The SEC's Proposed ESG Disclosure Rules: A Tool to Hold Public Companies Accountable Following CAFO Climate-Related Disasters

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May 2024 Preface

The research and data in this paper are current as of April 2022. On March 2023, the U.S. Securities and Exchange Commission (SEC) adopted a Final Rule regulating climate-related disclosures by public companies. The SEC excluded Scope 3 reporting requirements from the Final Rule. As a result, public industrial animal agriculture companies will not be required to report indirect emissions within their value chain. Emissions from contract growers, if categorized as Scope 3 (indirect emissions) would not require disclosure in public company Environmental Social and Governance (ESG) reporting to the SEC. However, because contract growers typically cannot negotiate their contract terms, they may be considered "controlled" by the public industrial animal agriculture company that they contract with. This may require Scope 1 reporting.

Since issuance of the Final Rule, the SEC has met legal challenges. As of today, May 24, 2024, the Final Rule remains stayed pending litigation. Nevertheless, regulation of company ESG disclosure reporting factors has moved forward in California, the European Union and other locations. Companies that do not fall under the SEC Final Rule may be subject to ESG reporting in those other jurisdictions. ESG regulation and compliance is an emerging area of law which will eventually provide new avenues for prosecution and private rights of action against companies that harm animals, people, and our shared planet.

I. INTRODUCTION

When climate disasters impact concentrated animal feeding operations (CAFOs) farmed animals suffer and are killed by extreme cold, heat stress, flooding, or other severe weather events. No federal law specifically requires the protection of farmed animals in CAFOs during climate disasters. Action must be taken to prevent farmed animal suffering and death by developing regulations that mandate climate disaster planning for CAFOs, create structural and equipment requirements, eliminate or limit mortality reimbursement, and require other mitigation efforts. Until legislation makes this possible, and wherever these mitigation efforts may fail, the Securities and Exchange Commission's (SEC) newly proposed environmental, social, and governance (ESG) disclosure rules could be used to bring investor lawsuits against public companies that omit or misreport their climate-related disclosures. Until the new SEC disclosure rules take effect, there is no mandatory ESG factor reporting.[1]

In recent years companies have increasingly made sustainability claims through their annual 10-K report or through public sustainability reports.[2] However, without standardized reporting rules and metrics, climate-related disclosures and sustainability claims are nebulous at best. The new SEC ESG reporting framework could potentially help individual and institutional investors decipher sustainability claims and determine whether company practices align with desired investment goals. The potential effectiveness of the new reporting framework is dependent upon many factors that cannot be fully examined in this short article. The SEC's five-hundred-page proposed rule is complex. Here it is examined through the narrow lens of ESG reporting as applied to the impacts of climate disasters on CAFOs, specifically, how public

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[1] *ESG Investing and Analysis*, CFA INST., https://www.cfainstitute.org/en/research/esg-investing, (accessed Dec. 18, 2022). It is currently uncertain when the disclosure rules will take effect. The proposed rule provides timing and attestation examples based on a December 2022 effective date. *See* 87 Fed. Reg. 21334, *infra* note 8.

[2] *ESG Investing and Analysis*, CFA INST., https://www.cfainstitute.org/en/research/esg-investing, (accessed Dec. 18, 2022).

companies may be held accountable for misreporting or omitting environmental damage from climate disasters caused to their business.

It is important to note that this narrow focus on the environmental prong of ESG is not the sole chink in big agriculture's armor. ESG factors are broader than reporting on climate change and carbon emissions, air and water pollution, and waste management.[3] ESG reporting factors also include community relations, human rights, lobbying, political contributions, and other standards that can be used as the focus of investor lawsuits.[4] Investors and money managers evaluate ESG factors when investment goals include sustainable, socially responsible, or impact investing.[5] To date, ESG factors have been applied inconsistently, are misleading, and lack transparency.[6] Industries were alerted that reporting requirement changes were coming. The SEC announced that it would increase "its focus on climate-related disclosure in public company filings" and "develop a more comprehensive framework that produces consistent, comparable, and reliable climate-related disclosures."[7] Keeping their promise, the SEC proposed rules[8] for climate-related disclosures on March 21, 2022.[9]

The aftermath of climate events on CAFOs leaves behind animal corpses, breached manure lagoons, and other pollution. Such contamination sources are directly linked to a lack of

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[3] *Id.*
[4] *Id.*
[5] Environmental, Social and Governance (ESG) Funds – Investor Bulletin, U.S. SEC. EXCH. COMM'N (Feb. 26, 2021), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-1.
[6] *The Division of Examinations' Review of ESG Investing*, U.S. SEC. EXCH. COMM'N (April 9, 2021), https://www.sec.gov/files/esg-risk-alert.pdf.
[7] Allison Herren Lee, SEC Acting Chair, *Statement on the Review of Climate-Related Disclosure*, U.S. SEC. EXCH. COMM'N (Feb. 24, 2021), https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure.
[8] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (proposed March 21, 2022) (to be codified at 17 C.F.R. §§ 210, 229, 232, 239, and 249) [hereinafter *SEC Proposed ESG Rules*], https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors.
[9] *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures to Investors*, U.S. SEC. EXCH. COMM'N (March 21, 2022), https://www.sec.gov/news/press-release/2022-46.

producer preparedness or mitigation efforts to protect farmed animals during severe weather events. Moreover, public companies with vertically integrated supply chains have repeatedly experienced these disasters and are aware that such events will continue to occur. The resulting pollution impacts local communities and the environment. Public companies continually allow weather events to kill animals and pollute the environment, yet claim to be sustainable or socially responsible may be omitting or misstating certain ESG metrics. Companies making inaccurate claims open themselves to litigation risk. A private right of action may be brought by an individual or organization that makes investment decisions based on the false environmental and social governance disclosures of a public company.

