U.S. Chamber of Commerce

1615 H Street, NW
Washington, DC 20062-2000
uschamber.com

June 16, 2022

Vanessa A. Countryman
Secretary
US Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Via email: rule-comments@sec.gov

Re: File Number S7-10-22
The Enhancement and Standardization of Climate-Related Disclosures for Investors

Dear Ms. Countryman:

The U.S. Chamber of Commerce appreciates the opportunity to comment on the proposed rules (the "Proposed Rules") of the Securities and Exchange Commission ("SEC" or "Commission") governing climate and the environment in Release No. 33-11042 (the "Proposing Release").[1] Combating climate change requires citizens, governments and businesses to work together. American businesses play a vital role in creating innovative solutions and reducing greenhouse gases ("GHGs") to protect our planet. The SEC, working in coordination with other government agencies whose primary responsibility it is to protect the environment, also has a role to play to the extent climate risk implicates the SEC's tripartite mission of investor protection, maintaining fair, orderly and efficient markets, and facilitating capital formation.

The Chamber believes that policy solutions addressing climate change should serve the goal of reducing emissions as much and as quickly as possible based on what the pace of innovation allows and the feasibility of implementing technical solutions at scale. The Chamber also believes that practical, flexible, predictable and durable market-based solutions and mechanisms are at the core of efforts to address climate risk and are reflected in the actions of the Chamber's members. Promoting private sector innovation across industry sectors will be central to solving climate change.

The Chamber supports climate policy that includes the disclosure of material information for investors to use, as well as policies that are not distorted or duplicative as a result of overlapping regulations and are not skewed by political interests. U.S. climate policy should recognize the need for action, while maintaining the national and international competitiveness of U.S. industry and commerce and ensuring consistency with free enterprise and free trade principles. Climate policy should also be informed by the best science and observations available and a rigorous assessment of available alternatives, outcomes, and cost-benefit tradeoffs to ensure that the optimal policies are implemented. We must consider the significant progress that the private sector has spurred by

[1] Release No. 33-11042, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 Fed. Reg. 21,334 (Apr. 11, 2022).

committing billions of dollars to research and development that have led to the creation and implementation of innovations that help manage climate risk and accelerate emissions reductions.

We are concerned that the Proposed Rules, when viewed holistically, do not strike the right balance and may, in fact, prove counterproductive by mandating that companies produce extensive amounts of information that is not material, thus obscuring for investors what is most important to making informed voting and investment decisions and creating confusion and misimpressions. This is not consistent with the SEC's longstanding tripartite mission and its stated goals in issuing the Proposed Rules. Mindful of the SEC's mission under the federal securities laws, the Chamber submits this comment letter to help the SEC improve the Proposed Rules to better serve the interests of investors and the U.S. capital markets without impeding the progress the business community has already made – and continues to make – in providing climate-related disclosure to investors and in developing strategies and technologies to reduce climate risk and its potential adverse impacts on society.

The Chamber is committed to working constructively with the SEC to develop and ensure an effective, standardized and consistent mandatory disclosure regime under the federal securities laws so that the marketplace has the benefit of material climate-related information that informs investor decision making as investors seek out financial returns. We agree that material climate risks and impacts should be disclosed to investors, and that the Commission's 2010 climate change interpretive guidance has been instrumental in improving the quantity and quality of disclosures on this topic.[2] However, the current Proposed Rules are vast and unprecedented in their scope, complexity, rigidity and prescriptive particularity, and exceed the bounds of the SEC's lawful authority as proposed. The Chamber respectfully urges the SEC to address the issues identified below before adopting any final rules.

1. Ground Any Final Rules in Materiality.

As with other areas of disclosure, the traditional and longstanding conception of materiality continues to serve as a critical bedrock in which to ground disclosure requirements to prevent an "avalanche" of information that can disadvantage investors. Basing disclosure mandates in materiality also serves to ensure that the SEC adheres to the purpose that the agency was established to serve, deferring to appropriate parts of government to take the lead on other valid goals and objectives.[3] As the Proposed Rules acknowledge, public companies now disclose significant amounts of information about the actual and potential impacts of climate change on their businesses, and both the quantity and quality of this disclosure has greatly increased over the past decade, and it continues to do so. Voluntary disclosures have been effective in detailing this information, as have existing disclosure mandates, including regarding risk factors and management's discussion and analysis ("MD&A"). The Proposed Rules should not mandate that companies disclose climate-related information that is not material.

[2] Release No 33-9106, *Commission Guidance Regarding Disclosure Related to Climate Change*, 75 Fed. Reg. 6,290 (Feb. 8, 2010).

[3] The Chamber addresses many of these issues in its 2017 white paper, *Essential Information: Modernizing our Corporate Disclosure System*.

The Chamber believes companies should disclose climate risks when material, and the SEC can provide companies with valuable structure and direction as to how to do so. A consistent theme of this comment letter, however, is that the Proposed Rules are too much, too soon and too inflexible.

Accordingly, any final rules adopted should be grounded in the established understanding of materiality, should be sensitive to the practical difficulties of meeting certain proposed disclosure requirements (including with respect to applicable compliance deadlines), and should be otherwise tailored to achieve an appropriate objective consistent with the SEC's mission and authority without potentially causing unnecessary adverse consequences, including for investors. As a result, any regulatory requirements the SEC ultimately does adopt should be revised from the current Proposal to reflect the alternatives presented below to more effectively advance the SEC's mission and provide investors with reliable, material information that assists them in making informed investment and voting decisions.

If finalized in their current form, the Proposed Rules would create significant implementation problems due to their massive scope and prescriptive particularity, centering around the inherent complexity in collecting required data and completing the calculations and analysis necessary to make the proposed disclosures. It is difficult to recall any other instance in which the SEC has mandated disclosures where there are so many significant uncertainties, data limitations and practical difficulties in developing the required information. A more streamlined approach that is principles-based, less prescriptive, and qualified by commonly-understood and traditionally-applied principles of materiality will produce a better outcome for the registrants that must prepare the disclosure and the investors who will consume it, leading to a rule that more effectively advances the SEC's mission and at a much lower cost than the current Proposal.

2. <u>The SEC Should Not Finalize Financial Reporting Rules Covering Climate Change</u>.

Proposed Article 14 of Regulation S-X is largely unworkable, and such disclosures are not likely to be material or useful for investors. The proposed requirements represent transformative rulemaking from the standpoint of financial reporting and disclosure controls, processes and procedures, but are not based on a legislative mandate and cannot be complied with using incremental builds on existing controls, processes and procedures given the vast and unprecedented scope, granularity, complexity and prescriptiveness of the Proposed Rules. Furthermore, the Proposed Rules require untold estimates, assumptions and judgments against the backdrop of significant data limitations and speculative impacts. The rigid and detailed mandates of proposed Article 14 are in stark contrast to the flexible principles regarding disclosure of climate-related financial impacts contemplated by TCFD and extend far beyond what is warranted to respond to what investors have called for, particularly in light of the high costs of compliance – costs that will be even higher to the extent these disclosures are subject to the financial statements audit. We urge the SEC not to adopt the component of the Proposed Rules for GAAP footnote disclosure of climate-related financial metrics. The SEC should instead defer to the Financial Accounting Standards Board ("FASB") for setting GAAP. To the extent the SEC nonetheless moves forward in a final rule with financial reporting requirements, such disclosures should be disclosed pursuant to existing MD&A disclosure requirements rather than be included in a registrant's financial statements. Further, if the SEC ultimately does mandate disclosures in the financial statements, materiality should be the standard for determining what must be reported instead of the 1% threshold as proposed by the Commission.

3. Scope 3 Emissions Reporting Should Be Entirely Voluntary.

Scope 3 emissions reporting should not be mandated, because of the myriad difficulties that the SEC itself recognizes in the Proposing Release. These difficulties compromise the usefulness of Scope 3 emissions disclosure, particularly when disclosed on the scale that the Proposed Rules contemplate. In its current state, when viewed in the aggregate, the nature and amount of estimation required to calculate Scope 3 emissions renders that information not material for investors. Instead of mandating Scope 3 emissions disclosures as the Proposed Rules do, the SEC should allow companies to disclose Scope 3 emissions on a voluntary basis as each company determines is appropriate. To help address the significant issues with Scope 3 emissions reporting that make mandating such reporting problematic, the Chamber stands ready to collaborate constructively to help facilitate discussions among the SEC, the EPA, the business community and other stakeholders to continue developing workable practices and methodologies that could produce consistent, comparable, and reliable Scope 3 emissions reporting on a practicable and achievable basis.

4. Permit a More Reasonable Compliance Period and Allow for a Reporting Deadline Later in the Year for Emissions Data.

The Commission should, in any final rules, extend the initial compliance deadlines by at least two years to provide the issuer community sufficient time to develop systems, controls, and audit methodologies over whatever new disclosures are ultimately adopted. This additional time will allow the SEC to better promote more reliable disclosures than a hurried compliance period. In addition to the initial compliance deadline being too soon as proposed, the timing of disclosure during the annual reporting process also presents compliance challenges.

Much of the emissions-related information in the Proposed Rules would be required in Form 10-K. Particularly for companies with a calendar fiscal year, this deadline is unreasonably tight, and for most companies (even large accelerated filers) there will be significant challenges in providing emissions-related disclosures by the required deadlines. Any perceived benefit associated with disclosures being made at the same time as a company's annual report is outweighed by the benefit of allowing companies more time so that they have a realistic opportunity to prepare disclosures that will, in turn, be more reliable and useful to investors. In short, investors benefit when registrants have the time and ability to collect the requisite data and subject the information to an effective disclosure process and set of controls and procedures. The Proposing Release acknowledges as much by permitting registrants to make use of fourth-quarter estimates under certain circumstances under proposed Regulation S-K Item 1504(e)(4)(i) as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter. While we appreciate the Commission's effort to allow an accommodation here, its proposed approach is not workable.

Indeed, the SEC's need to allow companies to use a fourth quarter estimate to meet their GHG emissions disclosure obligations is not only an accommodation the SEC has never needed to make before, but it underscores that the SEC recognizes that many companies simply will not be able to meet the emissions disclosure deadline for a variety of reasons. For example, key emissions data needed to complete the required audit may not arrive until it is too close to the deadline to be prepared for external assurance and made subject to such assurance. Moreover, including data based on these types of estimates, subject to future correction when the actual data is available, would pose significant challenges for any third party auditor of the resulting disclosure and could provide fodder for opportunistic third parties, such as politically-motivated activists, not motivated by the best interests of investors. This accommodation is not adequate to address the risk of being second-guessed and the attendant liability. It also does not help to ease potential investor confusion – if anything, use of a fourth-quarter estimate that is subsequently updated will likely spawn investor confusion and creates liability risk.

Additionally, accelerated and large accelerated filers with a calendar fiscal year would be required to make emissions disclosures under the Proposed Rules *before* the March 31 EPA reporting deadline for similar information. The March 31 EPA deadline is followed by an EPA comment period whereby disclosures are often modified in response to EPA comments, and these disclosures often do not become final until the fourth quarter of the calendar year.

Rather than front-running the EPA reporting process or providing the unusual workaround that permits disclosure of GHG emissions on the basis of a quarterly estimate, the Commission should delay the reporting deadline for emissions information to later in the year. There is already a basis for this concept within the SEC's rules. Form SD, for example, is not due until May 31. Therefore, the Commission should delay the GHG emissions reporting deadline to later in the year to avoid the need for estimates and updates to those estimates and the duplication of reporting information that is the same or similar as that reported to environmental regulators like the EPA. If the Proposed Rules are not modified to allow for a later reporting deadline, it is imperative that the SEC coordinate with the EPA to ensure consistency between the reporting regimes. To accommodate companies with different fiscal years and to allow sufficient time to collect the necessary data for reporting, any disclosure on emissions (including scope emissions) should be due no earlier than 180 days after the due date for Form 10-K for that particular registrant. If a company files emissions reports with another regulator, such as the EPA, and that regulator requires any amendment or modification of such emissions data, then the affected company should be permitted to amend its SEC disclosure without penalty or exposure to additional liability.

5. Provide for Reporting Outside the Form 10-K and Form 10-Q.

To the extent climate-related information is responsive to an existing disclosure mandate under Regulation S-K (e.g., MD&A or risk factors) it should continue to appear in Form 10-K and Form 10-Q, as applicable. However, if the Commission proceeds with requiring a separate set of bespoke climate disclosures along the lines of proposed Subpart 1500 of Regulation S-K, the required information is better suited for disclosure outside the Form 10-K and Form 10-Q. Climate disclosure of the nature and magnitude that the Proposing Release contemplates is of a different character than traditional financial and operational information that is material, whether forward-looking or historical. Among the many benefits of disclosure outside Form 10-K and Form 10-Q is that it will signal to investors that the disclosure is of a different tenor than other information that has long been required under the federal securities laws, which will work to mitigate the potential for investor confusion and distraction as discussed at length below.

6. Scope 1 Emissions Reporting Should Track EPA Regulations.

Where other disclosure systems exist, the SEC should endeavor to reduce duplication and the costs therein that are ultimately borne by investors. Elsewhere in this letter we discuss the practical challenges and shortcomings of mandated Scope 3 reporting at the current time, and as a result express the view that Scope 3 reporting should continue to be voluntary. Unlike Scope 3, however, Scope 1 reporting is already required for many issuers under EPA rules, and EPA disclosure requirements are an appropriate basis for any Scope 1 requirements adopted by the SEC. In the Proposing Release, the SEC states that "GHG emissions data compiled for the EPA's own GHG emissions reporting program would be consistent with the GHG Protocol's standards, and thus with the proposed rules," and therefore "a registrant may use that data in partial fulfillment of its GHG emissions disclosure obligations pursuant to the proposed rules."[4]

The SEC should not develop its own Scope 1 emissions reporting standards since the EPA has for years already required reporting on this information.[5] In addition to mitigating potential investor confusion were the information to appear in Form 10-K, this approach would also lead to better alignment between what the SEC proposes to mandate and environmental-related disclosures that public companies already make with the EPA or via other means of reporting.

7. Provide a Transition Period for Prior Years.

The Proposed Rules would require companies to provide GHG emissions disclosure and climate-related financial statements metrics for each year covered by the first annual report when the rules become effective. This requirement does not include a clear transition provision. In other words, even for the companies that have not started voluntarily disclosing any information, precise, quantified disclosure of metrics they have not previously tracked or reported would be required not only for the fiscal year covered by the first annual report under the newly effective reporting regime, but also for the two prior fiscal years. For example, Proposed Rule 14-01 of Regulation S-X would require disclosure for a registrant's most recently completed fiscal year and for the historical fiscal year(s) included in the registrant's consolidated financial statements in the applicable SEC filing. The Proposing Release refers to Securities Act Rule 409 and Exchange Act Rule 12b-21[6] as providing potential relief from the requirement to report on more

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[4] Proposing Release, 87 Fed. Reg. at 21,374.

[5] Any mandatory SEC GHG emissions reporting should be net of any offsets, rather than via the unusual convention in the Proposing Release that would require reporting on a gross basis without the use of offsets, which is contrary to market practices and would not accurately reflect a company's efforts to mitigate emissions.

[6] Proposing Release, 87 Fed. Reg. at 21,364.

than one year in the first year reporting is due. Nonetheless, subject to our position (described in detail elsewhere in this letter) that the SEC should not finalize financial reporting rules covering climate change, to the extent the Commission maintains this requirement and finalizes any mandate for retroactive disclosure, a clearer transition period is warranted without reliance on separate SEC rules.

For many companies, even those that have already established some level of voluntary reporting, historical information may only be available at great cost and difficulty and, even then, could be subject to significant uncertainties that would make the disclosure unreliable, if it could be provided at all. The need for third party assurance of this information, which would start as soon as the next year for GHG emissions and in the initial year for the climate-related financial statements metrics, further compounds this difficulty. If the requirements for disclosure around these metrics are maintained in any final rules, they should not apply retrospectively. While companies could be encouraged to provide information, if available, about the retrospective periods, companies should only be required to disclose new information for the year for which the first compliant annual report or other SEC filing is due.

SUMMARY OF KEY ISSUES

The remainder of this comment letter expands our discussion of many of the above alternatives and provides additional explanation as to why the totality of the Proposed Rules, as currently structured, are in many important respects unworkable and require further refinement to best serve the SEC's mission. As discussed more fully below, the Proposed Rules not only should be revised, if adopted, to reflect the above, but also should account for the following key legal, policy and economic considerations to improve them:

- **The SEC has not demonstrated that the sweeping scope of the Proposed Rules as drafted is warranted.** The Proposing Release repeatedly cites a demand for climate disclosure from select institutional investors. Although such interests warrant appropriate attention, they do not justify the whole of the Proposed Rules in terms of their combined breadth and prescriptive particularities, especially given the fact that these select investors have not requested all the required information contemplated by the Proposed Rules, nor have they requested it from all companies that are subject to reporting obligations under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Moreover, the Proposing Release is frequently dismissive of the significant climate and environmental disclosures that public companies already make, while at the same time using existing company disclosures to justify their extremely low estimate of the cost to comply with the Proposed Rules. The SEC should take a more tailored approach to disclosure.

- **If adopted, the Proposed Rules would impose weighty obligations unprecedented in the SEC's history.** The Proposed Rules, taken as a whole, would impose a vast and costly new reporting regime on public companies that dwarfs even Sarbanes Oxley implementation costs. They are in stark contrast to other critical disclosure obligations that are focused on financial disclosures, are principles-based and present information in a curated way, as viewed "through the eyes of management." The Proposed Rules would transform periodic SEC reports from filings that center on the financial and operating performance of companies into filings that, in notable respects, resemble what an environmental regulator might require and, in some cases, already requires.

- **The Proposed Rules exceed the Commission's statutory authority.** The SEC does not have general authority to impose climate- and environmental-focused regulation in the comprehensive fashion contemplated by the Proposed Rules.

- **The Proposed Rules would substantially revise the longstanding and traditional conception of materiality.** The Proposed Rules substantially deviate from the longstanding and traditional conception of materiality under the federal securities laws that for decades has advanced the best interests of investors, encouraged capital formation and helped ensure the integrity of our capital markets. The Proposed Rules often call for the disclosure of granular climate-related information that is required to be provided even if such information is immaterial under the standard of materiality the Supreme Court handed down decades ago.

- **The Proposed Rules raise serious constitutional questions.** The Proposed Rules raise significant First Amendment issues that must be addressed. The First Amendment imposes important limits on the government's ability to compel speech, including disclosure mandates under the federal securities laws like those provided for in the Proposed Rules. In their current form, the Proposed Rules violate the First Amendment. Further, the Proposed Rules are grounded in a reading of the SEC's authority that violates the non-delegation doctrine.

- **The Proposed Rules, if adopted as proposed, would result in extensive disclosure of non-material information that is not useful to investors.** Putting aside the significant burdens that would be placed on public companies to collect, prepare, and validate the new disclosures the Proposed Rules would compel, there remains substantial doubt that these new requirements will lead to better understanding of the complicated topic they cover. To the contrary, the totality of new, extensive disclosures under the Proposed Rules risk inundating investors with immaterial information and creating unnecessary confusion and misunderstanding, particularly as to the certainty of the disclosures and the meaning of the various mandated new metrics. Moreover, the new disclosure requirements – because of their unprecedented extensive, detailed, and prescriptive nature as compared to any other disclosure requirements under the federal securities laws – would place disproportionate emphasis on climate risk relative to other matters, which would make it harder for investors to discern and use the material information about non-climate related matters contained elsewhere in annual reports and registration statements or even the material climate-related information that companies already disclose in filings. Indeed, it is important to underscore that material climate-related disclosures already are made by companies, including as part of their risk factor and MD&A disclosures.

- **The Proposed Rules, if enacted, would discourage companies from entering or remaining in the public markets.** Seeing the vast cost and complexity of the new climate reporting regime, the real potential to divert managerial resources from other elements of the business, including resources needed to implement actions that actually reduce GHG emissions, and the opportunity for increased shareholder activism, many private companies will avoid accessing the public markets, limiting opportunities for retail investors to participate in the next generation of public company value creation. Many existing U.S.-listed public companies are likely to reach a similar conclusion and pursue efforts to exit the U.S. public markets while also avoiding transactional opportunities that could create value for U.S. shareholders, such as potential mergers, if pursuing such opportunities would require them to become subject to SEC-mandated disclosure obligations.

- **The nature and degree of the SEC's reliance on unregulated standard setters raise concern.** Many companies have been guided in their voluntarily reporting of climate-related risks and GHG emissions by the TCFD recommendations and the GHG Protocol. While voluntary reporting under these or other voluntary standards is entirely appropriate, the analysis is different when the SEC transforms voluntary standards into mandatory ones. The Chamber believes that, if the SEC adopts climate-related rules, the TCFD recommendations and the GHG Protocol should be considered and taken into account in preparing the rule. However, the SEC may not rely on TCFD and the GHG Protocol without undertaking a rigorous analysis of their appropriateness as mandatory requirements as compared to voluntary guidelines and frameworks. These organizations were created to address various policy considerations and respond to constituencies beyond those of the U.S. capital markets and investors. The process for third parties developing these voluntary standards is not subject to the rigors of the Administrative Procedure Act, and many of the standards address topics and are intended to achieve objectives far removed from the SEC's core expertise and authority as a capital markets regulator.

- **The SEC should not impose a GHG emissions attestation requirement.** The proposed GHG emissions attestation requirement poses significant implementation challenges. Instead of a mandatory assurance regime, GHG emissions attestation should continue to be voluntary.

- **If the SEC mandates Scope 3 disclosures, then it should revise and expand the disclosure safe harbor.** While the Chamber is of the view that requiring reporting of Scope 3 emissions would exceed the Commission's authority, should the SEC mandate their disclosure, then the proposed safe harbor from Scope 3 emissions disclosure liability is too narrowly crafted and does not provide adequate relief. Furthermore, the Commission should employ a meaningful safe harbor not just for Scope 3 emissions disclosures, but rather should provide a meaningful safe harbor to cover the entirety of the disclosure provided in response to any final rules in light of the unique challenges that the SEC itself recognizes companies must overcome to meet the proposed climate-related disclosure obligations.

- **The SEC should extend the effective dates of any final rules.** Given the scope and breadth of the Proposed Rules, as well as the new processes, procedures, systems and controls companies will be required to develop to ensure their ability to comply, a significantly longer transition period is needed. To provide a reasonable transition to compliance with any final rules, the Commission should provide for effective compliance dates two years beyond those indicated in the Proposing Release. To accommodate special challenges posed in mergers and acquisitions, the Commission should permit companies to delay reporting on acquired businesses for an additional year from the date of acquisition.

- **The economic analysis in the Proposing Release is incomplete and substantially underestimates compliance costs.** As the Commission's former Chief Economist, James Overdahl, explains in the report attached hereto as Annex A (the "Overdahl Report"), the Commission has failed to adequately assess the existing economic baseline, underestimated and ignored substantial costs of the Proposed Rules, and disregarded marginal costs and benefits, among other significant defects in the Commission's economic analysis.

- **The compressed comment period has significantly impeded the public's ability to comment on the Proposed Rules in a thorough way.** The Proposed Rules run 140 pages in the *Federal Register* and pose over 700 discrete questions. Even with a 28-day extension to the public comment period, the comment period duration has not afforded the public sufficient opportunity to study the vast Proposing Release and perform the kind of sophisticated analysis required by a rulemaking of such breadth and complexity. At the same time, the Commission has proposed a litany of other rules, all with similarly brief comment periods that overlap one another, which in total run over 1,000 pages in the *Federal Register*. The Chamber's own efforts to gather member feedback while analyzing and responding to the Proposing Release were substantially impeded by the inadequate comment period.

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OUTLINE OF DISCUSSION

I. THE SWEEPING BREADTH, PARTICULARITY AND PRESCRIPTIVENESS OF THE PROPOSED RULES IS NOT WARRANTED.

   A. The SEC has not demonstrated that the sweeping scope of the Proposed Rules as drafted is warranted.

   B. If adopted, the Proposed Rules would impose weighty obligations unprecedented in the SEC's history.

      1. Compliance with the Proposed Rules would impose significant burdens and costs on registrants.

      2. Climate disclosures should be materiality-focused and principles-based.

      3. The climate-related information required by the Proposed Rules could be provided in response to a number of existing disclosure requirements.

      4. There is potential for misuse of SEC-mandated climate information.

      5. The Proposed Rule seems aligned with implementing the Administration's climate change goals.

   C. The Proposed Rules exceed the Commission's statutory authority.

      1. The SEC's authority is limited to disclosure of information that is financial in nature and necessary for investors to assess a security's value.

