Carbon Emission Reporting Requirements by the SEC do not Pass a Cost-Benefit Test

The SEC's Notice of Proposed Rulemaking for requiring publicly-traded firms to report their Scope I, II, and III carbon emissions is problematic on several levels, and its implementation will increase the cost of doing business without providing a tangible benefit for investors. Several of my current and former colleagues have submitted comments to the SEC and my purpose here is to provide a summary of those comments and put forth a narrative that provides a comprehensive perspective on the proposed rule.

For starters, I believe that the SEC's estimated compliance costs are below the true compliance costs. Research done by Matthew Winden of the University of Wisconsin Whitewater looks at the impact of the proposed rule on the broader economy that goes beyond merely aggregating the cumulative compliance costs of public corporations, which is the SEC’s approach. Winden's economic modeling looks at the indirect and induced costs on the broader economy that this law would have by requiring firms to divert resources away from productive activities and into regulatory compliance.

What's more, the compliance cost estimates that the SEC and other public agencies generally provide often underestimate the true costs incurred by firms to meet the new rule. For instance, Michael Chow, former chief economist for the National Venture Capital Association, reviews analysis by the SEC for Dodd Frank and Sarbanes Oxley and finds that the estimated compliance cost for any number of rules emanating from these pieces of legislation proved to be below the *ex-post* calculations of the true costs. The SEC is not alone in underestimating compliance costs--Chow finds that the EPA also underestimated the compliance cost for several of its major regulations when he reviewed the relevant research as well.
The fact that the estimated compliance costs for this proposed rule are significant across all industries is important, but it will doubtless be more complicated--politically and practically--for companies that are involved in fossil fuels in some way. After all, the intent of the rule is to advance President Biden's agenda of reducing carbon emissions and slowing global warming. Given that Congress has made it impossible to advance major legislation to do so, the Administration has relied on the various agencies to pursue such changes.

The economist Bill Peacock observes that the rule's impact on the oil industry will go beyond the mere costs of reporting their carbon emissions, especially considering the fact that most publicly-traded energy concerns are already doing so. The Biden Administration has already taken other steps to reduce domestic oil and gas production in the last 18 months--stopping or scaling back lease auctions, slowing the approval of terminals for Very Large Crude Carriers, and delaying the approval of pipelines as well as giving the states greater power to stop their future construction, to name a few. In an economy that may be approaching a recession and that has record-high oil prices, creating a regime that will likely facilitate lawsuits against oil and gas companies regarding the accuracy of their Scope I, II, and III emission reporting as well as their impact on the environment is problematic.

Finally, James Allen, formerly a senior official at the CFA, notes that requiring the reporting of emissions would be somewhat superfluous given the fact that the Securities Exchange Act already requires companies to report anything that materially affects their bottom line. What’s more, EU law already requires companies with major European operations to report their emissions, so it is worth asking why the SEC felt compelled to force them to do this. While their answer is that investors asked them to do so, the reality is that it was a few (albeit large) investors who expressed an interest in having emissions reporting requirements standardized, but this was mainly for political and not fiduciary reasons, Allen submits.
The prioritization of policy agendas over what's best for the retirement funds of the millions of middle class investors with 401ks parked in index funds is a frustrating phenomenon that's easy to overlook in a Bear Market, but these days investors are less forgiving of a slight reduction in their portfolio value for such a dubious exercise.

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