This article analyzes the potential to use the proposed SEC ESG rules to bring actions against public companies based on their nondisclosure or misstatement of climate change-related environmental disasters impacting CAFOs. Part I provides basic information on ESG investing, the impacts of greenwashing, the current ESG reporting landscape, and proposed ESG disclosures. Part II covers current federal farmed animal protections (or lack thereof). Part III discusses the inclusion of emissions and pollution from climate disasters at CAFOs as a reporting item, and the materiality reporting standard. Part IV analyzes how ESG disclosure requirements can be applied to bring investor lawsuits against public companies where a climate event leads or may lead to CAFO-related GHG emissions and pollution.

II. ESG INVESTING, GREENWASHING, AND PRE-RULE REPORTING STANDARDS

a. EG INVESTING BASICS

ESG is an investment label indicating that an investment meets certain standards and metrics for sustainable investing[10] linked to environmental, social, and governance issues.[11] Examples of ESG factors include an investment's metrics relating to climate change, human rights, board diversity, corporate political activity, labor and equal employment opportunities, and other factors.[12] These disclosure metrics are reported to the SEC by corporations making sustainability claims about their business practices. Until the SEC's proposed rules are finalized, only companies that make ESG claims are required to disclose their ESG metrics and procedures to the SEC. Currently, companies that do not make ESG claims are not required to report ESG metrics to the SEC.[13]

Various ESG factors could apply to agriculture-related investment lawsuits including a company's climate change metrics related to CAFO emissions or social justice metrics for a company's practices around worker rights. The focus of this article is using ESG factors following climate disaster to potentially enforce against a CAFO-controlling public company, and will therefore be limited to examining potential environmental reporting requirements, the "E prong" of ESG scoring. The environmental prong "covers topics such as climate change, greenhouse gas emissions, air and water pollution, energy consumption, water usage, waste and

[10] ESG is not synonymous with sustainable investing. ESG factors can be incorporated into a sustainable investing strategy. Sustainable investing focuses on both an investor's desire to align their values with their investments as well as seeking returns. ESG strategies seek to increase financial returns "by analyzing material ESG considerations along with other material risks such as credit risk and counterparty risk." See *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction*, INV. CO. INST. 4 (July 2020), https://www.ici.org/system/files/attachments/pdf/20_ppr_esg_integration.pdf.
[11] *Sustainable and Impact Investing Overview 2020*, US SIF FOUND., https://www.ussif.org//Files/Trends/2020%20Trends%20Report%20Info%20Graphic%20-%20Overview.pdf.
[12] *Id*.
[13] At the time of this writing, H.R.1187, the Corporate Governance Improvement and Investor Protection Act, has not passed in the U.S. House of Representatives and is currently in the Senate. It would require the SEC to define ESG metrics, and make ESG reporting mandatory for all securities issuers. The bill's purpose is "[t]o provide for disclosure of additional material information about public companies and establish a Sustainable Finance Advisory Committee…" Congress indicates that ESG factors are material disclosures in the language of the prosed bill. https://www.congress.gov/bill/117th-congress/house-bill/1187/text. Although the bill has not passed, the SEC has already acted to propose ESG rules, ahead of pending legislation.

recycling…"[14] Because ESG reporting metrics and definitions vary,[15] it is difficult for investors to evaluate a company's ESG claims.[16] Standardization is needed to avoid investor confusion.[17] When companies omit material information[18] related to ESG factors or misrepresent ESG factors through nonstandard terminology and metrics, this could motivate investors to purchase a company's issuances based on incorrect or incomplete information.[19]

b. GREENWASHING AND THE "GREENIUM"

Misrepresentation of ESG factors has raised concerns that companies are "greenwashing"[20] their issuances in order to induce purchases from ESG-motivated investors.[21] Greenwashing occurs when a company promotes its "environmental concerns as an advertising gimmick."[22] They do this by making misleading statements about their ESG metrics.[23] The impact of greenwashing is a concern in ESG investing because record amounts of money are flowing into this sector.[24] It is

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[14] *Environmental, Social, and Governance Disclosures in Proxy Statements: Benchmarking the Fortune 50*, SIDLEY (Aug. 31, 2021), https://www.sidley.com/en/insights/newsupdates/2021/08/environmental-social-and-governance-disclosures-in-proxy.

[15] Some industry organizations have made suggestions for standardization of definitions. See *New Common Terminology for ESG Investing Strategies*, INV. CO. INST. (Aug. 11, 2020) https://www.ici.org/system/files/attachments/pdf/20_webinar_ici_esg_primer_0811_slides.pdf.

[16] See *Public Companies Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, GOV'T ACCOUNTABILITY OFF. (July 2020) https://www.gao.gov/assets/gao-20-530.pdf.

[17] *Recommendations for ESG*, U.S. SEC. EXCH. COMM'N ASSET MGMT. ADVISORY COMM. (July 7, 2021) https://www.sec.gov/files/spotlight/amac/recommendations-esg.pdf.

[18] What is considered "material" for ESG disclosure purposes has been a topic of debate. See *ESG Reporting & Regulations*, CFA INST., https://www.cfainstitute.org/en/advocacy/issues/esg-sustainable-investing#sort=%40pubbrowsedate%20descending (accessed Dec. 18, 2022).

[19] *SEC Again Urged to Regulate ESG Disclosures*, JONES DAY (June 2020), https://www.jonesday.com/en/insights/2020/06/sec-again-urged-to-regulate-esg-disclosures.

[20] "Greenwashing is the process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound. Greenwashing is considered an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly." See *What Is Greenwashing?*, INVESTOPEDIA, https://www.investopedia.com/terms/g/greenwashing.asp (accessed Dec. 18, 2022).

