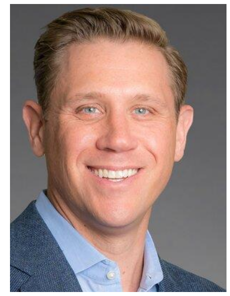
Navigating Potential Changes In Carbon Reporting Standards

By **Buck Endemann, Ken Gish and David Wang** (January 17, 2023)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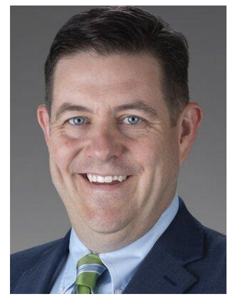
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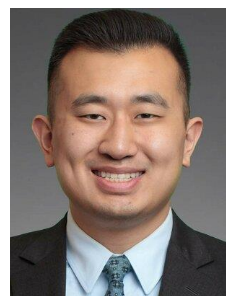
David Wang

Much has changed in the sustainable economy in the past decade, and the pace of change is accelerating.

Despite growing sophistication in measuring and making informed decisions on climate and environmental impacts, two fundamental elements driving corporate decision making — the Greenhouse Gas Protocol and the Federal Trade Commission's Green Guides — have not been updated in over a decade.

That may change soon. The World Resources Institute and the FTC have recently taken initial steps towards updating the GHG Protocol and Green Guides, respectively. This article describes the potential changes, how the changes may affect voluntary corporate sustainability actions and compliance reporting, and how companies can participate in these iterative processes to shape prudent carbon reporting, investing and marketing policies.

GHG Protocol

The GHG Protocol is a carbon accounting mechanism that establishes comprehensive global standardized frameworks to measure and manage GHG emissions. Over 90% of Fortune 500 companies that report data to the Carbon Disclosure Project use the GHG Protocol to measure or estimate their Scope 1, Scope 2 and Scope 3 emissions. Corporate sustainability departments and their service providers rely upon the Protocol to guide net-zero, carbon neutral and other climate goals and investments.

The GHG Protocol's corporate standard classifies GHG emissions into three scopes. Scope 1 emissions[1] include direct emissions from owned or controlled sources. Scope 2 emissions[2] include indirect emissions from the generation of purchased energy, like electricity, steam, heat and cooling.[3] Scope 3 emissions[4] are the trickiest to measure and include all non-Scope 2 indirect emissions that occur in the value chain of the reporting entity, including both upstream and downstream emissions.

Due to the difficulty of measuring and calculating a reporting entity's Scope 3 emissions, the GHG Protocol's Scope 3 guidance currently allows reporting entities to estimate — as opposed to measure — their Scope 3 emissions.[5]

While the GHG Protocol is often used for voluntary GHG emissions accounting, regulatory bodies have proposed incorporating the GHG Protocol into law. The U.S. Securities and Exchange Commission's proposed climate-related disclosure rule[6] announced in March 2022 would require SEC registrants to disclose at the minimum their Scope 1 and Scope 2 emissions, as measured by the GHG Protocol.

In addition, the Biden administration proposed a new rule[7] in November 2022 that would require major federal government contractors to use the GHG Protocol to disclose Scope 1, Scope 2 and relevant categories of Scope 3 emissions.

Potential Changes to the GHG Protocol

Over the past few years, companies have faced an increasingly complex and sometimes contradictory set of regulatory requirements and voluntary carbon disclosure preferences. The WRI has not updated the GHG Protocol's corporate accounting and reporting standard since 2004, and WRI's guidance for Scope 2 and Scope 3 emissions have not been updated since they were first released in the early 2010s.

In March 2022, the GHG Protocol announced[8] that it was "starting a process to determine the need and scope for additional guidance building on the existing set of corporate GHG accounting and reporting standards for scope 1, scope 2, and scope 3 emissions."

Several months later, the WRI and the World Business Council for Sustainable Development released a set of surveys to collect stakeholder input to establish the need, scope and potential approaches for additional guidance or updates to the corporate accounting and reporting standard,[9] Scope 2 guidance,[10] corporate value chain (Scope 3) accounting and reporting standard,[11] and technical guidance for calculating Scope 3 emissions.[12]

The surveys include an opportunity for stakeholders to submit proposals for suggested updates or additional guidance, as well as empirical research and analysis to inform any potential updates.

