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.

I welcome the opportunity to comment on the Commission's climate change disclosure rule and joined a recent dissent from the IAC's recommendation on climate change disclosures filed by my colleague Stephen Holmes.[1]

There are seven principal reasons why this proposed climate change disclosure rule is a serious threat to the independent and objective corporate reporting system and why this rule is unlikely to survive legal challenge. Here is a topline list of the issues that I will proceed to examine in depth throughout the proposal.

1) This proposal demonstrates a meager benefit despite significant added reporting costs. The proposal is therefore arbitrary and capricious and does not satisfy the strict economic analysis requirements articulated in *Business Roundtable v. SEC*.[2]

2) This proposal cites the support of union and state pension funds as evidence of investor interest in carbon disclosure, yet fails to account for these funds' conflicts of interest.

[1] Statement of Dissent by Stephen Holmes to the Investment Advisory Committee Approval of the ESG Disclosure Recommendation (May 21, 2020) (available at: https://www.sec.gov/spotlight/investor-advisory-committee-2012/dissent-by-stephen-holmes-to-the-investment-advisory-committee-approval-of-the-esg-disclosure-recommendation.pdf).
[2] 647 F.3d 1144 (D.C. Cir. 2011).

The proposal is therefore arbitrary and capricious and does not satisfy the strict economic analysis requirements contained in *Business Roundtable*.

3) This proposal mandates disclosures that would not qualify as material under federal securities laws. The proposal therefore does not satisfy the strict economic analysis requirements contained in *Business Roundtable*.

4) This proposal mandates reporting of estimates that are too speculative and subjective to comport with fundamental principles of accounting and finance. These fundamental principles underly the existing federal securities laws and financial reporting structure; the proposal is therefore arbitrary and capricious.

5) This proposal is an effort to regulate corporate behavior to reduce carbon emissions, not a sincere effort to provide material financial information to investors. The proposal therefore exceeds the statutory authority granted to the Commission and is both arbitrary and capricious, and not authorized by law.

6) This proposal compels corporate speech regarding the nature of climate change and its impact on company value and is therefore unconstitutional.

7) The Commission's economic analysis of the rule contains irrelevant information and cherry-picks the literature on stock price impacts of carbon emissions, and thus fails to meet the rigorous scrutiny of economic analysis required by *Business Roundtable*.

When analyzing an SEC rule, the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") distinguishes between its arbitrary and capricious review and its review of an agency's economic analysis. This comment letter will therefore consider them separately, though many of the arguments made in each line of analysis apply to the other.

The Commission describes the information provided in this proposal as consistent, comparable, and reliable.[3] The reality is that the disclosures contemplated by the proposal violate all three of those principles. When the Commission is acting in the public interest, as it is doing in this rulemaking, the Commission is required to consider the impact of its rules on efficiency, competition, capital formation, and investor protection.[4] These four objectives have together effectively mandated the Commission to engage in economic analysis, also described as benefit-cost analysis, when developing a rule.[5]

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[3] Securities and Exchange Commission, Proposed Rule for The Enhancement and Standardization of Climate-Related Disclosures for Investors 3 (April 11, 2022), https://www.sec.gov/rules/proposed/2022/33-11042.pdf [hereinafter Proposed Rule].

[4] 15 U.S.C. § 78c(f).

[5] *See* James D. Cox & Benjamin J.C. Baucom, *Reshaping Capital Markets & Institutions: Twenty Years On: The Emperor has no Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 Tex. L. Rev. 1811, 1813 (noting that the D.C. Circuit considers the Commission's statutory mandate to consider a rule's impact

For mandatory disclosure rules to satisfy a benefit-cost analysis, the Commission must show that such mandatory disclosures are material, as defined by an extensive set of doctrines under the federal securities laws.[6] The Commission could not otherwise satisfy a benefit-cost analysis.

In other words, what is the benefit of mandating disclosures that are immaterial? Clearly nothing.

In order to frame the discussion I will begin with these two paragraphs from *Business Roundtable* that sum up the agency's obligations well:

> Under the [Administrative Procedure Act], we will set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). We must assure ourselves the agency has "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choices made." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, 103 S.Ct. 2856, 77 L.Ed.2d 443 (1983) (internal quotation marks omitted). The Commission also has a "statutory obligation to determine as best it can the economic implications of the rule." *Chamber of Commerce v. SEC,* 412 F.3d 133, 143 (D.C. Cir.2005).
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> Indeed, the Commission has a unique obligation to consider the effect of a new rule upon "efficiency, competition, and capital formation," 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a–2(c), and its failure to "apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation" makes promulgation of the rule arbitrary and capricious and not in accordance with law. *Chamber of Commerce,* 412 F.3d at 144; *Pub. Citizen v. Fed. Motor Carrier Safety Admin.,* 374 F.3d 1209, 1216 (D.C. Cir.2004) (rule was arbitrary and capricious because agency failed to consider a factor required by statute).[7]

I. This proposal provides meager demonstrated benefit despite significant added reporting costs.

On pages 21 and 22 of the proposal, the Commission justifies its decision to mandate that climate related disclosures take place in form 10-K and/or a registration statement on the basis

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on efficiency, competition, and capital formation as a requirement that "SEC rulemaking must attempt, if not complete, an accurate cost-benefit determination.").

[6] *The Materiality Standard for Public Company Disclosure*, Business Roundtable 1 (2015), https://s3.amazonaws.com/brt.org/archive/reports/BRT.The%20Materiality%20Standard%20for%20Public%20Company%20Disclosure.2015.10.29.pdf ("A foundational principle of the U.S. securities laws is that public companies have an obligation to publicly disclose to prospective investors and shareholders information that is significant – or material – to making informed investment and proxy voting decisions.").

[7] Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011)

that because having all disclosures in one place will make it easier for investors to find.[8] This explanation is illogical.

In today's information age, few investors read form 10-K as a narrative. Investors instead overwhelmingly obtain information through synthesized information from market intermediaries,[9] or by considering information contained in a stock's price through active trading.

At page 28, the proposal references IAC deliberations regarding climate change disclosures in 2020. The proposal then notes that an IAC recommendation from these deliberations supports the Commission's rulemaking.[10] I served as a member of the IAC during that time.

The proposal fails to mention how that particular IAC proposal was adopted during an unusually contentious discussion by the IAC, in which members were fractured into disparate camps by this unusual and politically charged proposal. The Commission's proposal fails to mention that several IAC members vigorously dissented against the IAC's recommendation.[11]

On page 29, the Commission argues that under the current voluntary disclosure framework companies "may provide partial disclosures or they may choose not to participate every year."[12] To the Commission, this is a problem that can be remedied by mandatory disclosure requirements.[13] But the decision whether to disclose or not can offer a signaling function to users of the information, *i.e.*, the choice to disclose or not is already valuable information for investors to digest.