[21] Marc S. Gerber et al., *ESG: 2021 Trends and Expectations for 2022*, SKADDEN (Feb. 11, 2022) https://www.skadden.com/insights/publications/2022/02/esg-2021-trends-and-expectations-for-2022.

[22] Malachy Mitchell, *How Governments Can Foster ESG Policy in Agriculture*, LINKEDIN (April 14, 2021), https://www.linkedin.com/pulse/how-governments-can-foster-esg-policy-agriculture-malachy-mitchell/.

[23] Simon Constable, *What Is Greenwashing? Here Is What Investors Need to Know*, WALL ST. J. (Nov. 9, 2020), https://www.wsj.com/articles/what-is-greenwashing-here-is-what-investors-need-to-know-11604881371.

[24] Saijel Kishan, *ESG by the Numbers: Sustainable Investing Set Records in 2021*, BLOOMBERG GREEN (Feb. 3, 2022, 8:03 AM) https://www.bloomberg.com/news/articles/2022-02-03/esg-by-the-numbers-sustainable-investing-set-records-in-2021.

estimated that $35 trillion is invested in ESG assets, and this number is projected to increase to $50 trillion by 2025.[25] If investors are purchasing ESG assets based on misleading and incorrect data, those investors are paying a "greenium" for assets that do not meet ESG metrics.

While this article focuses on the ESG disclosure for individual companies, keep in mind that individual company issuances may be held within other financial instruments such as ESG-labeled mutual funds.[26] ESG fund management fees earned globally totaled $1.1 billion in 2020 and $1.8 billion in 2021.[27] Clearly, companies and fund managers are reaping the rewards of ESG labeling, despite inconsistencies in ESG definitions and how ESG metrics are applied. The SEC has indicated that it will increase investigation into potential greenwashing conduct in 2022.[28]

c. THE CURRENT ESG REPORTING LANDSCAPE AND PROPOSED ESG DISCLOSURES

The SEC has published for comment a mandatory ESG reporting framework that would apply to *all public companies*, not just to companies in sectors that have historically been regulated under environmental rules.[29] Prior to these rules taking effect, reporting is mandatory only for issuers that make ESG claims. The SEC has been progressing toward a mandatory ESG reporting system since 2010.[30] At present, the framework for reporting is based on metrics set by

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[25] *Id*.

[26] A mutual fund is a financial instrument that can hold stocks, bonds or other assets, and is managed by a money manager who chooses investments for the fund based on the stated investment objectives of the fund. *See* Adam Hayes, *Mutual Fund*, INVESTOPEDIA (Oct. 3, 2020), https://www.investopedia.com/terms/m/mutualfund.asp. If a mutual fund is labeled as ESG, the individual holdings within the fund must meet ESG metrics if the manager's investment selections are to be compliant with the fund's stated objectives.

[27] *Kishan*, *supra* note 24.

[28] *SEC Enforcement Related to ESG Investing Likely to Increase in 2022*, JD SUPRA (Jan. 7, 2022) https://www.jdsupra.com/legalnews/sec-enforcement-related-to-esg-6849948/.

[29] Richard Vanderford, *SEC Climate Disclosure Looms as Litigation Risk*, WALL ST. J. (March 26, 2022, 9:00 AM), https://www.wsj.com/articles/sec-climate-disclosure-proposal-looms-as-litigation-risk-11648299600.

[30] *Climate Disclosures and the SEC: What SEC Commentary and the Influence of Existing Frameworks Could Mean for Mandatory Climate Disclosures in the US*, LATHAM & WATKINS (Oct. 8, 2021), https://www.lw.com/thoughtLeadership/Climate-Disclosures-and-the-SEC.

nongovernmental third-party entities. U.S. companies are currently subject to mandatory reporting including those companies making ESG claims and companies who transact business with the U.S. government following President Biden's executive order requiring the General Services Administration to track the emissions of large government contractors.[31] In developing its own ESG framework, the SEC could choose to adopt metrics from an existing third-party reporting framework, implement factors and metrics currently used in the European Union, or develop a new framework based on a combination of these.

Currently, there are multiple third-party ESG reporting frameworks used in the U.S.[32] Of the existing foundational metrics, three have been recognized in previous SEC guidance.[33] In 2010, the SEC recognized the Carbon Disclosure Project (CDP) and the Global Reporting Initiative (GRI).[34] In September 2021, SEC Chair Gensler noted that in setting disclosure requirements, SEC staff should consider the Task Force on Climate-related Financial Disclosures (TCFD) and other frameworks.[35]

The European Union has a well-developed disclosure framework for financial reporting called the Sustainable Finance Disclosure Regulation (SFDR).[36] SFDR is aimed at investment managers and advisors, and mandates reporting of "sustainability risks."[37] Under SFDR, "sustainability risk is defined as an ESG event or condition which does or could negatively

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[31] *Biden Order Poses Climate Disclosure Challenges for Contractors*, BLOOMBERG LAW (Dec. 14, 2021, 3:00 AM), https://news.bloomberglaw.com/securities-law/biden-order-poses-climate-disclosure-challenges-for-contractors. This is in alignment with Biden's executive order calling for the U.S. federal government to be net zero for carbon emissions by 2050. See *Biden to Direct U.S. Government to Reach Net-Zero by 2050*, BLOOMBERG LAW (Dec. 8, 2021, 12:03 PM), https://news.bloomberglaw.com/environment-and-energy/biden-to-direct-u-s-government-to-reach-net-zero-by-2050-1.
[32] *Latham & Watkins*, *supra* note 30.
[33] *Id*.
[34] *Id*.
[35] *Id*.
[36] Julianne Hughes-Jennett and Rosa Polaschek, *The EU's Increasing ESG Regulation and its Implication for Business*, JD SUPRA (April 7, 2021), https://www.jdsupra.com/legalnews/the-eu-s-increasing-esg-regulation-and-7966413/.
[37] *Id*.