      2. The Proposed Rules are neither necessary nor appropriate for investor protection or the public interest.

D. The Proposed Rules would substantially revise the longstanding and traditional conception of materiality.

E. The Proposed Rules raise serious constitutional questions.

1. The Proposed Rules violate the First Amendment.

2. The Proposed Rules are grounded in a reading of the SEC's authority that violates the non-delegation doctrine.

II. THE PROPOSED RULES WILL LEAD TO SERIOUS ADVERSE CONSEQUENCES IF NOT SIGNIFICANTLY IMPROVED

A. The Proposed Rules, if adopted as proposed, would result in extensive disclosure of non-material information that is not useful to investors.

B. The Proposed Rules, if enacted, would discourage companies from entering or remaining in the U.S. public markets.

III. THE PROPOSED RULES MUST BE SUBSTANTIALLY REVISED IF ADOPTED.

A. The nature and degree of the SEC's reliance on unregulated standard setters raise concern.

B. The SEC should not create new financial reporting rules covering climate change.

1. The proposed 1% materiality threshold is unworkable.

2. Proposed Article 14 presents innumerable implementation difficulties and will result in extensive disclosure of immaterial information.

3. The SEC should not bypass the traditional FASB standard-setting process.

4. The climate-related financial statement metrics depart significantly from the TCFD recommendations.

C. The SEC should not impose a GHG emissions attestation requirement.

1. The proposed attestation requirements are an unnecessary departure from longstanding practice and pose significant implementation challenges.

2. Third-party attestation of Scope 1 and 2 emissions adds another costly layer to the proposed reporting requirements.

3. Attestation should continue to be voluntary.

D. Scope 3 emissions reporting should be entirely voluntary.

1. Scope 3 emissions are difficult to identify and accurately quantify and are uniquely uncertain and speculative.

2. Gathering reliable data to quantify Scope 3 emissions is costly.

3. The safe harbor provision for Scope 3 emissions disclosures does not provide the relief that is required for companies that would be subject to this reporting requirement.

4. Scope 3 emissions disclosures are inherently incomparable.

E. If the SEC mandates Scope 3 disclosures, then it should revise and expand the disclosure safe harbor.

1. The proposed safe harbor is too narrow.

2. The scope of Securities Act Rule 409 and Exchange Act Rule 12b-21 should be expanded and clarified with respect to climate-related disclosures.

F. The SEC should provide a transition period for prior years.

G. The SEC should permit a more reasonable compliance period and allow for a reporting deadline later in the year for emissions data.

H. The SEC should permit omission of disclosure by registrants that are wholly-owned subsidiaries of other reporting companies.

I. The SEC should not require reporting on an organizational boundary basis.

J. The SEC should extend the effective dates of any final rules.

1. The Proposed Rules do not allow for sufficient transition time.

2. The Commission should permit additional transition time for acquired businesses or assets.

IV. THE COST-BENEFIT ANALYSIS IN THE PROPOSING RELEASE IS INADEQUATE TO JUSTIFY THE ENTIRETY OF THE PROPOSED RULES.

A. The economic analysis in the Proposing Release is incomplete and substantially underestimates compliance costs.

B. The compressed comment period has significantly impeded the public's ability to comment on the Proposed Rules in a thorough way.

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DISCUSSION

I. THE SWEEPING BREADTH, PARTICULARITY AND PRESCRIPTIVENESS OF THE PROPOSED RULES IS NOT WARRANTED.

A. The SEC has not demonstrated that the sweeping scope of the Proposed Rules as drafted is warranted.

The Proposing Release repeatedly cites a demand for climate disclosure from select institutional investors. Investor demand for certain information may be driven by reasons other than such information being necessary to make a voting or investment decision and does not necessarily establish the materiality of such information for purposes of federal securities regulation. Although such interests warrant appropriate attention, they do not justify the whole of the Proposed Rules in terms of their combined breadth and prescriptive particularities. As an initial matter, investor demand for more climate information from public companies is not tantamount to investor demand for the totality of the Proposed Rules and the countless granular disclosure mandates the Proposed Rules would impose on companies. Moreover, although a part of the assessment, demand by certain investors for information does not substitute for a rigorous cost-benefit analysis by the SEC that considers the full range of institutional and retail investors, as well as other policy goals and objectives consonant with the SEC's mission as a capital markets (as compared to environmental) regulator.

In the context of the totality of material information that is made available to investors with a direct nexus to valuing a company and corresponding investor decision making, the Proposed Rules place disproportionate emphasis on matters relating to climate if the regulatory objective is to help investors seek and earn investment returns. The Proposed Rules are difficult to justify in the aggregate if the SEC is adhering to its traditional mission rather than regulating more akin to how a climate regulator would regulate.

The Proposing Release is frequently dismissive of the significant climate and environmental disclosures that public companies already make, both within SEC filings and in stand-alone sustainability or ESG reports, except to the extent the Proposing Release argues that because companies currently voluntarily disclose some of the information the Proposed Rules would mandate, the burden of the SEC's extensive and comprehensive proposed requirements is lessened. As discussed in more detail herein, the SEC is underestimating the value of the existing disclosures and the extent and difficulty of what companies will need to undertake to come into compliance notwithstanding present disclosure practices. All this causes pause when it comes to determining the marginal benefit versus marginal cost of the Proposed Rules when taken as a whole in light of other useful climate-related information investors already can access. The fundamental issue of whether full compliance with the Proposed Rules will have any meaningful benefit on climate or the environment is not within the SEC's mandate and not addressed in the Proposing Release.

There is great variation in the impacts climate-related risks may have on a company, in whether those impacts are material, and in what climate-related risks may impact a company. Likewise, the impacts of climate change on individual businesses are often far from certain, as the Proposing Release acknowledges, particularly when attempting to predict impacts that are years or even decades away and rooted in numerous scientific and economic uncertainties, which are unknown or even unknowable at this time. After accounting for uncertainty and discounting to present value, the effects of climate change are often not material for those seeking a financial return on their investments.

Record evidence confirms that climate-related information is often not material. The recent comment letter exchanges based on the form climate disclosure comment letter (i.e., a "Dear CFO,…" letter) published by the SEC staff in September 2021 similarly undercut the notion that climate-related information is often material.[7] In these exchanges, companies generally stated that the climate-related disclosures requested by the SEC staff – which resembled disclosures contemplated by the Proposed Rules – were not being included in the applicable filing because such disclosures were not material for financial and operating performance purposes.[8] The Sustainability Accounting Standards Board ("SASB") has made consistent findings – that climate-related risks are unlikely to be financially material to many industries – in its recently published climate risk technical bulletin.[9]

The proliferation of sustainability and ESG reports that include climate disclosure (often based on some of the same GHG Protocol and TCFD standards the SEC cites approvingly in the Proposing Release) over the past decade represent an effective forum that allows companies to voluntarily provide the customized kind of disclosure most appropriate to understanding their business. SEC periodic reports that companies file also routinely include climate-related disclosure, when material. Accordingly, the SEC has not demonstrated that the entirety of the expansive detailed disclosures that the Proposed Rules would mandate are warranted given that investors are already receiving material climate-related information under the SEC's current disclosure requirements as well as other climate-related information contained in sustainability or ESG reports that companies issue, going above-and-beyond the material information the federal securities laws currently mandate.

Further, the valuation of a company is based on a multitude of factors, including public perception of its brand and products, expertise of its management team, earnings and other financial metrics, the intrinsic value of its tangible and intangible assets and prospects for future growth. Climate, when material, is only one part of many considerations in the valuation picture. And even then, climate-related information can largely be extracted from publicly observable information, such as industry sector, company size, and the like. The type of disclosure requirements embodied in the Proposed Rules would place disproportionate emphasis on climate risk relative to other matters, which would make it harder for investors to discern and use the material information about non-climate-related matters contained elsewhere in annual reports and registration statements or even the material climate-related information that companies already disclose in filings, including as part of their risk factor and MD&A disclosures. The Proposed Rules should not mandate that companies disclose climate-related information that is not material.

B. If adopted, the Proposed Rules would impose weighty obligations unprecedented in the SEC's history.

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[7] Div. of Corp. Fin., Sec's & Exch. Comm'n, *Sample Letter to Companies Regarding Climate Change Disclosures* (modified Sept. 22, 2021), available at https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.

[8] *See* Nicola M. White, *SEC Drops Hints About ESG Rule in Retorts to Vague Disclosures*, Bloomberg Law (Mar. 18, 2022), available at https://news.bloomberglaw.com/securities-law/sec-scrutiny-of-big-companies-sheds-light-on-climate-priorities.

[9] Sustainability Accounting Standards Board, *Climate Risk – Technical Bulletin* (April 12, 2021), available at https://www.sasb.org/knowledge-hub/climate-risk-technical-bulletin/

1. Compliance with the Proposed Rules would impose significant burdens and costs on registrants.

The Proposed Rules, taken as a whole, would impose a vast and costly new reporting regime on public companies that goes well beyond the climate disclosures that companies generally make under current disclosure requirements and market practices. Indeed, it is exceedingly difficult to determine from the Proposed Rules the outer limits of what an issuer would have to disclose.

The Proposed Rules are in stark contrast to other critical disclosure obligations that the SEC has mandated public companies make. Rather than impose across all public companies a one-size-fits-all set of prescriptive disclosure mandates, as the Proposed Rules would, the SEC's longstanding central disclosures seek to present information in a curated way, as viewed "through the eyes of management,"[10] as the most effective manner of ensuring that investors have actionable, material information without inundating them with information of less significance. Conversely, with the Proposed Rules, the SEC departs from the approach that has guided the agency for decades in fashioning its disclosure framework, singling out climate risk as uniquely deserving, in the SEC's view, of an extensive set of detailed disclosure requirements that will yield disclosures that contain a tremendous amount of new, often immaterial information that is sure to overwhelm and will often not be useful to investors. Furthermore, because a great deal of the climate-related risk disclosures that the Proposed Rules mandate are so speculative and uncertain and, in some instances, the requisite information is not available and compliance with the obligations would be unworkable, the current Proposed Rules would fall short of the Commission's goal of increased consistency and comparability of disclosures across public companies. Therefore, expectations regarding enhanced reliability and comparability must be tempered, and this justification for the Proposed Rules must be questioned.

The Proposed Rules would transform periodic SEC reports from filings that center on the financial and operating performance of companies into filings that center on climate change and, in notable respects, resemble what an environmental regulator might require. The Proposing Release inadequately justifies the need for the totality of the SEC's numerous scientific and technical policy choices that are embedded in the Proposed Rules, instead unduly deferring to the stated preferences of a limited number of institutional investment firms and non-governmental organizations, as well as the conclusions reached by third-party voluntary standard setters that the SEC neither supervises nor regulates.

The Commission makes clear that it believes building on the TCFD recommendations will result in substantial compliance cost savings by enabling companies to efficiently leverage the framework with which many investors and issuers are already familiar. The Chamber disputes this notion. If the Proposed Rules are adopted, the compliance burden on all companies, even those that already report to some extent under TCFD, would be expanded dramatically. Notwithstanding

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[10] *See, e.g.*, Release No. 33-10890, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, 86 Fed. Reg. 2,080, at 2,089 (Nov. 19, 2020) (citing prior Commission interpretive releases from 1989 and 2003 that also reference "the eyes of management").

the fact that the SEC has modeled the Proposed Rules in part on the TCFD recommendations in a stated attempt to mitigate the compliance burden for issuers,[11] the reality is that even those companies that have already spent significant time and resources establishing climate-related reporting infrastructure will have a great deal of work to do if the Proposed Rules are made final in their current form.[12] As data presented in the Proposing Release makes clear, [13] U.S. companies currently select elements of the TCFD recommendations to follow and predominantly do not adhere to all parts of the framework. A similar conclusion can be drawn from the global reporting data that the Proposing Release itself references, as presented in the TCFD's 2021 status report (the "2021 TCFD Status Report").[14] Instead of disclosing everything that TCFD contemplates, companies have focused on that which is most meaningful to understanding their business and the potential risks and impacts climate may impose upon it, and what is reported varies in its extent and depth, in accordance with the latitude afforded by the TCFD recommendations. This is consistent with the principles-based nature of the TCFD recommendations, which are distinctly different than the granular and prescriptive disclosure mandates of the Proposed Rules.

The Proposed Rules go well beyond the TCFD recommendations, and some of the disclosures required by the Proposed Rules, such as the climate-related financial statements metrics contemplated by the proposed new Article 14 of Regulation S-X, have no real precedent in the TCFD recommendations. We note that given the lack of clarity as to how companies could operationalize the estimation of climate risk financial impacts demanded by proposed new Article 14 of Regulation S-X – in light of, among other things, the significant estimates and assumptions that would be required for each significant climate risk identified by a company – we anticipate that many companies would need a dedicated team to perform the analysis in each reporting period, comprising several functions (e.g., Finance, Sustainability, Environmental), to evaluate changes in operational costs that may be driven by climate-related events or transition activities. Various new processes and controls would need to be implemented to gather the data, perform the estimates, and comply with the Sarbanes-Oxley Act of 2002 (as amended, the "Sarbanes-Oxley Act"). Also, given the significant estimates and assumptions that would be involved and the need for new Article 14 disclosures to be audited, there would be significant additional costs associated with external audits.[15]

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[11] Proposing Release, 87 Fed. Reg. at 21,346.

[12] For example, a Well Known Seasoned Issuer that has made TCFD-aligned disclosures public on its website (including Scope 1, Scope 2 and Scope 3 GHG emissions disclosures) estimates that, combined with the amounts the company currently spends on voluntary climate disclosure, the company would need to spend a total of approximately $35 million over five years to implement climate-related reporting in order to comply with the Proposed Rules if they are made final in their current form. Within this amount, the company estimates one-time expenses of $19 million and recurring expenses averaging $3.1 million per year. The primary categories of expenses are audit fees, professional services, subscriptions, labor, licenses and training. These amounts are in stark contrast to the SEC's estimated cost of compliance for non-SRC registrants at $640,000 in year 1 and $530,000 in subsequent years.

[13] Proposing Release, 87 Fed. Reg. at 21,423.

[14] Task Force on Climate-related Financial Disclosures, *2021 Status Report* (October 2021), available at https://assets.bbhub.io/company/sites/60/2022/03/GPP_TCFD_Status_Report_2021_Book_v17.pdf.

[15] One Well-Known Seasoned Issuer we consulted with estimates the costs for compliance with proposed new Article 14 of Regulation S-X alone would be approximately $1.5 million - $2.5 million in year 1 of compliance, and likely $1.0 million - $2.0 million annually on an ongoing basis.

The cost – both in terms of expenses that would directly impact companies' financial performance and in terms of the diversion of time and attention of management away from the matters that are most financially and operationally material to the company – would be significant and would meaningfully exceed the estimates set forth by the SEC in the Proposing Release. We also note that the burden of compliance costs, relatively speaking, would fall heaviest on smaller companies that are far more likely to be starting from scratch in providing climate-related information and also are not able to benefit from the economies of scale of larger companies that mitigate the impact of fixed costs, which would be higher proportionately for smaller companies.

Private companies also would be swept up in the new requirements since they make up significant parts of public companies' value chains. It is not a surprise that more than two decades after the release of the GHG Protocol, it remains necessary for virtually all companies to rely upon assumptions, estimates and judgment to develop their Scope 3 emissions inventories and draw the requisite conclusions. The Proposing Release makes no effort to quantify the burdens and costs on private companies that would be required to expend significant time and effort measuring emissions and replying to requests for climate data from public companies upstream or downstream from them in the supply chain. Nor does the Proposing Release address the consequences if a registrant is unable to obtain the necessary information from private companies to meet a registrant's reporting obligations reliably.

More indirectly, but no less importantly, private companies face the potential adverse consequence of losing revenues, profits and valuable commercial relationships if public companies choose not to continue to do business with them because of their inability to provide data needed for public companies to comply with the Proposed Rules, and the Proposed Rules may also disincentivize registrants from using small, local and diverse suppliers in the first place.

2. Climate disclosures should be materiality-focused and principles-based.

The Supreme Court's traditional materiality standard should continue to be the guidepost that the SEC adheres to when crafting new disclosure obligations applicable to filed reports by reporting companies. Preserving the materiality standard will continue to ensure issuer and investor confidence in the relevance of information that promotes market efficiency, competition, liquidity and price discovery. Pursuing the more prescriptive set of disclosure mandates contemplated by the Proposed Rules could ultimately result in a disclosure system that does not provide investors with relevant information related to climate and other ESG matters and, conversely, inundates investors with disclosures that obfuscate what is truly material by giving these matters, on a prescriptive basis, disproportionate prominence relative to other matters. A far-reaching "one-size-fits-all" collection of such detailed and granular disclosure mandates that deprives management of the opportunity to emphasize in the company's disclosures what is most important to the company's strategy and risk management could prove counterproductive for investor protection, capital formation, competition and efficiency.

The Proposed Rules are prescriptive and require information to be provided whether or not it is material. This shortcoming is most prominently the case with respect to GHG emissions reporting and the climate-related financial metrics mandated by proposed Regulation S-X Article

14, which we discuss in more detail elsewhere in this letter; but there are other elements of the Proposed Rules that represent prescriptive requirements without a materiality qualifier. Case in point: the approach the SEC takes in proposed Regulation S-K Items 1502 (Climate-Related Risks and Impacts on Strategy, Business Model and Outlook), 1503 (Risk Management), 1504 (GHG Emissions Metrics) and 1506 (Targets and Goals) is a dramatic departure from the approach the SEC has taken in Regulation S-K Items 105 (Risk Factors) and 303 (MD&A).

A materiality-focused and principles-based approach to climate-related disclosures, consistent with the Commission's longstanding approach to disclosure, would be better suited to providing investors with relevant, useful information. Under this approach, all (or even some) of the disclosures required to be provided in response to proposed Regulation S-K Items 1501, 1502, 1503, 1504 and 1506 as well as proposed Article 14 would be qualified with a statement that responsive information need only be provided to the extent material to understanding a company's business and its financial and operating performance, including the material risks the business faces. Companies would then be able to evaluate and adapt the information they provide so that disclosures are most useful and give investors a view of what is material to the company when it comes to climate related matters through the eyes of management. This would be consistent with the objective articulated in the Proposing Release that the narrative discussion and analysis regarding climate should "serve a similar function to the MD&A but will focus on climate-related risk specifically."[16]

This approach is consonant with how federal securities law disclosure mandates have been crafted for decades. If maintained, this approach will continue to allow reporting of material climate-related information in SEC filings to evolve over time so that what is disclosed does not overload investors and does not become outdated as our understanding of climate risk and risk management techniques change. Accordingly, materiality-focused and principles-based disclosure obligations would continue to serve the interests of both the companies responsible for preparing disclosures and the investors who use the information. For Proposed Rules that regulate disclosures concerning a subject that is as dynamic as climate risk, allowing companies this flexibility is critical so that disclosures remain relevant as facts and circumstances evolve and the relative significance of different risks (and opportunities) to the company changes. The best way to ensure that disclosures are as dynamic as the facts and circumstances they describe is to allow companies flexibility in determining what matters most and what makes for the most effective communications with investors and the marketplace. This would also help address the First Amendment concerns associated with the Proposed Rules.

As the SEC articulated in its recent adopting release updating the rules governing MD&A, a "materiality-focused and principles-based approach facilitates disclosure of complex and often rapidly evolving areas, without the need to continuously amend the text of the rule to update or impose additional prescriptive requirements."[17]

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[16] Proposing Release, 87 Fed. Reg. at 21,348.
[17] *See generally* Release No. 33-10890, *supra* note 10.

In practice, companies need to be able to wield flexibility in reporting the information they and their investors deem relevant without overwhelming investors with information that is not useful when it comes to understanding that company's financial and operating performance. Including the ability to omit inapplicable, irrelevant and immaterial requirements in line with the SEC's typical materiality-focused and principles-based approach provides issuers the ability to precisely disclose useful information to investors without distracting them with information that is not useful and could be counterproductive.

As the SEC articulated in its recent adopting release on Modernization of Regulation S-K Items 101, 103 and 105:

> Each registrant's disclosure must be tailored to its unique business … and facts and circumstances …. [W]e did not include more prescriptive requirements because we recognize that the exact measures and objectives included in human capital management disclosure may evolve over time and may depend, and vary significantly, based on factors such as the industry, the various regions or jurisdictions in which the registrant operates, the general strategic posture of the registrant … as well as the then current macro-economic and other conditions that affect human capital resources, such as national or global health matters …. Given the varied and evolving nature of human capital considerations, we believe that this approach will likely lead to more meaningful disclosure being provided to investors.[18]

While the passage above refers to human capital management - another subset of ESG disclosures - the SEC's analysis in that context also should apply equally to climate-related disclosures. The Commission has not convincingly justified why, fewer than two years later, such a markedly different approach is warranted.

The TCFD recommendations, which serve as the putative model for the SEC's approach to climate-related disclosures, do not take a rigid and prescriptive approach and instead establish a principles-based framework that acknowledges the dynamic and varied landscape of climate-related disclosures. The TCFD recommendations, when they were first published in 2017[19] and as updated in 2021 (the "2021 TCFD Implementation Annex"), set forth as a fundamental tenet that "changes in disclosures and related approaches or formats (e.g., due to shifting climate-related issues and evolution of risk practices, governance, measurement methodologies, or accounting practices) can be expected due to the relative immaturity of climate-related disclosures." [20] The

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[18] Release No. 33-10825, *Modernization of Regulation S-K Items 101, 103, and 105*, 85 Fed. Reg. 63,726, 63,739 (Aug. 26, 2020).

[19] Task Force on Climate-related Financial Disclosures, *Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), available at https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf.

[20] Task Force on Climate-related Financial Disclosures, *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), available at https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing_Guidance.pdf, at 71 .

2021 TCFD Implementation Annex also acknowledges that "the level of exposure and the impact of climate-related risks differ by sector, industry, geography, and organization."[21] In this context, the analysis of current disclosure practices contained in the 2021 TCFD Status Report illustrates that, in practice, different companies and industries have taken advantage of the flexibility of the TCFD recommendations in tailoring their disclosures.[22] Given the Proposed Rules' reliance on the TCFD recommendations, the Commission must justify why it is appropriate to codify, as a hard and fast SEC regulation, recommendations that the TCFD itself has indicated must be flexible and periodically updated.

3. The climate-related information required by the Proposed Rules could be provided in response to a number of existing disclosure requirements.

As the Proposing Release frequently acknowledges, and as described below, almost all of the new disclosures required, if qualified by materiality, would be responsive to requirements under the SEC's existing rules. These disclosure requirements demonstrate that companies are already required to disclose material ESG information under current law; in other words, the characterization of information as related to climate or other topics now considered to fall under the "ESG umbrella" does not render, when material, such information qualitatively different from any other information companies are required to disclose under current securities regulation and does not justify any different treatment for such information. For example, in the Proposing Release, the SEC states that no climate-related compensation disclosure requirement has been proposed because the SEC believes that the existing rules requiring a compensation discussion and analysis should already provide a framework for relevant climate-related disclosure in this area.[23] The same should be true with respect to other relevant and material climate-related information. To the extent there is concern that companies are not adequately disclosing material climate-related information, the SEC could provide issuers updated or additional interpretive guidance regarding potential disclosure topics and considerations to keep in mind as they identify material climate-related information in response to extant disclosure mandates, as detailed below.

- *Proposed Article 14 of Regulation S-X*. As discussed in more detail elsewhere in this letter, this component of the Proposed Rules generally requires quantitative and qualitative disclosures of the financial impacts of climate-related matters, including climate-related financial statement metrics, in companies' historical financial statements. To the extent disclosures responsive to this proposed requirement are material, they could be disclosed pursuant to existing MD&A requirements.

  The overall objective of MD&A, as set forth in Regulation S-K Item 303(a), is:

  > [T]o provide material information relevant to an assessment of the financial condition and results of operations of the registrant including an evaluation

[21] *Id*. at 9.

[22] The 2021 TCFD Status Report found that the percentage of companies with responsive disclosure ranged from 13% to 52% for the 11 categories of disclosure in the TCFD recommendation. The percentages also varied by industry, ranging from 38% for materials and buildings companies to 16% for technology and media companies.

[23] Proposing Release, 87 Fed. Reg. at 21,360.

> of the amounts and certainty of cash flows from operations and from outside sources. The discussion and analysis must focus specifically on material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This includes descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are reasonably likely based on management's assessment to have a material impact on future operations.

