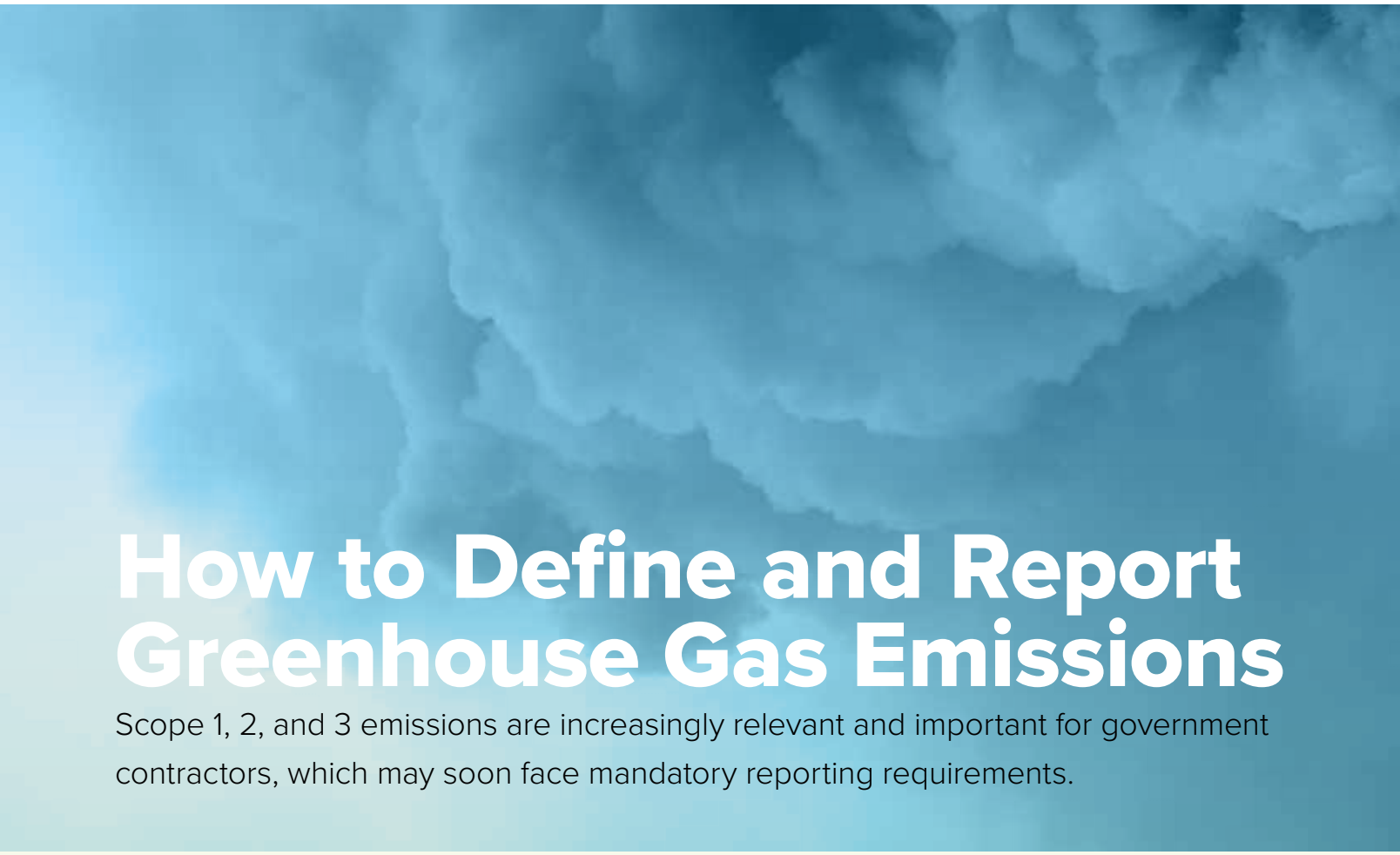


How to Define and Report Greenhouse Gas Emissions

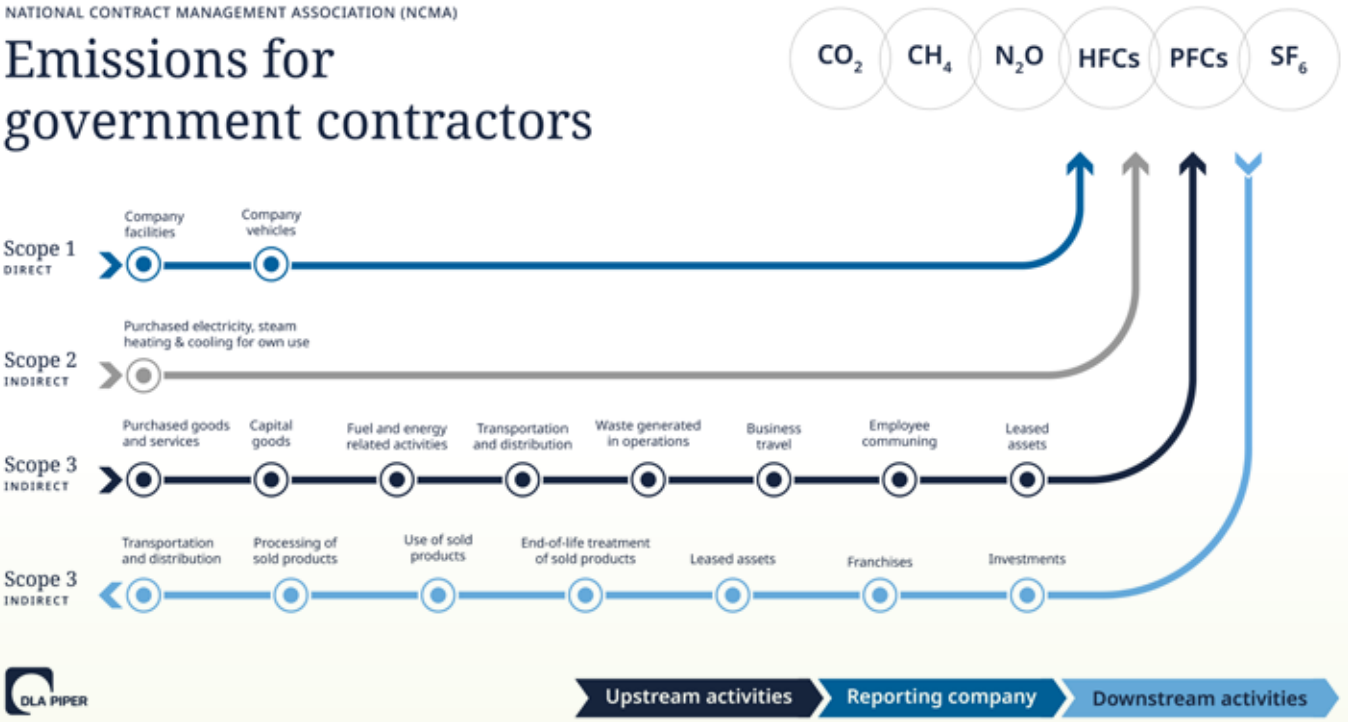
Scope 1, 2, and 3 emissions are increasingly relevant and important for government contractors, which may soon face mandatory reporting requirements.

BY TOM DALEY AND PILAR DIAZ

Over the past few years, disclosure of greenhouse gas (GHG) emissions has become increasingly relevant for government contractors. There is a proposed requirement that would mandate disclosure of GHG emissions for many federal contractors in order to receive new contract awards. Federal agencies, including the U.S. General Services Administration, have started to include disclosure of GHG emissions as an evaluation criterion.

Disclosure of GHG emissions, which are categorized as Scope 1, 2, and 3 emissions, is positioned to become a routine requirement in future procurements. This article provides an overview of existing and pending requirements that may apply to federal contractors. The article also provides an overview of the meaning of Scope 1, 2, and 3 emissions, as well as a summary of how contractors can perform GHG inventories.

Given that disclosure of GHG emissions may become a mandatory requirement for many federal contractors and that agencies are favorably evaluating those contractors that are already disclosing their emissions, contractors may wish to begin the process of inventorying their emissions and developing a climate action plan if they are not already doing so.