impact the value of the investment. Possible ESG risks are extensive – taking exposure to climate change as an example, this could include companies whose supply chains rely on low-lying farmland…"[38] In creating an ESG framework, the SEC had options to use third-party frameworks, or adopt metrics from the SFDR which would help create alignment between U.S. and international ESG metrics. Considering these options, the SEC has chosen to model the new U.S. ESG framework on existing frameworks including those of the Task Force on Climate-related Disclosures, and the Greenhouse Gas Protocol.[39]

The TCFD was created by the Financial Stability Board ("FSB") to develop climate-related financial disclosure recommendations with the goal of increasing market transparency for investors, lenders, and insurance underwriters.[40] There are four core elements of corporate operations included in the TCFD framework: governance, strategy, risk management, and metrics and targets.[41] Metrics under the TCFD's environmental prong total 28 as compared to the Global Reporting Initiative's 34 metrics[42] which were recognized in earlier 2010 SEC guidance. The Carbon Disclosure Project data metrics, also formerly noted by the SEC, have since been aligned with the TCDF disclosure recommendations.[43] Examples of TCDF environmental prong metrics include total greenhouse gas emissions by type, source, and scope, total freshwater withdrawals, amount of water withdrawn from areas of high baseline water stress, locations

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38 *Id*.
39 *Fact Sheet: Enhancement and Standardization of Climate-Related Disclosures*, U.S. SEC. EXCH. COMM'N, https://www.sec.gov/files/33-11042-fact-sheet.pdf (accessed Dec. 18, 2022).
40 *About*, TCFD, https://www.fsb-tcfd.org/about/ (accessed Dec. 18, 2022).
41 Executive Summary to *Recommendations of the Task Force on Climate-related Financial Disclosures*, TCFD at V (June 2017), https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf.
42 R. Boffo, et al., *ESG Investing: Environmental Pillar Scoring and Reporting*, OECD Paris 46 (2020) https://www.oecd.org/finance/esg-investing-environmental-pillar-scoring-and-reporting.pdf.
43 *Data & Tools*, CDP, https://www.cdp.net/en/investor/data-and-tools (accessed Dec. 18, 2022).

within a designated flood zone, board oversight of climate-related risks, disclosure of metrics used to assess climate-related risks, and many others.[44]

While the TCFD will serve as the climate-related reporting framework model for the proposed rules, the Greenhouse Gas Protocol (GHG Protocol) serve as the greenhouse gas emissions accounting and reporting model.[45] The standards and guidance of the GHG Protocol are used globally, and are also referenced by the U.S. Environmental Protection Agency.[46] The GHG Protocol provides measurement and reporting standards for seven Kyoto Protocol gasses: "carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, and nitrogen trifluoride."[47]

The SEC's proposed rules will incorporate the GHG Protocol's "scope" concept of emissions.[48] The scope concept introduced by the GHG Protocol is a way to categorize different types of GHG emissions based on the level of control a company has over the emission.[49] The scopes "help delineate those emissions that are directly attributable to the reporting entity and those that are indirectly attributable to the company's activities."[50] Scopes are divided into three categories.

> Scope 1 emissions are direct GHG emissions that occur from sources owned or controlled by the company… Scope 2 emissions are those emissions primarily resulting from the generation of electricity purchased and consumed by the company. Because these emissions derive from the activities of another party (the power provider), they are considered indirect emissions… Scope 3 emissions are all other indirect emissions not accounted for in Scope 2 emissions. These emissions are a consequence of the company's activities but are generated from sources that are neither owned nor controlled by the company.[51]

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[44] Boffo, *supra* note 42, at 46-49.
[45] *SEC Proposed ESG Rules*, *supra* note 8, at 34.
[46] *Scope 1 and Scope 2 Inventory Guidance*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-guidance (accessed April 18, 2022). The EPA tacks its own GHG emissions under a scope inventory. See *Greenhouse Gases at EPA*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/greeningepa/greenhouse-gases-epa (accessed Dec. 18, 2022).
[47] *SEC Proposed ESG Rules*, *supra* note 8, at 38-39.
[48] *Id.* at 39.
[49] *Id.*
[50] *Id.*
[51] *Id.*

As will be explained later, scope will be an important factor for attributing reportable GHG emissions to a company under circumstances where CAFOs cause pollution during a climate disaster.

d. LACK OF CURRENT FARMED ANIMAL PROTECTIONS: THE REASON ALTERNATIVE CAUSES OF ACTION SUCH AS INVESTOR ESG GREENWASHING LAWSUITS ARE NEEDED

There are no federal laws to protect farmed animals from being abandoned at a CAFO during a climate-related disaster. In the United States, there are a handful of federal laws purported to protect animals. The Animal Welfare Act provides minimum welfare standards for some animals but explicitly excludes farmed animals.[52] The Twenty-Eight Hour Law[53] regulates transportation of most farmed animals, but goes largely unenforced.[54] The Humane Methods of Slaughter Act dictates methods of animal slaughter, excluding poultry.[55] The Pets Evacuation and Transportation Standards Act of 2006[56] requires that states seeking Federal Emergency Management Agency assistance must accommodate certain companion and service animals of residents seeking shelter following a disaster. None of these laws protect farmed animals who are victims of a climate-related disaster.