More specifically, Regulation S-K Item 303(b) requires discussion and analysis of, among other things, (i) the underlying reasons for material changes from period-to-period in one or more line items in quantitative and qualitative terms without regard for offsets, (ii) any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way, (iii) the registrant's material cash requirements, including commitments for capital expenditures, (iv) any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations, and (v) material changes in financial condition from period to period. There is nothing in Item 303(b) that excludes discussion of these items if they are related to climate change.

These requirements focus management on describing the impacts of risks and events that have affected and may affect the company's financial results, including climate-related risks and events, which is the essence of the Proposed Rule, and are presented with as much contextual information, qualitative and quantitative, as management determines is useful and appropriate for investors to make informed decisions about the company. Therefore, any such items related to climate change should already be discussed by management pursuant to Item 303(b), and the Proposed Rule is unnecessary.

- *Proposed Item 1501 of Regulation S-K.* This element of the Proposed Rules generally requires disclosure describing the board's oversight of climate-related risks and management's role in assessing and managing climate-related risks.

  Disclosure of the type that would be responsive to proposed Regulation S-K Item 1501 could be provided pursuant to Regulation S-K Item 407(h), which requires disclosure regarding the extent of the board's role in the risk oversight of the registrant, such as how the board administers its oversight function. As an actual matter, many companies already choose (even to the extent not required to do so by applicable SEC rules) to provide extensive and detailed disclosures regarding their governance structures and practices with respect to ESG matters relevant to the company and its operations, including climate change and the environment, as part of detailed narrative descriptions in annual proxy statements regarding their overall governance. Such current disclosures could be leveraged to accomplish the objectives of this element of the Proposed Rules. Instead of proposing a completely new rule, the SEC could instead revise the existing rule to focus companies on providing climate-related risk information, to the extent material. Moreover, Regulation S-

K Item 401(e)(1) already requires a discussion of the specific experience, qualifications, attributes or skills that led each director to be nominated to serve on the board. This requirement provides an alternative to the mandatory requirement in proposed Regulation S-K Item 1501(a)(ii) to disclose whether any board member has expertise in climate-related risks and related details because it underscores that, to the extent relevant, information regarding such expertise is already subject to disclosure under existing SEC rules.

- *Proposed Item 1502 of Regulation S-K.* These Proposed Rules generally require disclosure of climate-related risks applicable to the company and related information regarding the company's approach to climate-related risks and their actual or potential impact on the registrant's strategy, business model, outlook, financial planning, capital allocation and consolidated financial statements.

  Key features of this proposed requirement are already required to be disclosed if material, as the SEC suggested in its 2010 guidance[24] on how existing disclosure rules may require disclosure of the impacts of climate change on a registrant's business or financial condition, in a company's disclosures under business (Regulation S-K Item 101), risk factors (Regulation S-K Item 105), legal proceedings (Regulation S-K Item 103) and MD&A (Regulation S-K Item 303). While not a focus in the 2010 guidance given that subsequent amendments to the applicable rules had not yet taken effect, we note Regulation S-K Item 101(a)(1)(i), which contemplates disclosure of any material changes to a previously disclosed business strategy. This disclosure enhancement is worth noting because it presumably would, for some companies depending on their respective facts and circumstances, contemplate disclosure of transition plans or other climate-related strategies adopted by a company and confirms that any such disclosure is subject to update.

  Additionally, the Regulation S-K Item 102 requirement for a company to disclose the location and general character of the registrant's principal physical properties could result in the provision of disclosures regarding properties subject to physical risk like those contemplated by proposed Regulation S-K Item 1502(a)(1)(i), but would require only material information, not the immaterial information (such as the zip code location of all of a company's assets) contemplated by proposed Regulation S-K Item 1502(a)(1)(i).

- *Proposed Item 1503 of Regulation S-K.* This element of the Proposed Rules generally requires disclosure of any processes the registrant has for identifying, assessing and managing climate-related risks and also requires certain disclosures regarding any transition plan that has been adopted by a company. The analysis above regarding proposed Regulation S-K Items 1501 and 1502 would generally apply here, too.

- *Proposed Item 1504 of Regulation S-K.* This element of the Proposed Rules generally requires disclosure of GHG emissions. The analysis above regarding proposed Regulation S-K Item 1502 would generally apply here, too.

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[24] *See* Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 2.

- *Proposed Item 1506 of Regulation S-K.* This element of the Proposed Rules generally requires certain disclosures regarding any targets or goals (including interim targets or goals) related to the reduction of GHG emissions set by a company, or any other climate-related target or goal to which the company is subject. These required disclosures would include the parameters of the target or goal (such as what metric does the target or goal relate to and over what time period is it supposed to be achieved), how the company intends to meet the target or goal and a requirement to disclose annual progress updates towards achievement of the target or goal. Proposed Regulation S-K Item 1506(a)(2) makes clear that a company may provide the disclosures required by proposed Regulation S-K Item 1506 as part of the company's disclosure in response to proposed Regulation S-K Item 1502 and 1503, and our analysis regarding such proposed items set forth above would also apply here. This analysis includes our belief that targets, goals and related information – including how the company intends to meet the target or goal and then provide annual progress – should be required to be disclosed only if it is material.

As noted above, many businesses have disclosed climate risk since the release of the 2010 guidance. This raises the question whether such a prescriptive approach, as employed by the SEC in the Proposed Rules, will provide any more material information or if, rather, an approach that seeks to enhance the 2010 guidance would suffice as an alternative to increase disclosure if needed.

4. <u>There is potential for misuse of SEC-mandated climate information.</u>

We are also concerned about the future potential for non-investor groups to use information disclosed under the Proposed Rules in a way that is detrimental to a company's investors. We are particularly apprehensive that special interest groups, making use of newly required information that by the Commission's own admission depends substantially on estimates and may be incomplete, will increase the frequency and magnitude of boycotts, protests and other pressure campaigns against public companies, private companies in their supply chains and individual executives and employees. The frequency of shareholder proposals under Rule 14a-8 is also likely to increase, further adding costs and leading to additional diversion of management time and attention from other strategic pursuits associated with running the business. Activist investors who do not represent the broad interests of all investors may seek to use information disclosed under the Proposed Rules to ratchet up pressure on public companies as well.

The Commission has failed to consider how these investor and non-investor groups can be expected to use the proposed disclosures to pursue their own "self-interested objectives rather than the goal of maximizing shareholder value."[25] Given the scope, breadth and depth of the Proposed Rules' disclosure mandates that all public companies would be subject to – and that would indirectly impact private companies that are part of public companies' value chains – an increase in "greenwashing" lawsuits seems likely, and could be accompanied by an increase in SEC enforcement actions. As discussed in more detail elsewhere in this letter, the Proposed Rules contemplate an additional new safe harbor, but its scope is too narrow. We have requested expansion of this safe harbor, but, even if the safe harbor is improved, companies are still subject

[25] *Bus. Roundtable & U.S. Chamber of Commerce v. SEC*, 647 F.3d 1144, 1152 (D.C. Cir. 2011).

to significant potential litigation costs as a result of the Proposed Rules. Safe harbors do not prevent opportunistic plaintiff's lawyers from filing suits, which must be defended at significant expense, even if they do not ultimately result in any legal liability for the company.

5. The Proposed Rule seems aligned with implementing the Administration's climate change goals.

Because of their unprecedented breadth, particularity, and prescriptiveness, the Proposed Rules appear to be set forth as part of a broader effort by the Biden Administration to address climate change challenges. The Biden Administration has taken concrete steps to prioritize climate change and institute mandatory climate reporting in various arenas.[26] Climate-risk disclosure has

[26]*See, e.g.,*

- Executive Order 14008, 86 Fed. Reg. 7,619 (Feb. 1, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-02-01/pdf/2021-02177.pdf (This Order announced the Biden Administration's whole-of-government approach to climate change for both domestic and foreign affairs. In a relevant part, the Order stated that "[t]he Federal Government must drive assessment, disclosure and mitigation of climate pollution and climate-related risks in every sector of our economy, marshalling the creativity, courage and capital necessary to make our Nation resilient in the face of this threat" (86 Fed. Reg. at 7,622 (emphasis added)).

- Executive Order 14030, 86 Fed. Reg. 27967 (May 25, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-05-25/pdf/2021-11168.pdf (This Order asked key federal agencies and financial regulators to embed climate risk considerations into all aspects of federal government spending and oversight. This was an early step taken by the Administration in developing a government-wide strategy on climate-related financial risk).

- G7 "Carbis Bay communique" White House Statement (June 13, 2021), available at https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/13/carbis-bay-g7-summit-communique/ (This statement committed the United States to enhance climate disclosures in the context of addressing the "climate and environment," not for purposes of protecting investors. The Administration explained that it "[supported] moving towards mandatory climate-related financial disclosures that are based on the Task Force on Climate-related Financial Disclosures (TCFD) framework, in line with domestic regulatory frameworks").

- U.S. and EU Global Methane Pledge (September 18, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/18/joint-us-eu-press-release-on-the-global-methane-pledge/ (An initiative to reduce global methane emissions by at least 30% from 2020 levels by 2030 and move towards using best available inventory methodologies to quantify methane emissions, with a particular focus on high-emissions sources). In November 2021, the Global Methane Pledge was unveiled at the UN Climate Change Conference COP-26, which was held in Glasgow.

- Plan to Conserve Global Forests: Critical Carbon Sinks (November 1, 2021), available at https://www.whitehouse.gov/wp-content/uploads/2021/11/Plan_to_Conserve_Global_Forests_final.pdf (Outlining the Administration's plans to support global efforts toward conserving global terrestrial carbon sinks and listing as one program was the Consortium on Forest Climate Risk Management, which would "support the development and adoption of best practice for forest-related climate financial disclosure").

become an ongoing focal point in the broader goal of addressing climate change. We note that alignment with the broader policy goals of an administration does not merit rulemaking at the SEC on its own; indeed, such rulemaking necessitates alignment with the SEC's core mission of investor protection, fair, orderly, and efficient markets, and capital formation, consistent with the limits of the Commission's statutory authority.

C. The Proposed Rules exceed the Commission's statutory authority.

The SEC does not have general authority to impose climate- and environmental-focused regulation in the comprehensive fashion contemplated by the Proposed Rules. Compliance with the Proposed Rules could have considerable impacts on the U.S. economy, such as through the redirection of capital flows, and have behavioral effects that extend far beyond the disclosure of additional climate-related information by public companies, including imposing direct and indirect obligations on the countless businesses upstream and downstream of public companies, many of which are privately held and not ordinarily subject to the SEC's mandatory disclosure regime under the federal securities laws.

With many other federal agencies clearly and explicitly tasked with detailed delegations of authority for regulating specific aspects of the environment, we do not believe that Congress intended for the SEC to set major environmental policy for American businesses or resolve major questions relating to climate change. Under what is sometimes called the "major questions doctrine," the "Supreme Court has repeatedly rejected agency attempts to take major regulatory action without *clear* congressional authorization."[27] Likewise, if the SEC could enact any rule or regulation whenever the "public interest" demands without a limiting principle, that would seem to give the SEC broad oversight authority over areas it has not traditionally regulated—an outcome Congress clearly did not intend. Additionally, an expansive "public interest" mandate that is not tightly tethered to the SEC's traditional tripartite mission risks the politicization of the SEC and the federal securities laws that the agency administers and enforces.

The Proposed Rules exceed the Commission's statutory authority. Like other federal agencies, the Commission "literally has no power to act . . . unless and until Congress confers power upon it."[28] Here, the Commission offers the Proposed Rules "under the authority set forth in Sections 7, 10, 19(a) and 28 of the Securities Act, as amended, and Sections 3(b), 12, 13, 15, 23(a) and 36 of the Exchange Act, as amended."[29] The Proposed Rules, as drafted, exceed this authority in two independent ways: First, the Commission's statutory authority is limited to requiring the disclosure of information that is both financial in nature and necessary for investors to assess a security's value; this authority does not extend to requiring public companies to broadly disclose climate-related information, particularly considering the serious constitutional concerns presented by the expansive interpretation the Commission proposes here, as discussed below.

[27] *U.S. Telecom Ass'n v. FCC*, 855 F.3d 381, 420 (D.C. Cir. 2017) (Kavanaugh, J., dissenting from the denial of reh'g en banc).

[28] *N.Y. Stock Exch. LLC v. SEC*, 962 F.3d 541, 553 (D.C. Cir. 2020) (alteration in original) (quoting *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986)).

[29] Proposing Release, 87 Fed. Reg. at 21,462; *accord id.* at 21,464.

Second and similarly, the Proposed Rules are neither necessary nor appropriate for investor protection or the public interest. For both reasons, the Commission lacks authority to finalize the Proposed Rules.

1. The SEC's authority is limited to disclosure of information that is financial in nature and necessary for investors to assess a security's value.

In the Proposing Release, the Commission claims a "broad authority" to require the disclosure of any information the Commissions deems "'necessary or appropriate in the public interest or for the protection of investors.'"[30] The Commission does not have that power. The cited statutory provisions "must be read in their context and with a view to their place in the overall statutory scheme."[31] (They must also be read to avoid unnecessarily triggering serious constitutional concerns.[32]) As the Commission has previously recognized, those provisions, read in context, limit the Commission's authority to requiring the disclosure of information that is both financial in nature and necessary for investors to assess a security's value.[33] The Commission does not have a freewheeling authority to require the disclosure of any information the Commission deems in the public interest.[34]

The Commission cites two "residual" clauses—in Sections 7(a)(1) and 10(c) of the Securities Act—but those clauses, read in context, demonstrate the *limited* nature of the Commission's authority. The residual clauses follow a list of specified categories of information and then empower the Commission to require the disclosure of "such other information" as the Commission deems "necessary or appropriate in the public interest or for the protection of investors."[35] While seemingly broad, these clauses are anything but.[36] Under the rule of *ejusdem generis*, the residual clauses are "controlled and defined by reference to the enumerated categories [of information] . . . which are recited just before [them]."[37] These clauses, in other words, must be "construed to embrace only [information] similar in nature to [the information] enumerated by the preceding specific words" in the statute.[38]

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[30] *Id.* at 21,335 & n.3.

[31] *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 320 (2014) (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000)).

[32] *See Solid Waste Agency of N. Cook Cnty. v. U.S. Army Corps of Engr's*, 531 U.S. 159, 172 (2001) (recognizing that a court must construe a statute to "avoid" constitutional problems so as "not to needlessly reach constitutional issues").

[33] *See, e.g., Nat. Res. Def. Council, Inc. v. SEC*, 606 F.2d 1031, 1039 (D.C. Cir. 1979) ("[T]hese laws, in the Commission's view, were designed generally to require disclosure of financial information in the narrow sense only.").

[34] *See, e.g.*, Release No. 33-10064, *Business and Financial Disclosure Required By Regulation S-K*, 81 Fed. Reg. 23,916, 23,970 & n.663 (Apr. 22, 2016) ("[D]isclosure relating to environmental and other matters of social concern should not be required of all registrants unless appropriate to further a specific congressional mandate or unless, under the particular facts and circumstances, such matters are material. . . . [T]he Commission . . . is generally not authorized to consider the promotion of social goals unrelated to the objectives of the federal securities laws . . . .").

[35] 15 U.S.C. §§ 77g(a)(1), 77j(c).

[36] *See, e.g., Cement Kiln Recycling Coal. v. EPA*, 493 F.3d 207, 221 (D.C. Cir. 2007) (narrowly interpreting the residual phrase, "other factors as may be appropriate").

[37] *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 115 (2001).

[38] *Id.* at 114-15.

In both Sections 7(a)(1) and 10(c), the enumerated categories of information preceding the residual clause concern information that is financial in nature and material to an investor's evaluation of a security. In both sections, the residual clause comes directly after a statutory command for certain disclosures to be accompanied by the information or documents specified in Schedule A (or some subset thereof).[39] Schedule A lists 32 categories of information or documents that materially relate to a company's financial condition. For example, Schedule A requires a company to disclose the proceeds to be derived from the sale of a security, the price at which the security will be offered, a balance sheet, and a profit and loss statement.[40] As the Commission itself has recognized, these and other items specified in Schedule A are all "financial in nature" and are "'indispensable to any accurate judgment upon the value of a security.'"[41] Under the rule of *ejusdem generis*, the residual clauses must be read in this context and can extend only to those categories of information that "share the common attribute of the listed items" in Schedule A.[42] Broad climate-related disclosures fall well outside this range.

Sections 12(b)(1) and 13(a)(1) of the Exchange Act are similarly circumscribed in terms of their grant of rulemaking authority. Section 12(b)(1) authorizes the Commission to require the disclosure of "information," "as necessary or appropriate in the public interest or for the protection of investors, *in respect of*" specific categories of information.[43] Section 13(a)(1) authorizes the Commission to require that same information be kept "reasonably current."[44] As in Sections 7(a)(1) and 10(c) of the Securities Act, discussed above, the specific categories of information referenced in Sections 12(b)(1) and 13(a)(1) of the Exchange Act are all financial in nature and materially related to the financial condition of the company, such as: the nature of the company's business; the terms of any outstanding securities; the remuneration to directors; balance sheets; profit and loss statements; and "further financial statements."[45] Again, none of these items bear any similarity to broad climate disclosures.

Section 13(a)(2) of the Exchange Act is likewise focused on material, financially focused information. That provision authorizes the Commission to require public companies to file "annual reports" and "quarterly reports,"[46] which, read in context, mean *financial* reports. Section 13(a)(2) itself contemplates that the annual reports will be certified by "independent public accountants," a requirement that makes sense only in the context of financial reporting.[47] Section 13(b)(1) demonstrates that these "reports" concern (among other things) "the balance sheet and the earnings statement," "the appraisal or valuation of assets and liabilities," and "depreciation and depletion"[48]

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[39] 15 U.S.C. § 77g(a)(1), 77j(a)(1), (c); *see also id.* § 77aa (Schedule A).

[40] *Id.* § 77aa sched. A(15), (16), (25), (26).

[41] Business and Financial Disclosure, 81 Fed. Reg. at 23,921 (quoting H.R. Rep. No. 73-85, at 3 (1933), 1933 WL 983, at *4).

[42] *Ali v. Fed. Bureau of Prisons*, 552 U.S. 214, 224 (2008).

[43] 15 U.S.C. § 78*l*(b)(1) (emphasis added).

[44] *Id.* § 78m(a)(1).

[45] *Id.* § 78l(b)(1).

[46] *Id.* § 78m(a)(2).

[47] *Id.*

[48] *Id.* § 78m(b)(1).

– all material financial information. Like the other provisions cited by the Commission, Section 13(a)(2) cannot reasonably be read to extend beyond material, financially focused disclosures.

The collection of provisions the Commission cites at the end of the Proposing Release does not support the Proposed Rules either.[49] Some provisions merely supply definitions or the authority to define trade terms,[50] which cannot support the Commission's substantive proposal. Other provisions authorize exemptions from general statutory requirements,[51] but have no purchase where the Commission seeks to require conduct, as here. Other provisions still apply some of the disclosure requirements discussed above to different types of companies,[52] but do not expand the scope of information within the Commission's authority. Finally, the Commission also cites provisions granting it general authority to issue regulations in the public interest.[53] However, these general rulemaking grants do not "empower the agency to pursue rulemaking that is not otherwise authorized."[54] To the contrary, these provisions authorize the Commission only to "carry out" its duties under other statutory provisions,[55] which, as discussed, do not themselves authorize the Proposed Rules.

The "sheer scope" of the Commission's claimed authority strongly "counsels against" it.[56] When Congress intends to "assign to an agency decisions of vast 'economic and political significance,'" Congress "speak[s] clearly."[57] In fact, when Congress has previously sought to empower the Commission to require disclosures of far less economic and political significance than the Proposed Rules, Congress has done so expressly. In the Dodd-Frank Act, for example, Congress explicitly required the Commission to issues rules requiring companies to disclose the presence of so-called "conflict minerals" in their products.[58] The Commission can point to no similar authorizing language here. That silence is telling. If Congress really wanted to "bring about an enormous and transformative expansion in the [SEC's] regulatory authority"[59]—to allow the Commission to require extensive disclosures on an issue of enormous public debate, at an external cost of more than $6 billion per year (under the SEC's own estimate)[60]—Congress would have said so clearly and explicitly. Yet, Congress said no such thing.

Congress's silence is particularly telling here, in light of the serious constitutional questions the Commission's conception of its authority would present. When an agency's "interpretation of a statute invokes the outer limits of Congress' power, [the courts] expect a clear indication that

[49] *See* Proposing Release, 87 Fed. Reg. at 21,464.
[50] *See* 15 U.S.C. § 78c(b).
[51] *See id.* § 77z-3, 78mm.
[52] *See id.* § 78o(d)(1).
[53] *See id.* §§ 77s(a), 78w(a)(1).
[54] *N.Y. Stock Exch.*, 962 F.3d at 556.
[55] *Id.* at 561; *see also Colo. River Indian Tribes v. Nat'l Indian Gaming Comm'n*, 466 F.3d 134, 139 (D.C. Cir. 2006) ("An agency's general rulemaking authority does not mean that the specific rule the agency promulgates is a valid exercise of that authority.")
[56] *Ala. Ass'n of Realtors v. Dep't of Health & Hum. Servs.*, 141 S. Ct. 2485, 2489 (2021).
[57] *Util. Air Regulatory Grp.*, 573 U.S. at 324 (quoting *Brown & Williamson*, 529 U.S. at 160).
[58] *See* 15 U.S.C. § 78m(p).
[59] *Util. Air Regulatory Grp.*, 573 U.S. at 324 (quoting *Brown & Williamson*, 529 U.S. at 159).
[60] *See* Proposing Release, 87 Fed. Reg. at 21,461.

Congress intended that result."[61] Here, the Commission's reading of its authority approaches (and exceeds) those limits in two different ways. First, as detailed below, the compulsion of speech on a matter of public controversy violates the First Amendment, particularly where, as here, that compulsion is not narrowly tailored to protecting investors from fraud. Second, by asserting an unfettered authority to require the disclosure of any information the Commission deems appropriate, the Commission has impermissibly usurped Congress's legislative power, in violation of the non-delegation doctrine. The Commission should construe its authority to avoid these issues.

2. <u>The Proposed Rules are neither necessary nor appropriate for investor protection or the public interest.</u>

The Proposed Rules exceed the Commission's statutory authority in another way: they are neither necessary nor appropriate for investor protection or the public interest.[62]

The Commission repeatedly conflates the "protection of investors" (the statutory standard)[63] with "investor demand" (a phrase that appears throughout the Proposing Release).[64] These are not the same thing.[65] As discussed earlier, investors may demand information for a variety of reasons. Some may wish to guide their investing based on moral beliefs, rather than financial considerations.[66] Others, such as some government pension funds, may wish to pursue a political agenda unrelated to the financial assessment of a potential investment.[67] Others still may wish to have publicly traded companies bear the costs of producing and standardizing information that facilitates their investment strategies.[68] None of this concerns the "protection of investors."

Investors need protection from fraud and material risks. At the time Congress enacted the Securities Act and Exchange Act, the concept of materiality was a background assumption already baked into pre-existing common law;[69] in light of that background, the concept of materiality has been the "cornerstone" of America's securities laws from the outset.[70] Here, however, the Commission has failed to show that the broad and detailed climate-related disclosures it contemplates are generally material to investors' investment decisions. In fact, the record evidence cuts decisively in the other direction: investors ordinarily do not uniformly base their decisions on

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[61] *Solid Waste Agency*, 531 U.S. at 172 ("This requirement stems from our prudential desire not to needlessly reach constitutional issues and our assumption that Congress does not casually authorize administrative agencies to interpret a statute to push the limit of congressional authority.").

[62] *See generally* Letter from Law and Finance Professors (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf..

[63] *See, e.g.*, 15 U.S.C. § 77g(a)(1).

[64] *See, e.g.*, Proposing Release, 87 Fed. Reg. at 21,335.

[65] *See, e.g.*, *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976) (Marshall, J.) (rejecting the idea that a fact is material if it "might" be important to an investor, because such a standard would overload investors "in an avalanche of trivial information").

[66] *See* Letter from Law and Finance Professors at 8 (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf.

[67] *See id.* at 5.

[68] *See* Letter from Law and Finance Professors at 4-5.

[69] *See Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 2002 (2016) ("[T]he common law could not have conceived of 'fraud' without proof of materiality.").

[70] Business and Financial Disclosures, 81 Fed. Reg. at 23,924.

climate factors,[71] because those factors generally are not material. Nor do investors ordinarily base their decisions on the granular-level details that the Proposed Rules would require be disclosed.