At pages 30 through 32, the Commission openly admits that the primary goal of this rule is to promote the goal of international climate change accords.[14] Yet this is not a valid purpose for securities regulations, and it's certainly not contemplated under the operative statutes that give the SEC its power. As the Commission's *own* former general counsel—Mr. Andrew N. Vollmer—has recently written, "[c]limate-change information is *outside the scope* of the subjects Congress has allowed the [Commission] to cover in disclosure rules, and imposing a set

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[8] Proposed Rule, at 21–22 ("The inclusion of climate-related disclosures in SEC filings should increase, the consistency, comparability, and reliability of climate-related information for investors.").
[9] *See* Jinkook Lee & Jinsook Cho, *Consumers' Use of Information Intermediaries and the Impact on Their Information Search Behavior in the Financial Market*, 39 J. Consumer Affs. 95, 95–96 (2006) (describing the "important role information intermediaries play[] in the current information-drenched decision environment. . . .").
[10] Proposed Rule, at 28 ("The IAC recommended that the Commission take action to ensure investors have the material, comparable, consistent information about climate and other [environmental, social and governance ("ESG")] matters that they need to make investment and voting decisions.").
[11] *Supra* note 1.
[12] Proposed Rule, at 29.
[13] *See id*.
[14] *Id*. at 30–32 (describing international developments regarding climate-related disclosures as showing "an increasing *global* recognition of the need to improve companies' climate-related disclosures, *which the proposed rules would help address*. . . .") (emphasis added).

of disclosure obligations . . . would have a subject and objective *different* from the disclosure provisions in the federal securities laws."[15]

One of the primary benefits espoused by the proposal is that the rule will standardize information related to climate change. In support, the Commission relies on developments including the Task Force on Climate-Related Financial Disclosures ("TCFD") and the Greenhouse Gas Protocol ("GHG Protocol").[16] The proposal also uses language that seems to compare these climate reporting frameworks with financial accounting methodologies.[17] But this comparison is less like apples and oranges, and more like apples and quantum computers.

Accounting methodologies have evolved over a long period of time. Modern financial accounting may be considered to have evolved over the past 100 years. But it is substantially grounded in the evolution of the double entry bookkeeping system—stretching back to the medieval era.[18]

Climate reporting by contrast is a very young phenomenon. For example, the Intergovernmental Panel on Climate Change—which has delivered "*the most comprehensive* scientific reports about climate change produced worldwide"—was only established in 1988.[19] Thus, climate reporting could benefit from continued evolution and competition between various organically developed methodologies utilized in the existing voluntary reporting dynamic. Prematurely imposing artificial standardization before climate change disclosure ultimately damages efforts to provide climate information to the investing public.

Financial accounting did not evolve through some top-down edict requiring immediate standardization but instead evolved through feedback from technical practitioners over hundreds of years.

Unfortunately the Commission's proposal goes beyond an inept analogy between climate and financial accounting. The proposal, particularly with respect to footnote issues, future estimates and Scope 3 emissions, does violence to core principles of independence and objectivity in generally accepted accounting principles ("GAAP").

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[15] Andrew N. Vollmer, *Does the SEC Have Legal Authority to Adopt Climate-Change Disclosure Rules?*, Mercatus Center 18 (2021), https://www.mercatus.org/system/files/vollmer_-_policy_brief_-_does_the_sec_have_legal_authority_to_adopt_corporate_disclosure_rules_on_climate_change_-_v1.pdf.
[16] Proposed Rule, at 34.
[17] *See id*. (describing the GHG Protocol as "a leading accounting and reporting standard for greenhouse gas emissions.").
[18] *See* Matthew J. Barrett, *The SEC at 70: The SEC and Accounting, In Part Through the Eyes of Pacioli*, 80 Notre Dame L. Rev. 837, 838 (2005) (noting that accounting historians trace the "first systematic written study of accounting" back to 1494).
[19] *History of the IPCC*, Intergovernmental Panel on Climate Change (2022), ipcc.ch/about/history/ (emphasis added).

On page 34, when describing the TCFD, the proposal is clear that its objective is to comply with international climate accords.[20] This means that the proposal is not focused on financial disclosures within the Commission's authority granted by the Securities Act of 1933 and the Securities Exchange Act of 1934 (the "33 and 34 Acts"). For the Commission to serve such a role as environmental regulator and international climate policy implementer, Congress would certainly need to first amend the Commission's empowering statutes.[21]

On page 167, the Commission presumes that in some environmentalist's nirvana future, legislation will pass to abolish carbon energy and massively reshape the economy.[22] On the basis of that assumption—about a remote possibility in the future—the proposal proceeds to construct a disclosure regime. Rulemaking premised on a hoped-for future law, rather than on previously adopted law, is the very definition of arbitrary and capricious rulemaking.[23]

Consider that speculative-future-law approach in the context of benefit-cost or economic analysis requirements that constrain the SEC's discretion. If a carbon tax or ban has a 5% or 10% chance of being passed in the future, then the benefits contemplated by the proposal must be risk adjusted to only 5% or 10% of the total benefits credibly presented. But regardless of whether a carbon tax or ban is passed, compliance costs of a new rule will be fully borne by registrants. This approach to rulemaking cannot survive the rigorous benefit-cost or economic analysis review required of the Commission.

Page 224 of the proposal outlines the Commission's assumption that fragmented and diverse sources of information in carbon and other environmental, social, and governance ("ESG") reporting is a problem that it must solve.[24] This assumption is necessary, otherwise the wealth of voluntary reporting currently available regarding carbon emissions disclosures seriously undermines the need for a mandatory rule.[25]

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[20] Proposed Rule, at 34 ("Our proposed climate-related disclosure framework is modeled in part on the TCFD's recommendations. A goal of the proposed rules is to elicit climate-related disclosures that are consistent, comparable, and reliable *while also attempting to limit the compliance burden associated with these disclosures*.") (emphasis added).

[21] *See* Vollmer, *supra* note 15, at 18.

[22] Proposed Rule, at 167 (noting that "[*f*]*or example*, *if* policy changes lead to mandatory emissions reductions or carbon pricing" then certain "emissions disclosure[s] could help convey to investors the financial risks facing a company related to any transition to a lower carbon economy.") (emphasis added).

[23] *See* Sorenson Communs. Inc. v. FCC, 755 F.3d 702, 708–09 (D.C. Cir. 2014); Horsehead Resource Dev. Co. v. Browner, 16 F.3d 1246, 1269 (D.C. Cir. 1994); Natural Resources Defense Council v. EPA, 859 F.2d 156, 210 (D.C. Cir. 1988).

[24] Proposed Rule, at 224 ("Although many registrants have voluntarily obtained some level of assurance for their climate-related disclosures, current voluntary ESG assurance practices have been varied. . . . This fragmentation has diminished the comparability of the assurance provided and may require investors to become familiar with many different assurance standards and the varying benefits of different levels of assurance.").

[25] *See, e.g.,* Statement of Commissioner Hester M. Peirce, We are not the Securities and Environment Commission – At Least Not Yet (Mar. 21, 2022), https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321 (noting that "[e]xisting rules require companies to disclose material risks regardless of the source or cause of the risk" and "[e]ven under our current rules, climate-related information could be responsive to a number of existing disclosure requirements.").

The current pre-rule environment, which includes a wealth of voluntary information and voluntary attestation, frames the baseline against which the Commission's proposal must be measured in benefit-cost or economic analysis review required by *Business Roundtable* and other cases. The Commission fails to consider a number of benefits from heterogeneity in the current and robust voluntary climate reporting space.

First, this is a nascent reporting space, and the Commission's top-down mandate risks inhibiting the evolutionary process in climate reporting early in its development.[26]

Second, the Commission fails to account for the role of intermediaries in synthesizing information about climate reporting from various sources and under different methodologies. But in November 2021, the Commission emphasized the vital role of proxy advisors in serving as information intermediaries to investors.[27]

Proxy advisors offer information to investors about voting and investment decisions on a variety of matters, including environment issues and climate emissions. Just last year, the Commission argued that information intermediaries provide a vital service to the market. Now, the Commission has neglected to mention that information intermediaries play an important role in synthesizing climate disclosure information. That inconsistent and conflicted assumption led the Commission's proxy advisor rule to be thrown out in *Business Roundtable*,[28] and the Commission risks that same fate in the coming litigation over this rule.