Disturbingly, federal law inadvertently incentivizes the abandonment of animals in CAFOs through the USDA's Livestock Indemnity Program (LIP). LIP pays producers when farmed animals die in excess of what is considered a normal mortality rate as a result of an adverse weather event.[57] Payment rates for owners are calculated at "75 percent of the average fair market value" of the animal, typically based on the nationwide price for that animal during the

[52] Animal Welfare Act, 7 U.S.C. §§ 2131-2159.
[53] 49 U.S.C. § 80502.
[54] *See* Animal Welfare Institute Farm Animal Program, *Animals in Transport Languish as Twenty-Eight Hour Law Goes Off the Rails*, 25:1 ANIMAL L. REV. 1 (2018).
[55] Humane Slaughter Act, 7 U.S.C. §§ 1901-1906.
[56] P.L. 109-308.
[57] 7 C.F.R. § 1416.

previous calendar year.[58] Growers who do not own the animals but contract with companies to raise company-owned animals are compensated differently. Growers receive an LIP payment rate equivalent to "75 percent of the average income loss sustained by the contract grower with respect to the dead livestock…based on the type, class, and weight of the animal at the time of the eligible loss condition and death."[59]

While owners can receive payments for losses when selling injured animals, "[c]ontract growers are not eligible for benefits for injured animals sold at a reduced price."[60] This provision incentivizes growers to avoid saving any injured animals. Essentially, the LIP creates a "close the barn doors mindset," with farmers leaving animals trapped, which will contain their dead bodies for more convenient counting and compensation as opposed to providing them with a chance for escape. The LIP program offers a convenient financial solution, funded by American taxpayers, for owners and growers to allow thousands of animals in CAFOs to perish during a climate disaster.

III. USING FUTURE ESG DISCLOSURE REQUIREMENTS TO DISINCENTIVIZE ABANDONMENT AND BRING INVESTOR LAWSUITS FOR REPORTING MISSTATEMENTS AND OMISSIONS

The proposed SEC ESG rules are a potential tool for deterring farmed animal abandonment during climate disasters, or conversely, suing public companies after the damage has been done. While 100% of companies in the oil and gas sector already report their ESG metrics, big agriculture is unprepared for new reporting frameworks.[61] Even before the proposed rules were released, it was anticipated that food companies would continue to face increased investor

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[58] 7 C.F.R. § 1416.306(b).
[59] 7 C.F.R. § 1416.306(c).
[60] 7 C.F.R. § 1416.303(d).
[61] *Why ESG is Increasingly Critical for the Food Industry*, BRCGS (Nov. 3, 2021), https://www.brcgs.com/about-brcgs/news/2021/why-esg-is-increasingly-critical-for-the-food-industry/. Actions brought against oil and gas companies should be examined in this context, but this is beyond the scope of this article.

demand for ESG reporting.[62] It was estimated that food companies would face significant pressure to report due to the industry's use of "70% of global freshwater withdrawal and a quarter of all global greenhouse gas emissions."[63]

The World Benchmarking Alliance has found that there are significant gaps in climate change preparedness "when ranking 350 of the world's largest food and agriculture companies on their contributions to transforming the global food system…"[64] Overall, there is a lack of ESG data provided by the food and agriculture sector, putting the industry behind the curve for future ESG reporting compliance.[65] Under the SEC's proposed ESG rules, companies are required to disclose physical risks and transition risks.[66] Physical risks are acute or chronic climate-related weather disasters and conditions.[67] Transition risks are those a company will face in the "transition to a less carbon-intensive economy."[68] Some examples of transition risks include climate-related legislation, climate-related litigation, and changing consumer and investor preferences.[69] Those climate-related disasters categorized as physical risks directly impact CAFOs. Environmental prong metrics can be used to measure these risks.

a. FUGITIVE EMISSIONS RELEASED WHEN CLIMATE-RELATED DISASTERS IMPACT CAFOs SHOULD BE REPORTED BY PUBLIC COMPANIES

The proposed rules require companies to identify emissions from sources that the company owns or controls.[70] If a company has control over a source that creates a direct emission from fugitive emission sources, this must be described within the company's

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[62] *Id*.
[63] *Id*.
[64] *Id*.
[65] *Id*.
[66] *SEC Proposed ESG Rules*, *supra* note 8, at 55.
[67] *Id*.
[68] *Id*.
[69] *Id*.
[70] *SEC Proposed ESG Rules, supra* note [8], at 190.

operational boundaries.[71] Examples of fugitive emission sources include: "equipment leaks from joints, seals, packing, gaskets, coal piles, wastewater treatment, pits, cooling towers, and gas processing facilities, and other unintentional releases."[72] If such fugitive emissions cause significant damage to the environment or community health, the company's business or financial statements may be impacted, so these risks require disclosure.

Industrial animal agriculture produces GHG emissions including carbon dioxide, nitrogen, methane, and other gases[73] and pollutants that contaminate water supplies.[74] These emissions are produced not only from livestock and poultry rearing, but from growing crops to feed farmed animals.[75] When animals die and are not used for human consumption, their bodies are disposed of in four ways: rendering, incineration, composting, or burial.[76] Studies have been conducted to compare the GHG emissions of composted or rendered animal bodies,[77] but

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[71] *Id.*

[72] *Id.* at 191.

[73] *Sources of Greenhouse Gas Emissions*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/ghgemissions/sources-greenhouse-gas-emissions#agriculture (accessed Dec. 18, 2022) [hereinafter *EPA GHG Sources*]. *Non-Water Quality Impact Estimates for Animal Feeding Operations*, U.S. ENV'T PROT. AGENCY (Dec. 2002), https://www3.epa.gov/npdes/pubs/cafo_nonwaterquality.pdf

[74] *Nutrients in Agricultural Production: A Water Quality Overview*, R43919, CONG. RSCH. SERV. (Feb. 29, 2016), https://crsreports.congress.gov/product/pdf/R/R43919. Sara Kangas, *Water Pollution Concerns Surround CAFOs*, NAT'L FARMERS UNION (Oct. 30, 2015) https://nfu.org/2015/10/30/water-pollution-concerns-surround-cafos/.

[75] *EPA GHG Sources, supra* note 73.

