of disclosures across companies, industries, locations, and time that the SEC seeks.

Third, to determine the financial impact of both realized and unrealized severe weather events or transition activities, a counterfactual would need to be established. For example, if a hurricane or extended heat wave occurs – or could potentially occur in the future – disrupting the supply, demand, and prices for energy, an energy company registrant would need to project the energy demand it would have had, the energy production it would have had, the associated market prices that would have prevailed, and the financial performance it would have enjoyed – but for the hurricane or heat wave. Establishing such a counterfactual would be heavily assumption-based, would not likely be performed in a similar manner by different companies, and therefore would not result in comparable and decision-useful disclosures.

Due to the concerns outlined above, EPSA believes that the Regulation S-X reporting requirements present significant challenges without achieving the SEC's stated objective of providing consistent, comparable, and decision-useful information to investors. *EPSA does not believe these challenges could be addressed through changes to the Proposed Rule and therefore strongly urges that the proposed new financial statement note requirement be excluded from the Final Rule.*

B. The Proposed Scope 3 GHG Emissions Disclosure Requirements Are Unreasonable And Disclosure Should Not Be Mandated At This Time

The Proposed Rule would require companies to disclose Scope 1 and Scope 2 GHG emissions (i.e., direct emissions and indirect emissions from purchased energy for company use, respectively), with attestations required for larger companies, and Scope 3 emissions (indirect upstream and downstream emissions in the value chain) if material, or if the company has set a GHG emissions target or goal that includes Scope 3 GHG emissions. The proposal would phase-in the Scope 3 GHG emissions disclosure after Scopes 1 and 2, and smaller reporting companies would be exempt from Scope 3 disclosure.

While EPSA appreciates the effort by the SEC to satisfy the requests of investors in this area, Scope 3 GHG emissions disclosure requirements pose significant challenges and should be removed from the Proposed Rule.[7]

[7] *See* Comment Letter of the Electric Power Research Institute ("EPRI") on the Proposed Rule at 8-10 (Filed June 7, 2022) (addressing the many technical issues associated with Scope 3 emissions disclosure), https://www.sec.gov/comments/s7-10-22/s71022-20130548-299406.pdf.

First and foremost, the Scope 3 emissions of one registrant are the Scope 1 or 2 emissions of another company. Requiring each registrant to report its Scope 3 emissions, if material, would therefore result in significant multiple-counting and reporting of emissions – with the attendant expectation that this quantum of emissions ultimately be reduced. For example, in the electric power industry, electricity generators have Scope 3 emissions from the production, transportation, and storage of the natural gas, coal, and oil used to generate electricity. Many of these same emissions would be also be counted by other companies, both in other parts of the energy value chain, as well as in other sectors of the economy such as transportation (manufacturers of internal combustion engine vehicles that run on gasoline and diesel fuel), industrial manufacturers (which may use natural gas to fuel industrial processes), buildings (which may use natural gas for heating), and financial services (which may be lending to companies in any or all of these sectors). If one of the purposes of disclosing Scope 3 emissions is ultimately to encourage registrants to reduce such emissions, taken literally, such a directive would result in the significant overshooting of emissions reductions – at significant cost to registrants and to the economy as a whole.

Second, unlike Scope 1 (and to a lesser extent, Scope 2) emissions, Scope 3 emissions are not directly observed by a registrant, but rather based largely on estimation and/or external information. They rely heavily on timely and accurate reporting of emissions by suppliers or third parties, and these data can be difficult to obtain and are outside the control of a reporting entity to affirm making them subjective and difficult to account for credibly.[8] Under the Proposed Rules, reporting companies would have liability for Scope 3 emissions disclosure with the limited Safe Harbor set forth in the Proposed Rules.

Third, conducting a fulsome inventory of Scope 3 emissions is extremely burdensome and can be costly to companies who need to set up appropriate procedures and controls to track activity across the value chain. It is costly even before companies put in place internal controls. Even if certain Scope 3-related emissions are immaterial, companies must conduct an inventory, involving intensive procedures, cost, and controls, to determine if such emissions are immaterial and, as a result, this requirement to conduct a review of Scope 3 emissions would apply to all public reporting companies regardless of the actual materiality of their Scope 3 emissions data.