The proposal notes that "[f]or the many large accelerated filers that are already voluntarily obtaining some form of assurance over their GHG emissions, any cost increases associated with complying with the proposed rules would be mitigated."[29] But the proposal does not mention that to the extent firms are already providing information voluntarily and obtaining assurances voluntarily, the benefits of this rule are equally mitigated.

II. This proposal fails to account for conflicts of interest at union and state pension funds whose support the proposal cites as evidence of investor interest in carbon disclosure.

In the proposal, the Commission references that some investors currently use climate emissions information in their decisions in how to buy, sell and vote their shares,[30] and support for that notion comes from several institutional investors. The materiality standard is however based

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[26] *See supra* text accompanying note 19.
[27] *See generally* Securities and Exchange Commission, Amendments to the Proxy Rules for Proxy Voting Advice 7, 12 (Nov. 17, 2021), https://www.sec.gov/rules/proposed/2021/34-93595.pdf.
[28] *See* Bus. Roundtable, 647 F.3d at 1148–49 (holding that the Commission's proxy advisor rule was arbitrary and capricious in part because "the Commission inconsistently and opportunistically framed the costs and benefits of the rule;" "neglected to support its predictive judgments;" and "contradicted itself. . . .").
[29] Proposed Rule, at 227.
[30] *Id*. at 157 ("We propose requiring disclosure of registrants' Scopes 1 and 2 emissions because . . . investors need and many investors currently use this information to make investment or voting decisions.").

on the reasonable investor—not a particular investor, not the most powerful investor, and not the most vocal investor.[31]

It is the reasonable investor, which is defined in part by tracking statistically significant stock price impacts from the revelation of true statements that alter prior erroneous statements.[32] But the proposal focuses on institutional investment managers who have expressed a preference for more climate change disclosure.

That emphasis ignores the problem that institutional investment managers represent in capital market intermediation. There is an ever present principal/agency conflict between institutional investment managers and beneficiaries of the funds on whose behalf they invest. There is similarly a potential conflict of interest between the investment managers and other shareholders in registered issuers.

Many of these vocal investment managers run state or union pension funds that are ultimately overseen by politically elected officials. The vast majority of pension funds that have written in support of climate change disclosure represent pension funds where the state's Treasurer and other top officials are Democratic party officials.[33] There is an ever-present danger that these officials vote based on their political preferences. This conflicts with the preferences of the beneficiaries they represent, and does not comport with the objective reasonable investor standard required under federal securities laws.

Indeed such conflict is demonstrated in a survey of retail investors and pension fund beneficiaries I oversaw. The survey showed that such investors overwhelmingly want their fund managers to focus on returns, not ESG goals.

In 2019, I worked with the Spectrem Group—a wealth management research firm—to survey retail investors regarding their views of proxy voting and proxy advisory firms.[34] The survey

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[31] *See* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 39 (2011) (the "materiality requirement is satisfied when there is '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.'") (quoting Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988)) (some internal quotation marks omitted).

[32] *See* In re Merck & Co., Inc. Sec. Derivative & ERISA Litig., 543 F.3d 150, 169 (3d Cir. 2008) ("[I]n the context of materiality, we have stated that in 'an efficient market, "information important to reasonable investors . . . is immediately incorporated into the stock price."'") (quoting Oran v. Stafford, 226 F.3d 275, 282 (3d Cir. 2000)); *see also* FindWhat Investor Group v. FindWhat.com, 658 F.3d 1282, 1310 (11th Cir. 2011) (noting that after discovery of a material misrepresentation—which has artificially inflated a stock's value—"the market will recalibrate the stock price to account for this change in information, eliminating whatever artificial value it had attributed to the price.").

[33] For example, one commentor is the Washington State Investment Board ("WSIB"). The WSIB "manages investments for 17 retirement plans for public employees, teachers, school employees, law enforcement officers, firefighters and judges." *WSIB Story*, Washington State Investment Board 1 (2022), https://www.sib.wa.gov/docs/info/wsib_story.pdf. And virtually all of Washington State's top government officials—including its Governor and State Treasurer—are Democrats.

[34] *Exile of Main Street: Providing a Voice to Retail Investors on the Proxy Advisory Industry*, Spectrem Group 3 (2019), https://corpgov.law.harvard.edu/wp-content/uploads/2019/04/Exile-of-Main-Street-A-Spectrem-Group-

received responses from more than 5,000 retail investors who held assets of at least $10,000 in various types of accounts, such as defined contribution plans, brokerage accounts, and individual retirement accounts.[35] The results of the survey showed that "[t]he increased focus of fund managers and proxy advisors on political and social activism, rather than maximizing returns, is out of sync with the expectations of ordinary investors."[36]

The survey further found that retail investors are largely absent from the proxy process—demonstrated by participation levels and retail investors' inability to influence institutional shareholder voting.[37] This absence means that "the voice of retail investors, who own 30 percent of public corporations in the United States, is being drowned out."[38] Now, the Commission is relying on such fund managers—whose support for ESG does not align with the beneficiaries they represent—as support for the proposal.

The Commission's failure to consider these conflicts sets up a potential déjà vu moment when an inevitable challenge to the climate disclosure rule is brought. Failure to consider pension fund conflicts when promulgating the proxy advisor rule was one of the final nails in the coffin when it was struck down by the D.C. Circuit.[39] The Commission's repeat of that failure in this proposal will inevitably lead to the same outcome.

Beyond their conflicts, institutional investor pledges, commitments, and surveys are of little value in demonstrating the real preferences of those particular investors. They are instead little more than cheap happy talk.

The economics, statistics, and econometrics professions strongly disfavor use of surveys as a means to show consumer preferences. Instead the only true means of understanding consumer preferences is hedonic price studies, which in this case would be in the related function of stock price impact studies.

Yet this proposal has only a very limited engagement with that nascent literature. Rather, it cites a small handful of studies and a cherry-picked selection of the literature. Nowhere does the proposal reference the many studies challenging whether climate change disclosure or firm climate change policies lead to positive abnormal returns or have significant stock price impacts.

Whitepaper-Providing-a-Voice-to-Retail-Investors-on-the-Proxy-Advisory-Industry.pdf [hereinafter Specterm Survey].

[35] *Id*.

[36] *Id*. at 4.

[37] *Id*.

[38] *Id*.

[39] Bus. Roundtable, 647 F.3d at 1152 ("By ducking serious evaluation of the costs that could be imposed upon companies from use of the rule by shareholders representing special interests, *particularly union and government pension funds*, we think the Commission acted arbitrarily.") (emphasis added).

The proposal contends that agency problems can be exacerbated by the differences between a firm's long-term horizon focus and a manager's shorter-term horizon concern.[40] But that problem exists with the same union and state pension funds which the proposal cites as proof that there is interest in mandatory climate change reporting.

Union and pension fund managers may leave long before their commitments to sustainable impact investing ultimately generate insufficient returns to meet pension beneficiary commitments.

III. This proposal mandates disclosure which would not meet the definition of materiality contained in the federal securities laws.

