Public Input Welcomed on Climate Change Disclosures

Questions for Consideration

June 11, 2021

Dear Commissioner Lee,

Please find below comments from the Competitive Enterprise Institute (CEI) in response to selected questions posted on the Securities and Exchange Commission's (SEC) website on March 15, 2021 under the heading "Public Input Welcomed on Climate Change Disclosures."

CEI has published research in support of free markets and limited government since 1984 and has long advocated policies that increase investor choice and reduce barriers to accessing capital. CEI policy experts have recently commented on regulatory proceedings regarding the use of derivatives by registered investment companies (SEC)[1], cryptocurrency wallets (FinCEN),[2] and board diversity (SEC/NASDAQ).[3] Regarding matters of environmental, social, and governance (ESG) investing theory, CEI experts have commented on recent rulemakings on the requirements of pension fiduciaries in selecting plan investments[4] and fiduciary duties regarding proxy voting[5] (Department of Labor), and on ESG theory in general in a recent in-depth study.[6]

In the current proceeding, CEI has submitted two comments: this document and a second authored by Senior Fellow Marlo Lewis, Jr. in response to an alternate set of questions from the March 15 "Public Input Welcome" solicitation. This comment is also co-signed by representatives of eight additional public policy and research organizations, listed below.

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[1] John Berlau and Ryan Radia, "Comment of the Competitive Enterprise Institute in the matter of 'Use of Derivatives by Registered Development Companies,' Release No. 34-87607," Competitive Enterprise Institute, April 30, 2020, https://www.sec.gov/comments/s7-24-15/s72415-7138143-216193.pdf.

[2] Ryan Nabil and John Berlau, "Comment of the Competitive Enterprise Institute in the matter of Financial Crimes Enforcement Network (FinCEN) Proposed Rulemaking 'Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets,' FinCEN-2020-0020," Competitive Enterprise Institute, March 29, 2021, https://cei.org/wp-content/uploads/2021/03/Comments-to-FinCEN-on-virtual-currency-transactions-3-29-21.pdf.

[3] Richard Morrison, "Comment of the Competitive Enterprise Institute in the matter of 'Proposed Rule Change to Adopt Listing Rules Related to Board Diversity,' Release No. 34-90574," Competitive Enterprise Institute, March 11, 2021, https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8486496-229961.pdf.

[4] Richard Morrison, "Comment on Employee Benefits Security Administration proposed rule 'Financial Factors in Selecting Plan Investments,' RIN 1210-AB95," Competitive Enterprise Institute, July 29, 2020, https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00489.pdf.

[5] Richard Morrison, "Comment on Employee Benefits Security Administration proposed rule 'Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,' RIN 1210–AB91," Competitive Enterprise Institute, September 30, 2020, https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00102.pdf.

[6] Richard Morrison, "Environmental, Social, and Governance Theory: Defusing a Major Threat to Shareholder Rights," *Profiles in Capitalism* No. 6, Competitive Enterprise Institute, May 2021, https://cei.org/wp-content/uploads/2021/05/Richard-Morrison-ESG-Theory.pdf.

The authors of both documents would like to thank CEI's Myron Ebell, Iain Murray, John Berlau, and Ryan Nabil for their contributions to research on financial regulation, climate change policy, and related topics.

Sincerely,

Richard Morrison
Research Fellow
Competitive Enterprise Institute
[redacted]

Saulius "Saul" Anuzis
President
60 Plus Association

David T. Stevenson
Director, Center for Energy and Environment
Caesar Rodney Institute

Craig Rucker
President
Committee For A Constructive Tomorrow (CFACT)

David Ridenour
President
National Center for Public Policy Research

Craig Richardson
President
Energy and Environment Legal Institute

James Taylor
President
Heartland Institute

Beverly McKittrick
Director, Regulatory Action Center
FreedomWorks

Jason Isaac
Director, Life:Powered
Texas Public Policy Foundation

1) **How can the Commission best regulate, monitor, review, and guide climate change disclosures in order to provide more consistent, comparable, and reliable information for investors while also providing greater clarity to registrants as to what is expected of them? Where and how should such disclosures be provided? Should any such disclosures be included in annual reports, other periodic filings, or otherwise be furnished?**

Jurisdiction and Appropriateness

Before answering those questions, we should ask whether such an effort is justified by statute and prudence, and whether other non-regulatory incentives or processes will satisfy the legitimate needs of relevant parties. The questions that are part of the March 15, 2021 "Public Input Welcomed on Climate Change Disclosures" [7] suggest a planned proceeding that would exceed the limits not only of the SEC's statutory jurisdiction but also the constitutionally limited powers of any government entity. The agency's mission must respond to changing market and finance industry conditions, but it cannot be infinitely elastic.