The Increasing Relevance of GHG Emissions

In November 2022, the Federal Acquisition Regulatory (FAR) Council issued a proposed rule that requires "significant contractors" (*i.e.*, those with $7.5 million to $50 million in federal contract obligations in the prior federal fiscal year) to perform annual GHG inventories of their Scope 1 and 2 emissions and disclose those emissions in SAM.gov.

The proposed rule also requires that "major contractors" (*i.e.*, those with more than $50 million in federal contract obligations in the prior federal fiscal year) inventory and disclose their Scope 1, 2, and 3 emissions on an annual basis, in addition to other requirements such as completing an annual climate disclosure and setting emission-reduction targets. The proposed *FAR* rule is expected to be finalized later this year.

Additionally, agencies, at least in certain requests for proposals (RFPs), have included evaluation criteria favorable to contractors that are publicly disclosing their GHG emissions. For example, the most recent draft RFP for the Alliant 3 procurement awards points to offerors that are disclosing Scope 1 and 2 emissions, as well as additional points to those disclosing Scope 3 emissions.

The draft Alliant 3 RFP also requires that a contractor provide, as a deliverable during contract performance, an annual "Sustainable Practices and Impact Disclosure" that includes, among other requirements, disclosure of Scope 1 and 2 GHG emissions. Scope 3 emissions are "encouraged but not required" to be included in those disclosures. Thus, independent of the proposed *FAR* rule, disclosure of GHG emissions may competitively benefit contractors in certain competitions and may be required as a deliverable during contract performance.

GHG reporting requirements are not unique to the federal government. California has requirements for certain companies to disclose Scope 1, 2, and 3 emissions, and other states, including Washington, New York, and Illinois, are currently considering implementing similar requirements. The U.S. Securities and Exchange

Commission also recently issued its climate disclosure rules requiring disclosure of material Scope 1 and 2 emissions, although those rules are currently stayed. Contractors, therefore, may be subject to, or may become subject to, GHG reporting requirements outside of the federal procurement process.

Scope 1 Emissions

Scope 1 emissions are direct GHG emissions or emissions from sources that are owned or controlled by a contractor, including emissions from combustion in contractor-owned or contractor-controlled boilers, furnaces, equipment (*e.g.*, propane forklifts, on-site generators), and vehicles. Contractors can generally think of Scope 1 emissions as those emissions that originate from sources on the contractor's facilities or within the contractor's control and those that are released during industrial process and on-site manufacturing.

To inventory Scope 1 emissions, contractors need to identify and understand their boundaries and collect data on fuel usage, as well as other direct GHG-emitting activities associated with their operations. Challenges in calculating Scope 1 emissions often arise from difficulties with data collection, such as obtaining accurate fuel usage data.

For example, the cost associated with energy usage does not always relate to actual units of consumption by the contractor. Contractors will need to sort through this data to determine actual consumption. Therefore, maintaining accurate records pertaining to consumption and having a clear understanding of what is material based on the level of control or ownership a contractor has is key for calculating Scope 1 emissions.

Scope 2 Emissions

Scope 2 emissions are indirect emissions that are associated with the generation of purchased electricity, heating, and cooling that a contractor acquires for its own consumption. Unlike Scope 1 emissions, Scope 2 emissions occur outside of the contractor's facilities but are used by the contractor within its facilities.

For example, the emissions associated with the generation of electricity that a contractor uses to turn on the lights in an office building it uses would be considered Scope 2 emissions. Contractors in carbon-intensive industries (*e.g.*, manufacturing) may have higher Scope 2 emissions than those in industries that have lower energy demands (*e.g.*, professional services).

Scope 2 emissions can be particularly challenging for contractors in multi-tenant buildings to account for due to variations in building-management practices (e.g., inconsistent use of submeters), electricity sourcing, and shared services like heating from a common boiler system. To address this issue, the GHG Protocol's Scope 2 Guidance states that leases typically confer operational control to the tenant, which results in those emissions being included in a tenant's Scope 2 inventory.