Just as the Proposed Rules cannot be justified on investor protection grounds, they cannot be justified on public interest grounds. Contrary to the Commission's current assertion, "public interest" does not refer to the promotion of any social goal the Commission deems worthy.[72] Rather, as explained in detail above, the phrase "public interest" refers to other goals that are related to the objectives of the securities laws,[73] such as the promotion of capital formation.[74] Matters outside the scope of these objectives, such as reductions in GHG emissions, are left to other agencies, such as the EPA. Here, the Commission has entirely failed to establish that the Proposed Rules will further the objectives of the securities laws. As discussed, the Proposed Rules would deter capital formation, stifle competition and reduce efficiency across the board. The Commission has shown no market failure that the Proposed Rules would correct.[75] In these circumstances, the Commission cannot justify the Proposed Rules as measures necessary to further the public interest within the legal meaning of that term.

D. The Proposed Rules would substantially revise the longstanding and traditional conception of materiality.

The Proposed Rules substantially deviate from the longstanding and traditional conception of materiality under the federal securities laws that for decades has advanced the best interests of investors, encouraged capital formation and helped ensure the integrity of our capital markets. Instead, the Proposed Rules repeatedly call for the disclosure of granular climate-related information even though the required information often is immaterial under the standard of materiality the Supreme Court handed down decades ago.

In the landmark case of *TSC Industries, Inc. v. Northway, Inc.*,[76] Justice Marshall, writing for a unanimous Supreme Court, articulated a meaningful standard of materiality that was designed to provide investors with the significant information they need to make informed voting and investing decisions, but with a caution – namely, that the "disclosure policy" under the federal securities laws "is not without limit"[77] because investors should be safeguarded from being overwhelmed with information that runs counter to the goal of better investor decision making.[78] The Court operationalized this principle in its decision – subsequently affirmed by the Court in *Basic, Inc. v. Levinson*[79] – by rejecting the notion that information is material if it "might" be important to an investor in favor of the following test: information is material for purposes of

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[71] *See* Austin Moss et al., *The Irrelevance of ESG Disclosure to Retail Investors: Evidence from Robinhood (*2020), available at https://papers.ssrn.com/abstract_id=3604847.

[72] Business and Financial Disclosure, 81 Fed. Reg. at 23,970 n.663 ("[T]he Commission . . . is generally not authorized to consider the promotion of social goals unrelated to the objectives of the federal securities laws . . . .").

[73] *See id*.

[74] *See, e.g.*, 15 U.S.C. § 77b(b).

[75] *See* Overdahl Report at ¶¶ 26-56.

[76] 426 U.S. 438 (1976).

[77] *Id.* at 448.

[78] *See id*. at 448-9.

[79] 485 U.S. 224 (1988).

federal securities regulation if "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote" or invest.[80] As an alternative articulation, Justice Marshall wrote that for information to be material "there must be a 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,"[81] indicating that the materiality of a particular item of information is to be judged against the backdrop of other information that companies disclose or investors otherwise have access to.

The standard of materiality that the Court formulated, and that extensive lower court jurisprudence has applied over the years, not only helps shield investors from the harms of information overload, but it also appropriately tethers federal securities regulation to the reason the SEC and the federal securities laws exist in the first place – that is, to protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation. Traditionally, materiality has centered on information that is important for investors focused on understanding the financial and operating performance of companies as investors attempt to gain wealth and earn income. In other words, investment returns – as compared to other interests that, even when worthwhile, fall outside the SEC's remit – is the well-established touchstone of materiality. Bounding the meaning of materiality with reference to the SEC's mission keeps the SEC and the federal securities laws from being politicized, injects regulatory certainty and predictability into the U.S. capital markets, avoids placing the SEC in the difficult position of regulating outside its expertise, and protects investors.

The Chamber shares the goal of providing material information to investors so that they can make informed voting and investment decisions. Unfortunately, in unprecedented respects, the Proposed Rules go well beyond the limits of materiality that the courts have set and that have steadily guided the SEC's development and administration of disclosure requirements historically. This comment letter details many examples from the Proposed Rules demonstrating the SEC's meaningful deviation from the Supreme Court's abiding approach to materiality, several themes and consequences of which are highlighted below.

First, the Proposed Rules place particular emphasis on institutional investors, including their appreciable assets under management ("AUM"), that, according to the Proposing Release, "have demanded climate-related information."[82] In general, while investor demand is a valid consideration, that investors have expressed an interest in information has not been determinative, standing alone, that the information must be recognized as material under the federal securities laws. This is for good reason. Investors may demand information for all sorts of reasons unrelated to the objectives of the federal securities laws.

If investor desire for information necessarily rendered it material as a matter of law, public company disclosure documents would endlessly expand with each investor's claim for more information, causing disclosure documents to become increasingly dense and voluminous, if not

[80] *TSC Industries*, 426 U.S. at 449.
[81] *See id*. at 449-50.
[82] Proposing Release, 87 Fed. Reg. at 21,340.

impenetrable. If investor demand were, in-and-of-itself, dispositive of materiality, materiality would essentially be read out of the federal securities laws because there will always be some investors that demand some element of information. That is particularly true for issues as to which some investors have ideological interests in seeking expanded disclosure.

Additionally, the particular weight the SEC places on investor demand in the Proposing Release is ultimately unworkable as a practical basis for determining the content and contours of the mandatory disclosure regime because it places the SEC in what would be an impossible bind. The SEC eventually would have to decide *which investors' demand* and *how much AUM* clears the hurdle for concluding something is material (not to mention that the formulation in the Proposing Release does not adequately account for retail investors). If the degree of investor demand were the predominant test of materiality, how would the Commission address a situation where other investors argue against the very same disclosures, such as on the grounds that the information is not useful, distracts attention from more useful information, or is too costly and time-consuming for companies to develop and prepare? Making these sorts of value judgments across diverse investor preferences and establishing quantitative AUM thresholds like this would jeopardize the Commission's integrity as an unbiased regulator. It also would exacerbate the very real First Amendment concerns discussed later in this letter.

The Chamber appreciates that investor demand can be a factor relevant to evaluating materiality. However, the SEC must still determine that the information sought is material for investors as a whole, including for retail investors, is in accord with the SEC's mission and statutory authority, and that the benefits of mandatory disclosure justify its costs. The concept of materiality, as traditionally conceived and understood, has served investors and the U.S. economy exceptionally well for decades in calibrating mandatory disclosures and ensuring that the sheer volume of information does not overwhelm investors to the detriment of investors' best interests.

Second, the Chamber does not at all dismiss the relevance of investor interest in climate-related information and believes that the progress companies have made and continue to make in disclosing more-and-more climate-related information is of great note and accomplishment. In fact, the Chamber has repeatedly acknowledged that climate-related information can be material under the traditional conception of materiality and has to be disclosed when it is.[83] However, a demand by investors for climate-related information is not dispositive of the materiality of that information, and generally is not tantamount to a demand by investors for the specific disclosure requirements in the Proposed Rules or the totality of everything in the Proposed Rules, which sweep farther in their breadth and detail than existing voluntary disclosure standards, characterized by flexibility that allows companies to tailor their disclosures so they are more useful and informative than following prescriptive mandates. In some cases, the Proposed Rules require more disclosure than key environmental regulators like the EPA do and substantially more disclosure than the TCFD recommendations themselves.[84]

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[83] *See generally* U.S. Chamber of Commerce, *ESG Reporting Best Practices* (Fall 2019), available at https://www.projectgo.com/wp-content/uploads/2019/10/CCMC_ESG-Booklet_v4-DIGITAL.pdf.

[84] For example, the EPA's Greenhouse Gas Reporting Program requires reporting on direct emissions from individual sources under the Clean Air Act, not on a company-wide basis, including Scope 1, 2 and 3 emissions. The

Third, the Proposed Rules upset the balance that materiality for years has been calibrated to achieve. The following selections from the Proposing Release are illustrative, but not exhaustive.

- Under the Proposed Rules, public companies would have to disclose "climate-related risks," defined to include "the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole."[85] It is far from clear what constitutes a "potential" impact. "Potential" is more tenuous and speculative than the *Basic v. Levinson* materiality test for forward-looking statements calling for the "indicated probability" of an event and its "anticipated magnitude" to be balanced.[86]

- Proposed "transition risk" disclosures require far-reaching information concerning, among other things, the impacts on a company's "value chain" associated with a range of current or future developments, such as those relating to change in law or policy, changes in market demand, technological advances, competitive pressures and reputational impacts that "might trigger changes to market behavior, consumer preferences or behavior, and registrant behavior."[87] The use of the word "might" in the Proposed Rules is notable in light of the Supreme Court's explicit rejection of "might" as the test of materiality in *TSC*.[88] Further, it is very difficult to discern the outer boundaries of what these disclosure requirements mandate given their stated breadth.

- Companies would be required to disclose climate-related risks that "may manifest over the short, medium, and long term,"[89] as defined by the company. We do not ask the SEC to define these time frames, but we do note that, in the context of climate events and associated impacts, long term could be many years from now, perhaps even generations. Depending on what constitutes "long term" for these purposes, companies might have to disclose information that, because what it covers is so indeterminate, off in the future, and subject to change, would not be relevant or informative to include in a typical model of asset valuation or, worse, lead to unreasonable speculation. Consideration of potential impacts decades from now is considerably outside the time frames considered in materiality assessments that companies conduct today. Furthermore, the word "may" seems akin to "potential" and, in any case, is reminiscent of the word "might" that the Court intentionally steered away from in *TSC*. "May" bears no similarity to the use of the word "known" in Regulation S-K Item 303 providing for MD&A.

Proposed Rules also go much further than federal environmental regulatory requirements regarding reporting of climate risks. Neither the EPA nor any other agency has defined such risks specifically for companies, nor attempted to require such reporting under the environmental laws.

[85] Proposing Release, 87 Fed. Reg. at 21,349.

[86] *Basic*, 485 U.S. at 238-9.

[87] Proposing Release, 87 Fed. Reg. at 21,466.

[88] *TSC Industries*, 426 U.S. at 445-7.

[89] Proposing Release, 87 Fed. Reg. at 21,467.

- Regarding the disclosure of "physical risks," the Proposed Rules would obligate companies to describe the "location and nature of the properties, processes, or operations subject to the physical risk."[90] "Location" is defined to mean a ZIP code or, in a jurisdiction that does not use ZIP codes, a similar subnational postal zone or geographic location. If the risk concerns "flooding," companies would also have to disclose "the percentage of those assets (square meters or acres) that are located in flood hazard areas."[91] If the risk concerns "high or extremely high water stress" locations, companies would have to disclose "the amount of assets (e.g., book value and as a percentage of total assets) located in those regions." No other Regulation S-K disclosure Item requires information that is this particular – down to a ZIP code or plot sizes. For example, the materiality of providing the ZIP code for thousands or possibly hundreds of thousands of individual electric transmission and distribution towers and poles for electric utilities is of questionable value to investors. Disclosure of information at this level of granularity, particularly if the disclosure regards the value of assets, would improperly expose competitively sensitive information. Additionally, requiring ZIP code-level reporting could threaten national security, as it would essentially provide a map to bad actors of areas of critical business assets used by both the private and public sectors. Moreover, the meaning of "flood hazard areas" and regions of "high or extremely high water stress" is not clear. Companies will interpret these terms differently, resulting in lack of comparability for investors.

- The Proposed Rules would mandate that companies address numerous distinct items regarding climate-related risk management. The specifics of this proposed disclosure stand in sharp contrast to current risk factor disclosure requirements under Regulation S-K Item 105, which is principles-based and requires a company to discuss "material factors that make an investment . . . speculative or risky."[92]

- The Proposing Release would mandate the disclosure of Scope 3 emissions, but Scope 3 concern data of *other* companies, not the issuer.[93] Requiring issuers to report the data of other companies is inconsistent with traditional materiality-based standards, and is improper, inherently unreliable, and exceeds the Commission's authority.

- When assessing materiality of Scope 3 emissions, the Proposing Release says, "registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions."[94] Indeed, the Commission suggests a 40% quantitative threshold of Scope 3 emissions as compared to a company's total emissions is material for purposes of the proposed Scope 3 disclosure requirement. The proportion of a company's Scope 3 emissions as compared to its overall emissions is an arbitrary threshold and cannot be squared with the traditional materiality test under the federal securities laws, which asks

[90] *Id* at 21,350.
[91] *Id*.
[92] 17 C.F.R. §229.105.
[93] This is true of Scope 2 emissions, as well.
[94] Proposing Release, 87 Fed. Reg. at 21,379

whether the information is significant to a reasonable investor focused on investment returns.

- The Proposing Release notes that a company may have "gaps in the data required to calculate its GHG emissions."[95] We agree that companies are at various places along the continuum of how to collect GHG data. The Proposed Rules go on to state, "A registrant's GHG emissions disclosure should provide investors with a reasonably complete understanding of the registrant's GHG emissions in each scope of emissions."[96] The standard of "reasonably complete [investor] understanding" differs from the historical securities law focus on ensuring that there are no material misstatements or omissions when disclosures are made.

- The Commission proposes to require that companies disclose the financial statement impacts on a line-item by line-item basis of severe weather events, other natural conditions, transition activities and identified climate-related risks unless the aggregated impact is less than 1% of the total line item for the relevant year.[97] As discussed elsewhere in this letter, one percent has not typically been the threshold for quantitative financial statement line-item materiality, especially since a given line item itself might not be material for a given company. Furthermore, there is no other financial statement disclosure requirement under Regulation S-X that requires any similar disclosure for any other specific type of risk.

- The Commission proposes requiring detailed disclosure, including ongoing updates, regarding transition plans and any climate-related targets or goals without regard to the materiality of such plans, targets or goals and whether or not they have been publicly disclosed. Targets, goals and related information – including how a company intends to meet its target or goal and disclosures concerning the company's annual progress doing so – should only be mandated if material. While targets and goals related to GHG emissions are generally the most common, the Proposed Rules also require disclosure of *any* climate-related target or goal (e.g., regarding energy usage, water usage, conservation or ecosystem restoration, or revenues from low-carbon products) whether or not such target or goal has been publicly disclosed. Practically speaking, the impact of this requirement will not only discourage companies from conceiving and publishing targets or goals but may also chill private and preliminary discussions at the board or management level of constructive initiatives that could be construed as potentially implicated by this disclosure obligation. This ultimately could lead to dampened enthusiasm and organizational efforts within companies in pursuit of these worthy objectives and therefore, fewer achievements beneficial for the climate and environment would be realized.

- The Commission proposes required disclosure regarding "any analytical tools, such as scenario analysis, that the registrant uses to assess the impact of climate-related risks on its business and consolidated financial statements and to support the resilience of its strategy

[95] *Id* at. 21,387.
[96] *Id*.
[97] *Id*. at 21,366.

and business model."[98] If companies are mandated to disclose scenario analyses and similar tools that they use and implement, this would present significant risk and cost for reporting companies with little value to investors. Moreover, requiring these disclosures irrespective of materiality may be a deterrent for a company to perform such analyses and may prove unhelpful for investors because analytical tools like scenario analysis still are in early stages of development and based on many assumptions, some of which could be extremely remote and unlikely but nonetheless a company may consider them in order to be exhaustive. Some scenarios may be useful as an input to internal planning and risk assessment but not have been conceived or implemented in contemplation of public disclosure. Publicly disclosing scenario analyses and related information and analysis could do competitive harm to companies by exposing sensitive information that is not material. Additionally, for most companies, preparing a scenario analysis will require retaining a third-party expert with climate projection expertise. If the requirement to disclose analytical tools is retained, such disclosure should only be required if the outcome of the scenario or similar analysis identifies a material climate-related risk (or, at the option of the company, climate-related opportunity).

- The degree and detail of climate-related governance disclosures that the SEC proposes for the board of directors and management exceeds what the SEC mandates regarding the board oversight of and management's assessment and management of any other risk a company faces. Furthermore, proposed Regulation S-K Item 1501(a)(ii) requires disclosure regarding board members' climate-risk expertise. If this disclosure requirement were adopted, then any board member identified as having such expertise should have the same protections[99] as an audit committee financial expert under current rules or a cybersecurity expert under the recently proposed cybersecurity rules.[100] That said, the Chamber is not supportive of this proposed requirement, especially insofar as it represents an emerging SEC trend of implicitly mandating "subject matter experts" on the board of directors,[101] which could crowd out the broader enterprise governance and risk oversight skills and experience that directors must have. Specialized board experts should not proliferate due to government regulation, and, even more practically, finding qualified board members with particular subject-matter expertise could be difficult, creating a supply and demand imbalance that would be more costly to the quality of corporate governance – with respect to climate-related risks and other matters – than it would be helpful. Indeed,

[98] *Id.* at 21,468.

[99] Generally, these protections are as follows: (i) a person who is determined to have applicable expertise will not be deemed an expert for any purpose, including, without limitation, for purposes of Section 11 of the Securities Act, as a result of being designated or identified as a director with such applicable expertise; (ii) the designation or identification of a person as having applicable expertise does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the board of directors in the absence of such designation or identification; and (iii) the designation or identification of a person as having applicable expertise does not affect the duties, obligations or liability of any other member of the board of directors.

[100] Release No. 33-11038, *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure,"* 87 Fed. Reg. 16590 (March 23, 2022).

[101] *See id*.

the Commission has not provided sufficient evidence that having climate "experts" on boards would increase the effectiveness of companies' climate-related risk postures or advance the SEC's mission.

- By way of further illustration and in addition to items noted above, we note the following non-exhaustive list from proposed Regulation S-K Items 1502 and 1503 of disclosure that a public company would have to provide untethered from any materiality threshold or qualification:

    - the location (defined under proposed Item 1500(k) as a ZIP code or, in a jurisdiction that does not use ZIP codes, a similar subnational postal zone or geographic location) properties, processes, or operations subject to any identified physical risk (Item 1502(a)(1)(i));

    - if a risk concerns the flooding of buildings, plants, or properties located in flood hazard areas, the percentage of those assets (square meters or acres) that are located in flood hazard areas in addition to their location (Item 1502(a)(1)(i)(A));

    - the amount of assets (e.g., book value and as a percentage of total assets) located in regions of high or extremely high water stress and the percentage of the registrant's total water usage from water withdrawn in those regions (Item 1502(a)(1)(i)(B));

    - the actual and potential impacts of any climate-related risks identified (Item 1502(b));

    - whether and how any impacts described are considered as part of the registrant's business strategy, financial planning and capital allocation and, if applicable, the role that carbon offsets or renewable energy credits (RECs) play in the registrant's climate-related business strategy (Item 1502(c));

    - the existence of, and information related to, any internal carbon price maintained by the registrant (Item 1502(e));

    - any processes the registrant has for identifying, assessing and managing climate-related risks (Item 1503(a)); and

    - whether and how any processes described are integrated into the registrant's overall risk management system or processes and how any separate board or management committee that is responsible for assessing and managing climate-related risks interacts with the registrant's board or management committee governing risks (Item 1503(b)).

Fourth, underlying the U.S. securities laws is the expectation – embodied in the materiality requirement – that investors will make better decisions with the benefit of the required disclosure.

However, that is not necessarily the real-world result of any-and-all possible disclosure mandates. As the Supreme Court expressed in *TSC*, it is "hardly conducive to informed decision-making" if investors are inundated with information.[102] The Proposing Release introduces another concern: that much of what the SEC would obligate companies to disclose is more speculative and uncertain than any other disclosures that companies currently make.

To its credit, the SEC mentions this in the Proposing Release. For example, it states, "We recognize that the methodologies pertaining to the measurement of GHG emissions, particularly Scope 3 emissions, are evolving."[103] The Commission also allows, "We acknowledge 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."[104] Also notable is the SEC's statement, "While we encourage registrants to provide as accurate a measurement of its GHG emissions as is reasonably possible, we recognize that, in many instances, direct measurement of GHG emissions at the source, which would provide the most accurate measurement, may not be possible."[105] In light of this, the SEC proposes to allow companies some flexibility in how they determine certain disclosures, such as GHG emissions, and would require companies to describe the methodologies, assumptions, calculation tools and data (and data gaps) that underpin certain of the mandated disclosures.

The SEC concludes from "the uncertainty surrounding the future path of climate change and the evolving nature of the science and methodologies measuring their economic impacts"[106] that companies may under-disclose climate-related risks.[107] However, a different conclusion seems warranted. Climate-related disclosures, to the extent grounded in data limitations, uncertainties around impact, distant time horizons and ongoing scientific and technological learning, can run counter to informed investor decision making if, as a result, climate-related disclosures spawn investor confusion and create misimpressions and misunderstandings. The concern is that investors will misinterpret mandated climate-related information that companies disclose as having greater precision, objectivity and certitude than warranted, especially when the disclosure takes the form of a definitive numerical value such as emissions of CO_2e. For investors to assess these types of quantitative climate-related disclosures, the data, assumption, modelling and scientific nuances and judgments that are the basis of the disclosures must also be assessed to place climate-related information in its proper context, including in connection with comparisons to other companies.

Fifth, the animating philosophy of the federal securities laws is to provide investors with material information and then allow investors to decide how capital will be allocated across our economy. Congress did not give the SEC merit review authority. Although the Proposed Rules do not constitute quintessential merit regulation, they could have a comparable effect, even if the mechanism is more subtle than direct substantive environmental regulation.

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[102] *See TSC Industries*, 426 U.S. at 449.
[103] Proposing Release, 87 Fed. Reg. at 21,377.
[104] *Id.* at 21,381.
[105] *Id*. at 21,387.
[106] *Id*. at 21,427.
[107] *See id*.

Without question, the Proposed Rules call for far more sweeping and detailed disclosures on a single topic (i.e., climate) than any other disclosure mandate that the SEC has adopted, or that Congress has enacted, regarding any other topic throughout the SEC's nearly 90-year history. Against the backdrop of all the material information that drives valuations and investor decisions, the Proposed Rules place unique weight on mandating disclosures relating to climate, particularly when one considers that material climate-related information already is required to be disclosed by companies pursuant to existing disclosure requirements, such as risk factor disclosures and MD&A, and that companies provide additional climate-related information voluntarily in sustainability or ESG reports. By singling out climate to the unprecedented degree that the Proposing Release does, the SEC is bound to heighten the salience of climate-related information above other information bearing on a company's financial and operating performance. The likely result is to affect how capital is allocated, with the Proposed Rules' disclosure regulation taking on attributes that resemble merit regulation.

To best serve the goal of improving investor decision making without securities regulation itself unduly influencing the choices investors and the companies they invest in make, any final rules that are adopted must adhere to the longstanding conception of materiality that the Supreme Court handed down decades ago.

E. The Proposed Rules raise serious constitutional questions.

1. <u>The Proposed Rules violate the First Amendment.</u>

The First Amendment "prohibits the government from telling people what they must say."[108] The Proposed Rules violate this right by forcing companies to engage in costly speech on a matter that is the subject of much political debate.[109]

Strict scrutiny applies here. The Proposed Rules compel speech and are thus necessarily based on the content of the speech.[110] Furthermore, the Proposed Rules implicate political speech.[111] Addressing climate change is an important political issue and the subject of robust public debate that includes discussion of the specific consequences climate change may have and the responsibilities corporations have to address climate change. Prominent political figures fall on every side of this debate.[112] The Proposed Rules would inevitably force all public companies into the middle of it, compelling them to discuss, at great cost, issues that are often highly complex and fraught with uncertainty and controversy. This is a "significant encroachment[ ] on First Amendment rights," which "cannot be justified by a mere showing of some legitimate

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[108] *Rumsfeld v. Forum for Academic & Institutional Rights, Inc.*, 547 U.S. 47, 61 (2006).

[109] *See* Letter from Law and Finance Professors at 8 (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf.

[110] *R.J. Reynolds Tobacco Co. v. FDA*, 696 F.3d 1205, 1211 (D.C. Cir. 2012).

[111] *See Citizens United v. FEC*, 558 U.S. 310, 340 (2010) ("Laws that burden political speech are 'subject to strict scrutiny' . . . .").