Advocates of expanded corporate disclosures and government enforcement of them frequently claim that there is already a "consensus" on the need and desire for such a policy. But if so much of corporate America and the finance industry is already in agreement on the subject, why is a mandate necessary?

Recent research by scholars at Boston and Harvard Universities finds that "environmental shareholder activism increases the voluntary disclosure of climate change risks" and that "companies that voluntarily disclose climate change risks following environmental shareholder activism achieve a higher valuation post disclosure."[8] This is evidence of mutually beneficial information exchange and a flourishing market for disclosure. The SEC should be very wary of disturbing the functioning and evolution of such a system.

Moreover, the scope of the current proceeding could become the first act of an ever-expanding drama of mission creep for the agency, as its final question suggests. Commissioner Lee's March 2021 speech at the Center for American Progress suggests that a wide array of matters, such as health care (in particular the COVID-19 pandemic) and civil rights (in particular protests relating to the murder of George Floyd), fall under the SEC's rulemaking authority because "the perceived barrier between social value and market value is breaking down."[9]

In light of this, the SEC's leadership should ask itself several questions. Are there any statutory or prudential guard rails that will limit further expansion of the agency's authority in the future? What about other federal agencies? Will the Commission object if, for example, the Department of Health and Human Services decides to regulate publicly traded pharmaceutical companies in a way that preempts

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[7] Allison Herren Lee, "Public Input Welcomed on Climate Change Disclosures," Securities and Exchange Commission, March 15, 2021, https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.
[8] Caroline Flammer, Michael W. Toffel, and Kala Viswanathan, "Shareholder Activism and Firms' Voluntary Disclosure of Climate Change Risks," *Harvard Business School Working Papers*, March 17, 2021, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3468896.
[9] Allison Herren Lee, "A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC," Securities and Exchange Commission, March 15, 2021, https://www.sec.gov/news/speech/lee-climate-change.

its own normal functions? If the SEC has decided to extend its reach to areas outside of investor protection and capital formation, what principled defense will it have against overreach by other agencies?

Economist John Cochrane, responding in recent congressional testimony to a similar call for increased financial scrutiny of climate change-related topics, made an important point.[10] The Central Banks and Supervisors Network for Greening the Financial System (NGFS), which the U.S. Federal Reserve recently joined, says that it plans to "mobilize mainstream finance to support the transition toward a sustainable economy."[11] The SEC now seems to have a similar goal. As Cochrane points out, however, "financial regulators are not allowed to 'mobilize' the financial system, to choose projects they like and de-fund those they disfavor."[12] Yet, the SEC appears poised to engage in just such an illegitimate economy-wide "mobilization," without any authorization from Congress.

Disclosure Mandates as Failed Climate Policy by Other Means

The past actions of Congress on this topic are key. The types of "progress" in climate policy that the SEC seeks to obtain by other methods have repeatedly been rejected legislatively. The U.S. Senate, for example, unanimously approved the Byrd-Hagel Resolution in 1997 by a vote of 95-0, calling for the rejection of the Kyoto Protocol, which President Clinton signed as part of the United Nations Framework Convention on Climate Change treaty process.[13] When Sens. John McCain (R-AZ) and Joe Lieberman (D-CT) introduced three successive "Climate Stewardship" Acts in 2003, 2005, and 2007, they all failed to garner the necessary support of their elected colleagues, despite extensive debate, news coverage, and lobbying.[14] A similar defeat greeted the Lieberman-Warner Climate Security Act in 2008.[15]

Later, under President Barack Obama, the Environmental Protection Agency (EPA) proposed an ambitious new program to regulate carbon emissions from the power sector, the Clean Power Plan (CPP). Based in part on President Obama's famed 2014 boast that he would pursue a program of unilateral executive policymaking via "pen and phone," the CPP essentially sidestepped Congress

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[10] "21st Century Economy: Protecting the Financial System from Risks Associated with Climate Change," United States Senate Committee on Banking, Housing, and Urban Affairs, March 18, 2021, https://www.banking.senate.gov/hearings/21st-century-economy-protecting-the-financial-system-from-risks-associated-with-climate-change.

[11] "Origins and Purpose," Central Banks and Supervisors Network for Greening the Financial System, accessed June 7, 2021, https://www.ngfs.net/en.

[12] John Cochrane, "Testimony on financial regulation and climate change," *The Grumpy Economist*, March 18, 2021, https://johnhcochrane.blogspot.com/2021/03/testimony-on-financial-regulation-and.html.

