Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

via SEC internet submission form

Re: **[Release No. 33-11042; File No. S7-10-22]; Comments on Proposed Rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors**

Dear Ms. Countryman,

I am an Associate Professor of Law at the Antonin Scalia Law School, George Mason University, where I teach accounting, securities, and corporate law, and spent two years as Chief Economist and Senior Counsel for the U.S. House Committee on Financial Services.

Until early this year I was a member of the Security and Exchange's ("SEC" or "Commission") Investor Advisory Committee ("IAC"), where I served on the executive committee and as Chairman of the IAC's subcommittee on market structure. I am a Certified Public Accountant, a Certified Fraud Examiner, certified in Financial Valuation, and am a member of the Financial Accounting Standards Board's ("FASB") Advisory Council. I do not speak on behalf of any other institution or of any group of which I am a member.

This is my second comment letter on this matter, please review my prior comment letter on this matter.

The SEC has proposed a massive shift in securities regulation with its climate change disclosure rule. This rule is expected to face a legal challenge. The SEC's reliance on carbon emissions measurement consulting firms, like South Pole and Persefoni, may feature as key elements of that challenge, as both firms have seen their methodologies called into question.

Just as a house built on a weak foundation will eventually crumble, financial regulation built on flawed evidence or methodology will not endure. Subsequent shifts in agency leadership or judicial challenge will eventually erode a rule built on such a weak foundation. This describes the SEC's climate disclosure rule, which rests on the work of a couple of climate measurement firms that have come under scrutiny.

Investigative journalists at Follow the Money published an expose about the climate consulting firm "South Pole" and used employee leaks of internal models to throw doubt into the emissions calculations generated by that firm's climate model. That report gained momentum as additional reporting, including by Bloomberg, raised questions about the propriety of their model and its continued use in carbon emission credit markets.

The SEC's climate change disclosure rule relied on limited econometric evidence to support the rule's mandate to disclose more emissions information, including forward looking emissions projections, and to disclose highly speculative guesses about the impact of carbon on reporting companies.

Only a handful of the 1,000 plus footnotes cited economic evidence in support. (The rule proposal instead relied more heavily on citations to international climate accords, which might win SEC officials a friendly fist bump at Davos but has no relevance for the regulatory cost-benefit mandate as explained in *Business Roundtable v. SEC*.)

Among the rare footnotes citing economic evidence, four were citations to South Pole's work. The SEC met privately with South Pole representatives in designing their rule. Now that the SEC has tied the fate of its climate rule so closely to the reliability of South Pole's climate impact estimation methodology, the South Pole expose spells trouble for the climate rule given the likely court challenge.

Unconsidered conflicts of interest were at the heart of the SEC's defeat in Business Roundtable v. SEC, a case which brought renewed force to the SEC's statutory mandate to conduct vigorous cost-benefit analysis when it adapts rules. In that case, the SEC's failure to consider conflicts of interest at pension fund leadership (some of which are quite politically active) when the SEC adopted a rule that would empower pension funds to appoint nominees to corporate boards ultimately brought down the SEC's rule in court.

In the same way, the SEC's failure to consider conflicts of interest at carbon emissions consulting firms to misreport the cost of carbon to inflate the value of their services, and conflicts with their work in facilitating emissions credit trading, could similarly spell doom for the pending climate rule.

The SEC has effectively encouraged firms to rely on work by South Pole and itself relied on South Pole's work in its rule. By analogy, what if the SEC had in the early 2000s encouraged companies to use special purpose vehicles and cited Enron's valuation of SPV projects, and by doing so encouraged other firms to similarly rely on Enron? The subsequent scandal of Enron's SPV valuations frauds in 2002 would certainly bring judicial scrutiny of such a rule. The SEC's over-reliance on South Pole in its rule proposal has put the SEC in that difficult position.

Indeed the reports by South Pole insiders lead to questions of whether carbon offset measurements can ever be congruent with financial reporting. Financial reporting and auditing of financial information requires that information be measurable, objective and falsifiable. If a carbon impact measurement relies on a promise that benefits from a carbon credit were dependent on that credit, you set up an incentive to lie.

Imagine tree growers working with South Pole in South America are asked whether they would have grown new trees without an associated credit, or whether they'd like a credit payment if they are willing to claim that credit is essential to their project. They would be fools not to get the joke and respond that, why yes, this payment is essential to the reforestation project! This is part of the issue with some of South Pole's multi-billion dollar carbon projects, and it calls into question the entire field of carbon emissions estimation methods themselves.

The SEC's relationship with Persefoni, a firm that has openly described how the new climate disclosure rule will create artificial demand for their "climate accounting" practice, will also likely take center stage in any litigation challenging the SEC's rule. In much the same way that the Sarbanes-Oxley Act gifted the accounting industry with what is now effectively two audits instead of one, firms like this one hope for the same windfall from the SEC's new rule.

The ongoing revolving door between SEC staff who worked on the climate rule and this firm, and the SEC's apparent reliance on this firm for its compliance costs estimates, may help Persefoni share the stage with South Pole during the expected litigation over the climate rule.

The friendly alliance between this consulting firm branding itself as an accounting firm, and the SEC climate rule's subjective estimation methods it expects firms to employ, risks together distorting the objective and independent character of financial accounting that forms the bedrock of the financial reporting system.

The SEC's proposal is biased toward negative impacts from carbon, rather than remaining neutral to the impact of carbon on any particular company. Biasing estimation methods to socially engineer outcomes is antithetical to the ethos of financial accounting, which is neutral and objective. Financial accounting is a system built to measure outcomes, not encourage preferred outcomes.

The SEC's proposal also seeks to encourage future estimates, up to fifty years into the future, and then translate those macro level estimates into micro level impacts on individual firms. The level of outright guesses in such an exercise are unlike anything that exists in financial accounting.

In other areas in which financial accounting methods require estimates of contingent liability, the rule of conservatism applies. Forward looking discounted cash flow models rarely look more than ten years into the future in valuation models employed by financial accountants.

To brand such an exercise "accounting" is fundamentally misleading and risks undermining the objectivity of financial accounting itself. Perhaps most dangerously the SEC flexes its muscles in Footnote 316 of the rule to directly threaten the independence of the Financial Accounting Standards Board.

The climate rule is built on an eroding foundation of conflicts of interest and subjective estimation methods posing as objective accounting metrics. If it is allowed to go into effect, it may further erode the foundation of the objective financial reporting system itself. This disaster can be averted if the SEC withdraws the rule or if, as is likely, courts take notice of these cracks in the rule's foundation through legal challenge grounded in administrative law and in the SEC's economic cost-benefit analysis mandate.

Sincerely,

J.W. Verret

Associate Professor, George Mason University Antonin Scalia Law School
& former member, SEC Investor Advisory Committee