[112] *See, e.g.*, Comments of Rep. Bill Huizenga (Aug. 23, 2021), available at https://www.sec.gov/comments/s7-10-22/s71022-20127683-288889.pdf; Comments from Elizabeth Warren (June 11, 2021), available at https://www.sec.gov/comments/climate-disclosure/cll12-8911344-244296.pdf.

governmental interest."[113] Rather, the compulsion of speech contemplated here must survive strict scrutiny—it must be narrowly tailored to promote a compelling government interest.[114] And if a less restrictive alternative would serve the Commission's purpose, that alternative must be taken.[115]

The Proposed Rules cannot survive strict scrutiny. In the First Amendment context, the government cannot "rest on . . . speculation or conjecture."[116] It needs evidence. And, here, the record lacks evidence that the Proposed Rules would in fact further a compelling government interest. The only potentially compelling government interest the Commission could cite is protecting investors from fraud or other material risks; the "simple interest in providing" the public with "additional relevant information" does not suffice.[117] On the investor-protection front, however, the Commission has not come close to meeting its burden. The Commission has not shown that investors are not receiving material information relating to climate or are being harmed by a lack of additional climate-related disclosures beyond those required to be disclosed under existing rules. Nor has the Commission shown that the Proposed Rules would protect investors from harm. Rather, the record shows that the Proposed Rules would not. They would inundate investors with a great amount of immaterial information, lead to significant confusion and fail to provide information that investors would actually act upon.[118]

Moreover, the Proposed Rules are not narrowly tailored. There are many less burdensome means of furthering any compelling interest in protecting investors. For instance, the securities laws *already* require public companies to disclose material risks. The Commission has not shown why any new rule should not be limited by materiality, nor why the Commission's existing guidance is not sufficient to ensure that these requirements are satisfied or why, even if it were not sufficient, augmenting such guidance – a more narrowly tailored solution – would not achieve the goal of investor protection. Similarly, the Commission has failed to demonstrate why its enforcement authority does not adequately ensure the protection of investors. In these circumstances, the Commission cannot establish that using its existing powers, or a reasonable, less-restrictive alternative, would not suffice—the Commission has not even "tried."[119] In these comments, the Chamber identifies a number of more measured approaches that would be narrower and less burdensome than what the Commission has proposed.

The SEC is not exempt from the requirements of the First Amendment, as the U.S. Court of Appeals for the D.C. Circuit made clear in the 2015 "conflict minerals" case.[120] The court there confronted an SEC rule that required companies to disclose, among other things, whether their

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[113] *Buckley v. Valeo*, 424 U.S. 1, 64 (1976) (per curiam).
[114] *Nat'l Inst. of Family & Life Advocates v. Becerra*, 138 S. Ct. 2361, 2371 (2018).
[115] *Id.* at 2376.
[116] *Nat'l Ass'n of Mfrs.& U.S. Chamber of Commerce v. SEC*, 800 F.3d 518, 526 (D.C. Cir. 2015).
[117] *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 348 (1995); *see also Riley v. Nat'l Fed'n of the Blind of N.C., Inc.*, 487 U.S. 781, 798 (1988) (state interest in "informing donors how the money they contribute is spent" not sufficiently "weighty" to justify compelled speech).
[118] *See* Moss et al., *supra* note 71.
[119] *Bruni v. City of Pittsburgh*, 824 F.3d 353, 370 (3d Cir. 2016).
[120] *See NAM*, 800 F.3d 518.

products were free of so-called "conflicts minerals." The court agreed with the National Association of Manufacturers and the Chamber that this disclosure requirement violated the First Amendment. And in doing so, it made clear that the SEC's long history of requiring disclosures did not mean that new SEC disclosure requirements were presumptively permissible under the First Amendment or subject to relaxed First Amendment scrutiny.[121]

The Commission cannot proceed in the expectation that a lesser degree of First Amendment scrutiny will apply here. Although the Supreme Court has subjected some compelled disclosures to lesser scrutiny, it has done so only where the disclosures involved "commercial advertising" and concerned "purely factual and uncontroversial information."[122] Neither standard is met here. The Proposed Rules compel speech outside of the advertising context—going far beyond "commercial speech" that merely "propos[es] a commercial transaction"[123]—and they plainly concern an issue that is controversial. The subject matter of the Proposed Rules alone subjects them to heightened scrutiny; the impact that corporations have on climate change, and the steps they should take to address it, is "anything but an 'uncontroversial' topic."[124] Indeed, it must be expected that some participants in the climate debate will use companies' disclosures about emissions and about their plans to address them, as a basis to criticize the companies or to call for increased regulation or other concerted action, whether by regulators or by the companies themselves.[125] Similar concerns underlaid the invalidation of the conflict mineral disclosure on First Amendment grounds, where the court perceived that SEC disclosures would be used to "stigmatize" companies and attempt to "shape their behavior."[126] By compelling companies to talk on the government's terms, the Proposed Rules would also necessitate public pronouncements regarding subjective judgment calls about future risks; force companies into politically charged discussions about why they do or do not have certain policies or expertise; and "skew the public debate."[127]

The Proposed Rules would not survive even a lesser level of constitutional scrutiny. Under intermediate scrutiny, the Proposed Rules fail because the Commission has not shown why less-

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[121] *See id.* at 521 ("To support the conflict minerals disclosure rule, the dissent argues that the rule is valid because the United States is thick with laws forcing '[i]ssuers of securities' to 'make all sort of disclosures about their products.'" Charles Dickens had a few words about this form of argumentation: 'Whatever is right'; an aphorism that would be as final as it is lazy, did it not include the troublesome consequence, that nothing that ever was, was wrong." (citations omitted)).

[122] *Id.* at 522-23.

[123] *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 637 (1985).

[124] *Nat'l Inst. of Family & Life*, 138 S. Ct. at 2372.

[125] *See, e.g.*, Basit Mahmood, *There are 100 Companies Responsible for Climate Change, Activist Says*, Newsweek (Sept. 8, 2020), https://www.newsweek.com/climate-change-xr-extinction-rebellion-fossil-fuels-climate-greenhouse-gasses-emissions-1530084; Desmond Tutu, *We Need an Apartheid-Style Boycott to Save the Planet*, Guardian (Apr. 10, 2014), https://www.theguardian.com/commentisfree/2014/apr/10/divest-fossil-fuels-climate-change-keystone-xl; Alastair Marsh & Danielle Bochove, *Dear Bank CEO, You are Cordially Invited to Defund this Pipeline*, Bloomberg (July 1, 2021), https://www.bloomberg.com/news/articles/2021-07-01/how-climate-activists-pressure-banks-to-defund-the-oil-industry; Andrew Edgecliffe-Johnson, *Activists Target Public Relations Groups for Greenwashing Fossil Fuels*, Financial Times (Jan. 11, 2022), https://www.ft.com/content/f90562d6-6673-457a-901e-257eb4578d98.

[126] *NAM*, 800 F.3d at 530.

[127] *Id.*

restrictive alternatives would be inadequate.[128] Moreover, as discussed elsewhere in this letter, the Proposed Rules are more extensive than necessary to serve the Commission's purpose.[129] Under even lesser scrutiny, the Proposed Rules fail, since they are "unjustified," "unduly burdensome," and "broader than reasonably necessary."[130] Simply put, under any standard, the Proposed Rules cannot survive First Amendment scrutiny and, accordingly, should be withdrawn.

2. <u>The Proposed Rules are grounded in a reading of the SEC's authority that violates the non-delegation doctrine.</u>

The Proposed Rules are also grounded in a conception of the SEC's authority that violates the non-delegation doctrine. As discussed, the Commission claims a "broad authority" to promulgate any disclosure requirements that the Commission deems "'necessary or appropriate in the public interest or for the protection of investors.'"[131] This understanding of the Commission's rulemaking authority cannot be squared with the Constitution's separation of powers and, in particular, with the non-delegation doctrine, which "bars Congress from transferring its legislative power to another branch of Government."[132]

It is well-settled that a congressional conferral of rulemaking authority on a regulatory agency must "lay down . . . an intelligible principle" to guide the agency's exercise of that authority.[133] As traditionally understood, the intelligible-principle standard requires "Congress, and not the Executive Branch, to make the policy judgments."[134] Congress may authorize the Executive Branch "to make factual findings," for example, but Congress, not the Executive Branch, must "set forth the facts that the executive must consider and the criteria against which to measure them."[135] A majority of the Supreme Court has recently expressed its support for reinvigorating this important structural safeguard.[136]

The SEC's claimed authority to promulgate any disclosure requirements that it deems—in its sole discretion—necessary or appropriate in the public interest or to protect investors violates the traditional understanding of the intelligible-principle requirement in a number of ways. Most notably, the SEC's position fails the "most important []" consideration in the traditional test: The Proposed Rules reflect "policy judgments" of the "Executive Branch," not of "Congress."[137] Moreover, in "proposing to require disclosures about climate-related risks and metrics reflecting

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[128] *Id.* at 556.
[129] *Id.*
[130] *Nat'l Inst. of Family & Life*, 138 S. Ct. at 2377.
[131] Proposing Release, 87 Fed. Reg. at 21,335 (citing 15 U.S.C. §§ 77g, 78l, 78m, 78o).
[132] *Gundy v. United States*, 139 S. Ct. 2116, 2121 (2019) (plurality opinion).
[133] *Id.* at 372 (alteration in original) (quoting *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409 (1928)).
[134] *Gundy*, 139 S. Ct. at 2141 (Gorsuch, J., dissenting).
[135] *Id.*
[136] *See id.* at 2131 (Alito, J., concurring in the judgment); *id.* at 2137–42 (Gorsuch, J., with whom Roberts, C.J., and Thomas, J., join, dissenting); *Paul v. United States*, 140 S. Ct. 342, 342 (2019) (Kavanaugh, J., respecting the denial of certiorari).
[137] *Gundy*, 139 S. Ct. at 2141 (Gorsuch, J., dissenting).

those risks,"[138] the Proposed Rules do not merely fill in "gaps" in the statutory scheme or "mak[e] factual findings,"[139] but craft a novel, expansive and generally applicable policy. Proceeding with the Proposed Rules would therefore transgress the constitutional separation of powers.

II. THE PROPOSED RULES WILL LEAD TO SERIOUS ADVERSE CONSEQUENCES IF NOT SIGNIFICANTLY IMPROVED

A. The Proposed Rules, if adopted as proposed, would result in extensive disclosure of non-material information that is not useful to investors.

The Chamber has supported the SEC's recent bipartisan efforts across several administrations under the SEC's disclosure effectiveness initiative to streamline disclosures and make them even more meaningful, which has markedly improved the overall quality and usability of public company disclosure. This laudable project has sought to provide timely, useful information to our markets through simplification of disclosure mandates, a focus on what is most significant when evaluating a business and its operations, improvement in the readability and navigability of public company reports filed with the SEC, and the removal of repetitive and otherwise distracting information that does not appreciably advance the goal of informed investor decision making. The framers of the TCFD recommendations are in accord and have been guided by the principles, consistent with the SEC's longstanding and prudent approach, that "[d]isclosures should be eliminated if they are immaterial or redundant to avoid obscuring relevant information"[140] and that companies should "avoid generic or boilerplate disclosures that do not add value to users' understanding of issues."[141] Given its heavy reliance on the TCFD recommendations in other respects, the Commission has not adequately explained its decision to depart sharply from the TCFD recommendations in this respect.

We are deeply concerned that the Proposed Rules, especially when taken as a whole, mark a significant step backward from the worthy objectives of the SEC's disclosure effectiveness initiative. In many instances, the Proposed Rules may actually spawn investor confusion and create misimpressions and misunderstandings that, if anything, could undercut the goals of more informed decision making and investor protection. In turn, they could potentially stifle capital formation in the public markets.

Putting aside the significant burdens that would be placed on public companies to collect, prepare and validate the new disclosures the Proposed Rules would compel, there remains substantial doubt that these new requirements will lead to better understanding of the complicated topic they cover. To the contrary, the totality of new, extensive disclosures under the Proposed Rules risk inundating investors with immaterial information and creating unnecessary confusion and misunderstanding, particularly as to the certainty of the disclosures and the meaning of the various mandated new metrics. Moreover, the new disclosure requirements, because of their unprecedented extensive, detailed, and prescriptive nature as compared to any other disclosure

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[138] Proposing Release, 87 Fed. Reg. at 21,335.
[139] *Gundy*, 139 S. Ct. at 2141 (Gorsuch, J., dissenting).
[140] 2021 TCFD Implementation Annex at 132.
[141] *Id*.

requirements under the federal securities laws, would place disproportionate emphasis on climate risk relative to other matters. This would make it harder for investors to discern and use the material information about non-climate related matters contained elsewhere in annual reports and registration statements or even the material climate-related information that companies already disclose in filings. Indeed, it is important to underscore that material climate-related disclosures already are made by companies, including as part of their risk factor and MD&A disclosures.

The Proposing Release frequently cites the preferences of some institutional investors but says conspicuously little about retail investors. A recent survey[142] conducted by Finra and National Opinion Research Center ("NORC") at the University of Chicago tested the ESG perceptions and preferences of 1,228 randomly selected retail investors. The study included questions about retail investors' awareness and use of ESG investments, and their perception of socially responsible and environmentally sustainable investing. A quarter of the sample incorrectly believed that ESG stands for "earnings, stock, growth." More than half of the survey respondents—54% —never or rarely considered environmental impacts when making investment decisions. To survey respondents, environmental factors were the least important considerations relative to social, governance and financial considerations when making investment decisions.

The problem of creating unnecessary confusion and misunderstanding, particularly as to the certainty of the disclosure, is particularly acute with respect to Scope 3 emissions disclosures. This is one of the reasons, as described in more detail elsewhere in this letter, we believe reporting of Scope 3 emissions should be entirely voluntary. Scope 3 emissions disclosures are not likely to be comparable across companies since even under the Proposed Rules they are a function of disparate company sizes, methodologies, data and assumptions. Moreover, this lack of comparability is consistent with the design of the GHG Protocol standard for Scope 3 emissions, which is not intended to allow investors to compare one company's Scope 3 emissions to another company's Scope 3 emissions.[143]

In view of the litany of required caveats, qualifications and explanations set forth in proposed Regulation S-K Item 1504(e), the SEC has failed to demonstrate that, notwithstanding the degree to which the disclosure is ultimately subject to significant assumptions and limitations, investors will be able to absorb the information in a way that will assist them in making investment decisions. The risk is that the disclosure elicited by the Proposed Rules will provide merely a veneer of comparability – indeed, false comfort that there is comparability – and will thereby obscure potentially vast differences across the quantitative emissions companies disclose as companies utilize diverse and varying data and methodologies in their good faith attempts to navigate the complexities and uncertainties embedded in the Proposed Rules' disclosure mandates.

[142] *Investors say they can change the world, if they only knew how: Six things to know about ESG and retail investors* (Mar. 2022), available at https://www.finrafoundation.org/knowledge-we-gain-share/consumer-insights-money-investing.

[143] *See* GHG Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard*, available at https://ghgprotocol.org/standards/scope-3-standard, at 6 ("Use of this standard is intended to enable comparisons of a company's GHG emissions over time. It is not designed to support comparisons between companies based on their Scope 3 emissions. Differences in reported emissions may be a result of differences in inventory methodology or differences in company size or structure.").

Commissioner Peirce expressed a similar concern that, from the standpoint of investor protection and fair and efficient markets, the mandated Scope 3 emissions disclosures could create confusion:

> Requiring companies to put these faulty quantitative analyses in an official filing will further enhance their apparent reliability, while in fact leaving investors worse off, as Commission-mandated disclosures will lull them into thinking that they understand companies' emissions better than they actually do.[144]

The Proposing Release highlights an additional reason why too much disclosure that is too intricate and requires too much contextualizing can harm investors even if they are receiving more information on an absolute basis: "the complex and multidimensional nature of certain climate-related risks may further impede investors' abilities to detect misreporting."[145]

B. The Proposed Rules, if enacted, would discourage companies from entering or remaining in the U.S. public markets.

There is an inflection point for all companies at which the costs and burdens of a U.S. public listing outweigh the benefits of that listing. Exacerbating the degree to which the Proposed Rules could make the U.S. public markets less attractive, notwithstanding the few accommodations afforded emerging growth companies and smaller reporting companies under the Proposed Rules, the aggregate impact of the new disclosure obligations would be borne disproportionately by these types of companies.

The Chamber is deeply concerned that the Proposed Rules will serve as a disincentive for private companies to enter the U.S. public markets and make many public companies (particularly those that are not accelerated filers) reassess the value proposition of remaining public. In 2012, bipartisan congressional majorities passed the Jumpstart Our Business Startups Act to reverse the decline of the number of public companies by providing incentives to go public. The Commission should not undermine the congressionally mandated policy goals under this important legislation via this rulemaking.

Beyond the additional out-of-pocket costs associated with hiring new employees who are climate specialists, retaining third-party environmental consultants and attestation firms, and developing new systems and controls to track and report climate data at the granular detail that the Proposed Rules require, compliance with the reporting regime contemplated by the Proposed Rules will place many new responsibilities on corporate managers and senior executives. There is an opportunity cost associated with these new responsibilities. Time spent on climate reporting is time away from other strategic and operational pursuits intended to grow the business, manage relevant risks and enhance investor returns.

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[144] Statement of Commissioner Hester Peirce, *We are Not the Securities and Environment Commission - At Least Not Yet* (Mar. 21, 2022), available at https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321#_ftn74. (hereinafter "Peirce Statement").

[145] Proposing Release, 87 Fed. Reg. at 21,427.

While the Proposed Rules are ostensibly targeted towards investors, inevitably there are many non-investor groups that will make use of the information for purposes other than enhancing shareholder value. Many activist organizations are motivated differently than investors and such groups are not always aligned with traditional investors in seeking to increase shareholder value over the long term. Instead, some interested parties may use information called for by the Proposed Rules in a way that will diminish sustainable financial returns in exchange for achieving other objectives. Dramatically increasing the likelihood of pressure campaigns on the part of groups whose interests are adverse to traditional investors should not be an objective of any SEC rulemaking. The Commission should guard against such foreseeable outcomes and mitigate against the possibility that its rules will unintentionally frustrate the SEC's mission.

Many private companies will avoid accessing the public markets altogether, seeing the vast cost and complexity of the climate reporting regime that the Proposed Rules in their entirety would create, the real potential to divert managerial resources from other elements of the business, and the opportunity for increased activism. Many private companies will continue to seek debt and equity financing from private sources and remain private indefinitely. The capital markets suffer when fewer opportunities exist for investors to participate in the next generation of public company value creation. Retail investors, who typically do not have access to the private markets in the same way institutional investors do, are disproportionately disadvantaged when regulation discourages companies from going public or remaining public. Many existing U.S.-listed public companies are likely to reach a similar conclusion and pursue efforts to exit the U.S. public markets while also avoiding transactional opportunities that could create value for U.S. shareholders, such as potential mergers, if pursuing such opportunities would require them to become subject to SEC-mandated disclosure obligations. Along similar lines, to avoid related disclosure obligations, some companies may sell assets to private buyers in transactions that are on terms that adversely impact the value of publicly traded shares of common stock.

To facilitate the transition from private to public and help encourage IPOs, companies that are at a relatively early stage of development and therefore qualify as emerging growth companies under the SEC rules may take advantage of certain accommodations and scaled disclosure requirements. For these same reasons, emerging growth companies should also be permitted additional transition time to comply with the Proposed Rules. Failure to do so could further discourage private companies from going public. At a minimum, given the fact that, as the SEC notes, in comparison to smaller reporting companies, emerging growth companies "may similarly face resource constraints related to company size or age,"[146] emerging growth companies should be entitled to the same accommodations, for example exemption from Scope 3 emissions reporting requirements, as smaller reporting companies.

In placing new burdens on companies, the SEC must evaluate how the Proposed Rules will impact the competitiveness of the U.S. capital markets. The SEC has failed to provide an analysis for comment in this regard.

[146] Proposing Release, 87 Fed. Reg. at 21,450.

III. THE PROPOSED RULES MUST BE SUBSTANTIALLY REVISED IF ADOPTED.

A. The nature and degree of the SEC's reliance on unregulated standard setters raise concern.

Many companies have been guided in their voluntary reporting of climate-related risks and GHG emissions by the TCFD recommendations and the GHG Protocol. While voluntary reporting under these or other voluntary standards is entirely appropriate, the analysis is different when the SEC transforms voluntary standards into mandatory ones. The Chamber believes that, if the SEC adopts climate-related rules, the TCFD recommendations and the GHG Protocol should be considered and taken into account in preparing the rule. However, the SEC may not rely on TCFD and the GHG Protocol without undertaking a rigorous analysis of their appropriateness as mandatory requirements as compared to voluntary guidelines and frameworks. These organizations were created to address various policy considerations and respond to constituencies beyond those of the U.S. capital markets and investors. The process for third parties developing these voluntary standards is not subject to the rigors of the Administrative Procedure Act, and many of the standards address topics and are intended to achieve objectives far removed from the SEC's core expertise and authority as a capital markets regulator. Accordingly, while there can be practical reasons for drawing from well-established frameworks to the extent registrants have considerable experience applying them and they have proven to be workable, there are concerns with grounding the Proposed Rules in third-party standards that were not designed with an emphasis on the SEC's statutory mission as compared to a broader set of environmental and geopolitical ambitions. Moreover, it is a fundamental change to essentially transform a voluntary disclosure standard into a mandatory requirement under the SEC's regulatory regime. Third-party standard setters can rightly inform the Commission's policy approach but should not be given an outsized role in determining and justifying the SEC's approach given their structure and purpose.

Section 4A of the Exchange Act provides the express authority of the SEC to delegate functions to a division of the SEC, an individual SEC commissioner, an administrative law judge, or an employee or employee board, but not to any other party. When Congress has intended to authorize the SEC to delegate authority to a third party, such as FASB or the Public Company Accounting Oversight Board (the "PCAOB"), Congress has done so explicitly by statute, and has imposed important conditions that appear lacking in the case of the various third-party standard setters (most notably the TCFD and the GHG Protocol) that the Proposed Rules are grounded in.

The PCAOB was established by an express act of Congress, pursuant to Section 101 of the Sarbanes-Oxley Act. Regarding the parameters within which the PCAOB must operate, the Sarbanes-Oxley Act provides for:

- the explicit duties of the PCAOB, which are subject to the SEC's oversight and enforcement authority over the PCAOB pursuant to Section 107 of the Sarbanes-Oxley Act (as described below) and include registration and oversight of and enforcement authority over registered public accounting firms, setting its own budget and managing the operations of its staff and performing such other duties or functions as the PCAOB (or the

SEC, by rule or order) determines are necessary or appropriate to otherwise to carry out the Sarbanes-Oxley Act, in order to protect investors, or to further the public interest;

- standards and qualifications for who can serve as a board member of the PCAOB, including that each board member must serve on the PCAOB full time and be financially independent of any public accounting firm, and procedures for appointing and replacing members of the PCAOB, which is an authority reserved for the SEC; and

- the powers of the PCAOB to include administering the self-funding mechanism established pursuant to Section 109 of the Sarbanes-Oxley Act, which is subject to SEC approval and contemplates the assessment of audit support fees on public company issuers and registered broker-dealers[147] in an aggregate amount that is based on an SEC-approved budget and does not exceed the recoverable budget expenses.

The SEC's oversight and enforcement authority over the PCAOB pursuant to Section 107 of the Sarbanes-Oxley Act expressly includes:

- authority to cause the PCAOB to make and disseminate such reports as the SEC, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act and to examine the PCAOB's records;[148]

- a requirement that all PCAOB rules (with limited exceptions for initial or transitional standards) receive prior SEC approval in accordance with the process applicable to rules of self-regulatory organizations set forth in Section 19(b) of the Exchange Act, which provides for publication, hearings and standards for approval and disapproval;

- a provision allowing the SEC, by rule, to amend PCAOB rules in accordance with the process applicable to rules of self-regulatory organizations set forth in Section 19(c) of the Exchange Act as the SEC deems necessary or appropriate in furtherance of the purposes of the Sarbanes-Oxley Act;

- provisions allowing the SEC to review and modify disciplinary actions taken by the PCAOB; and

- provisions allowing the SEC to rescind the PCAOB of enforcement responsibilities and censure or impose limitations upon the activities, functions and operations of the PCAOB or censure or remove members of the PCAOB.

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[147] *See, e.g.*, the most recent announcement of the PCAOB budget and the related annual accounting support fee, available at https://www.sec.gov/news/press-release/2021-260.

[148] These are the authorities the SEC over a "registered securities association" pursuant to Section 17(a)(1) and 17(b)(1) of the Exchange Act. Section 107(a) of the Sarbanes-Oxley provides that such sections shall apply to the PCAOB as fully as if the PCAOB was a "registered securities association" for purposes of such sections.

Section 108 of the Sarbanes-Oxley Act amended Section 19 of the Securities Act to add a new Section 19(b) thereby establishing criteria for the SEC to exercise its authority to recognize an accounting-standard setting body as "generally accepted" for purposes of establishing accounting principles to be used under the federal securities laws and, shortly thereafter, the SEC made the determination required such that FASB would continue to serve in that role.[149] To meet these criteria (as the SEC determined FASB did), a standard-setting body must:

- be organized as a private entity;
- have, for administrative and operational purposes, a board of trustees serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the two-year period preceding such service, associated persons of any registered public accounting firm;
- be funded as provided in Section 109 of the Sarbanes-Oxley Act as described above;
- have adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and
- have considered, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

It is also worth noting the express statutory provisions in Sections 6 and 19 of the Exchange Act, which govern the relationship between registered national securities exchanges and registered self-regulatory organizations require, among other things, similar SEC oversight over rulemaking by a national securities exchange or a self-regulatory organization as applies to the PCAOB and FASB.