[13] S. Res. 98 – A resolution expressing the sense of the Senate regarding the conditions for the United States becoming a signatory to any international agreement on greenhouse gas emissions under the United Nations Framework Convention on Climate Change, 105th Congress, First Session, June 12, 1997, https://www.congress.gov/bill/105th-congress/senate-resolution/98.

[14] Marianne Lavelle, "John McCain's Climate Change Legacy," *Inside Climate News*, August 26, 2018, https://insideclimatenews.org/news/26082018/john-mccain-climate-change-leadership-senate-cap-trade-bipartisan-lieberman-republican-campaign/.

[15] Kate Sheppard, "Climate Security Act dies, failing to muster enough votes to move forward," *Grist*, June 6, 2008, https://grist.org/article/an-inhospitable-climate/.

entirely.[16] As the Competitive Enterprise Institute's William Yeatman wrote at the time, "If finalized, the rule would constitute an unprecedented usurpation of power by the EPA from the states and fundamentally overhaul the electric industry. In fact, Congress never approved such a gross expansion of the regulatory state."[17]

Eventually, after being subjected to numerous legal challenges (including a highly unusual stay issued by the U.S. Supreme Court),[18] the CPP was replaced when the EPA implemented the Affordable Clean Energy (ACE) rule in 2019, correcting much of the EPA's earlier overreach.[19] The ACE rule itself was vacated by the U.S. Court of Appeals for the D.C. Circuit in 2021.[20] Then EPA Administrator Michael S. Regan told members of the Senate Environment and Public Works Committee in February 2021 that the Biden administration would not attempt to reimplement the CPP.[21]

All of that history and conflict appears to have weighed heavily on the minds of climate change policy advocates and helped shape their strategies going forward. They are now pursuing the same policy goals that have been rejected by Congress and repealed and replaced by the EPA through other regulatory agencies—including the Securities and Exchange Commission, the Department of the Treasury, the Federal Reserve, and other finance-related entities.

The effort to target alleged climate risks in investing via SEC regulations bears an uncanny resemblance to the effort launched under the Obama administration to target "high-risk" customers in the banking industry. Operation Choke Point, as it was known, demonized legal businesses in politically disfavored industries, negatively affecting their ability to access financial services. This multi-agency effort by the Department of Justice, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation, among others, went after businesses, like firearms, against which activists and members of Congress had repeatedly tried, and failed, to target legislatively. As the Competitive Enterprise Institute's Iain Murray wrote in 2014, "Shifting the costs onto supervised bodies is not an acceptable

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[16] Juliet Eilperin, "Obama promises to use a 'pen and a phone' to push his agenda," *The Washington Post*, January 14, 2014, https://www.washingtonpost.com/news/post-politics/wp/2014/01/14/obama-promises-to-use-a-pen-and-a-phone-to-push-his-agenda/.
[17] William Yeatman, "EPA's Illegitimate Climate Rule: Hidden from Voters, Contrary to Congressional Intent, and Crafted by Special Interests," *OnPoint* No. 196, Competitive Enterprise Institute, July 28, 2014, http://cei.org/sites/default/files/Yeatman%20-%20EPAs%20Illegitimate%20Climate%20Rule_0.pdf.
[18] Jonathan H. Adler, "Opinion: Supreme Court puts the brakes on the EPA's Clean Power Plan," *The Washington Post*, February 9, 2016, https://www.washingtonpost.com/news/volokh-conspiracy/wp/2016/02/09/supreme-court-puts-the-brakes-on-the-epas-clean-power-plan/.
[19] Myron Ebell, "EPA Releases Final Rule to Replace 'Clean Power' Plan," *OpenMarket*, Competitive Enterprise Institute, June 24, 2019, https://cei.org/blog/epa-releases-final-rule-to-replace-clean-power-plan/.
[20] David Raphael, Cliff Rothenstein, and Sandra Safro, "D.C. Circuit Vacates Trump's ACE Rule and Deals Biden's EPA New Hand for Regulating Power Plant Greenhouse Gas Emissions," JD Supra, January 27, 2021, https://www.jdsupra.com/legalnews/d-c-circuit-vacates-trump-s-ace-rule-1939088/.
[21] Jean Chemnick, "Biden won't revive Obama's Clean Power Plan. So now what?," E&E News, February 9, 2021, https://www.eenews.net/stories/1063724547.

principle of governance. Businesses need to be allowed to make their own business decisions without the threat of being required by their regulators to do their job for them."[22]

This leaves a close observer with the impression that any proposed rulemaking arising out of the process proposed by the SEC will simply be more climate change activism in a finance regulation wrapper, rather than a serious effort to foster better price discovery or remedy any real damage to investors. To the extent that the SEC's current leadership is genuinely pursuing the latter, it should explicitly dedicate any resulting rules to maximizing market efficiency and risk-adjusted market returns to investors, not seek to minimize environmental metrics like greenhouse gas emissions. If this is really about financial risk, a future notice of proposed rulemaking should make that clear.