On page 24, the Commission notes that a series of institutional investors have demanded climate-related information from companies—which justifies the Commission's proposed mandate that such climate-related information be disclosed.[41] But the definition of materiality under federal securities laws takes no notice of expressed preferences that have no price impact. Materiality is instead a definition measured with statistical significance in stock price impact measures.[42]

The proposal references the fact that multiple institutional investors have signed on to a number of joint statements regarding climate change. Publicly expressed sentiment by institutional investment managers regarding United Nations statements have no more bearing on materiality under federal securities laws than the CalPERS management expressing their preference for The Beatles over The Rolling Stones.

Statements of personal preference do not provide a window into what the reasonable ordinary investor takes into account in making investment decisions. Only information that has a recognizable impact on stock prices can meet the definition of materiality.

This point is similar to a point frequently made in econometrics: hedonic price studies are more valuable than voluntary surveys regarding consumer preferences in assessing consumer behavior. This is because the price a typical consumer says they are *willing* to pay for a product in a voluntary survey will often be worlds apart from the price the consumer *actually* pays on the market.

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[40] Proposed Rule, at 328 ("Agency problems can worsen to the extent that the investment horizons of a firm's shareholders and its management are misaligned.").
[41] *See id*. at 24.
[42] *See* Jill E. Frisch, Jonah B. Gelbach, & Jonathan Klick, *The Logic and Limits of Event Studies in Securities Fraud Litigation*, 96 Tex. L. Rev. 553, 562 (2018) ("Proof of price impact for purposes of analyzing reliance and causation also overlaps with the materiality requirement."); *see also* Richard A. Booth, *The Two Faces of Materiality*, 38 Del. J. Corp. L. 517, 522–23 (2013) (noting that the Supreme Court has "indicated repeatedly" that "in the context of a securities fraud class action . . . the plaintiff must show price impact in order to show materiality. . . ." Furthermore, "the Circuits appear to agree that *materiality and price impact are essentially the same thing* and that the presumption of reliance under the [fraud on the market] theory is based on equating the two.") (emphasis added).

From an economics perspective, consumer surveys about price materiality are, much like press releases and signing statements, little more than cheap happy talk. Likewise, these surveys of institutional investors are unreliable in assessing materiality—which is at the core of federal securities laws and financial accounting rules under GAAP—and at the core of the economic or benefit-cost analysis requirements that limit the Commission's discretion under *Business Roundtable.*

On page 43, the Commission places a materiality qualifier on Scope 3 emissions disclosures.[43] But the Commission admits that "the calculation and disclosure of Scope 3 emissions may pose difficulties compared to Scopes 1 and 2 emissions. . . ."[44] Furthermore, "[i]t may also be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data."[45] It does little good to put a materiality qualifier on such an inherently speculative estimate with little link to the concept of materiality in the first place. Such a depth of cognitive dissonance is one of this proposal's primary "Achilles' Heels."

The Commission notes that materiality has been traditionally understood to have both quantitative and qualitative aspects.[46] While that is an accurate description of language contained in the SEC's Staff Accounting Bulletin No. 99, it is an incomplete description of materiality.

The qualitative aspect of materiality focuses on items that, while not presently quantitatively material, have a high expected probability of quickly becoming quantitatively material.[47] For example, the risk that a low-level fraud may quickly snowball into a higher magnitude fraud if left undetected.

The Commission cannot however hide speculative estimates—like Scope 3 emissions—that are largely unrelated to the specific registrant and otherwise focus on macro level environmental impacts, under the umbrella of qualitative disclosure. To do so reflects a misunderstanding of how the qualitative and quantitative aspects of materiality relate to each other.

On page 121, the Commission suggests that issuers should utilize a 1% threshold to determine material reporting. If climate-related (among other) risks exceed 1%, the risks would need to be disclosed on a discrete line item by line item basis. But the standard practice in financial accounting is to apply materiality thresholds to aggregate totals such as gross or net revenue,

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[43] Proposed Rule, at 43 ("Scope 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. . . .") (emphasis added).
[44] *Id*. at 208.
[45] *Id*.
[46] *Id*. at 64.
[47] *See* Staff Accounting Bulletin No. 99 (Aug. 12, 1999), available at https://www.sec.gove/interps/account/sab99.htm ("[T]he staff believes that there are numerous circumstances in which misstatements below 5% could well be material. Qualitative factors may cause misstatements of quantitatively small amounts to be material. . . .").

total assets or total liabilities.[48] Courts use these aggregate line items more often as a denominator in a materiality determination.[49]

Staff Accounting Bulletin No. 99, which outlines the Commission's approach to materiality, does not exclusively limit materiality determinations to specific quantitative thresholds. But it does suggest quantitative thresholds as a guide and offers 5% as a starting point for assessing materiality.[50] Lowering the bar from 5% to 1% in the rule proposal is a substantial departure from existing concepts of materiality. The Commission briefly mentions that there are a few other rules in which a 1% threshold was required for materiality. But that only proves that the Commission has previously instituted such a requirement, not that it was authorized to do so.

On page 162, the Commission again mentions that Scope 3 emissions will only be required to the extent they are material.[51] But there is no guidance concerning when Scope 3 emissions will be material. The reality is that Scope 3 emissions are an unprecedented departure from any disclosure ever required in securities law or financial reporting.

The proposal begins to define required Scope 2 and Scope 3 emissions on page 39.[52] But these definitions are categorically incongruent with the concept of materiality that is core to federal securities laws and financial accounting principles. That concept is premised on ratio analysis, with the ratio denominator being traditional items found on an income statement or balance sheet, *e.g.*, revenues, expenditures, assets, liabilities, or equity.

The denominator in a ratio is not a societal or global measure, but a particular type of firm-specific financial measure. A particular type of emissions maybe material to the planet on an aggregate basis, or a particular type of emissions maybe material to participants in the environmental movement. But that has no relevance whatsoever in defining materiality under federal securities laws and the financial accounting principles underlying GAAP.

The drafters of the proposal must have been aware that Scope 3 emissions were a risky stretch of the Commission's authority, as evidenced by the intense internal debate among the Commissioners who generally supported this proposal and the Chairman. Bloomberg reported

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[48] *See, e.g.*, *Materiality in the Audit of Financial Statements*, International Accounting, Auditing & Ethics 5 (2017), https://www.icaew.com/-/media/corporate/files/technical/iaa/materiality-in-the-audit-of-financial-statements.ashx.

[49] *See* Litwin v. Blackstone Grp., L.P., 634 F.3d 706 (2d Cir. 2011).

[50] Staff Accounting Bulletin No. 99, *supra* note 46 ("The use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that – without considering all relevant circumstances – a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material. The staff has no objection to such a 'rule of thumb' as an initial step in assessing materiality.").

[51] Proposed Rule, at 162.

[52] Proposed Rule, at 39 ("Scope 2 emissions are those emissions primarily resulting from the generation of electricity purchased and consumed by the company. . . . 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.").

that the Chairman was hesitant to include Scope 3 emissions in the proposal as it would subject the proposal to significant risk that the rule would fail to survive a legal challenge.[53]

Scope 3 emissions are highly speculative and beyond anything contemplated by the securities laws. It appears that the compromise struck was to require Scope 3 emissions disclosures, but only to the extent that Scope 3 emissions are "material," and provide no guidance about when such emissions are material. Instead, the proposal drops that uncertainty onto registrants trying to comply.