Even if Congress had delegated authority to the SEC to subsequently delegate the authority over climate-related standards to third parties, the substantive and procedural structure and composition of the TCFD and the GHG Protocol do not meet the requirements set forth by the applicable statutes for when the SEC may delegate authority to a third party. Neither the TCFD nor the GHG Protocol has a self-funding mechanism in accordance with Section 109 of the Sarbanes-Oxley Act, and the SEC does not have any direct (or indirect) oversight over either body or its rulemaking process. More specifically:

- the members of their governing bodies are not independent, and the SEC has no direct influence over, let alone authority to appoint or remove, members;

[149] Release No. 33-8221, *Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter* (Apr. 25, 2003), available at https://www.sec.gov/rules/policy/33-8221.htm#P53_8931.

- the process by which rules and guidance are adopted is opaque, and the SEC has no direct influence, let alone authority, over such process; and

- the sources and amounts of funding for these organizations are not transparent.

To be clear, we are not saying that the TCFD and GHG Protocol processes are not appropriate for the purposes for which they were intended or that they do not provide value to the climate reporting landscape including, perhaps, serving as an alternative to the SEC proposing any new rules on climate-related risks. However, we are indicating that it is of great consequence that their standard-setting processes, governance and sources of funding do not comport with what Congress has required when Congress has allowed the SEC to delegate authority to other bodies.

While compliance with the TCFD recommendations or the GHG Protocol is not mandatory,[150] the SEC has relied on them in crafting the mandatory requirements of the Proposed Rules.[151] Accordingly, companies will look to guidance published by the TCFD, the GHG Protocol and various other third-party organizations and industry groups as to how to apply the TCFD and the GHG Protocol, including guidance that the SEC has recommended to companies in the Proposing Release.[152] This may prove problematic in practice given that the Proposed Rules deviate from the TCFD and the GHG Protocol in many respects. Some of these deviations are relatively clear and are analyzed by the SEC in the Proposing Release.[153] Other deviations and inconsistencies, however, are more subtle and may reveal themselves to companies only when they are further immersed in the granular details of the process that will be required to produce disclosures responsive to the Proposed Rules.

Even though companies are not required to follow the TCFD and the GHG Protocol standards and related guidance, companies seeking to navigate the intricacies of the Proposed Rules will also consult with the rules and other guidance published by the TCFD, the GHG Protocol and third parties when doing so, particularly when a question arises as to how to resolve or address an uncertainty or inconsistency. Moreover, neither the TCFD nor the GHG Protocol is

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[150] *See* Proposing Release, 87 Fed. Reg. at 21,377. ("While we expect that many registrants would choose to follow the standards and guidance provided by the GHG Protocol when calculating their GHG emissions, the proposed rules would not require registrants to do so").

[151] *See id*. at 21,343 ("Our proposed climate-related disclosure framework is modeled in part on the TCFD's recommendations"); *Id.* at 21,345 ("We have based our proposed GHG emissions disclosure requirement primarily on the GHG Protocol's concept of scopes and related methodology"); and *Id.* at 21,374 ("We also have proposed definitions of Scope 1, Scope 2, and Scope 3 emissions that are substantially similar to the corresponding definitions provided by the GHG Protocol")

[152] *See, e.g.,* Partnership for Carbon Accounting Financials, Global GHG Accounting & Reporting Standard for the Financial Industry (2020), available at https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf.

[153] *See, e.g.,* Proposing Release, 87 Fed. Reg. at 21,384-5 (discussing the differences between the approach to organizational boundaries contemplated by the Proposed Rules and the GHG Protocol). The GHG Protocol bases its organizational boundaries on either an equity share or a control approach. The Proposed Rules would have a registrant use the same scope of entities, operations, assets, and other holdings within its business organizations included in its GAAP consolidated financial statements.

static, as each engages on an ongoing basis in considering and proposing updates.[154] While the updates may be based on stakeholder input, the process by which they are conceived and finalized is not fully transparent or subject to oversight by or consultation with the SEC. The same is generally true for any related guidance that may be published by a third-party organization or an industry group.

The dynamic described above is but one more reason why the Proposed Rules should be principles-based and only require disclosure that is material. We fear the prescriptive nature of the Proposed Rules means they will not have the flexibility necessary to accommodate improvements in the understanding, standards, and practices for climate-related reporting as those understandings, standards, and practices develop and evolve. The consequences will be to "lock in" TCFD and GHG standards as they exist at the time the SEC considered them in crafting the Proposed Rules, stifling improvement in U.S. practices and creating conflicts as other practices develop and improve over time. How are companies to address these conflicts? Moreover, there can be no assurance that future changes will be changes that the SEC would agree with, from a practical or a policy perspective, and there is no mechanism to address this other than the cumbersome process of amending the SEC's rules. With changes in third-party guidance, how the Proposed Rules are interpreted and applied by companies will change, and the SEC will have no role in overseeing any of those changes as they will have been determined by what third parties do and promulgate in guidance.

An even more important conflict along these lines may arise from the fact that the missions of the TCFD and the GHG Protocol are not coextensive with the SEC's mission. The TCFD's mission is the "widespread adoption [of the TCFD recommendations] by companies in the financial and non-financial sectors" within the remit granted by the FSB, which is an international body composed primarily of representatives of the G20 governments[155] that established the TCFD, with the intent of causing "companies' and investors' understanding of the potential financial implications associated with transitioning to a lower-carbon economy … [to] grow."[156] The FSB monitors and makes recommendations about the global financial system and has a mandate to "promote[] international financial stability . . . by coordinating national financial authorities and international standard-setting bodies as they work toward developing strong regulatory, supervisory and other financial sector policies."[157]

The GHG Protocol is "a multi-stakeholder partnership of businesses, nongovernmental organizations (NGOs), governments and others convened by the World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD)[, and the] mission of the GHG Protocol is to develop internationally accepted greenhouse gas (GHG) accounting and reporting standards and tools, and to promote their adoption in order to achieve a low emissions

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[154] *See, e.g.*, 2021 TCFD Implementation Guidance, at 4 (summarizing recent changes to the TCFD recommendations).

[155] See the current list of members at https://www.fsb.org/about/organisation-and-governance/members-of-the-financial-stability-board/.

[156] https://www.fsb-tcfd.org/about/

[157] https://www.fsb.org/about/#mandate

economy worldwide."[158] The WRI is a global non-profit organization that "works with governments, businesses and civil society to transition toward a zero-carbon economy where all people can thrive,"[159] and the WBCSD is a "global, CEO-led community of over 200 of the world's leading sustainable businesses working collectively to accelerate the system transformations needed for a net zero, nature positive and more equitable future."[160]

These third-party standard setters could be influenced by a variety of considerations that are in conflict with the SEC's mission, which may ultimately cause the Proposed Rules to have an effect that is contrary to what is intended and adverse to the best interests of U.S. investors and our capital markets. The TCFD recommendations and GHG Protocol were developed to address a series of environmental, geopolitical and other public policy objectives beyond those of the federal securities laws. The important but unanswered questions about organizational governance, due process and funding sources for these third-party standard setters may present other, potentially serious, conflicts of interest. Moreover, these organizations are not directly or indirectly accountable to the SEC.

B. The SEC should not create new financial reporting rules covering climate change.

Proposed Article 14 of Regulation S-X is largely unworkable, and such disclosures are not likely to be material or useful for investors. The proposed requirements represent transformative rulemaking from the standpoint of financial reporting and disclosure controls, processes and procedures, but are not based on a legislative mandate and cannot be complied with using incremental builds on existing controls, processes and procedures given the vast and unprecedented scope, granularity, complexity and prescriptiveness of the Proposed Rules. Furthermore, the Proposed Rules require untold estimates, assumptions and judgments against the backdrop of significant data limitations and speculative impacts. The rigid and detailed mandates of proposed Article 14 are in stark contrast to the flexible principles regarding disclosure of climate-related financial impacts contemplated by TCFD and, the Chamber believes, go far beyond what is warranted to respond to what investors have called for, particularly in light of the high costs of compliance – costs that will be even higher to the extent these disclosures are subject to the financial statements audit.

From an overarching perspective, disclosing climate-related effects by financial statement line-item, as defined at the 1% level (using absolute values) applied to each line-item, is at odds with the measurement uncertainty inherent in such financial metrics. It requires much more precision than is reasonable to expect or, for that matter, has been required by the SEC up to this point in financial reporting. These requirements will not provide climate-related information that is consistent or comparable – either over time or cross-sectionally. Further, the myriad disclosure requirements under the Proposed Rules will rapidly lead both regulators and registrants away from the core principles of market regulation and financial reporting that have been the cornerstone of

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[158] GHG Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard*, available at https://ghgprotocol.org/standards/scope-3-standard, at 4.

[159] https://www.wri.org/climate

[160] https://www.wbcsd.org/Overview/About-us

our capital markets. The resulting complexity from implementing these requirements will obscure the fundamentals of fair markets, as well as what is essential to the resiliency of adaptive enterprises.

We urge the SEC not to adopt the component of the Proposed Rules for GAAP footnote disclosure of climate-related financial metrics. The SEC should instead defer to the FASB for setting GAAP. To the extent the SEC nonetheless moves forward in a final rule with financial reporting requirements, such disclosures should be disclosed pursuant to existing MD&A disclosure requirements rather than be included in a registrant's financial statements. Further, if the SEC ultimately does mandate disclosures in the financial statements, materiality should be the standard for determining what must be reported instead of the 1% threshold as proposed by the Commission.

1. The proposed 1% materiality threshold is unworkable.

The Proposed Rules would require a registrant to consider the impacts of climate-related financial metrics at the 1% level for all line-items (and years) in the consolidated, annual, audited financial statements (without considering any qualitative or other factors). We believe the justification for this threshold is not compelling and that the support for it is thin.

The Proposing Release provides only three instances of the SEC using a 1% threshold among all the SEC's many rules and regulations. The three involve either investment companies (not registrants) or focus on one specific type of transaction (i.e., excise taxes included in sales and revenues or related party transactions).[161] These instances do not provide justification or support for requiring public companies to apply a 1% threshold at the line-item level (using absolute values) across a registrant's (comparative) consolidated balance sheets, income statements and statements of cash flow, as proposed. The level of granularity and prescriptiveness in this regard is unprecedented.

In applying the 1% threshold, the Proposing Release would also require the aggregation of unrelated and individually immaterial climate events within each financial statement line-item, with both positive and negative events and transactions counted together to reach 1%. A problem with this approach can be illustrated by assuming a calendar-year reporting registrant has operations affected by two events – a June wildfire under drought conditions in California and a September hurricane in Florida – and the effects of each individual event are immaterial. Nonetheless, the Proposing Release would require the registrant to aggregate the impacts of these individually immaterial events for each financial statement line-item to determine whether (the absolute values of) the combined effects exceed 1% of any reported line-item amount. We do not support such an aggregation approach.

The Proposing Release is transformative, and we believe that no registrants—even large accelerated filers—have experience developing the necessary information to disclose the climate-related metrics as proposed at the 1% level considering each financial statement line-item.

[161] Proposing Release, 87 Fed. Reg. at 21,366 n. 347.

Registrant accounting systems do not have separate accounts that record the SEC-defined climate-related activities. Rather, the amounts are embedded in existing (traditional) accounts and a registrant would have to develop approaches for determining them. Moreover, registrant control systems likely do not operate at a 1% level of precision across all financial statement line-items. All registrants will need to consider the implications of any final rule for both their accounting systems and internal controls over financial reporting, whether subject to both Sarbanes-Oxley Act Sections 404(a) and (b) or only Section 404(a). The Proposed Rules would require significant effort to ensure tracking and aggregation of expansive data elements to meet the rule, likely resulting in significantly burdensome and costly investments in systems and IT.

We further note that increasing the 1% threshold to a higher numeric threshold or allowing it to be calculated on a net basis would not improve the workability of proposed new Article 14 of Regulation S-X. Because it is impossible for a registrant to know at the beginning of a period what its results will be for each line item at the end of that period, controls in place at the beginning of the period would need to capture effectively all transactions and assess if each one should be counted towards that numeric threshold. Simply increasing the arbitrary 1% threshold to a higher arbitrary threshold would not resolve that issue; registrants would still need to evaluate each transaction to determine if it counts towards that threshold and would not be able to calculate a dollar value for that threshold until the end of the relevant period. In short, the cost and burden must be incurred by a registrant even if no disclosure is ever required.

2. Proposed Article 14 presents innumerable implementation difficulties and will result in extensive disclosure of immaterial information.

The vast scope and breadth of proposed Article 14 cannot be understated, and it presents innumerable additional implementation difficulties for registrants, which would not be solved by simply raising the 1% threshold. We have identified and discuss ten types of matters that are representative of these additional complications. To be clear, the difficulties under proposed Article 14 are not limited to these ten topics, as the challenges to operationalize the proposed climate-related financial metrics are manifold.

First, the financial metric definitions are overly broad and will not be easily understood or consistently interpreted by financial statement users, preparers and auditors. Because they introduce a new lexicon of subjective, often-undefined terms, they will also present significant challenges for financial statement users and preparers who are not trained as climate scientists or environmental engineers. In some instances, the Proposing Release provides examples "for further clarity." However, the SEC always cautions that these examples are not exhaustive. Thus, while helpful, they do not resolve all issues.

As one example, under the requirement to disclose the financial impacts of severe weather events and other natural conditions, the examples incorporated in the Proposing Release include flooding, drought, wildfires, extreme temperatures and sea level rise. But this is not an exhaustive list. Does the SEC intend earthquakes to be included under "other natural conditions"? Earthquakes are not typically associated with climate change, but they may be considered a natural condition.

Further, as another example, the definition of "wildfires" within the Proposing Release requires clarification. One commonly accepted definition is "a large, destructive fire that spreads quickly over woodland or brush." Would the SEC consider fires started by humans, whether accidentally or intentionally, to be wildfires that require determination of the impact on every financial statement line-item? An intentionally started fire would not seem to be causally attributable to climate change. Alternatively, are these types of fires to be excluded from the financial metrics – along with other fires such as fires in over-populated areas, but not involving significant "woodland or brush"? On the other hand, if such fires occur under drought conditions that may be linked to climate change, would that cause them to be included, at least to the extent the drought conditions made the fire worse? Then how would one determine if the drought conditions are typical in the history of the planet and unrelated to climate change or what the impact of the fire would have been had there been no drought? Financial statement preparers, many of whom are not also trained as climate scientists, are not well positioned to resolve these kinds of thorny interpretive questions, some of which simply are indeterminable. Similarly, what are "severe weather events," the impacts of which are to be reported? "Severe weather" could be interpreted as a severe summer thunderstorm or a category 4 or 5 hurricane. How severe would a thunderstorm have to be to qualify? How would it be determined that a particular thunderstorm was related to climate change? Again, financial statement preparers are not trained as climate scientists and are therefore not positioned to resolve these kinds of interpretive questions.

Financial metrics related to transition activities, which involve efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks, would similarly present a need for clarification. For example, the Proposing Release states that "a registrant may be required to disclose the amount of expense or capitalized costs, as applicable, related to research and development of new technologies, purchase of assets, infrastructure, or products that are *intended* to reduce GHG emissions, increase energy efficiency, offset emissions (purchase of energy credits), or improve other resource efficiency."[162] However, what if a registrant undertakes such activities without the *intent* (another term that is not defined in the Proposed Rules and could have a wide range of reasonable interpretations under the circumstances) to do so, but the activities result in the reduction of GHG emissions, increase energy efficiency, or improve other resource efficiency as a by-product? Does the SEC intend that, nevertheless, the registrant should include these expenses or capitalized costs as climate-related in the financial metric? What if the activities are part of routine periodic capital investments and maintenance or product development cycles and not a direct response to transition risks, or what if it is both simultaneously? Additionally, as mentioned above, registrant accounting systems do not have separate accounts that record the SEC-defined climate-related activities, for example, categorization of expenses related to either severe weather events or transition risk, and thus registrants would have to develop new cost based accounting systems, as this level of expense "tagging" is not commonplace in most companies. In addition to the initial system design and cost, companies will then need to develop new processes and training for employees to assist in the consistent "tagging" of expenses.

Registrants may also encounter difficulties because there are some impacts that are required to be disclosed under proposed Article 14 that are not also required to be disclosed under

[162] *Id*. at 21,433.

proposed Regulation S-K Item 1502. Proposed Regulation S-K Item 1502 requires the disclosure of impacts from climate-related risks (and, at the registrant's option, opportunities) reasonably likely to have a material impact. Proposed Article 14 requires disclosure related to the impacts that are disclosed under proposed Regulation S-K Item 1502 as well as from other events, regardless of whether such events have a material impact on the registrant or its consolidated financial statements. Not only will this create confusion, both for preparers and users of the information, but it will also put pressure on registrants concerned with the apparent inconsistency to disclose events that are *not* reasonably likely to have a material impact on the registrant merely because such events would require disclosure under proposed Article 14. This will add to the complexity of the disclosure without any benefit by eliciting immaterial information under proposed Regulation S-K Item 1502, adding to the burden of the disclosure while also obscuring the portions of the responsive disclosure that are most important to the registrant. If the financial statements metric requirement is maintained, this disclosure "disconnect" should be resolved: only impacts that relate to events that are material to the registrant, and therefore are required to be disclosed pursuant to proposed Regulation S-K Item 1502, should require disclosure under Article 14.

Second, the boundaries for defining the types of climate-related effects to include in determining the financial statement metrics also lack clarity. For example, does the SEC contemplate that a registrant would include both direct and indirect effects of climate-related events in determining the financial statement metrics? This is a matter of particular concern because the types of indirect effects could be endless and the challenges in determining how such effects should be reflected, if at all, in GAAP financial statement line-items would be substantial.

Third, an additional category of questions involves the SEC's expectations on how registrants should sort out the SEC-defined climate activities from other non-climate activities and allocate the amounts to each for determining the registrant's line-item disclosures at a 1% threshold – as well as determine the aggregate amounts of expenditures expensed and capitalized costs incurred during the year. Clearly, determining each of the climate-related financial metrics will require many assumptions, estimates and judgments, such as identifying any relevant amounts embedded in financial statement line-items (computing aggregate amounts for expenditures expensed and capitalized costs) and allocating those amounts to climate-related activities. Some of the questions posed in the Proposing Release recognize these issues, as does the proposed requirement to disclose contextual information on these estimates and assumptions.

However, such contextual disclosure does not solve the essential problem for registrants or their auditors because they are still left with the practical difficulty of sorting through and categorizing activities and their impacts in the manner proposed Article 14 would require. Also, what is the SEC's expectation with respect to disclosures on a requirement to describe how each specified metric was derived, including a description of significant inputs and assumptions used, and, if applicable, policy decisions made by the registrant to calculate the specific metric?[163] How detailed and all-encompassing are these disclosures expected to be? The Proposing Release provides no guidance on important issues such as this.

[163] *Id.* at 21,363.

Fourth, another important consideration is that the Proposing Release definitions and descriptions for the climate-related financial metrics do not necessarily comport with GAAP or extant SEC terminology. For example, GAAP financial statement line-items do not include amounts for lost revenues, cost savings, or cost reductions. It would represent a complete shift in the financial reporting regime to provide "what if" disclosures such as these under the umbrella of GAAP. Any climate-related financial statement metrics should be based on items clearly recognized, measured, and reported under GAAP.

Further, one of the proposed metrics requires the disclosure of the impact of any climate-related risks (separately by physical risks and transition risks) on any of several other proposed financial statement metrics.[164] In this regard, the Proposed Rules use the terms "actual or potential" in defining climate-related risks, transition risks, and climate-related opportunities. Yet, "potential" is not a defined term under GAAP or SEC regulations, nor does it comport with a likelihood that is defined by FASB or the SEC. Additionally, the Proposed Rules include an example of disclosing impacts of "changes to revenues or costs from disruptions to business operations or supply chains," resulting in companies disclosing estimates of lost revenues or opportunity costs, which are amounts not recorded in the financial statements. Thus, it is not obvious whether or how financial statement line-items include the climate-related amounts or were impacted by the climate-related risks to be disclosed, as defined and described in the Proposing Release.

Fifth, another matter adding confusion is that the text of the Proposed Rules and the narrative in the Proposing Release do not necessarily agree. For example, rather than using "potential" as in the Proposed Rules, the narrative text states that "the proposed rules would require a registrant to disclose information about … How any climate-related risks identified by the registrant have had or *are likely to have* a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term."[165]

Sixth, the text of the Proposed Rules defines climate-related risks and opportunities such that a registrant must consider the impacts on the registrant's consolidated financial statements, business operations and value chains. In addition, climate-related risks include physical risks and transition risks and, in turn, these risks involve both acute and chronic risks to a registrant's business operations or those with whom it does business. It is near-impossible for a registrant to determine the impacts of this sprawling set of risks on GAAP financial statement line-items and to compute the required climate-related metrics for its entire value chain. Making these determinations will further require registrants to make judgments and assessments that do not easily lend themselves to the mathematical precision associated with the correlating accounting disclosures. The Proposing Release provides no guidance on this point, again leaving registrants and their financial statement preparers and auditors at a significant disadvantage.

Seventh, yet another matter that is unclear, also in regard to the impact of any climate-related risks, is what the SEC contemplates as to the nature of this computation. For example, are

[164] *Id*. at 21,345.
[165] *Id.*

these impacts expected to be disclosed as dollar amounts or in some other quantitative fashion? This simple distinction has a cascading effect on the nature of the reporting and the associated assurance over it. The Proposing Release is again silent.

Eighth, it is noteworthy that the Proposing Release contemplates consideration of risks and uncertainties over short-, medium-, and long-term time horizons. Requiring the use of an unlimited time horizon in determining the required climate-related financial metrics poses a more than difficult challenge for registrants. It is certain to require the disclosure of numbers bound to be incorrect – and likely materially incorrect. What is unknowable cannot be computed and disclosed.

We appreciate that the Proposing Release states that the SEC is not proposing to specify a range of years to define the various time horizons. Rather, a registrant would be required to describe how it defines short-, medium-, and long-term in order to allow flexibility in determining the most appropriate horizons for the registrant's circumstances. However, this approach does not solve the fundamental forecasting challenges for registrants or auditors. Further, this approach will diminish comparability of the information among registrants and represents one of many areas in the Proposing Release for second-guessing, including through private litigation and SEC enforcement.

Ninth, we are uncertain what the SEC means in using the phrase "financial statements as a whole" in defining climate-related risks and climate-related opportunities. We cannot reconcile this terminology with the climate-related metric disclosure requirements involving every line-item in the financial statements at the 1% level. Were the SEC to proceed with a requirement of this kind, it should clarify what is meant by this ambiguous term and provide further instruction to financial statement preparers on its ramifications for the financial reporting process.

Tenth, the myriad of practical challenges – including the necessity for untold estimates, assumptions, and judgments – raises concerns about the auditability of the proposed footnote for financial statement climate metrics and related internal control over financial reporting. Further, auditor quantitative materiality considerations in planning and conducting audits do not operate at the 1% level for every financial statement line-item.[166] Even if these concerns can be addressed, the proposed footnote disclosures would leave auditors, and thereby registrants, open to undue second-guessing through the PCAOB inspection process – as has been learned from experience in implementing Section 404 of the Sarbanes-Oxley Act.

3. <u>The SEC should not bypass the traditional FASB standard-setting process.</u>

In important ways, the rulemaking is an unprecedented action by the SEC, particularly in the post-Sarbanes-Oxley Act era. The Proposing Release departs from the SEC's designation of, and reliance on, FASB as the standard setter for GAAP financial statements (which include footnote disclosures); diminishes the role of FASB as an independent GAAP standard setter; and overlooks FASB's currently underway projects related to disclosing disaggregated information

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[166] *See* A. Eilifsen and W. F. Messier, Jr., *Materiality Guidance of the Major Auditing Firms*, in Auditing: A Journal of Practice & Theory (May 2015)at 3-26.

and ESG-related reporting matters that are based on extensive outreach and feedback, including from investors. In addition, if provisions in the Proposing Release had been contemplated, FASB may not have promulgated some standards in their current form (e.g., the ASU on Financial Instruments – Credit Losses (Topic 326) that focuses on estimation of expected losses over the life of the loans). In circumventing FASB, the Proposing Release represents a problematic precedent for the SEC by using financial reporting for purposes that, to some degree, fall outside the SEC's tripartite mission.