Long Term Uncertainty and Climate Science

Similarly, any effort to compel firms to disclose information about investment risks related to future anthropogenic climate change needs to be grounded in a well-established understanding of market dynamics and the business planning process, not vague predictions of extremely long-range possibilities. Most corporate financial planning exists on a time scale of only a few years into the future. Critics of the current regime frequently complain that this is the narrow-minded short-termism that they seek to remedy with additional climate disclosure requirements.

But the relatively short-term planning process for most business decisions is not due to managers and directors not caring about the future. It is due to the fact that, in a rapidly changing and competitive market, no one has enough information to plan intelligently much further ahead than five or perhaps ten years.

The time scale for assessing climate policy often encompasses decades or even a full century. In the current third decade of the 21st century, policy advocates and journalists often invoke the year 2100 as the year to which we should target our efforts.[23]

No corporate manager can make specific, intelligent plans over such a massive span of time. No company board meeting in 1942 could have predicted the future development and importance of the integrated circuit—much less the chip shortage currently impacting the auto, appliance, and aerospace sectors.[24] Even if the most sophisticated technology thinkers in the world *could* have predicted events in 2021, they would have been foolish to ignore then-current market conditions in order to position themselves for a future that was so distant.

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[22] Iain Murray, "Operation Choke Point: What It Is and Why It Matters," *Issue Analysis 2014* No. 1, Competitive Enterprise Institute, July 2014, http://cei.org/sites/default/files/Iain%20Murray%20-%20Operation%20Choke%20Point.pdf.

[23] Jeff Tollefson, "How hot will Earth get by 2100?" *Nature*, April 22, 2020, https://www.nature.com/articles/d41586-020-01125-x.

[24] Esther Shein, "The global chip shortage: What caused it, how long will it last?," *TechRepublic*, May 28, 2021, https://www.techrepublic.com/article/the-global-chip-shortage-what-caused-it-how-long-will-it-last/.

On a long enough timeline, all seemingly smart business decisions become falsified by unknowable variables. CDs replaced LPs for listening to music in the 1990s, but that does not mean that Columbia, RCA Victor, and Decca were wrong to make large capital investments in vinyl record manufacturing in the middle of the 20th century.[25] Changes in the global climate might make certain investments today less valuable in 2100 than they would otherwise have been, but that does not mean investors should immediately drop any firm in that category from their portfolios today.

Even more importantly, the ostensible risks generated by future climate change are themselves subject to a great deal of uncertainty. As American Enterprise Institute scholar Benjamin Zycher pointed out in March 2021 testimony before the Senate Banking Committee, finance regulators and corporate managers, without any of the necessary scientific expertise, will need to select the "correct" value from a range of possible values on multiple dimensions of climate science to generate any predictions of future risk that might need to be disclosed.[26]

Zycher argues that the range of alternative assumptions from which the relevant parties would be required to choose is "too great to yield clear implications" for anybody allocating financial capital with the goal of mitigating climate risks, much less decision makers who will need to balance future climate risk itself as one of several investment considerations.

For example, policymakers and disclosing entities would need to consider which of several climate models to use to guide their estimates, what level of climate sensitivity to increases in greenhouse gases concentrations they will assume, and the predicted future greenhouse gas increases over the next several decades. These are variables about which there is significant debate among professional physicists and climatologists. Asking accountants and compliance attorneys to guess which are the "correct" values might produce more content to disclose, but is unlikely to produce the "decision-relevant" data that is the goal of this proceeding.

Finance Industry Validation?

Advocates of greater regulation have suggested that the approval of prominent finance industry leaders validates the notion that mandatory disclosures would not be overly burdensome to registrant firms. Some market participants, however, have a direct financial interest in more bureaucracy and litigation, so they can be expected to approve of its expansion. Accounting companies, consultants, and law firms with compliance practices can be expected to welcome more disclosure requirements for self-interested professional reasons.[27] Their approval is merely evidence of rent-seeking positioning in the regulatory process, not proof of the wisdom of increased regulation itself.

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[25] "The History of Vinyl," American History Now, January 27, 2014, http://americanhistorynow.org/2014/01/27/the-history-of-vinyl/.

[26] Zycher refers to the Federal Reserve, but his analysis applies just as well to the SEC. Benjamin Zycher, "Testimony: Climate 'risk' and the distortion of U.S. financial markets," American Enterprise Institute, March 18, 2021, https://www.aei.org/research-products/testimony/testimony-climate-risk-and-the-distortion-of-u-s-financial-markets/.