Based on the GHG Protocol's announcements, stakeholder surveys and the recent incorporation of the protocol in other standards and rules, several potential changes are under consideration. These potential changes could come with their own opportunities and complications.

First, the GHG Protocol announced that the potential revisions would focus on aligning the protocol's accounting rules with the major disclosure initiatives by North American and European governmental bodies.[13]

For example, because the SEC could incorporate the GHG Protocol into its proposed climate disclosure rule, certain modifications are required to resolve differences between the GHG Protocol and the generally accepted accounting principles standard used in the U.S. While harmonizing the protocol with SEC disclosure may simplify the compliance reporting process, such revisions could affect an entity's current emissions reporting or complicate the reporting preferences of companies who are not subject to the SEC's proposed rule.

Second, the GHG Protocol's survey questions suggest potential revisions of the methods available to calculate specific Scope 3 emissions.[14] The protocol has not updated its Scope 3 reporting standard or Scope 3 technical guidance in a decade. Based on the survey responses, the protocol may remove, add or modify any of the calculation methods detailed within the 15 subcategories of a company's upstream and downstream emissions.

Any alteration to the calculation methodologies for Scope 3 emissions would require a company to ensure compliance with the revised reporting requirements and could complicate a company's investment in offset or inset projects used to mitigate Scope 3 emissions up and down its supply chain.

Third, the GHG Protocol's survey questions also suggest that it may be considering expanding market-based accounting approaches that are currently used in the Scope 2 guidance to account for Scope 1 or Scope 3 emissions as well.[15]

The protocol is looking for feedback whether a variety of different market-based accounting approaches — e.g., offset credit purchases, inset credit purchases, supply shed or value chain interventions, mass balance certification, book-and-claim certifications — should be used to account for direct and value chain emissions as well.

The survey also asks stakeholders whether the protocol should continue to set standards for a market-based accounting system related only to Scope 1 and Scope 3 emissions, or whether it should administer any programs itself to better verify and enforce the market-based accounting.[16]

Fourth, the GHG Protocol may be evaluating potential alternatives regarding the use of market-based instruments like renewable energy certificates, or RECs, in Scope 2 calculations.[17]

Presently, many companies use contractual mechanisms like virtual power purchase agreements, or vPPAs, to procure RECs to offset their Scope 2 emissions. These vPPAs are often associated with the construction of new renewable energy projects within the same general region as the company's electricity load. However, most are not connected directly to the company's factories, offices, data centers or other operations.

Industry sources suspect that the protocol's potential revisions to these practices could include: (1) disallowing RECs for a company using the market-based accounting method to calculate Scope 2 emissions, and (2) requiring the demonstration of additionality[18] when calculating the net emissions for Scope 2.

A recent study by Anders Bjørn, published in Nature Climate Change Vol. 12, "Renewable energy certificates threaten the integrity of corporate science-based targets," suggested that acquiring RECs under a market-based accounting method may not accurately reflect a reporting company's actual Scope 2 GHG emissions reductions.

Even if such reduction is valid, the RECs may result in double counting if one company uses market-based accounting and another company uses location-based, or some other form of accounting.[19]

If the GHG Protocol removes the ability for companies to offset Scope 2 emissions with market-based RECs, a company may feel compelled to significantly revise its net-zero or carbon-neutral investments to remain consistent with its publicly announced emission reduction efforts.

Any potential changes to the GHG Protocol and others may complicate a reporting entity's ability to comply with voluntary or compliance emissions reporting requirements. Regardless of how the GHG Protocol is modernized, companies should take a comprehensive look at how a revised GHG Protocol affects their sustainability strategy and investments.

Next Steps

The survey period will be open through Feb. 28. Following the conclusion of the survey period, the GHG Protocol secretariat will share a summary of the survey results and written submissions, which will inform the next steps for updating the standards or developing additional guidance.

The information received during the survey process will be used to align the GHG Protocol with global best practices in an effort to increase the credibility of the GHG Protocol's accounting principles and the accuracy of its emission-based calculations.

If any update to the GHG Protocol affects your current or future business initiatives, we recommended you participate in the survey process. The GHG Protocol's announcement of the survey process[20] provides further instruction, including the required information to submit valid responses to the surveys and access to the online submission portal, and more information about the rationale for updating the GHG Protocol and other potential areas of the protocol requiring updates.