[76] *Carcass Disposal Options*, OKLA. DEP'T AGRIC. FOOD FORESTRY (March 16, 2020) https://ag.ok.gov/wp-content/uploads/2020/11/carcassdisposaloptions.pdf; Shafiqur Rahman & Mary Berg, *Animal Carcass Disposal Options: Rendering, Incineration, Burial, Composting*, N.D. STATE UNIV. (September 2017) https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjAqIGqkoX8AhXtBjQIHU10A8YQFnoECBQQAQ&url=https%3A%2F%2Fwww.ag.ndsu.edu%2Fpublications%2Fenvironment-natural-resources%2Fanimal-carcass-disposal-options-rendering-incineration-burial-composting%2Fnm1422.pdf%2F%40%40download%2Ffile%2Fnm1422.pdf&usg=AOvVaw0SU2PkFirsB6uO3XA4PHqE: *Assessing Your Dead Animal Management Practices*, IOWA FARM-A-SYST (Jan. 2001), https://www.johnsoncountyiowa.gov/sites/default/files/2020-04/deadAnimals.pdf.

[77] *See* Matias Marchesan de Oliveira et al, *Aeration Frequency on Accelerated Composting of Animal Carcasses*, 42 CIÊNCIA E AGROTECNOLOGIA, 653 (Nov./Dec. 2018), https://www.scielo.br/j/cagro/a/RxjGGzv7vNcMFWvy65xDS8S/?lang=en; Charles H. Gooding & David L. Meeker, *Review: Comparison of 3 Alternatives for Large-scale Processing of Animal Carcasses and Meat By-products*, 32 PRO. ANIMAL SCIENTIST 259 (2016), http://dx.doi.org/10.15232/pas.2015-01487; Qi Yuan et al., *Methane and Carbon Dioxide Production From Simulated Anaerobic Degradation of Cattle Carcasses*, 32 WASTE MANAGEMENT 939 (2012), https://doi.org/10.1016/j.wasman.2011.11.015.

exacting data on GHG emissions produced by animals killed in climate events and left to decompose in open air or in water are unavailable.

The EPA warns that improper carcass disposal has negative impacts on human health and the environment.[78] Decomposing carcasses release chemical and biological leachate, ammonia, hydrogen sulfide, methane, and other emissions.[79] Methane is the second most abundant GHG in the atmosphere following carbon dioxide.[80] While methane constitutes only 20% of anthropogenic GHG emissions, it is far more effective at trapping radiation within the Earth's atmosphere.[81] Methane has a shorter half-life than carbon dioxide, but "pound for pound, the comparative impact of [methane] is 25 times greater than [carbon dioxide] over a 100-year period."[82] If a climate-related disaster kills thousands of animals, possibly at multiple CAFOs controlled by the same company, the economic impact to the company's bottom line could be material, in which case those fugitive methane emissions would require disclosure.

In addition to decomposing carcasses, environmental contamination from manure lagoon breaches or field runoff may occur during climate-related weather events.[83] Animal waste-related pollutants include nitrogen, phosphorus, ammonia, pathogens, antibiotics, and hormones.[84] Leakage and runoff of animal waste damages the environment and can contaminate human water

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[78] *Carcass Management of Non-Diseased Animals in Response to the Coronavirus Outbreak*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/agriculture/carcass-management-non-diseased-animals-response-coronavirus-outbreak-covid-19 (accessed Dec. 18, 2022).

[79] *Id.*

[80] *Importance of Methane*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/gmi/importance-methane (accessed Dec. 18, 2022).

[81] *Id.*

[82] *Overview of Greenhouse Gases*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/ghgemissions/overview-greenhouse-gases#methane (accessed Dec. 18, 2022).

[83] Hannah Pugh et al., *Industrialized Agricultural Facilities' Impact on U.S. Waters*, REGUL. REV. (Dec. 26, 2020), https://www.theregreview.org/2020/12/26/saturday-seminar-industrialized-agricultural-facilities-impact-waters/; Tara Heinzen, *We Just Scored a Big Win Against Factory Farm Water Pollution*, FOOD & WATER WATCH (Oct. 6, 2021), https://www.foodandwaterwatch.org/2021/10/06/we-just-scored-a-big-win-against-factory-farm-water-pollution/.

[84] *Environmental Assessment of Proposed Revisions to the National Pollutant Discharge Elimination System Regulation and the Effluent Guidelines for Concentrated Animal Feeding Operations*, U.S. ENV'T PROT. AGENCY (JAN. 2001), https://www3.epa.gov/npdes/pubs/cafo_proposed_env_assess_ch1-3.pdf.

supplies.[85] It can impact watersheds, kill aquatic species, cause antibiotic resistance and endocrine disruption, and spread disease.[86] "The impacts from CAFO [pollution] are more substantial after major effluent spills or when CAFOs are flooded and in direct contact with surface waters."[87] Leakage or runoff of CAFO animal waste during a climate event could be categorized as a fugitive emission source.