[27] Richard Morrison, "Should the SEC Require More Climate Data from Public Companies?," *OpenMarket*, Competitive Enterprise Institute, May 28, 2021, https://cei.org/blog/should-the-sec-require-more-climate-data-from-public-companies/.

Moreover, the fact that *some* market participants might want access to additional information from public firms should not make them automatically entitled to receive it at those firms' expense. The SEC's job is not to shift costs away from ratings agencies and asset management analysts and onto individual firms just because the agencies and analysts in question would prefer such an outcome. The SEC always retains the authority to punish the production of demonstrably false climate risk information, of course, but its authority to compel production of new material should be applied with more restraint.

As with many of the proffered goals of ESG theory, additional climate disclosure is, at best, a conditional good that often gets treated as absolute. Some firms might seek additional disclosure on some topics. Some investors may accrue some benefit from that additional information. That does not mean that dramatically increasing disclosure burdens—and litigation and enforcement risks—across the board is universally desirable or beneficial.

In addition, advantages to market participants from access to this augmented universe of disclosed information will vary significantly—assuming it is specific and reliable enough to be useful. A firm's cost o generate disclosure on a hypothetical Topic A, about which there is a high degree of interest, may be the same as for Topic B, about which there is low interest. A priced market system for such disclosures would have a far better chance of creating efficient information exchange than rules based on *ex ante* predictions of what kinds of information will prove most valuable.

A proposal from law professors Kevin Haeberle of William and Mary and M. Todd Henderson of the University of Chicago offers an interesting alternative structure. In their 2016 paper "Making a Market for Corporate Disclosure," they suggest that allowing firms to sell tiered access to financial information currently covered by mandatory public disclosure would be "an innovative and far-reaching tool for use in [the] long struggle to get socially valuable information out beyond firms." By allowing early access to such information to become a product, and those demanding it to become customers, companies "would produce and share more information, in enhanced formats, more frequently."[28]

While the full implications of Haeberle and Henderson's proposal may be beyond the scope of the current proceeding, it raises some important points for the Commission to consider. First, markets are powerful tools for information discovery and exchange. Preparing data solely to avoid SEC enforcement action provides a different incentive than satisfying the needs of a paying customer. Firms could be expected to innovate on their own in expanding the scope and detail of disclosures beyond SEC requirements if they were allowed to sell tiered access. They would also have an additional incentive to make such disclosures as practical and useful as possible. That incentive would likely be more effective at producing useful data than any future climate or ESG disclosure framework enforced by a central authority.

Not All Information Is Data, and Not All Data Are Useful

A new regime of mandatory climate disclosures might well produce a new volume of paperwork, but there is reason to be skeptical about how useful most of it would be. The phrase "decision-useful," for

[28] Kevin S. Haeberle and M. Todd Henderson, "Making a Market for Corporate Disclosure," *University of Chicago Coase-Sandor Institute for Law & Economics Research Paper No. 769*, January 1, 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2814125.

example, has increasingly crept into discussions of ESG-themed disclosure goals.[29] Yet, previous generations of corporate sustainability officers have often been confronted with mountains of data that was not, in fact, useful.

In recent years, many corporate professionals have emerged as harsh critics of ESG and climate-themed disclosure as practiced to date. Some still hold out hope that more SEC control will solve the movement's more obvious problems – even as its clear conceptual limitations have been laid bare. Kenneth Pucker, former chief operating officer of footwear and apparel maker Timberland, wrote recently for *Harvard Business Review* (HBR) that "the impact of the measurement and reporting movement has been oversold," adding that "the focus on reporting may actually be an obstacle to progress."[30]

Pucker laments the absence of an agreed-upon standard for sustainability reporting in which compliance is ensured by a referee like the SEC. Yet his HBR essay contains several admissions that what is missing is not a lack of will or a standard framework but a fundamental problem with generating the kinds of information that a regulator would demand. Timberland, a company whose environmental bona fides and good intentions are strongly established, either declined to calculate, stopped calculating, or had serious reservations about publishing information about multiple dimensions of its operations because of "challenges in calculating them." The company decided that 95 percent of its carbon emissions fell into scope 3, but that its expanding global supply chain has "made traceability problematic."