Fourth, Scope 3 emissions are very difficult to estimate. For example, many electricity retailers sell electricity that comes from two sources: their owned and operated power generation assets as well as electricity purchased from third-party power generators

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[8] *See e.g.* Comments of the Electric Power Supply Association on the Request for Information, Department of Energy, *In The Matter Of Securing The United States Bulk-Power System*, Docket DOE-HQ-2020-0028, (Filed August 24, 2020) (As a parallel, the EPSA comments highlight the difficulty – and perhaps inability – to get required information from suppliers for certain DOE cyber or supply chain reporting, which can include the suppliers not having, collecting or keeping the information the reporting entity needs.) *Available here* https://epsa.org/wp-content/uploads/2020/08/EPSA-DOE-BPS-RFI-Comments-082420.pdf.

which is then resold to the retailers' end-customers. The emissions of the first source of electricity are accounted for as Scope 1 emissions and are directly observed and controlled by a company; the second source of emissions is extremely challenging to quantify given the impossibility of tracing individual electrons as they flow from their generation source to the end customer via the various electricity grids in the U.S. Moreover, given the dynamic nature of electricity grids, which are subject to second-by-second demand fluctuations, the fuel mix of the electricity flowing at any given time (*i.e.,* a mix of renewable, natural gas, coal, oil, nuclear, hydropower, and geothermal-generated electricity) is highly variable, further complicating the measurement of Scope 3 emissions from purchased electricity.

Fifth, in addition to the difficulty in collecting the requisite data and estimating the amounts, the various methods companies can take in calculating emissions within each Scope 3 category do not support comparability of disclosures. For example, in the situation discussed above, without additional guidance from the SEC, the methodology implemented would be at the discretion of management and would therefore remove any comparability of Scope 3 emissions reporting of similarly situated public retail energy companies. The SEC acknowledges in the Proposed Rule the current challenges companies face with collecting this data and that the impact of Scope 3 emissions can vary significantly across industries and companies.[9]

Finally, the Proposed Rule includes a limited Safe Harbor from liability for Scope 3 disclosures, providing that such disclosures will not be deemed fraudulent, "unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." EPSA has strong concerns that this limited Safe Harbor does not provide meaningful protection for companies for disclosure and reporting of Scope 3 data and urges adoption of a stronger mechanism. Reporting companies would have little ability to determine whether the information provided by suppliers and third parties is true and complete as noted above, and the standard as to what would be a reasonable basis for determining the accuracy of third-party Scope 3 emissions data is unclear. Holding reporting companies to any standard of liability for third party disclosure is neither fair nor appropriate and will permanently impact the way public companies do business with their suppliers. They would need to account for indemnification and other legal protections from third parties with which they do business. This would have an extremely adverse impact on business as usual in the U.S. markets. The SEC acknowledges in the Proposed Rule the current challenges for companies with collecting this data and that the impact of Scope 3 emissions can vary significantly across industries and companies.[10] Based on that concern, and to the extent the SEC determines Scope 3 emissions disclosure is required, at a minimum, a meaningful Safe Harbor is necessary.

Additionally, and to the extent the SEC determines Scope 3 emissions disclosure is required, for all the reasons explained above, the Scope 3 data should be "furnished"

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[9] Proposed Rule at 169.

[10] Proposed Rule at 169.

and not “filed” given the complexities surrounding data collection, measurement, and verification of this information.[11]

In summary, the proposed Scope 3 disclosure requirements are overly burdensome given existing carbon accounting methodologies, measurement complexities, and data collection challenges. While companies should have the flexibility to report Scope 3 emissions that relate to their businesses, subject to feasibility and accuracy constraints, it would be much better for the SEC to focus on disclosure of Scope 1 emissions, which are directly knowable and controllable by each registrant. If this approach were taken, each metric ton of CO_2e emissions could uniquely be addressed by its owner, the company that is best positioned to control such emissions and take action to reduce them. *For all of these reasons, the SEC should not mandate disclosure of Scope 3 emissions at this time.*

C. The Proposed Disclosure Compliance Timeline Presents Significant Challenges For GHG Emissions Reporting And Should Be Amended

EPSA appreciates the SEC’s proposed phase-in periods and accommodations for the Proposed Rule to facilitate the transition to this new disclosure and reporting regime.