Rather than threading the needle, this compromise ties the thread into knots. The uncertainty created by this compromise renders the proposed rule arbitrary and capricious because it provides no concrete standard for compliance. Registrants will be left to guess about what disclosures are required and face a torrent of agency comments on their future filings, pushing for more Scope 3 disclosures.

Imagine if the Commission restated this approach a bit differently, by requiring disclosure of Scope 3 emissions, but only "to the extent that the 34 Act and administrative law permits the SEC to require such."

Would such a qualifying phrase survive review by the D.C. Circuit? Certainly not.

Or would such an obtuse and unclear rule generate such regulatory uncertainty that it would be deemed to be arbitrary and capricious? It is my considered view that we will soon see the latter is more likely.

IV. *This proposal mandates reporting of estimates that are too speculative and subjective to comport with fundamental principles of accounting and finance that underly the existing federal securities laws and financial reporting structure.*

In what may be the understatement of the year, the Commission notes that "we recognize that determining the likely future impacts on a registrant's business may be difficult for some registrants."[54] On page 173, the Commission further admits that "a registrant's material Scope 3 emissions is a relatively new type of metric, based largely on third-party data, that we have not previously required."[55]

[53] Robert Schmidt, *SEC Sets Up Climate Clash with Rule on Indirect Emissions*, Bloomberg (Mar. 18, 2022, 12:59 PM), https://www.bloomberg.com/news/articles/2022-03-18/sec-sets-up-climate-clash-with-rule-to-report-indirect-emissions
[54] Proposed Rule, at 66.
[55] *Id*. at 173.

As noted on pages 48 and 49, the core of the proposal is a fundamental reliance on the TCFD framework.[56] But the TCFD framework was not developed by international financial regulators, and it includes estimation methodologies that are entirely inconsistent with modern financial theory. Thus, the Commission's reliance on the TCFD framework is a house of cards.

A 2017 study by IHS Market concludes that the TCFD framework is inconsistent with fundamental principles of securities disclosure.[57] That study finds the following incongruencies between the TCFD framework and the securities disclosure system:

> Some elements of the TCFD framework, such as climate-related governance, strategy, and risk management, can help investors understand how companies comprehend and manage potential risks relating to climate change.
>
> But the recommendations for standard disclosures of climate-related financial risks in financial filings and the TCFD focus on metrics and scenarios could undermine the [Financial Stability Board's] goal of improving capital allocation decisions and market functioning. Adopting them would *obscure material information* and create a false sense of security around the financial implications of long-term scenario exercises. This, as well as disclosure of metrics not correlated to financial risk, could lead investors to misunderstand opportunities and risks, misprice assets, and forgo future returns.[58]

On page 55 of the proposal there is more language that biases toward negative consequences for individual firms rather than accepting the possibility that the consequences of climate change for publicly traded firms might be as likely ambiguous or positive. On page 55, the proposal highlights the harms climate change might cause individual firms. But the proposal fails to accept the possibility that the consequences of climate change for publicly traded firms maybe equally ambiguous or positive.

Throughout Section II.B. and the proposal writ large, there is a demonstrated failure to appreciate the limitations of modeling the impact of climate change on particular firms. Modeling the weather on a macro level across the country in the short term is difficult. Yet this proposal would require companies to predict the weather on a particular city block or zip code on which a company holds equipment, and model that prediction up to 50 years in the future.

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[56] *Id*. at 48–49 (noting that commenters' support for the TCFD framework "comport with our understanding that the TCFD framework has been widely accepted by issuers, investors, and other market participants and reinforce our view that the framework would provide an appropriate foundation for the proposed amendments.").

[57] *See Climate-Related Financial Risk and the Oil and Gas Sector*, IHS Markit 5 (May 2017), https://legacy-assets.eenews.net/open_files/assets/2017/05/17/document_cw_01.pdf ("IHS Markit believes that the TCFD recommendations would undermine the [Financial Stability Board's] goal of improving capital allocation decisions and market functioning. . . . The linkages between climate-related indicators and financial impacts are complex and uncertain, *and users could not consistently deduce the scale, timing, or even direction of climate-related financial risk from this information*.") (emphasis added).

[58] *Id*. at 11 (emphasis added).

The proposal consistently assumes that climate change poses a universal risk—rather than a potential opportunity—for firms. For example, a number of U.S. firms have pledged to bring their GHG emissions to net zero over the coming decades.[59] But to the extent that U.S. demand for fossil fuels endures over the intermediate term, those firms not making net zero pledges may see a tremendous climate change related profit opportunity.

The proposal's consistent assumption—that climate change poses a universal risk—is exemplified on pages 62 and 63. Here, the proposal notes that a registrant "at its option, may disclose information about any climate-related opportunities it may be pursuing when responding to the proposed disclosure requirements governance, strategy and risk management in connection with climate-related *risks*."[60] This means that climate opportunities—as opposed to risks—are exempted from the proposal's mandated disclosures, and treated as optional afterthoughts.

The thin veneer of objective financial reporting is lifted as the Commission would not require disclosure about climate related opportunities. That would be too impolitic. The Commission would only mandate disclosure about climate related risks.

The proposal describes a number of potential time frames that might be utilized to further define medium and long-term reporting in climate change disclosure—potentially up to 50 years into the future.[61]

This is a radical departure from the type of discounted cash flow ("DCF") modeling that is frequently utilized by financial theorists, valuation analysts, and certified financial advisors in the industry. DCF is also used in valuations relied upon by financial accountants and auditors for GAAP and auditing standards relating to valuation.

Valuation professionals rarely create DCF models that stretch beyond 5 to 10 years into the future. This is because estimates of expenses or revenues beyond that timeframe are highly unreliable.

On page 104, the Commission notes its assumption that future laws will be adopted to restrict GHG emissions and transition the economy toward carbonless energy.[62] This assumption underlies much of the proposal particularly its transition reporting requirements.

This would be the first time in the Commission's history that it would require disclosures about hypothetical and contentious laws not yet adopted. The proposal requires registrants to presume that these hypothetical laws will be adopted in the future, then require registrants to

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[59] Richard Mattison, *The State of Net Zero, For Now*, GreenBiz (Feb. 14, 2022), https://www.greenbiz.com/article/state-net-zero-now.
[60] Proposed Rule, at 62–63 (emphasis added).
[61] *Id*. at 67.
[62] *Id*. at 104.

provide a disclosure which will undoubtedly provide a highly contested political perspective of one party.

It's hard not to describe this aspect of the proposal as anything less than a politicization of the securities disclosure system. That description is not hyperbole, but rather straightforward in light of the proposal's requirements like those contained on page 104 of the proposal.

The proposal references required financial metric disclosures concerning items like estimated loss contingencies, changes in fair value estimates, and other estimations common to financial accounting.[63] The Commission claims that this is a simple modification of existing structures and financial reporting, but it is far more than that.

This section usurps the traditional role of the independent FASB in developing accounting principles. The information that would be contained in these new changes is fundamentally different from that in traditional estimates. For example, GAAP is built upon a foundation of fundamental principles like the rule of conservatism, which does not permit estimation of future gains or losses that are not reasonably estimable.

It is important to consider the stark contrast between FASB's thoughtful and conservative approach to environmental disclosure reforms in GAAP against the scattershot and thinly evidenced approach demonstrated in this proposal. FASB's current agenda for environmental and ESG related issues focuses narrowly on carbon emission specific bonds and environmental liability disclosures.