Even if every public company were to report far more information, the kind of system that Timberland's Pucker and the SEC's Commissioner Lee seem to envision would still confront the problem that mass disclosure computation is necessarily formalistic and quantitative, while any attempt to understand what the data actually mean must include qualitative and contextual analysis. The SEC's Hester Peirce addressed this very problem, in a 2019 speech. She described analysts using simplistic box-checking to categorize a company's ESG-related operations as being in either one favored category or a disfavored one, without any need for understanding the firm's final output, much less the cost/benefit ratio of the resources consumed or waste produced.[31]

These problems cannot be solved by a new organization simply picking one computation method over another. In Timberland's case, even the most highly motivated and intimately knowledgeable company employees were unable to create meaningful quantitative measurements of certain phenomena because such measurements are so context-laden and subject to multiple assumptions (including regarding what constitutes an impact over which the firm has responsibility) that they cannot be said to constitute objective information at all. Pucker also notes: "The Coca-Cola Company's own estimates [for

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[29] Jay Clayton, "Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures," Securities and Exchange Commission, January 30, 2020, https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30. Janine Guillot, Letter to SEC Chairman Gary Gensler, Sustainability Accounting Standards Board, May 19, 2021, https://www.sasb.org/wp-content/uploads/2021/05/SASB_SEC_Climate_Letter_2021-05-19_FINAL.pdf.
[30] Kenneth P. Pucker, "Overselling Sustainability Reporting," *Harvard Business Review*, May-June 2021, https://hbr.org/2021/05/overselling-sustainability-reporting.
[31] Hester Peirce, "Scarlet Letters: Remarks before the American Enterprise Institute," Securities and Exchange Commission, June 18, 2019, https://www.sec.gov/news/speech/speech-peirce-061819

the amount of water necessary to make a one-liter bottle] have varied from less than two liters of water to 70 liters, depending on the methodology used."

An increased emphasis on metrics and comparability will not lead to improved outcomes if the reality they are presuming to measure does not, of itself, consist of comparable scenarios. As SEC Commissioner Elad Roisman told attendees of a recent ESG-themed public event, "some of the data that has been requested is inherently imprecise, relies on underlying assumptions that continually evolve, and can be reasonably calculated in different ways. And ultimately, unless this information can meaningfully inform an investment decision, it is at best not useful and at worst misleading."[32]

A spreadsheet with dozens of rows of figures will no doubt look impressively specific and precise, but that apparent precision will not mean anything if the parties sharing it do not agree on the meaning of what it is measuring. Competitive Enterprise Institute founder Fred Smith referred to this elevation of numbers above context and conflicting values as "SONKing"—the Scientification of Non-Knowledge.[33] This illusory precision can help create a consistent data set, but will only distort decision-making and lead investors astray if it is accepted as the truth simply because of its apparent uniformity.

The essential problem with many measurements of climate impact and other ESG topics is an unavoidable disagreement among market participants about what is valuable, worthwhile, reasonable, and just, what is the right amount of information, which information is overly intensive, and so on. Those disagreements are layered on top of the technical problems of how to measure and quantify certain phenomena. Those value judgments cover areas about which reasonable, intelligent, and law-abiding people can differ. An expanded SEC disclosure framework that attempts to "solve" these problems by simply overriding the judgement of managers and directors at thousands of firms in dozens of industries of widely varying size will not be smart or reasonable.

What the Commission is contemplating is less an exercise in fixing inconsistent "apples to oranges" comparisons than it is redefining all fruits, for regulatory purposes, to be pears. This problem is dramatically expanded when it comes to other ESG concerns that are even less amendable to standardized quantitative measurement than something like greenhouse gas emissions. There is no more a single correct way to assess climate impacts than there is a correct religion or best work of art.

First Amendment Concerns

In addition to jurisdictional and conceptual concerns, some climate and ESG-themed disclosure mandates could become compelled speech that conflicts with First Amendment protections. For example, West Virginia Attorney General Patrick Morrisey's letter of March 25, 2021 to then-Acting

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[32] Elad Roisman, "Putting the Electric Cart before the Horse: Addressing Inevitable Costs of a New ESG Disclosure Regime," Securities and Exchange Commission, June 3, 2021, https://www.sec.gov/news/speech/roisman-esg-2021-06-03.

[33] Fred L. Smith, Jr., "Competitive Enterprise Institute Comments: OMB Draft Report to Congress on the Costs and Benefits of Federal Regulation," Competitive Enterprise Institute, May 5, 2003, http://cei.org/sites/default/files/Angela%20Logomasini%20-%20CEI%20Comments%20on%20OMB's%20Draft%20Report%20to%20Congress%20on%20the%20Costs%20and%20Benefits%20of%20Federal%20Regulations.pdf.