However, the proposed disclosure compliance date of Fiscal Year 2023 (filed in 2024) for large companies for all proposed disclosures, including Scope 1 and Scope 2 GHG emissions, creates tremendous burdens on independent power producers to put in place appropriate controls and procedures to compile, test, and audit the information being requested in the Proposed Rule.

The reporting of GHG emissions in the Form 10-K requires submission of this information on a timeline that is significantly more accelerated than currently required of companies under the EPA reporting timeline (GHG emissions quarterly reports are not due until the end of March), and it would therefore be very challenging to meet this timeline. The proposed relief to report estimates in the 10-K creates significant liability concerns, as well as uncertainty regarding the ability to obtain audit assurance of estimates that will later be updated.

To address these concerns, *EPSA proposes that the SEC require reporting of Scope 1 and Scope 2 GHG emissions data on a form separate from the 10-K that is due no earlier than 180 days following the fiscal year end.*

Additionally, *EPSA recommends that the proposed climate change disclosures, including GHG emissions disclosures, should be “furnished” and not “filed” information given the significant increased risk and liability associated with these disclosures.*

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11 Proposed Rule at 299; *see* Question 195.

D. Climate-Related Risk Methodology Disclosures Pose Competitive Sensitivities

The SEC also proposes Regulation S-K amendments that involve non-financial disclosures related to a company's climate-related risks (or opportunities) and related strategy, governance, and risk management processes. Significant additional disclosures are required for companies that have transition plans, conduct scenario analysis, use internal carbon pricing, have publicly issued climate-related targets or goals as part of a climate-risk management strategy, and/or are purchasing carbon offsets and/or renewable energy credits (RECs) to achieve their climate goals.

EPSA members are extremely concerned that the requirements to include disclosures around scenario analysis, internal carbon pricing, and the costs of carbon offsets and RECs will involve the disclosure of competitively sensitive information that will impact them in the markets in which they operate. We believe this information is too granular for investors and should be reserved for management only. This information is not decision-useful for investors while at the same time imposing competitive harm and burden on companies.

Further, these expansive and prescriptive disclosure requirements regarding climate risk management would require very detailed disclosure that would not be consistent and comparable across companies and would therefore not be decision-useful for investors. Given the scope of the Proposed Rule, EPSA member companies expect that the proposed disclosure would dwarf the currently provided governance and risk disclosure of public companies, leading to a disproportionate focus on these items in public company reporting.

Lastly, *EPSA urges the SEC to utilize a principles-based approach to disclosure of material climate-related risks and opportunities, consistent with the SEC's broader rulemaking objectives.* This approach strikes the right balance between providing investors with decision-useful information and the increased burden and compliance costs for companies.

III. Conclusion

EPSA appreciates the opportunity to provide these comments on the Proposed Rule, and as illustrated by the examples above, the proposal seeks a specific outcome on certain disclosures, such as financial statement metrics and risk quantifications, and yet lacks principles-based guidance. This will require companies to apply varying assumptions, producing results that are not comparable and in direct contradiction of the SEC's objective of providing investors with consistent, comparable, and decision-useful information for making their investment decisions.[12] Accordingly, EPSA urges the Commission to consider these concerns and make necessary modifications consistent with this feedback in finalizing the rule to ensure that investors have access to information that is material and decision-useful related to climate change. If you have any questions, please contact the undersigned.

Sincerely,

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[12] *See e.g.*, Statement of Paul Munter, SEC, Acting Chief Accounting, *"Assessing Materiality: Focusing on the Reasonable Investor When Evaluating Errors,"* (March 9, 2022) (Addressing the concept of materiality and objective assessment of the materiality standard), *available here* https://www.sec.gov/news/statement/munter-statement-assessing-materiality-030922.