The Commission appears to be using this proposal to threaten FASB's independence, including dangerous posturing by the Commission in footnote 316.[64] And similarly on page 190, the Commission takes a very dangerous turn—unprecedented in the history of financial accounting—as it seeks to directly preempt the role of FASB as an independent and objective accounting standard setter. The Commission overtakes FASB's role in this section as it reshapes the entity assumption—which implies that economic activity can be identified with a particular unit of accountability—and the financial consolidation process.

It may not be apparent to the average reader why such independence matters for technical concepts like the entity assumption and reporting consolidation. But usurping FASB's role violates the principle of independent and objective accounting standard setting that has been at the heart of financial reporting. And independent accounting standard setting has helped to make American capital markets the best in the world.[65]

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[63] *Id*. at 110.

[64] *Id*. at 111 n.316 ("The Commission has broad authority to set accounting standards and principles.").

[65] *See* David S. Ruder, Charles T. Canfield, & Hudson T. Hollister, *Creation of World Wide Accounting Standards: Convergence and Independence*, 25 NW J. Int'l L. & Bus. 513, 517–18 (2005) ("For some, a well designed system means that the standard setters should be independent of outside commercial and government influence and therefore free to pursue high quality standards. . . . [T]he requirement for success in creating a high quality,

If the Commission proceeds to distort independent standard setting to forward a climate agenda this time, what will stop future political appointees from using accounting standard setting to advance a gun rights agenda, a pro-life agenda, an anti-immigration, or an anti-free trade agenda?

The true harm in this back and forth will be the dissolution of independent reporting as it becomes distorted by policy objectives entirely unrelated to financial reporting objectives.

Imagine a future Commission equally politicized by the political right as today's leadership tilts toward the political left. And posit that such a Commission could assert the same dominance over GAAP contained in footnote 316 to mandate disclosures that may have cultural significance for the political right. It would be no different, and it would do equal violence to the independent and objective financial disclosure system.

The Commission seeks to clarify that these new disclosures will remain consistent with GAAP,[66] but those principles are fundamentally inconsistent with the majority of suggested disclosures in this rule.

For example, 50-year predictions do not comport with the reasonable estimation qualifier under GAAP. Such a proposal therefore cannot be considered consistent with existing accounting standards. Unless of course, you read this rule to mean that FASB is on notice that to the extent existing pronouncements from FASB conflict with the rule, the pronouncements must change. This reasonable reading of that language suggests that the SEC is directly threatening the independence of the FASB in this proposal.

Fundamentally altering FASB's current standards supports my contention that this rule represents a fundamental threat to the independent, reliable, and objective nature of financial accounting and securities disclosures.

On page 116, the Commission describes the definition of climate change risk and outlines how climate change risk disclosures will need to be included in other financial reporting items.

If the Commission hopes to maintain any legitimacy in financial reporting, it must make clear in the final rule that the registrant will be permitted to indicate that the impact of climate change on the registrant cannot be reasonably estimated. Unless it is clearly specified in the final rule that this form of simple representation is explicitly permitted, I doubt very much this rule will survive the inevitable legal challenge.

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transparent, and comparable accounting standards is that the standard setters *should be independent of all business and government special interests*.") (emphasis added).

[66] Proposed Rule, at 112 ("Although 17 [Code of Federal Regulations] 210.4-01(a)(1) already states that financial statements filed with the Commission that are not prepared in accordance with GAAP will be presumed misleading or inaccurate unless the Commission has otherwise provided, clarifying the application of this concept in the proposed rules may be helpful. . . .").

The discussion on page 118 of the proposal, providing examples about the anticipated climate impacts on real estate, further demonstrates the bias that pervades the entire rule. If this were an objective proposal, it would equally explore the possibility that a registrant owning substantial real estate may obtain opportunities by investing in properties distant from a receding coastline that may become coastline adjacent as a result of climate change.

But of course, the weight of the proposal leans toward risk and loss because this proposal is not actually intended to mandate disclosures about *financial* data. Analysis on page 119 similarly focuses on the negative, but makes only brief mention—in half a sentence—about the remote possibility of positive impacts from climate change. In the end, the ultimate impact of climate change on particular registrants over long periods of time simply remains ambiguous and uncertain.

On page 122, the Commission suggests revenue impact disclosures that would be fundamentally inconsistent with financial accounting principles contained in GAAP. These disclosures would require the allocation of fixed costs in ways that are not contemplated by GAAP, and indeed are often difficult even in non-GAAP managerial or cost accounting.

The Commission appears to take for granted that large scale asset impairments will occur as a result of climate change disclosures.[67] But that requires presuming that the impacts on assets are estimable and directionally consistent; and presuming that negative future cash flow preconditions for impairment testing have been met.

All of these assumptions are a stretch with respect to climate change disclosures. It is rather unlikely they will result in asset impairments at all, given those weighty assumptions. Instead, it is more likely that climate change disclosures will not result in significant asset impairments.

On page 139, the Commission proposes a requirement that registrants must disclose whether the estimates used to produce financial statements were impacted by exposures to risks or impacts of climate related events.

The proposal—and a final rule—should make clear that registrants can rely on an opinion that the macro level effect of climate change on a firm is not readily estimable under existing principles of GAAP (in much the same way that registrants often rely on similar opinions with respect to loss contingencies in other areas).

On page 144, the Commission suggests that climate related metrics in the financial statements should be included in the scope of any required audit. In some cases, historical reporting about

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[67] *See* Proposed Rule, at 124 ("[T]he proposed rule would include the following examples of disclosures that may be required to reflect the impact of severe weather events and other natural conditions . . . impairment charges and changes to the carrying amount of assets (such as inventory, intangibles, and property, plant and equipment) due to the assets being exposed to severe weather, flooding, drought, wildfires, extreme temperatures, and sea level rise. . . .").

Scope 1 emissions for energy intensive firms may be produced using information that is auditable. But Scope 2 and Scope 3 emissions, and estimates of future impacts are far too speculative and subjective to lend themselves to the process of audit. Audits are built on the verification of historical and objective information, not the kind of speculative information proposed in this proposal.

On page 160, the Commission emphasizes the requirement for registrants to disclose information about other entities in the marketplace which they do not control as a component of Scope 3 emissions disclosure. This will result in unreliable reporting, because registrants will be required to disclose information about items completely outside registrants' control.

On page 181, the Commission appears to make up random ratio analysis metrics out of the blue when the proposal notes that "if the registrant has no revenue for a fiscal year, it would be required to calculate its GHG intensity with another financial measure…"

Ratio analysis is a carefully crafted tool used by accountants and financial valuation professionals. It measures an item in the denominator with a variable in the numerator when there is a close link between them. And ration analysis compares both variables when that link may demonstrate a unique relationship that can help constructive a narrative about a firm's financial health.

For example, in the "times interest earned" ratio, the numerator contains Earnings Before Interest and Taxes (earnings available to pay interest) and the denominator contains interest payments over the next year. This ratio shows a firm's ability to pay upcoming interest out of normal earnings. The Commission's casual and random approach to mandated ratios ignores the standards of accounting and valuation professions regarding ratio analysis.

Of course this approach is consistent with the proposal's overall tenor, and further demonstrates that the proposal's true goal is not to provide financial information to investors, but instead to conduct environmental regulation via indirect means.

On page 244, the Commission identifies a fairly grandiose goal: to merge the fields of financial accounting and engineering and require that financial accounting judgements be made about engineering estimates that underly them.