FTC's Green Guides Updates Could Be on the Horizon

On Dec. 20, 2022, the FTC published a request for comment on potential revisions to the Green Guides. Below is an overview of the Green Guides, the topics covered by the request and how such revisions may affect a company's marketing of it sustainability practices.

Section 5 of the Federal Trade Commission Act prohibits unfair methods of competition in or affecting commerce. For the last few decades, consumers have begun expressing preferences for products that meet certain environmental or sustainability criteria, and the FTC's Green Guides have provided nonenforceable guidance to companies looking to avoid making unfair or deceptive marketing claims about such criteria.

The Green Guides include both general environmental claims and specific environmental claims, such as carbon offset, compostable, degradable, free-of, nontoxic, ozone safe or friendly, recyclable, recycled content, refillable, renewable energy and materials, and source reduction claims.

The current version of the Green Guides was published in October 2012. Since then, there has been virtually no enforcement or precedent issued on some of the more modern and popular environmental marketing strategies, including renewable energy, carbon offsets and source reduction.

Given the emerging prominence of such strategies in corporate sustainability plans, the request is a good opportunity to align modern sustainability pledges with the FTC's scientific and consumer protection expectations.

Topics Covered by the Request

The request broadly covers the efficiency, costs, benefits and the regulatory affect of the Green Guides, and seeks to reaffirm whether and to the extent the Green Guides are important to consumer protection.

Of particular note, the request addresses the following topics with more specificity:

- Enforceability: The FTC is considering rulemaking that would establish the Green Guides as an independently enforceable requirement related to unfair and deceptive environmental claims. Currently, the Green Guides are simply guidance that inform enforcement priorities of the actual regulations.

- Carbon Offsets and Climate Change: The FTC is considering revising guidance for claims related to carbon offsets and climate change such as claims of net-zero, carbon neutral, low carbon and carbon negative. This could have significant interaction with the pending GHG Protocol stakeholder process, identified above.

- Recyclability: The FTC is considering updating guidance on recyclable claims. Further, the FTC is determining whether marketers should be able to make recyclable claims for products that are collected by recycling program but not ultimately recycled due to market demand and budgetary constraints, among other factors. Given that many jurisdictions are rethinking their decades old recycling and waste management laws, companies should think carefully about how flexible the Green Guides can and should be.

- Energy Use and Energy Efficiency: The FTC is seeking input on whether it should add guidance relating to the energy use of efficiency claims for home-related products, electric vehicles or other similar products.

- Sustainability: The FTC is considering adding guidance on how consumers should interpret sustainable claims. Currently, this word means many things to many people.

The potential revisions to the Green Guides have several implications.

The FTC may use the Green Guides as an independently enforceable requirement for unfair and deceptive environmental claims, imposing additional compliance costs on businesses. Should the Green Guides endorse one of the several carbon accounting standards in the marketplace, an FTC-sanctioned carbon offset and climate change standard could cause significant alignment in that growing industry.

There could also be potential conflicts with other voluntary or even compliance carbon accounting standards, like the pending revisions to the WRI's GHG Protocols. The FTC has a strong track record of suing companies for deceptive claims, particularly for waste claims and environmental sourcing claims, resulting in multimillion dollar settlements.[21] Corporate sustainability pledges and related marketed efforts could soon be subject to the same level of scrutiny.

Next Steps

Public comments in response to the request must be received by Feb. 21, 60 days after the request was published in the Federal Register. A lengthy drafting and review process can be expected after public comments are received due to the level of detail included in the request.

If the FTC elects, based on the comments, to proceed with an update of the Green Guides, new regulations will be promulgated consistent with notice and comment rulemaking procedures.

Conclusion

Companies are investing billions of dollars in renewable energy, environmental remediation and other climate change mitigation strategies to meet environmental, social and corporate governance, and net-zero goals.

Many companies want to attract customers by placing these sustainability efforts front and center. Various state and federal compliance regimes are beginning to require companies to accurately report on their respective impacts to the climate and environment. Regulators and consumers are paying more attention to how you measure your carbon footprint and how you market the results.