Long ago the SEC delegated day-to-day responsibility for setting the form and content of registrants' financial statements to an independent private sector body. In keeping with this delegation, the SEC formally recognized FASB as the authoritative GAAP standard setter at the time of FASB's formation,[167] which the SEC reaffirmed after enactment of the Sarbanes-Oxley Act, in accordance with Section 108 of the Act.[168] To date, FASB is the only GAAP standard-setting body recognized by the SEC under Section 108 of the Sarbanes-Oxley Act.[169]

FASB has developed a robust and comprehensive set of due process procedures for all standard setting.[170] Under these due process procedures, FASB's board identifies financial reporting issues based on requests or recommendations from stakeholders. The FASB regularly undertakes a formal agenda-setting process. The FASB board votes whether to add a project to its technical agenda based on the FASB staff's analysis of the relevant issues. FASB then deliberates the various issues at one or more public meetings, and then FASB issues an exposure draft of the new or amended standard. The FASB board typically holds one or more public roundtables to debate the exposure draft and reviews written comment letters from the public. In many cases, public feedback necessitates further revision to the proposed standard and the issuance of a revised exposure draft. After all public comments are considered, FASB issues an amendment to its Accounting Standards Codification.

The FASB process also allows for gradual evolution of accounting standards in a careful, deliberate way that, among many other benefits, seeks to thoroughly consider all unintended consequences.

[167] *See* Accounting Series Release No. 150 (issued Dec. 20, 1973).

[168] *See* Release No. 33-8221, *Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter* (Apr. 25, 2003), available at https://www.sec.gov/rules/policy/33-8221.htm#P53_8931.

[169] Although the SEC accepts filings from foreign private issuers (FPIs) containing financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board (IASB) without reconciliation to U.S. GAAP, the SEC has never recognized the IASB under Section 108 of the Sarbanes-Oxley Act. Apparently, a requirement in the Proposing Release (see footnote 319, page 21,364) would be the first time the SEC has added to IFRS. That footnote also describes the requirement that FPI's in filings using home country GAAP (with appropriate reconciliation to U.S. GAAP) would have to use U.S. GAAP as the basis for calculating and disclosing the climate-related financial metrics.

[170] *See generally* FASB Rules of Procedure (Aug. 10, 2021), available at https://www.fasb.org/page/ShowPdf?path=FASB_Rules_of_Procedures-Aug-2021.pdf&title=Rules%20of%20Procedure-August%2010,%202021.

Promulgating the Proposed Rules for climate-related GAAP footnote disclosures in a manner that bypasses FASB represents a significant departure from both the spirit and substance of the SEC's longstanding policy and approach to accounting standards, financial reporting and its reaffirmation of FASB in 2003. It undermines the well-developed and collegial working relationship between FASB and the SEC staff in addressing GAAP financial reporting and disclosure matters post-Sarbanes-Oxley Act, and it represents a potential challenge to the independence of FASB.

Importantly, FASB currently has its own projects underway on disclosing disaggregated financial statement amounts and on accounting for financial instruments with ESG-linked features and regulatory credits. These projects represent the culmination of extensive stakeholder outreach and feedback, including discussions with FASB advisory groups – both the Financial Accounting Standards Advisory Council (FASAC) and the Investor Advisory Committee (IAC).

The objective of the disaggregated financial statement project (Disaggregation – Income Statement Expenses (formerly known as the Financial Performance Reporting – Disaggregation of Performance Information)) is to improve the decision usefulness of business entities' income statements through the disaggregation of certain expense captions. In February 2022, the FASB board decided to revise the scope and objective of the project to focus on improving the decision usefulness of income statements through the disaggregation of (1) selling, general and administrative expenses, (2) cost of services and other cost of revenues, and (3) cost of tangible goods sold.

Moreover, as it does in all its standard-setting projects, in these projects, FASB is using its Conceptual Framework (Statements of Financial Accounting Concepts (SFACs)) to guide the development of sound, internally consistent standards for financial reporting and disclosure in order to provide useful information for investors. It is also worth noting the SFACs include guidance on materiality that aligns with the securities laws that FASB also considers in promulgating GAAP.

The Proposing Release has unintended consequences for current and future FASB projects. For example, on one hand, it creates a disincentive for registrants to disclose disaggregated line-items in the financial statements,[171] such as an ongoing FASB project involving the disaggregation of performance information, which FASB added to its technical agenda in September 2017.[172] On the other hand, it provides an opening for special interest groups to call on the SEC to promote more 1% line-item disclosures relating to topics other than climate-related risks.

The SEC's proposal sets a troubling precedent for undercutting FASB's approach to standard-setting, which is grounded in the Conceptual Framework and occurs through a transparent, deliberative due process. With its pervasive requirement for registrants (and their

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[171] The Proposing Release appears not to require the application of the "1% line-item" test to disaggregated amounts reported by a registrant in the GAAP footnotes (e.g., footnote disclosure of the disaggregated amounts included in a line-item for "other income/(loss)" on the income statement).

[172] Financial Accounting Standards Board: Financial Performance Reporting – Income Statement Expenses (previously: Financial Performance Reporting – Disaggregation of Performance Information).

auditors) to consider every line-item of the financial statements (balance sheet, income statement (statement of comprehensive income) and statement of cash flows) for climate-related amounts at a threshold of 1% of that line-item, the SEC is carving out a "special case" for disclosure of disaggregated information.

In summary, FASB's standard-setting practice proceeds at a deliberate pace over time, involving multiple opportunities for public input and comment to incorporate each stakeholder's perspective. In this way, FASB carefully achieves a balanced result that incorporates the varying perspectives of financial statement users and preparers, investors, auditors and regulators. The Chamber does not see a justification here for the SEC to circumvent FASB's role as an independent GAAP standard setter and thereby to deviate from the traditional path for developing financial reporting standards, particularly in light of the numerous complexities and unintended consequences associated with proposed Article 14.

4. The climate-related financial statement metrics depart significantly from the TCFD recommendations.

Proposed Article 14 appears to be informed by the TCFD recommendation that organizations should describe the impact of climate-related issues on their financial performance (e.g., revenues, costs) and financial position (e.g., assets, liabilities). The Proposed Rules, however, do not provide nearly the same flexibility that TCFD does in terms of allowing companies to only provide quantitative information that it is possible to provide:

> These impacts may be described in qualitative, quantitative, or a combination of both qualitative and quantitative terms. The Task Force encourages organizations to include quantitative information, where data and methodologies allow.[173]

Additionally, the TCFD recommendations are more flexible than proposed Article 14 in not dictating that climate impacts on specific line items be disclosed, nor in directing companies to use a 1% threshold to determine what impacts should be disclosed.

Moreover, the Proposed Rules do not take into account the empirical evidence and analysis included in TCFD publications that serve to illustrate the significant challenges entailed in producing objectively verifiable amounts in response to certain elements of this requirement. The 2021 TCFD Status Report contains an analysis of the state of play with respect to disclosure of financial impacts of climate-related risks. This analysis makes clear that companies do not often make disclosures about financial impacts that are quantitative rather than qualitative. It further illustrates that when companies do make quantitative disclosures about financial impacts, such quantitative disclosures are primarily focused on forward-looking potential financial impacts estimated based on scenario analysis rather than the comprehensive, granular and precise actual financial impacts (i.e., impacts on historical financial statements) that the Proposed Rules would require companies to include in their audited financial statements. The 2021 TCFD Status Report

[173] 2021 TCFD Implementation Annex, at 26 n.38.

goes on to state that quantitative disclosures primarily focus on potential financial impacts rather than actual financial impacts in light of how "challenging [it is] to identify and disaggregate from other non-climate events … when a monetary effect has multiple drivers in addition to climate (e.g., technology trends, political instability)."[174] In other words, the objective quantification of certain climate-related financial statement metrics demanded by the Proposed Rules are unworkable because the determinations required to attribute specific monetary amounts to specific events are so inherently subjective and whether an impact is "climate-related" is often unknowable. The challenges identified by the TCFD in quantifying actual financial impacts also include "difficulties with obtaining relevant data and selecting and applying assessment methodologies" and "divergent time horizons between accounting and climate reporting frameworks."[175] We note the SEC recognition of these significant challenges as well.[176]

The fact that some companies published examples of climate-related quantitative actual financial impacts does not justify requiring all companies to examine every line item in their financial statements and develop comprehensive and all-inclusive reporting. The limited examples of quantitative actual financial impacts contained in TCFD's 2021 guidance on metrics, targets and transition plans (the "2021 TCFD Metrics Guidance")[177] – which the SEC cites in the Proposing Release as "examples that illustrate the feasibility of some of the disclosures that would be required by the proposed rules"[178] – are limited, discrete examples and do not invoke the comprehensive and granular level of detail on each line item for each impact that the Proposed Rules demand:

- The TCFD identifies the "proportion of earnings before interest, taxes, depreciation and amortization (EBITDA) aligned to low-carbon products, services and technologies" as an example of disclosure of actual financial impact, but what is presented are three line items which correspond to information that is derived from reported information by specific reporting segments (business lines) that constitute an example of a company's low-carbon products, services and technologies businesses.[179]

- Of three examples of actual quantitative financial impacts, two cover the impacts as they relate to certain costs directly attributable to extreme weather events and one covers the impacts as they relate to an estimate of fuel costs saved due to the use of "one of the cleanest and efficient [generation fleets] in the country," a single number included in a stand-alone sustainability report not subject to any external assurance and not accompanied by contextual disclosure describing how the number was calculated (i.e. over what period,

[174] 2021 TCFD Status Report, at 63.
[175] *Id.* at 65.
[176] *See* questions 60 and 61 in the Proposing Release, 87 Fed. Reg. at 21,368-9.
[177] *See* Task Force on Climate-related Financial Disclosures, *Guidance on Metrics, Targets and Transition Plans* (October 2021), available at https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf, at 57.
[178] Proposing Release, 87 Fed. Reg. at 21,365 n.337.
[179] 2021 TCFD Metrics Guidance, page 50.

measured against what baseline and subject to what other assumptions and estimates) and what it represents.[180]

C. The SEC should not impose a GHG emissions attestation requirement.

1. The proposed attestation requirements are an unnecessary departure from longstanding practice and pose significant implementation challenges.

The Chamber strongly believes in the value of financial statement audits by independent auditors and appreciates the important role of audits and other types of assurance services in our public and private markets. However, from the standpoint of imposing regulatory requirements for assurance services, the Proposing Release breaks new ground. It not only renders the climate-related financial metrics subject to annual audit under the GAAP umbrella, but also requires registrants to obtain assurance over GHG emissions disclosures provided outside the financial statements. The SEC has not adequately explained, however, why this information, unlike all the other qualitative and quantitative information companies are required to provide outside the financial statements by other Regulation S-K requirements, needs to be audited. Companies and their management are relied upon as a matter of course to provide information that is accurate and complete in all material respects, and there are robust systems, controls and processes in place to ensure that is the case. Attestation is not needed and is an unnecessary and costly departure from longstanding practice. Moreover, in a departure from the current market practice of some companies that choose to seek assurance of their voluntary disclosure at a “limited assurance” level, the Proposing Release would also mandate assurance at the higher “reasonable assurance” level.

Further, the SEC provides that assurance on GHG disclosures can be provided by either PCAOB-registered or non-PCAOB registered firms. The Proposing Release would also result in new obligations on the PCAOB. Both the GHG and climate-related financial statement metric assurance requirements have consequences, for PCAOB-registered or non-PCAOB registered firms alike, regarding legal liability and regulatory enforcement risks.

Implementing the assurance provisions of the Proposing Release – for financial statement audits (whether integrated or financial statement only) and attestation engagements on GHG disclosures (whether under limited or reasonable assurance) – will require much work by audit firms. This work will take time. For example, any final rule will require audit firms to educate their workforce around the world who perform public company audits; to develop new systems, processes and global methodologies (considering both group audits and audits of FPIs); and (similar to registrants) to obtain interpretive guidance from the SEC, as well as the PCAOB, as to the meanings of the myriad undefined terms in proposed Article 14.

The largest audit firms may accommodate these challenges, although doing so within the proposed time frames will be challenging at best and will likely require an extension of any

[180] *Id.* at 63.

compliance dates. Even with a postponement of the compliance dates of any final rules, smaller audit firms may face even more of a challenge.

The Proposed Rules also have meaningful implications for audit standard setters like the PCAOB. If the Proposed Rules are made final, the PCAOB would be called on to provide guidance on implementing each of the required assurance-related provisions. Additionally, the PCAOB may need to consider updating its standards, particularly the attestation standards that auditors use to provide limited or reasonable assurance on GHG emissions.

Unlike the attestation standards of the AICPA Auditing Standards Board (ASB) and the International Auditing and Assurance Standards Board (IAASB), the PCAOB attestation standards have not been updated in more than two decades. Except for conforming amendments, the PCAOB's current attestation standards remain as the AICPA ASB attestation standards that the PCAOB adopted in 2003 as "interim" standards, although the PCAOB subsequently dropped the term "interim."

The Proposing Release also has implications for the PCAOB's other regulatory activities including inspections and enforcement. While the Proposal is unclear as to whether any climate-related assurance engagements would be subject to these activities for PCAOB registered and inspected CPA firms, investors generally may expect this to be the case. Further, notwithstanding the proposal for registrant disclosures when using non-CPA firms or non-PCAOB registered CPA firms for assurances on GHG emissions, confusion over the role of the PCAOB regarding these assurance providers will likely ensue.

The Proposing Release comes at a time when talent constraints are a major problem for registrants, accounting firms and regulators alike. Current staffing challenges in hiring and retaining the right people highlight a capacity problem for implementing this sea-change in SEC disclosure and attestation requirements.

2. <u>Third-party attestation of Scope 1 and 2 emissions adds another costly layer to the proposed reporting requirements.</u>

While some companies are already reporting in some form their Scope 1 and Scope 2 emissions, the broad and mandatory nature of this proposed reporting requirement would likely require companies to re-analyze whether their prior calculations and determinations meet all of the requirements of the Proposed Rules and adjust if necessary to address any deviation between what companies may have been disclosing in accordance with the GHG Protocol already disclosures and disclosures that would be compliant with the Proposed Rules.[181] The Chamber has two primary concerns in this regard. First, Scope 1 emissions calculations are generally based on fuel consumption for most industries, which is not a relatively complicated calculation. Accordingly, the attestation requirement is unlikely to add value relative to the cost. Second and similarly for Scope 2 emissions, objective information like purchase records and average emissions factors are

[181] For example, a company that had been using different organizational and operational boundaries than those that are permitted by the Proposed Rule.

typically used to calculate such emissions, meaning that the attestation requirement would add cost but not commensurate value in terms of giving investors greater confidence in relying on the information.

Independence is foundational in providing assurance services. However, in terms of burden, ensuring that attestation providers meet all of the qualifications and also are "independent" within the meaning of the Proposed Rules will limit the available pool of providers. At this point in time, there are a limited number of providers who would be available to perform the required attestations, and many of these same firms have been employed by companies in their efforts to generate recommendations and techniques for reducing GHG emissions as well as for development of voluntary reports. Consultants who are already familiar with the processes of a given company may not meet the independence requirements. Companies will be hard pressed with internal staffing challenges, which have only been exacerbated in the COVID-19 pandemic, to meet the new requirements, even if they have already been reporting Scope 1 and 2 emissions. This is because the new layer of regulatory assurance (even limited assurance) will require resources to be devoted to preparing for the attestation exercise.

We highlight that the TCFD recommendations and the GHG Protocol do not require attestation, and, as discussed above, the SEC's basis for requiring attestation of Scope 1 and Scope 2 emissions is unclear.

If the SEC proceeds with mandated Scope 1 and Scope 2 emissions disclosures, no assurance should be required, given that there is no indication that companies are not appropriately reporting their Scope 1 and 2 emissions in the current voluntary regimes. The Commission has not provided evidence that there is a real benefit in terms of data quality if these costly additional attestation requirements are imposed. Alternatively, to the extent companies are obtaining assurances, the SEC's alternative that registrants disclose what type of assurance, if any, they are obtaining may be appropriate. Depending on the nature of the operations of a company, there may be limited value to any outside assurance, because a calculation may be based on straightforward records. If a company has a more complex calculation, it may choose to provide an assurance level.

3. <u>Attestation should continue to be voluntary.</u>

Attestation over GHG emissions should not be mandatory. Instead, as mentioned above, the SEC should allow a commensurate market-based approach to third-party assurance for climate-related reporting for companies that choose to take that approach. Companies are in the best position to determine how to signal to investors the use of outside expertise through third-party assurance, how that assurance is suited to their individual circumstances and, if so, the type of assurance signal to provide. A market-based approach allows for good practices regarding third-party assurance to evolve along with the evolution of climate-change reporting and the criteria for such reporting.

Alternatively, if attestation is required at all, it should be required only for disclosures the issuer has determined to be material and then only at the "limited assurance" level. The federal securities laws do not support a costly attestation requirement for matters that are not material to investors.

Moreover, as discussed in more detail above, if the climate-related financial statement metrics requirement is maintained in substantially the form proposed, we would suggest, among other things as described elsewhere in this letter, permitting these disclosures to take place outside of the audit process.

D. Scope 3 emissions reporting should be entirely voluntary.

Scope 3 emissions reporting should not be mandated because the myriad difficulties that the SEC recognizes in the Proposing Release compromise the usefulness of Scope 3 emissions disclosure, particularly when they are beyond a company's direct control and require disclosure on the scale that the Proposed Rules contemplate. Instead of mandating Scope 3 emissions disclosure as the Proposed Rules do, the SEC should allow companies to disclose Scope 3 emissions on a voluntary basis as each company determines is appropriate.[182]

To help address the significant issues with Scope 3 emissions reporting that make mandating such reporting problematic, the Chamber stands ready to collaborate constructively to help facilitate discussions among the SEC, the EPA, the business community and other stakeholders to continue developing workable practices and methodologies that could produce Scope 3 emissions reporting, if material, on a practicable and achievable basis. Scope 3 emissions may be broadly categorized as either emissions generated by a company's suppliers or emissions generated by consumers of a company's products and everything in between, up and down the company's value chain.

The Chamber agrees that, as with other requirements, a materiality qualifier, consistent with the longstanding conception of materiality discussed above, is essential if any Scope 3 emissions disclosure is to be required.[183] That being said, we do not believe that Scope 3 emissions should be included as a separate mandated disclosure category for several reasons, chiefly that there are significant challenges in providing accurate, reliable calculations of a company's actual Scope 3 emissions.

Moreover, the Proposing Release contains commentary that will make the materiality determination regarding Scope 3 emissions a fraught one for many companies. Companies will feel pressured to disclose Scope 3 emissions not only because of the SEC's apparent bias towards finding that Scope 3 emissions are material, as discussed below, but also because of uncertainty about the standard of "understandability" that the SEC would apply in evaluating whether a company has made an adequate disclosure "to investors to understand the basis for that determination" that the SEC suggests should be made. A determination as to whether or not a disclosure is material should always have a reasonable basis, but it is not consistent with the SEC's

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[182] In recommending that Scope 3 emissions disclosures should be voluntary, the Chamber recognizes that a range of views and practices exist currently among companies when it comes to making certain Scope 3 emissions disclosures.

[183] Materiality should be a precondition for any mandatory Scope 1 or Scope 2 reporting as well.

typical practice to require disclosure that would allow investors to "understand" such a basis and related information. This inconsistency with current practice highlights an unnecessary distrust of public companies and managements' determinations with respect to materiality and unnecessarily increases the costs associated with compliance with these already burdensome rules.

Compounding the difficulty and problematic nature of the materiality determination described in the preceding paragraph, the Proposing Release includes commentary that supports the inference that the SEC has improperly predetermined the outcome when it comes to materiality and prefers for companies to disclose Scope 3 emissions even though the Proposed Rules do not technically require it for all companies:

> Scope 3 emissions information may be material in a number of situations to help investors gain a more complete picture of the transition risks to which a registrant may be exposed. … When assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions. While we are not proposing a quantitative threshold for determining materiality, we note that some companies rely on, or support reliance on, a quantitative threshold such as 40 percent when assessing the materiality of Scope 3 emissions.[184]

While the Proposed Rules do not require Scope 3 emissions if they are not material, the Proposing Release suggests otherwise. As Commissioner Peirce sums it up in her analysis: "the Commission suggests that such emissions generally are material" and that any "materiality doubts" should be resolved in favor of disclosure.[185]

The "40 percent test" also yields the illogical conclusion that if a company with relatively low Scope 1 and 2 emissions concludes that its total GHG emissions are immaterial, its Scope 3 emissions would be material solely because of the proportion they comprise of the company's total emissions. This formulation for determining whether Scope 3 emissions must be disclosed does not find support in the longstanding standard of materiality under the federal securities laws. In addition to the fact that such a conclusion does not make sense in the context of materiality determinations for federal securities law purposes, some companies may feel pressured to disclose their Scope 3 emissions simply because such emissions make up 40% (or perhaps even less) of their otherwise immaterial total emissions.

If the SEC maintains the Scope 3 emissions requirement subject to a materiality determination, the commentary in the Proposing Release should be replaced with guidance that makes clear that the standard governing materiality in this context is the same as it would be in any other relevant context under the securities laws: Scope 3 emissions are material if there is a

[184] Proposing Release, 87 Fed. Reg. at 21,378-21,379.
[185] *See* Peirce Statement, supra note 144.

substantial likelihood that a reasonable investor would consider them important when making an investment or voting decision.

The Proposed Rules would also require non-material Scope 3 emissions disclosure if a registrant has set a GHG emissions reduction target or goal that includes Scope 3 emissions. The Chamber respectfully disagrees that the mere existence of a target or goal should mandate an obligation to disclose non-material emissions. The fact that a company has set a target or goal for a category of Scope 3 emissions means that company has examined its Scope 3 emissions and made a determination that certain categories warrant a target or goal for any variety of business reasons. Whether disclosure should be mandated should turn on materiality, rather than turning on the setting of a target or goal in-and-of-itself. For those companies for which certain Scope 3 emissions are material under the federal securities laws, these companies should not be required to disclose other Scope 3 categories that the company has determined are not in fact material. Further, this requirement to disclose Scope 3 whenever a goal or target is set could discourage companies from setting targets or goals for Scope 3.

1. Scope 3 emissions are difficult to identify and accurately quantify and are uniquely uncertain and speculative.

As compared with Scope 1 and Scope 2 emissions, which themselves can be challenging to quantify, Scope 3 emissions disclosures present even more challenges and, in the degree to which they are uncertain and speculative, would constitute an unprecedented disclosure mandate. This is not least because Scope 3 emissions are composed of upstream and downstream emissions that are far more difficult to determine precisely, requiring companies to rely on third parties for data, make myriad assumptions and choose from still evolving methodologies. Thus, mandating disclosure of Scope 3 emissions moves even farther away from providing data to a reasonable investor that is material.

The vastness of the scope of emissions that fall under Scope 3 emissions, which attempts to quantify emissions throughout a company's value chain, includes[186] 15 different emissions categories which must be addressed without regard to materiality under the Proposed Rules:

(1) purchased goods and services;
(2) capital goods;
(3) fuel- and energy-related activities;
(4) upstream transportation and distribution;
(5) waste generated in operations;
(6) business travel;
(7) employee commuting;
(8) upstream leased assets;
(9) downstream transportation and distribution;
(10) processing of sold products;
(11) use of sold products;

[186] *See* Proposing Release, 87 Fed. Reg. at 21,380.

(12) end-of-life treatment of sold products;
(13) downstream leased assets;
(14) franchises; and
(15) investments.

This underscores what the SEC acknowledges: that "depending on the size and complexity of a company and its value chain, the task of calculating Scope 3 emissions could be challenging."[187]

Even in excluding the requirement for reporting of Scope 3 emissions for smaller reporting companies, the SEC acknowledges "the potential relative difficulty in data collection and measurement."[188] Additionally, the SEC acknowledges that the methodologies for evaluating GHG emissions continue to evolve, particularly for Scope 3 emissions.[189] Further, the calculation of Scope 3 emissions is largely dependent on third-party data that may only be available at industry-average or national-average basis, or simply not available at all.[190] To a significant extent, the calculation of Scope 3 emissions will require collecting data from third parties over which companies have no direct control and in many instances have no ability to influence (or may only be able to exert influence at the expense of financial performance, such as paying more under contracts in exchange for an agreement that the counterparty will provide the information needed for Scope 3 emissions calculations). For some types of businesses, such as large manufacturers with multitudes of privately held suppliers or large franchisors with multitudes of franchisees, these challenges may be insurmountable. Developing actual knowledge of how products are actually being used by customers during the products' lifetime is almost impossible. Companies do not control their own products once they are sold, and there are numerous ways – some perhaps unanticipated – in which products may be used and the time frames over which associated GHG emissions will occur based on that use and where the product is in the value chain when it is sold by the particular registrant to various consumers, customers or contractual counterparties.[191] Also, for companies that create components used by other companies to create their own end-use products, detailed and variable knowledge about the end-use products in order to allocate emissions to an intermediate product will be necessary. In many cases this will be impossible, and companies would need to use countless assumptions in the calculations. One clear example is military products and their use. This information is unlikely to be available for national security reasons.