By contrast, when accountants are otherwise asked to rely on external specialists in assessing information, those specialties will involve fields closely related to accounting, like accounting systems or financial valuation.

The ambitious goal of merging the fields of engineering and accounting envisioned by this section of the proposal are unachievable and contribute to the proposal's arbitrary and capricious nature.

V. The proposal is an effort to regulate corporate behavior to reduce carbon emissions, not a sincere effort to provide material financial information to investors

On pages 401 and 403, the Commission briefly lifts the veil on the proposal's true goal by noting that one of its benefits will be behavioral changes regarding climate emissions.

In the section beginning on page 72, the proposal focuses on a number of things that registrants are strongly encouraged to do in order to achieve goals related to climate change. It is astounding to see this level of micromanagement by the Commission, and shows that this rule is about far more than objective hands-off disclosures to investors.

The number of different business decisions that the Commission suggests issuers "might consider," mimics the tone of a mafioso suggesting to a grocer they "might want to pay protection money" because "this is a nice store you have here, it would be a shame if something happened to it." This proposal uses disclosure as a cudgel to change business decisions that are not within the Commission's statutory purview.

VI. This proposal compels corporate speech regarding the impact of climate change on company value and the nature of climate change itself

On page 83 the proposal suggests estimates about changes in global temperature that should be used in creating scenario analysis as 3 degrees Celsius, 2 degrees Celsius, and 1.5 degrees Celsius above preindustrial levels. The proposal suggests that when registrants analyze the resilience of their strategies under future climate scenarios, registrants should assume global temperature increases of 3, 2, and 1.5 degrees Celsius.[68]

Will the Commission make assertions about predicted future global climate change and questions it provides to registrants in their filings? Will registrants be permitted to derive assumptions based on a range of 0.1-0.5 degrees Celsius above preindustrial levels? Or will the Commission take an official position on this question?

Will the Commission mandate via this rule—either explicitly or implicitly—that registrants engage in compelled speech regarding a particular opinion about the status of global warming and climate change?

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[68] Proposed Rule, at 83 ("The proposed definition of scenario analysis . . . states that . . . registrants might use scenario analysis to test the resilience of their strategies under future climate scenarios, including scenarios that assume different global temperature increases, such as, for example, 3 ˚C, 2 ˚C, and 1.5 ˚C above pre-industrial levels.").

Will registrants be permitted to disclose the apparent fact that climate change mitigation in Western nations is likely to have precious little impact on climate change given the lack of climate sensitivity in China, India, Russia and other developing nations?

Our will registrants be effectively compelled to express agreement with conclusions about climate change that have been reached in the TCFD?

In short, this proposal consistently assumes that issuers completely agree with the Commission's reliance on the TCFD's framework. But in so doing, the Commission risks a similar result as the last time it flirted with compelled speech for registrants, when the D.C. Circuit found that the Commission's conflict mineral disclosure rule violated the First Amendment.[69]

This proposal's assumption of universal agreement with the TCFD framework will effectively compel speech regarding debatable positions on the status of global climate change.

The proposal takes an interesting turn on page 95, as the Commission purports to preempt the state-based corporate governance system which has traditionally been respected by rules under the 33 and 34 Acts. By micromanaging boards' oversight and discussion about climate issues, the Commission violates core principles of securities law interpretation maintained by the internal affairs doctrine,[70] and effectively preempts state corporation law.

As the rule micromanages speech contained in internal board deliberations, it appears to prohibit the view that climate change will not have a measurable impact on a specific registrant, further compelling preferred and limiting disfavored corporate speech.

Scope 3 emissions disclosures implicate compelled speech tactics the Commission has disastrously deployed in the past. Much like the Commission's failed attempt to compel speech regarding conflict minerals disclosures, the Commission will fail in its effort to compel speech about emissions by other unrelated participants in the market with which registrants occasionally interact.

The Commission proffers a number of steps that registrants can take to control the emissions of other firms in the marketplace.[71] The thin veil of financial disclosure objective is again lifted,

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[69] *See* Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518 (D.C. Cir. 2015).

[70] VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1112 (Del. 2005) ("The internal affairs doctrine is a long-standing choice of law principle which recognizes that only one state should have the authority to regulate a corporation's internal affairs – the state of incorporation."); Edgar v. Mite Corp., 457 U.S. 624, 645 (1982) ("The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs . . . because otherwise a corporation could be faced with conflicting demands.").

[71] Proposed Rule, at 161 ("Although a registrant may not own or control the operational activities in its value chain that produce Scope 3 emissions, it nevertheless may influence those activities, for example by working with its suppliers and downstream distributors to take steps to reduce those entities' Scopes 1 and 2 emissions. . . . A registrant could also seek to reduce the potential impacts on its business of downstream emissions by producing

and the proposal's real goals of compelling speech about climate change and regulating underlying environmental emissions are revealed. But the Commission lacks the statutory authority to do either of those things.

VII. The SEC's economic analysis of the rule contains irrelevant information and cherry-picks the literature on stock price impact of carbon emissions

In the proposal's economic analysis section, the Commission again nakedly asserts that information asymmetries exist with respect to climate reporting, but does not reference the role of information intermediaries.[72]

The Commission also references the existence of principal/agency conflicts between firm managers and shareholders.[73] But the proposal conveniently fails to address the presence of principal/agency conflicts between politically active state and union pension fund managers and their beneficiaries, and between those pension managers and the broader group of a registrant's retail shareholders. This déjá-vu moment traces back to the Commission's defeat in *Business Roundtable*, and will ultimately be a harbinger of this rule's demise.

On page 302, the proposal repeats the assertion that voluntary disclosure by firms is inadequate. But the Commission does not explain why existing voluntary reporting outside of 10-Ks is unreliable. In fact, the Commission fails to offer a single example of unreliable voluntary climate disclosure by registrants that who volunteer such information outside of their 10-Ks.

On page 310, the Commission notes a growth in voluntary reporting from 35% in 2008 to 60% in 2020. This note furthers a two-sided argument: the rule is both easy to comply with because of voluntary reporting, but necessary because voluntary reporting is not yet at 100%.

This argument presumes that the optimal level of reporting is in fact 100%, but perhaps the optimal level is actually 60%. The optimal level could be sub-100% because: (1) climate emissions reporting is irrelevant to firms outside of the energy industry; (2) some firms in energy intensive industries that profit from burning carbon have shareholders that are satisfied with the shareholder profits produced by burning carbon; (3) of a host of other reasons

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products that are more energy efficient or involve less GHG emissions when consumers use them, *or by contracting with distributors that use shorter transportation routes.*") (emphasis added).

[72] *Id*. at 293–94 ("The primary benefit [of this proposal] is that investors would have access to more consistent, comparable, and reliable disclosures with respect to registrants' climate-related risks, which is expected to enable investors to make more informed investment or voting decisions. . . . [T]he proposed rules may reduce information asymmetry both among investors, which can reduce adverse selection problems and improve stock liquidity, and between investors and firms, which can reduce investors' uncertainty about estimated future cash flows, thus lowering the risk premium they demand and therefore registrant's cost of capital.").

[73] *Id*. at 294.

On page 314, the Commission states that existing voluntary frameworks tend to comport with the TCFD framework. This serves to undercut the economic or benefit-cost analysis of the Commission's proposal, because it shows that existing voluntary reporting environment significantly discounts any purported benefits from this rule.