Chair Lee outlines some of these concerns in detail, citing precedent from the U.S. Supreme Court and other federal courts in compelled speech cases.[34]

This concern is vital to address if future regulations were to require a firm to make a statement about itself that is subjective and disparaging. In *National Association of Manufacturers v. SEC*, a federal appeals court partially invalidated the Dodd-Frank conflict minerals disclosure requirement based on compelled speech grounds.[35] As Judge A. Raymond Randolph wrote in the majority opinion, this compelled speech is not even "reasonably related" to the SEC's mission of "preventing consumer deception." The opinion concludes, "By compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment." At least some proposed climate disclosure provisions, by which companies must confess to having metaphorical blood on their hands with regard to future catastrophic effects of climate change, would face similar First Amendment concerns.

6) How should any disclosure requirements be updated, improved, augmented, or otherwise changed over time? Should the Commission itself carry out these tasks, or should it adopt or identify criteria for identifying other organization(s) to do so? If the latter, what organization(s) should be responsible for doing so, and what role should the Commission play in governance or funding? Should the Commission designate a climate or ESG disclosure standard setter? If so, what should the characteristics of such a standard setter be? Is there an existing climate disclosure standard setter that the Commission should consider?

Any agency guidance, much less formal regulation, in such a rapidly evolving field should prioritize flexibility and responsiveness. While the agency's request for public input mentions the possibility of "a broader ESG disclosure framework," even climate-specific policies need to be crafted in such a way as to avoid regulatory sclerosis that has hobbled many other industries in the past.

The question of whether an outside organization should be charged with administering or updating any disclosure framework should be guided by a balance between authority and accountability. The greater potential peril that regulated entities are exposed to, the more important democratic accountability and due process needs to be. For example, in 2018 the U.S. Supreme Court, in its decision in *Lucia v. SEC*, found that the appointment of the agency's administrative law judges needed to be consistent with the higher standard of the Constitution's Appointments Clause, in part because of the degree of their discretion and the gravity of the cases over which they preside.[36]

In this case the SEC, in its role as creator of any new framework, faces a unique challenge. It should allow for maximum flexibility and stakeholder buy-in to any future system, yet also guarantee regulated

[34] Patrick Morrissey, Letter to Allison Herren Lee, Office of the Attorney General of the State of Vest Virginia, March 25, 2021, https://www.sec.gov/comments/climate-disclosure/cll12-8563794-230748.pdf.
[35] *National Association of Manufacturers, et al., v. Securities and Exchange Commission, et al.* (2014), https://www.sec.gov/rules/final/2014/34-67716-decision.pdf.
[36] *Lucia et al., v. Securities and Exchange Commission* (2018), https://www.supremecourt.gov/opinions/17pdf/17-130_4f14.pdf.

entities due process administered by democratically accountable officers. This suggests that the best system will be one that is advisory rather than mandatory and one in which transparency is itself considered a *de facto* enforcement mechanism. The market preference among many investors will be a powerful incentive to motivate firms to increase climate and ESG-related disclosures under an expanded advisory framework (See also related response to question 12).

In the longer term, the Commission should keep in mind research that has found that any governmental regulatory framework will create significant costs, burdens, and market frictions, often in excess of that acknowledged by policy makers. Many of the ostensible advantages of such a system, either for firms or for society in general, are eroded by having and enforcing a mandatory framework at all. The Competitive Enterprise Institute's Wayne Crews lays out a range of such costs in "A Brief Outline of Undisclosed Costs of Regulation"[37] and in more detail in his annual regulatory study *Ten Thousand Commandments*.[38]

Increasing the reporting burden for firms on the issue of climate change cannot be assessed in a vacuum. Public companies already operate under a significant burden of existing international, federal, state, and local regulation. That combined vertical weight needs to be acknowledged and understood. Greater regulatory burdens are generally associated with slower economic and job growth and less innovation.[39]

9) **What are the advantages and disadvantages of developing a single set of global standards applicable to companies around the world, including registrants under the Commission's rules, versus multiple standard setters and standards? If there were to be a single standard setter and set of standards, which one should it be? What are the advantages and disadvantages of establishing a minimum global set of standards as a baseline that individual jurisdictions could build on versus a comprehensive set of standards? If there are multiple standard setters, how can standards be aligned to enhance comparability and reliability? What should be the interaction between any global standard and Commission requirements? If the Commission were to endorse or incorporate a global standard, what are the advantages and disadvantages of having mandatory compliance?**

Contrary to the repeated insistence of many regulation advocates, neither the U.S. nor the global community need rely on one single framework for climate and ESG-themed disclosures. Multiple competing and evolving systems can function as a much better discovery mechanism than a single mandated one. That continual refinement of competing systems provides value to participants. If it turns out that one system really *is* clearly superior to the others, it will come to dominate through market evolution, not state force.