Measuring the impacts of these efforts, and accurately reporting them to government agencies and marketing them to customers, is incredibly complicated. This complexity stretches across several distinct bodies of law, including consumer protection, securities and environmental regulation.

The pending updates to the GHG Protocol and FTC Green Guides are welcome efforts to reflect modern sustainability strategies. If not harmonized under a broader theory of climate regulation, however, companies risk facing a confusing and potentially contradictory set of requirements, which could chill investment and stall progress toward important climate goals.

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[1] https://ghgprotocol.org/corporate-standard.

[2] https://ghgprotocol.org/scope_2_guidance.

[3] For the past decade, the corporate trend of purchasing renewable energy through virtual power purchase agreements (vPPAs) has been the primary mechanism to offset an entity's Scope 2 emissions.

[4] https://ghgprotocol.org/standards/scope-3-standard.

[5] For a criticism of the GHG Protocol's current approach to calculating Scope 3 emissions, see also Robert S. Kaplan and Karthik Ramanna, "Accounting for Climate Change," Harv. Bus. Rev. (Nov.-Dec. 2021), https://hbr.org/2021/11/accounting-for-climate-change.

[6] https://www.sec.gov/news/press-release/2022-46.

[7] https://www.whitehouse.gov/briefing-room/statements-releases/2022/11/10/fact-sheet-biden-harris-administration-proposes-plan-to-protect-federal-supply-chain-from-climate-related-risks/.

[8] https://ghgprotocol.org/blog/ghg-protocol-assess-need-additional-guidance-building-existing-corporate-standards.

[9] https://ghgprotocol.org/corporate-standard.

[10] https://ghgprotocol.org/scope_2_guidance.

[11] https://ghgprotocol.org/standards/scope-3-standard.

[12] https://ghgprotocol.org/scope-3-technical-calculation-guidance.

[13] See Press Release, Mollie Freeman, GHG Protocol, GHG Protocol to assess the need for additional guidance building on existing corporate standards (Mar. 31, 2022), https://ghgprotocol.org/blog/ghg-protocol-assess-need-additional-guidance-building-existing-corporate-standards.

[14] See Scope 3 Standard and Scope 3 Calculation Guidance Survey Memo, GHG Protocol (2022), https://ghgprotocol.org/sites/default/files/Scope%203%20Survey%20Memo.pdf (questions 23 to 25).

[15] See Market-Based Accounting Approaches Survey Memo, GHG Protocol (2022), https://ghgprotocol.org/sites/default/files/Market-based%20accounting%20Survey%20Memo.pdf.

[16] See id. (questions 46 and 47).

[17] See Scope 2 Guidance Survey Memo, GHG Protocol (2022), https://ghgprotocol.org/sites/default/files/Scope%202%20Survey%20Memo.pdf (questions 36 and 37).

[18] Additionality refers to any GHG emissions reductions that are additional if they would not have occurred in the absence of the purchase of RECs. In other words, the GHG emissions must be over and above business as usual: if the GHG emissions reductions would have happened anyways (i.e., without the financial or compliance gain that comes from the trading of RECs), then the reductions are not additional. Calculating additionality is notoriously difficult. See Michael Gillenwater, "How do you explain additionality?", GHG Mgmt. Inst. (Jan. 25, 2012), https://ghginstitute.org/2012/01/25/how-do-you-explain-additionality.

[19] See Anders Bjorn et al., Renewable energy certificates threaten the integrity of corporate science-based targets, 12 Nat. Climate Change 539 (2022).

[20] https://ghgprotocol.org/survey-need-ghg-protocol-corporate-standards-and-guidance-updates.

[21] See, e.g., United States v. Walmart Inc., Case No. 1:22-cv-00965 (D.D.C. Apr. 8, 2022), https://www.ftc.gov/system/files/ftc_gov/pdf/2023173WalmartComplaint.pdf; United States v. Kohl's Inc., Case No. 1:22-cv-00964 (D.D.C. Apr. 8,

2022), https://www.ftc.gov/system/files/ftc_gov/pdf/2023171KohlsOrder.pdf; FTC v. Truly Organic Inc., Case No. 1:19-cv-23832 (S.D. Fla. Sept. 18, 2019), https://www.ftc.gov/system/files?file=documents/cases/truly_organic_stipulated_final_order_0.pdf.