The animal agriculture industry, with its aversion to transparency, will fight hard to defang the proposed rules, but the final rules will be interpreted through test cases. Whether or not GHG emissions from climate-related disasters are categorized as "material" for reporting purposes could be a key point of contention. Recall that ESG does not necessarily pertain to an investor's personal values. These financial reporting rules are meant to alert investors to potential climate change-related factors that will impact a company's bottom line. If GHG emissions from a climate-related disaster on a CAFO sufficiently impact a company's bottom line, then they are arguably material. If they are material, climate disaster-related GHG emissions must be reported on Form 10-K or any required disclosure forms. The following section considers materiality under the proposed rule.

b. DETERMINING MATERIALITY OF ESG-RELATED RISKS UNDER THE PROPOSED RULES

As it stands now, companies either voluntarily or mandatorily reporting ESG factors cannot misstate or omit material facts related to security sales or purchases. To do so is unlawful. Public companies must provide material financial disclosures to the SEC, and may not misstate

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[85] See *Id*.
[86] *Id*.
[87] JoAnn Burkholder et al., *Impacts of Waste from Concentrated Animal Feeding Operations on Water Quality*, 115 ENV'T HEALTH PERSP. (Feb. 2007), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC1817674/pdf/ehp0115-000308.pdf.

or omit material information from those filings. Annual disclosures are reported to the SEC on Form 10-K.[88] Under 17 C.F.R. § 240.10b-5(b) it is

> unlawful for any person, directly or indirectly…[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading… in connection with the purchase or sale of any security.
> Materiality is based on a "reasonable investor" standard.[89] "[A] matter is material if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote."[90] Quantitative and qualitative considerations help determine if a matter is material.[91] Materiality determinations are fact-specific.[92]

The Supreme Court reaffirmed the materiality definition under *Matrixx Initiatives, Inc. v. Siracusano*, as "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[93] The Financial Accountability Standards Board (FASB) reporting framework aligns with this jurisprudence in that materiality is compromised where "the magnitude of the [misstated or omitted fact] is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."[94] The SEC has indicated that ESG disclosure rules will heighten standards for material disclosure for any public company making ESG claims.

Materiality determinations are also forward-looking. Assessing the materiality of "potential future events requires an assessment of both the probability of the event occurring and

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[88] *Form 10-K*, SEC. EXCH. COMM'N, https://www.sec.gov/files/form10-k.pdf (accessed Dec. 18, 2022).
[89] *See* 17 C.F.R. § 240.12b-2.
[90] *SEC Proposed ESG Rules, supra* note 8, at 64.
[91] *Id.*
[92] *Id.*
[93] 563 U.S. 27, 38 (2011), citing *Basic Inc., et al., v. Levinson*, 485 U.S. 224, 236 (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).
[94] *Amendments to Statement of Financial Accounting Concepts No. 8*, FED. ACCT. STANDARDS BD. (Aug. 2018), https://fasb.org/document/blob?fileName=Concepts%20Statement%208%E2%80%94Chapter%201%20(As%20Amended).pdf.

its potential magnitude, or significance to the registrant."[95] Under the proposed rules, the materiality determination process will be similar to the process used for the existing management discussion and analysis (MD&A)[96] The MD&A is a section of the annual report which requires disclosure of "material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition."[97]

When the proposed rules take effect, material events and uncertainties will include acute physical risk and chronic physical risk under the E prong. As previously described, acute risks are event-driven.[98] Acute physical risks are shorter-term and include individual extreme weather events such as tornadoes, hurricanes, or floods.[99] Chronic physical risks result from the effects of long-term weather patterns.[100] Examples that could impact CAFOs include availability of fresh water, drought, increased wildfires, higher temperatures, and sea level rise.[101] The proposed rules require companies to report acute and chronic physical risks that could materially impact the business or its financial statements.[102] For each physical risk the company must provide the zip code of the risk location to allow investors to evaluate risk exposure.[103] This means that if CAFOs are to be reported as physical risk locations within the company's value chain, their locations must be disclosed.

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[95] *SEC Proposed ESG Rules, supra* note 8, at 64-65.
[96] *Id.* at 65. The MD&A also discusses a company's compliance, performance, and future goals in addition to potential risks.
[97] *Id*.
[98] *Id.* at 57-58.
[99] *Id*.
[100] *Id.* at 58.
[101] *Id*.
[102] *Id.* at 59.
[103] *Id*.

IV. DISCLOSURE OF CLIMATE DISASTER GHG EMISSIONS SHOULD FALL UNDER SCOPE 1 DUE TO VERTICAL INTEGRATION: MISSTATEMENT OR OMISSION OF SUCH MATERIAL FACTS PROVIDES A CAUSE OF ACTION

Vertical integration occurs when a company takes direct control over multiple stages of its production, increasing control over its value chain and processes.[104] As a business model, vertical integration is only possible for large corporations.[105] Animal agriculture has become increasingly vertically integrated and is dominated by a handful of companies.[106] These large meat companies have integrated processes including producing animal feed, breeding animals, transporting animals, contracting with growers, operating slaughter and processing facilities, and selling the final products.[107] This model integrates processes that are upstream or downstream.[108] The proposed rules define "value chain" as "the upstream and downstream activities related to a registrant's operations."[109]

Upstream activities are those that occur earlier in the production process, and under the proposed rules, include "activities by a party other than the registrant that relate to the initial stages of a registrant's production of a good or service."[110] Downstream activities are those that occur later in the production process, and under the proposed rules, those are "defined to include activities by a party other than the registrant that relate to processing materials into a finished product and delivering it or providing a service to the end user."[111] Large, vertically integrated

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[104] *Vertical Integration*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/strategy/vertical-integration/ (accessed Dec. 18, 2022) [hereinafter *Vertical Integration CFI*].

[105] Stephen Mihm, *Vertical Integration Is Making a Comeback at U.S. Companies*, WASH. POST (Jan. 12, 2022, 2:23 PM), https://www.washingtonpost.com/business/energy/vertical-integration-is-making-a-comeback-at-us-companies/2022/01/12/52cad1ba-73bd-11ec-a26d-1c21c16b1c93_story.html.

[106] Mary Hendrickson & William Hefferman, *Vertical Integration and Concentration in US Agriculture*, ENCYCLOPEDIA FOOD & AGRIC. ETHICS (Jan. 2013), https://doi.org/10.1007/978-94-007-6167-4_216-1.

[107] *Vertical Integration*, NAT'L CHICKEN COUNS., https://www.nationalchickencouncil.org/industry-issues/vertical-integration/ (accessed Dec. 18, 2022) [hereinafter *Vertical Integration NCC*].