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[37] Clyde Wayne Crews, Jr., "A Brief Outline of Undisclosed Costs of Regulation," *OpenMarket*, Competitive Enterprise Institute, January 30, 2019, https://cei.org/blog/a-brief-outline-of-undisclosed-costs-of-regulation/.

[38] Clyde Wayne Crews, Jr., *Ten Thousand Commandments 2020: An Annual Snapshot of the Federal Regulatory State*, Competitive Enterprise Institute, May 26, 2020, https://cei.org/studies/ten-thousand-commandments-2020/.

[39] Patrick A. McLaughlin, Nita Ghei, and Michael Wilt, "Regulatory Accumulation and Its Costs: An Overview," *Mercatus Center Policy Brief*, Mercatus Center at George Mason University, November 2018, https://www.mercatus.org/system/files/mclaughlin2c_ghei2c_and_wilt_-_policy_brief_-_regulatory_accumulation_ep_update_-_v1_1.pdf.

As mentioned in the response to Question 1, no single system will be able to encompass the "correct" values for every possible category of disclosure. Different groups of managers and investors will have different ideas about how to measure the most important variables involved, and will have different value hierarchies about which aspects of climate and ESG theory should be prioritized.

Encouraging multiple competing frameworks will obviously limit the ability of analysts to assemble a single universal data set of metrics for every public company. But the knowledge generated and exchanged by a competitive evolving system will vastly outweigh that deficiency, especially since the market actors who will be using the resulting data to make investment decisions will have diverse goals and strategies that cannot possible be mutually satisfied by a single system, so matter how carefully planned.

Multiple industries and groups of consumers are already operating successfully, under competing voluntary frameworks. There are voluntary certifications and guidelines for fair trade and non-GMO agricultural products, sustainable seafood, and kosher food products. Contrary to experts who insist that a single, government-enforced framework is necessary, kosher food certification globally is overseen by hundreds of different bodies, each with its own requirements and guidelines.[40] The decisions as to what should qualify as allowable in such an area are value-laden and personal. No technocratic experts committee can be expected to adequately represent the values and interests of all relevant sub-groups.

12) **What are the advantages and disadvantages of a "comply or explain" framework for climate change that would permit registrants to either comply with, or if they do not comply, explain why they have not complied with the disclosure rules? How should this work? Should "comply or explain" apply to all climate change disclosures or just select ones, and why?**

Yes, the SEC should build in maximum flexibility for any eventual rules, including provisions for a "comply or explain" framework. Comply or explain will be especially important given the misapplication of the didactic "good vs. bad" framework for many climate and ESG topics. Many of the problems resulting from such a framework can be at least partially address by allowing narrative submissions that describe why a firm has chosen to prioritize some climate and ESG-related priorities over others. (See also the related response to Question 6.)

15) **In addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental, social, and governance, or ESG, matters. Should climate-related requirements be one component of a broader ESG disclosure framework? How should the Commission craft climate-related disclosure requirements that would complement a broader ESG disclosure standard? How do climate-related disclosure issues relate to the broader spectrum of ESG disclosure issues?**

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[40] "Directory of Kosher Certifying Agencies," Chicago Rabbinical Council, accessed June 7, 2021, https://www.crcweb.org/agency_list.php.

As addressed in the response to Question 1, significantly extending the agency's climate-specific framework for disclosure is an example of mission creep, but erecting a "comprehensive ESG disclosure framework," as Commissioner Lee has announced, would be an even more dramatic step into unilaterally redefining the SEC's mission.

As with some aspects of climate-specific disclosure, the problems and conflicts about which market participants currently complain cannot be solved by more rules, because even reasonable, well-informed individuals have fundamental disagreements about which behaviors are "good," which are "bad," and which can be either good *or* bad, depending on specific and contextual circumstances.

That application of a Manichean dichotomy is the most significant conceptual flaw of most current thinking on climate and ESG-themed disclosure. Certain metrics, policies, and behaviors are assigned the status of being either categorically good or categorically bad and therefore to be universally minimized or maximized. Volume of greenhouse gases emitted should always be minimized, median wages should always be higher, and tonnage of raw materials consumed by production should always be lower, and so on, with little consideration of the tradeoffs involved.

That simplistic view does not account for a cost/benefit analysis when assessing any of these topics, much less individual management decisions, and can even impair the ability of firms to maximize other ESG-affiliated goals. Building new natural gas-powered electrical capacity might be the best way to raise living standards, and the social status of women and girls, in a developing country, but the imperative to always shrink an institution's carbon footprint would block such a development. Should a U.S. firm end a contract with a textile factory in Bangladesh over the average age of its workers or will that simply cause those teenage employees and their families to fall even further into poverty when their factory closes? Isn't poverty alleviation itself a major ESG goal?