Page 316 references existing carbon emissions pledges from registrants. Without evidence that these pledges have a statistically significant and enduring stock price impact, this fact is irrelevant in determining whether these disclosures are in fact material.

The proposal once again references survey data as part of the economic analysis section on page 319. It is worth emphasizing again that survey data is strongly disfavored in econometric methods.[74]

On page 320, the Commission continues the mistaken assumption that *institutional* investor membership in climate related groups bears any relevance when determining what information is material to the reasonable investor.

The "reasonable investor" standard that has evolved from courts' interpretations of materiality, is similar to the "reasonable man" standard that has long been at the center of contract law, tort law, and other common law concepts.[75] It is an objective standard, not one that is judged against surveys of groups of individuals.

The proposal references actual preferences of investors for the first time on pages 321 and 322; and cites six economic articles in footnote 802. But only two of those articles are relevant to the question of stock price impact of environmental events. This is a fairly thin set of evidence to support a rule that is estimated to increase the cost of securities compliance by a greater factor than the Sarbanes-Oxley Act rulemakings of 2002.

And footnote 802 similarly cherry picks the literature on stock price impact of climate change disclosures. The literature on such stock price impact is mixed at best. Failing to mention contrary evidence to that supported in footnote 802 renders the economic analysis incomplete.

The economic analysis section skips over econometric evidence fairly quickly and jumps into broad theoretical concepts like principal/agency problems on page 324. Again, the proposal completely fails to reference principal/agency problems and conflicts of interest posed by pension and union fund managers that may have divergent goals from their beneficiaries, and from other shareholders in affected registrants.

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[74] *See, e.g.*, John Calfee, Clifford Winston, & Randolph Stempski, *Economic Issues in Estimating Consumer Preferences from Stated Preference Data: A Case Study of the Value of Automobile Travel Time*, 83 Rev. Econ. and Stat. 699 (2001).

[75] *See* Amanda M. Rose, *The "Reasonable Investor" of Federal Securities Law: Insights from Tort Law's "Reasonable Person" & Suggested Reforms*, 43 J. Corp. L. 77, 79 (2017) ("[T]he 'reasonable investor' is not without kin in the law. To the contrary, the reasonable investor has a well-known legal antecedent: tort law's storied 'reasonable person.'").

On page 326, the Commission erroneously assumes that, absent a mandatory disclosure regime, managers have carte blanche to misreport climate change information. This is simply an inaccurate description of the law.

Voluntary disclosures outside the four corners of a formal SEC filing, and voluntary disclosures currently provided in SEC filings, are all subject to Rule 10b-5's prohibition on fraud.[76] Indeed, there are ongoing securities class action and corporate litigation cases regarding voluntary reporting of climate change emissions, commitments and compliance.[77]

Further, the Commission appears to discount the value of reputational sanctions related to climate change misreporting outside of the mandatory disclosure system, and yet the SEC provides no justification for ignoring the role of such reputational sanction.

The Commission also observes on page 326 that voluntary disclosures are unverifiable. First, much of the information suggested in the climate change mandatory disclosure rule will continue to be highly speculative and unverifiable. Second, to the extent that historical looking information is verifiable, existing voluntary attestation measures are already able to verify them.

On page 327, the proposal mentions the long-term nature of climate risks—this long-term nature makes quantifying climate risks speculative.

The Commission admits that there exists an "uncertainty surrounding the future path of climate change and the evolving nature of the science and methodologies measuring their economic impact."[78]

This admission is used to bolster the argument that voluntary disclosures will remain insufficient.[79] But the Commission ignores the fact that this aspect of climate change analysis will make future reporting anticipated by this proposal vastly more speculative than any methods in existing financial reporting.

That kind of internally inconsistent and cherry-picked use of evidence was precisely what led to the defeat of the Commission's proxy access rule in *Business Roundtable*.

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[76] 17 C.F.R. § 240.10b-5.
[77] *See* Roshaan Wasim, Note, *Corporate (Non)Disclosure of Climate Change Information*, 119 Colum. L. Rev. 1311, 1314 (2019) ("Exxon is currently in the midst of a securities fraud class action . . . which alleges that the company failed to disclose climate change information and misrepresented the effects of climate change on certain company assets.").
[78] Proposed Rule, at 330.
[79] *Id*. ("The uncertainty and complexity of climate-related risks are likely to cause substantial heterogeneity with respect to investors' interpretation of related disclosures and their understanding of firms' exposures to such risks, resulting in heterogenous and unpredictable investor responses.").

The proposal notes on page 331 that multiple registrants utilize inconsistent components of climate reporting frameworks. Yet this is a function of how climate change reporting is still evolving, not proof that such reporting is ready for the standardization akin to financial accounting methodologies that have evolved over centuries.

Page 333 of the proposal cites a single economics article to prove that "a large body of studies" have demonstrated the stock price impact of climate reporting. This is another example of cherry-picking, because no contrary evidence is cited to any extent.

The analysis of benefits of Scope 3 emissions disclosures on page 356 is as speculative as the process of Scope 3 emissions reporting itself. The Division of Economic and Risk Analysis is put into a difficult position because the proposal offers no guidance regarding what a Scope 3 emissions disclosure must consist of—only that such a disclosure is required to the extent that it is material.

Footnotes 964 through 966 cherry-pick the literature to argue that climate-related disclosures impact stock prices. But there are studies that suggest such disclosures actually have little effect.[80]

Page 400 lists a couple of additional economic impacts of climate change disclosure, including on equity spreads, but this impact is irrelevant in determining materiality. Materiality is solely a function of stock price impact, not efficiency of trading represented in spreads.

Conclusion

This comment letter has offered a number of problems contained in a voluminous rule. I will close with a suggestion. The Commission is required to measure its rule against reasonable alternatives. D.C. Circuit cases overturning SEC rules for failure to consider reasonable alternatives have made clear that a reasonable alternative offered by a dissenting SEC Commissioner will provide a standard benchmark against which a rule will be measured for economic or benefit-cost analysis purposes.[81]

A reasonable alternative that should be advanced by a dissenting Commissioner who shares these concerns may be to suggest that the ultimate rule should make clear that a registrant is explicitly permitted to disclose, in reliance on the opinion of experts, that it is:

1) unable to provide estimates about the future impact of climate change on the firm given the speculative nature of that exercise; and

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[80] *See e.g.*, Yulia Veld-Merkoulova & Svetlana Viteva, *Does CO_2 Emissions Performance Matter for Stock Prices?*, *in* Carbon Finance 79, 79–128 (2016).

[81] *See* Chamber of Com. v. SEC, 443 F.3d 890, 894 (D.C. Cir. 2006); Chamber of Com. v. SEC, 412 F.3d 133, 145 (D.C. Cir. 2005).

2) unable to provide Scope 2 and Scope 3 emissions data given the external, speculative, and unverifiable nature of that information.

A reasonable alternative advanced by a dissenting Commissioner may also provide that the rule proposal must:

1) respect the independence of FASB's process for the promulgation of GAAP, and be premised on the existing boundaries of GAAP; and
2) analyze the principal/agency conflicts presented by state pension and union pension fund managers to the same extent that the proposal explored this problem for registrants' managers.

I hope the Commission takes these concerns seriously, and I remain available to further advise the Commission as I have done during the last 4 years of my term as a member of the IAC.

Sincerely,

J.W. Verret

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