[108] *Vertical Integration CFI*, *supra* note 104.

[109] *SEC Proposed ESG Rules, supra* note 8, at 57.

[110] *Id.*

[111] *Id.*

meat companies own or control their entire value chain (both upstream and downstream). Because all parts of the value chain are either owned or controlled by the company, all emissions resulting from the value chain should be categorized as Scope 1 GHG emissions. The proposed rules are modeled after the GHG Protocol which defines Scope 1 emissions as "direct GHG emissions that occur from sources owned or controlled by the company."[112]

Within this vertically integrated value chain, meat companies contract with growers to raise animals.[113] Growers who receive young company-owned animals are responsible under contract to provide housing, labor, and operating expenses until the animals are ready for slaughter.[114] Contracts between the meat company and the grower create an imbalance of power.[115] Grower contracts are typically nonnegotiable, dictate the terms of the agreement through obscure language, include confidentiality provisions, and state that the growers are responsible for the environmental impacts of the animals.[116] "Growers often have little market power and little to no autonomy over their farming operations."[117] Despite the unfairness of these contracts, growers are inclined to accept them because if farmers raised their own animals, they would have nowhere to slaughter or sell them due to market domination of large vertically integrated meat companies.[118] These growers occupy space in the middle of the vertically integrated value chain.

[112] *Id.* at 39.
[113] *Protecting Contract Growers*, INST. LOCAL SELF-RELIANCE, https://ilsr.org/rule/protecting-contract-growers/ (accessed Dec. 18, 2022).
[114] *Vertical Integration NCC*, *supra* note 107.
[115] Joseph J. Molnar et al., *Passing the Cluck, Dodging Pullets: Corporate Power, Environmental Responsibility, and the Contract Poultry Grower*, 18 S. RURAL SOCIOLOGY 88, 96 (2002), https://egrove.olemiss.edu/cgi/viewcontent.cgi?article=1226&context=jrss.
[116] *Protecting Contract Growers*, *supra* note 113.
[117] *Precautionary Moratorium on New and Expanding Concentrated Animal Feeding Operations*, AM. PUB. HEALTH ASS'N. (Nov. 5, 2019), https://www.apha.org/policies-and-advocacy/public-health-policy-statements/policy-database/2020/01/13/precautionary-moratorium-on-new-and-expanding-concentrated-animal-feeding-operations.
[118] *Unchecked Corporate Power and Exploitation: The Truth About Contract Growing*, FOOD INTEGRITY CAMPAIGN (Dec. 14, 2021), https://foodwhistleblower.org/unchecked-corporate-power-and-exploitation-the-truth-about-contract-growing/.

It is likely that the meat industry will seek to categorize GHG emissions and fugitive emissions from contract growers as Scope 3. To be categorized as Scope 3, an emission must be "a consequence of the company's activities but generated from sources that are neither owned nor controlled by the company."[119] The proposed rules provide examples of Scope 3 emissions which would include "emissions associated with the production and transportation of goods a registrant purchases from third parties, employee commuting or business travel, and the processing or use of the registrant's products by third parties."[120] Based on the definition and examples of Scope 3, the emissions created by animals held by a grower clearly do not fit into this category. This is because the meat company owns and controls the vertically integrated value chain, both upstream and downstream from the grower. The meat company owns the animals being grown. The meat company controls the grower through a nonnegotiable contract and the grower cannot raise and sell animals on their own because the meat company dominates the market. Where a company owns and controls direct emissions, those emissions fall under Scope 1 and must be reported under proposed SEC ESG rules when they take effect.

Under the proposed rules, a climate-related risk is "the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole."[121] The environmental damage done when the animals die and are dumped, or manure pools leak, could be material and may require mandatory reporting under the proposed rules. Even where contracts foist environmental responsibility onto growers, this does not avoid the fact that GHG emissions produced through a climate-related disaster is the responsibility of the company for ESG reporting purposes. If the company owns or controls the emission source, it is a Scope 1 emission. Even if such emissions were to be classed

[119] *SEC Proposed ESG Rules, supra* note 8, at 39.
[120] *SEC Proposed ESG Rules, supra* note 8, at 39-40.
[121] *SEC Proposed ESG Rules, supra* note 8, at 56.

as Scope 3, companies must report "[s]cope 3 GHG emissions and intensity, if material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions…"[122]

V. CONCLUSION

The newly proposed SEC ESG disclosure rules will eventually require all public companies to report their environmental prong metrics through a TCFD framework and their GHG emissions based on the GHG Protocol Scope classification system. Industrial agriculture is ill-prepared to begin filing these required disclosures to the SEC. Once in place, these rules will lend transparency to company value chain emissions and pollution through standardized reporting requirements.

Future strategic impact litigation targeting climate disaster-related financial reporting could benefit investors, and indirectly help farmed animals subjected to climate-related disasters in CAFOs. Environmental prong ESG metrics could be used to indirectly help animals by categorizing emissions and pollution from climate-related disasters on CAFOs as Scope 1 direct emissions. If the damage caused equates to a material risk for SEC disclosure purposes, this opens noncompliant companies to litigation risk. Successful investor lawsuits awarding damages based on misrepresentation or omission of material ESG information could modify big agriculture industry practices in an effort to avoid future litigation. This could have the effect of disincentivizing companies and growers who rely on the Livestock Indemnity Program for loss mitigation in a climate disaster. Ultimately, LIP should be eliminated or restructured to offer minimal to no cash payment for dead CAFO animals, lack of emergency planning, and the environmental impact of climate disasters. In the meantime, the proposed SEC ESG disclosure

[122] *SEC Proposed ESG Rules, supra* note 8, at 43.

rules are a potential strategic impact litigation tool to indirectly improve future farmed animal welfare during climate disasters.