The GHG Protocol is a comprehensive standardized framework for measuring and managing GHG emissions from operations, value chains, and mitigation actions. The Proposed *FAR* Rule requires that significant and major contractors follow the standards when inventorying their GHG emissions.

Navigating these challenges requires careful consideration of both the physical and contractual aspects of energy consumption. For that reason, the GHG Protocol provides two methods for calculating Scope 2 emissions: the location-based method and the market-based method. The location-based method considers the average emissions intensity of the grid on which a contractor is located. The market-based method accounts for the choice in electricity sourcing, including renewable energy purchases.

Leveraging the correct methodologies and data sources can enable contractors to make informed decisions about their energy use and result in more accurate total GHG emissions.

Scope 3 Emissions

Scope 3 emissions are indirect emissions that are generated as a result of the contractor's operations, but that occur at sources other than those owned or controlled by the contractor. There are 15 categories of Scope 3 emissions, including emissions associated with the goods and services that a contractor purchased for its own use, transportation, and distribution of products and services; customers' use of sold products; waste generated in operations; business travel; and employee commuting.

For government contractors, one aspect of Scope 3 emissions includes emissions generated from activities occurring in their supply chains (*e.g.*,

emissions from subcontractors). Scope 3 emissions are the broadest of the three scopes and have a reputation of being challenging to calculate, as it can be difficult to collect reliable data needed to calculate those emissions and certain subcontractors may not be monitoring their GHG emissions.

Accurately accounting for Scope 3 emissions requires a contractor to collect spent data (per commodity) and activity data. Data collection strategies may differ based on whether suppliers are homogeneous (*i.e.*, supplying similar goods and services) or diversified, which affects the complexity of data gathering and analysis.

The use of primary data is preferred in a Scope 3 calculation; however, in many cases, especially with indirect emissions, estimates based on expenditure, emissions factors, and extrapolated data from similar activities or industries are necessary. Additionally, effectively managing Scope 3 emissions requires contractors to understand the relationship between their organizational functions and the manner in which stakeholders use their products. This may require contractors to work with stakeholders to map their value chain and identify the activities that should be included in the inventory.

How to Perform a GHG Inventory

The initial step in producing a GHG inventory is to identify the scope, boundaries, and objectives before deciding which operations, activities, and sources of GHG emissions will be included in the report.

Collecting the correct data and applying appropriate emission factors helps ensure the quality of the calculations and, by extension, the accuracy of the analysis and reporting for public disclosure. Details in methodology, data sources, and opportunities for reduction are often excluded from inventories when producing a GHG emissions report in-house.

Many companies do not have employees who are experienced with inventorying and disclosing GHG emissions, completing annual climate disclosures, and setting emission-reduction targets. These companies typically will engage an external team to assist with understanding the legal requirements pertaining to disclosure of GHG emissions, developing internal basic carbon literacy, performing work needed to meet any disclosure or climate-related requirements, and developing an overall climate strategy.

Although carbon-accounting software is publicly available, given the complexity of carbon accounting and the nuances of disclosure requirements, working with a specialized team can help a contractor reduce the risk of errors or omissions that could impact the accuracy of a GHG disclosure, while also expediting the process of inventorying GHG emissions. Working with external sustainability experts can also transform the GHG inventory from a compliance exercise into a strategic tool for better business planning.

Additionally, as discussed above, contractors may be, or may become, subject to regulations or state laws that mandate disclosure of GHG emissions. Contractors should evaluate which reporting regimes they are subject to and seek to develop efficiencies where there is overlap between requirements.

In certain instances, contractors may have the option of relying on the disclosures or emission-reduction targets of a parent company. Those contractors should carefully consider whether to report at the entity level or the parent level, as there are advantages and disadvantages associated with both approaches.

For example, it may be administratively convenient to rely on the disclosure of a parent company, but a company with relatively low GHG emissions may benefit from reporting at the entity level rather than the parent level in the event that it wishes to use its low GHG emissions as a competitive discriminator. Thus, as companies begin, or continue to, disclose GHG emissions, they should evaluate their disclosures in the broader context of the evolving requirements regarding disclosure of GHG emissions, as well as in the context of how federal agencies are using emissions data. CM

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