[187] *Id*. at 21,390.
[188] *Id*. at 21,377.
[189] *Id*. at 21,411.
[190] *See id*. at 21,380-1.
[191] The SEC states that it anticipates some of these challenges may be ameliorated by relying on other companies' Scope 1 and 2 emissions to determine their own Scope 3 emissions. While this concept is theoretically appealing, it is unlikely to play out in practice. The basic idea being offered is that Company A will be able to examine the Scope 1 and 2 emissions disclosures of Companies B, C, and D to determine Company A's upstream or downstream Scope 3 emissions. As a practical matter, Companies B, C, and D will have complex commercial relationships with a range of other entities, such that each of their Scope 1 and 2 emissions will not easily be disaggregated to capture in the Scope 3 emissions of Company A. We think that the SEC cannot rely at all on the notion that companies' Scope 1 and 2 publicly-available data will be able to inform other companies' Scope 3 calculations.

There are a variety of other difficulties and challenges associated with the process required to calculate Scope 3 emissions, many of which underscore the inherent unreliability and subjectivity that characterizes Scope 3 emissions information. The TCFD itself[192] has published the following non-exhaustive list of these difficulties and challenges:

- organizations struggle to collect relevant and sufficiently granular primary data and to manage the amount of data needed to determine Scope 3 GHG emissions;
- using secondary data or industry average GHG emissions factors presents issues, such as how to account for uncertainties in industry-average GHG emissions factors around data collection or quality and an uneven distribution of GHG emissions within an industry;
- it is a challenge to estimate GHG emissions for suppliers that do not calculate their own emissions;
- it is a challenge to of define an appropriate calculation approach for each Scope 3 category;[193]
- double counting may occur when GHG emissions are aggregated across multiple organizations;
- users of an organization's disclosures must understand sources of uncertainty regarding whether a value accurately represents the activity in an organization's value chain, whether variations in calculated GHG emissions are due to methodological choices and whether there are any limitations as a result of the modeling approaches used to reflect the real world;
- establishing clear value chain boundaries when calculating Scope 3 GHG emissions presents another challenge, as the GHG Protocol allows companies flexibility in choosing which, if any, Scope 3 activities to include in their calculation; and
- while in principle the 15 GHG emissions categories defined for Scope 3 emissions by the GHG Protocol (which are consistent with the 15 categories included in the Proposed Rules) are designed to be mutually exclusive, in practice there can be overlaps in reporting boundaries due to a company's involvement at multiple points in the life cycle of products and can result in double counting of Scope 3 GHG emissions.

Given these difficulties, which also are discussed elsewhere in this letter, the reporting of Scope 3 emissions as proposed should not be required from any company. At the very least, if Scope 3 emissions are to be reported in SEC filings, then the reporting of Scope 3 emissions should be entirely voluntary. While it is true that several companies and organizations are working to improve methodologies regarding Scope 3 emissions calculation, such measurements still would

[192] 2021 TCFD Metrics Guidance at 57.

[193] With respect to each category, the GHG Protocol allows companies to choose from among multiple calculation methods and rely on different sources of data.

not address the fundamental challenge of lack of reliance on third parties for essential data. The notion that the SEC should move forward with these regulations now, while those systems are in the earliest stages of development, is inappropriate. Indeed, it underscores the points made elsewhere in this letter that mandating Scope 3 emissions disclosures would not only fail a materiality test but would also be counterproductive in that the disclosures will cause confusion, given the current state of methodologies and significant data limitations.

2. Gathering reliable data to quantify Scope 3 emissions is costly.

The Proposing Release anticipates vast increases in reporting burden hours and associated costs of reporting.

In many instances, the amount of Scope 3 emissions will depend on how a product or raw material is used or produced, respectively. The ability of companies to track materials and production upstream and use of products downstream is limited in today's complex, world-wide markets. It is unrealistic and unreasonable to conclude that companies will be able to accomplish this tracing across multiple tiers of entities throughout their value chains, particularly to the level of detail that the SEC seeks in the Proposed Rules to the extent many suppliers and customers of certain registrants would not be subject to Scope 3 disclosure requirements.

The Proposing Release does not adequately account for these costs and burdens.[194] If these costs and burdens were fully considered, the Proposed Rules would not require disclosure of Scope 3 emissions from any entity, given the relative value of the disclosure compared with the burden of preparing and making the disclosure. As detailed elsewhere in this letter, to allow sufficient time to collect the necessary data for reporting, to the extent any final rules require disclosure of Scope 3 emissions from any registrant, such disclosure (along with any other emissions disclosure) should be due no earlier than 180 days after the due date for Form 10-K for that particular registrant.

3. The safe harbor provision for Scope 3 emissions disclosures does not provide the relief that is required for companies that would be subject to this reporting requirement.

The SEC states that it recognizes that registrants *may* need to rely on assumptions about how customers will use their products to calculate Scope 3 emissions. There is no question that registrants *will* need to rely on various assumptions in calculating Scope 3 emissions, made all the more difficult by significant data limitations and methodological variability. Indeed, inherent in estimating any emissions are key assumptions, be they for Scope 1, 2, or 3 emissions calculations, but assumptions, as well as uncertainties, will be most acute in the area of Scope 3 emissions.[195]

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[194] Indeed, a Well-Known Seasoned Issuer we consulted estimates that the costs for compliance with proposed Scope 3 reporting will be $15.6 million over five years.

[195] *See* Proposing Release, 87 Fed. Reg. at 21,388.

The Proposing Release states that the SEC seeks to alleviate concerns that registrants may have about liability for information that would be derived largely from third-parties in the value chain, yet it would provide an inadequate safe harbor, as discussed in more detail elsewhere in this letter.

4. Scope 3 emissions disclosures are inherently incomparable.

The SEC states that the Proposed Rules are intended to provide comparable data that is useful, when in fact the Proposing Release highlights discrepancies in the reliability of different data sources for determining Scope 3 emissions.[196] There are multiple methods for estimating Scope 3 emissions depending on the data that is available and used. The method chosen by a particular company can be dependent upon a company's business operations, its size, as well as the complexity required to estimate Scope 3 emissions along with other judgments a registrant makes in determining which methodology to use. Moreover, the data needed to quantify Scope 3 emissions vary in availability and quality. Even if third-party attestation of Scope 3 emissions could be obtained (and we recognize it is not required and should not be required), it can often differ based on which party does the attestation, adding an additional layer of complexity to an already complex process.

As discussed earlier in this letter, the risk is that the disclosure elicited by the Proposed Rules will provide merely a veneer of comparability – indeed, false comfort that there is comparability – and will thereby obscure potentially material differences across the quantitative emissions companies disclose, since companies utilize diverse and varying data and methodologies in their good faith attempts to navigate the complexities and uncertainties embedded in the Proposed Rules' disclosure mandates.

It is also worth noting that the GHG Protocol discourages the reporting of the same Scope 3 emissions that other companies are reporting. Here, the Proposed Rules ignore that suggestion and propose multiple overlapping reporting of emissions by companies, which would lead to many tons of CO_2e being accounted for multiple times by multiple reporting companies. A simple hypothetical illustrates the problems with the Proposed Rules' approach. Take as an example an automobile. The factory producing the automobile is likely to produce Scope 1 emissions during the manufacturing process, and it purchases electricity to power the factory from the local utility. To the manufacturer, the emissions associated with the electricity are its Scope 2 emissions. These same emissions are double counted by the utility providing that electricity as its Scope 1 emissions. If the automobile is powered by electricity, it will generate emissions associated with its operation through its consumption of electricity, and those emissions will constitute Scope 3 emissions both for the manufacturer and the utility. A bank that provides financing to the utility or the manufacturer will also have to capture their emissions as part of the bank's own Scope 3 emissions disclosure – the same emissions are accounted for multiple times by various other entities under the Scope 3 emissions reporting regime. The dealer that sells the automobile to the end consumer would also recognize Scope 3 emissions from its production, distribution, use and disposition, just to name a few categories which the manufacturer would also recognize. If the automobile is

[196] *See id*. at 21,393.

powered by internal combustion, many of the same opportunities for double-counting exist, with the likelihood that several additional companies may each have to account for the Scope 3 emissions of the same automobile: the exploration and production company upstream that extracts crude oil from the earth; the refiner that processes crude oil into gasoline; the pipeline company that transports the refined gasoline to market; the transportation company that trucks the gasoline from a distribution facility to the service station; and finally the service station itself that sells gasoline to the owner of the automobile. We note again that the design of the GHG Protocol standard for Scope 3 emissions is not intended to allow investors to compare one company's Scope 3 emissions to another company's Scope 3 emissions.[197]

This simple hypothetical presents one of the principal public policy questions on reporting emissions: how many times are the same emissions associated with a single consumer product to be counted under the current emissions accounting approach? Investors would not benefit, and would be inherently confused, through the disclosure of the same emissions by multiple unrelated companies, which would ultimately in the aggregate produce emissions calculations that are incorrect and overstated by orders of magnitude.

Again, for the foregoing reasons, we urge that Scope 3 emissions be excluded from any mandated reporting requirements in favor of a voluntary reporting approach.

E. If the SEC mandates Scope 3 disclosures, then it should revise and expand the disclosure safe harbor.

1. <u>The proposed safe harbor is too narrow.</u>

As the Proposing Release itself acknowledges, reporting on Scope 3 emissions poses many difficulties and challenges.[198] The Proposing Release acknowledges it "may be difficult to obtain activity data from suppliers and other third parties in a registrant's value chain, or to verify the accuracy of that information."[199] The Proposing Release continues, "It may also be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data."[200] Indeed, Scope 3 emissions disclosures are based on numerous and significant uncertainties.

The challenges associated with definitively reporting on climate-related information are not limited to Scope 3 emissions, however. Much of the climate-related information that the Proposing Release calls for requires significant management estimates and judgment, relies in whole or in part on information provided by unaffiliated third parties, and is dependent on a reporting regime that is in its infancy. It is extremely difficult for a company to isolate the exact

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[197] See GHG Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard*, available at https://ghgprotocol.org/standards/scope-3-standard, at 6 ("Use of this standard is intended to enable comparisons of a company's GHG emissions over time. It is not designed to support comparisons between companies based on their Scope 3 emissions. Differences in reported emissions may be a result of differences in inventory methodology or differences in company size or structure.").

[198] *See* Proposing Release, 87 Fed. Reg. at 21,390.

[199] *Id.*

[200] *Id.*

extent to which climate change in-and-of-itself has impacted the company in the way the Proposed Rules contemplate through their detailed qualitative and quantitative disclosure prescriptiveness. Reporting concepts, measurement tools and other methodologies continue to evolve at a rapid pace, and we continue to learn more about climate science. Elements of the Proposed Rules, such as targets and goals, are inherently subjective and often forward-looking; targets and goals are also often prepared only for internal management analysis on a proprietary basis and are not necessarily designed with public disclosure in mind. Assurance principles are unsettled, as are key concepts of legal liability around climate information. The familiarity of the Commission and its staff with climate-reporting concepts and methodologies is also still developing.

In light of these factors, the Chamber has significant concern regarding the potential for second-guessing and liability regarding the disclosure of climate-related information were the Proposed Rules to be enacted.

We appreciate the Commission's recognition of the liability environment and believe the proposed Scope 3 safe harbor is a good starting point for any expanded climate disclosures. However, the safe harbor must be significantly expanded to be meaningful. Our concern is that the proposed safe harbor from Scope 3 emissions disclosure liability is too narrowly crafted and does not provide adequate relief. Furthermore, the Commission should employ a meaningful safe harbor not just for Scope 3 emissions disclosures, but rather should provide a meaningful safe harbor to cover the entirety of the disclosure provided in response to any final rules in light of the unique challenges that the SEC itself recognizes companies must overcome to meet the proposed climate-related disclosure obligations. Such a safe harbor should mimic the one available under the Private Securities Litigation Reform Act, but not be limited only to forward-looking information. Instead, the totality of SEC-mandated climate-related disclosure, excluding governance disclosures, should benefit from such a safe harbor. Likewise, climate-related disclosures made in an initial public offering registration statement should have the benefit of such a safe harbor as well.

We also believe the SEC should make clear that the safe harbor applies to the reporting company as well as any publicly-traded company providing data to other publicly-traded companies on Scope 3 emissions.

We acknowledge that the proposed Scope 3 safe harbor is grounded to some degree in Rule 175 under the Securities Act. But like Rule 175, the proposed Scope 3 safe harbor is heavily conditional, and, like Rule 175, in particular requires a registrant to act on a "reasonable basis" and in "good faith." These concepts are not well understood in the context of the federal securities laws, and the requirement to act reasonably could be construed to imply a negligence standard.

Since a cause of action under Rule 10b-5 of the Exchange Act requires a showing of scienter, the loss of a potential safe harbor on a showing of negligence appears to create a conceptual mismatch, and as a practical matter would render the purported safe harbor illusory. Conversely, if an issuer acts reasonably and in good faith, the proposed safe harbor would seem to provide no additional insulation against many other claims under the federal securities laws. For example, a safe harbor rooted in non-negligence would seem to provide no defense against a claim sounding in negligence, such as one initiated by the Commission under Section 17(a)(2) or 17(a)(3) of the Securities Act, again diluting the practical value of the proposed safe harbor. And Section 11 of the Securities Act includes an affirmative due diligence defense already. It is also unclear from the Proposing Release whether the proposed safe harbor is intended only to serve as a defense to a claim in an SEC enforcement action, or whether it would extend to private securities litigation as well – the Chamber holds it should do both.

2. The scope of Securities Act Rule 409 and Exchange Act Rule 12b-21 should be expanded and clarified with respect to climate-related disclosures.

In multiple instances in the Proposing Release, the SEC refers to the availability of Securities Act Rule 409 and Exchange Act Rule 12b-21 as a basis for non-compliance with requirements of the Proposed Rules that the SEC anticipates will be difficult for certain companies to meet due to the complexity, uncertainty or potential unavailability of information necessary to prepare responsive disclosure. Rule 409 and Rule 12b-21 generally provide that information that would otherwise be required in an annual report or registration statement need be given only insofar as it is known or reasonably available to the registrant. If any required information is unknown and not reasonably available to the registrant, either because the obtaining thereof could involve unreasonable effort or expense, or because it rests peculiarly within the knowledge of another person not affiliated with the registrant, the information may be omitted, subject to the following conditions: (a) the registrant shall give such information on the subject as it possesses or can acquire without unreasonable effort or expense, together with the sources thereof; and (b) the registrant shall include a statement either showing that unreasonable effort or expense would be involved or indicating the absence of any affiliation with the person within whose knowledge the information rests and stating the result of a request made to such person for the information. Moreover, historically, the availability of Securities Act Rule 409 and Exchange Act Rule 12b-21 has had very little, if any, practical impact.

If the Commission intends for companies, as a practical matter, to be able to avail themselves of Securities Act Rule 409 and Exchange Act Rule 12b-21 under various circumstances associated with compliance with the Proposed Rules to the extent contemplated by the Proposing Release, then the Commission should make clear that Securities Act Rule 409 and Exchange Act Rule 12b-21 will apply in all instances where, due to the myriad challenges inherent in, and that may arise in connection with, efforts to comply with the Proposed Rules, companies may need to avail themselves of the reasonable accommodations contemplated by such rules in connection with preparing and reporting climate-related disclosures. Moreover, there should be a presumption in favor of any determination by a company to avail itself of these rules and a safe harbor from liability with respect to any such determination and any alleged omission or misstatement resulting from the exclusion of information from an annual report or registration statement in reliance on Securities Act Rule 409 and Exchange Act Rule 12b-21.

F. The SEC should provide a transition period for prior years.

The Proposed Rules would require companies to provide GHG emissions disclosure and climate-related financial statements metrics for each year covered by the first annual report when the rules become effective. This requirement does not include a clear transition provision. In other words, even for the companies that have not started voluntarily disclosing any information, precise, quantified disclosure of metrics they have not previously tracked or reported would be required not only for the fiscal year covered by the first annual report under the newly effective reporting regime, but also for the two prior fiscal years. For example, proposed Rule 14-01 of Regulation S-X would require disclosure for a registrant's most recently completed fiscal year and for the historical fiscal year(s) included in the registrant's consolidated financial statements in the applicable SEC filing. The Proposing Release refers to Securities Act Rule 409 and Exchange Act Rule 12b-21[201] as providing potential relief from the requirement to report on more than one year in the first year reporting is due. Nonetheless, subject to our position (discussed in detail elsewhere in this letter) that the SEC should not finalize financial reporting rules covering climate change, to the extent the Commission maintains this requirement and finalizes any mandate for retroactive disclosure, a clearer transition period is warranted without reliance on separate SEC rules.

For many companies, even those that have already established some level of voluntary reporting, historical information may only be available at great cost and difficulty and, even then, could be subject to significant uncertainties that would make the disclosure unreliable, if it could be provided at all; accordingly, no disclosures should be required for periods prior to the adoption of any final rules. The need for third party assurance of this information, which would start as soon as the next year for GHG emissions and in the initial year for the climate-related financial statements metrics, further compounds this difficulty. If the requirements for disclosure around these metrics are maintained in any final rules, they should not apply retrospectively. While companies could be encouraged to provide information, if available, about the retrospective periods, companies should only be required to disclose new information for the year for which the first compliant annual report or other SEC filing is due.

G. The SEC should permit a more reasonable compliance period and allow for a reporting deadline later in the year for emissions data.

The Commission should, in any final rules, extend the initial compliance deadlines by at least two years to provide the issuer community sufficient time to develop systems, controls, and audit methodologies over whatever new disclosures are ultimately adopted. This additional time will allow the SEC to better promote more reliable disclosures than a hurried compliance period. In addition to the initial compliance deadline being too soon as proposed, the timing of disclosure during the annual reporting process also presents compliance challenges.

Much of the emissions-related information in the Proposed Rules would be required in Form 10-K. Particularly for companies with a calendar fiscal year, this deadline is unreasonably tight, and for most companies (even large accelerated filers), there will be significant challenges in providing emissions-related disclosures by the required deadlines. Any perceived benefit associated with disclosures being made at the same time as a company's annual report is outweighed by the benefit of allowing companies more time so that they have a realistic opportunity to prepare disclosures that will, in turn, be more reliable and useful to investors. In short, investors benefit when registrants have the time and ability to collect the requisite data and

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[201] Proposing Release, 87 Fed. Reg. at 21,364.

subject the information to an effective disclosure process and set of controls and procedures. The Proposing Release acknowledges as much by permitting registrants to make use of fourth-quarter estimates under certain circumstances under proposed Regulation S-K Item 1504(e)(4)(i) as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter. While we appreciate the Commission's effort to allow an accommodation here, its proposed approach is not workable.

Indeed, the SEC's need to allow companies to use a fourth quarter estimate to meet their GHG emissions disclosure obligations is not only an accommodation the SEC has never needed to make before, but it underscores that the SEC recognizes that many companies simply will not be able to meet the emissions disclosure deadline for a variety of reasons. For example, key emissions data needed to complete the required audit may not arrive until it is too close to the deadline to be prepared for external assurance and made subject to such assurance. Moreover, including data based on these types of estimates, subject to future correction when the actual data is available, would pose significant challenges for any third-party auditor of the resulting disclosure and could provide fodder for opportunistic third parties not motivated by the best interests of investors. This accommodation is not adequate to address the risk of being second-guessed and the attendant liability. It also does not help to ease potential investor confusion – if anything, use of a fourth-quarter estimate that is subsequently updated likely spawns investor confusion and creates liability risk.

In addition, accelerated and large accelerated filers with a calendar fiscal year would be required to make emissions disclosures under the Proposed Rules *before* the March 31 EPA deadline for similar information. The March 31 EPA deadline is followed by an EPA comment period whereby disclosures are often modified in response to EPA comments, and these disclosures often do not become final until the fourth quarter of the calendar year.

Rather than front-running the EPA reporting process or providing the unusual workaround that permits disclosure of GHG emissions on the basis of a quarterly estimate, the Commission should delay the reporting deadline for emissions information to later in the year. There is already a basis for this concept within the SEC's rules. Form SD, for example, is not due until May 31. Therefore, the Commission should delay the GHG emissions reporting deadline to later in the year in order to avoid the need for estimates and updates to those estimates and the duplication of reporting information that is the same or similar as that reported to environmental regulators like the EPA. If the Proposed Rules are not modified to allow for a later reporting deadline, it is imperative for the SEC to coordinate with the EPA to ensure consistency between the reporting regimes. To accommodate companies with different fiscal years and to allow sufficient time to collect the necessary data for reporting, any disclosure on emissions (including scope emissions) should be due no earlier than 180 days after the due date for Form 10-K for that particular registrant. If a company files emissions reports with another regulator, such as the EPA, and that regulator requires any amendment or modification of such emissions data, then the affected company should be permitted to amend its SEC disclosure without penalty.

H. The SEC should permit omission of disclosure by registrants that are wholly-owned subsidiaries of other reporting companies.

The Commission has for many years permitted registrants that are wholly-owned subsidiaries of other registrants to omit certain information from Exchange Act periodic reports. General Instruction I to Form 10-K and General Instruction H to Form 10-Q provide the conditions for this exemption and detail certain disclosures by the wholly-owned subsidiary (such as the Business or MD&A discussions) that may be omitted. We urge the Commission to expand this accommodation to wholly-owned subsidiaries as it concerns climate reporting.

We believe parent-level reporting for wholly-owned subsidiaries would be sufficient for investors. Under both an organizational-boundary and an operational-boundary approach, information for wholly-owned subsidiaries would already be subsumed into a parent's climate reporting. Reporting on an operational boundary approach would also align with the way that most companies currently track climate and emissions data for wholly-owned subsidiaries, which are often not managed with a view towards doing so on a stand-alone basis. In addition to eliminating the need to provide duplicative information for two or more registrants under common ownership, this accommodation would have the additional benefit of reducing compliance costs for the wholly-owned subsidiary.

I. The SEC should not require reporting on an organizational boundary basis.

In a departure from the GHG Protocol, the Proposed Rules would require emissions reporting on an organizational boundary and operational boundary basis using the same scope of entities, operations, assets and other holdings as those included in a registrant's consolidated financial statements. The Commission's approach is contrary to the one embodied in the GHG Protocol, which permits companies to rely on operational boundaries or equity ownership. Further, most companies currently report on emissions data using an operational boundary approach rather than an organizational boundary one.

The Proposed Rules would require registrants to maintain two different sets of records for GHG emissions reporting. The Proposed Rules would also require reporting on joint ventures, minority investments, and other operating interests in which the registrant does not maintain operational control. We believe this approach would be confusing to investors by implying control when none in fact exists and will further compound the difficulty of tracking and obtaining reliable data since a registrant may have no practical ability to obtain such data from entities it does not control. It is also unclear how a registrant would obtain third-party assurance over data outside its control that has been supplied by third parties. Accordingly, we request that any final rules permit disclosure on the basis of operational boundaries or equity ownership rather than organizational ones.

J. The SEC should extend the effective dates of any final rules.

Given the scope and breadth of the Proposed Rules, as well as the new processes, procedures, systems and controls companies will be required to develop to ensure their ability to comply, a significantly longer transition period is needed. To meet the compliance deadlines indicated in the Proposing Release, many registrants would be required to begin developing systems and controls now—an impossible task since there are no final rules to design those systems and controls around and a task that is inconsistent with the objectives and spirit of a notice and comment period following the proposal of new rules. Accordingly, to provide a reasonable transition to any final rules, we recommend that the Commission provide for effective dates two years beyond those indicated in the Proposing Release.

1. The Proposed Rules do not allow for sufficient transition time.

The Proposing Release calls for the climate-related financial metric disclosures to apply to large accelerated filers in fiscal year 2023, accelerated and non-accelerated filers in fiscal year 2024, and smaller reporting companies in fiscal year 2025. With disclosure requirements this unique and sweeping in scale and scope considering only the climate-related financial metrics, even large accelerated filers will need at least two years after any rules are finalized by the SEC in order to implement the requisite systems, controls, procedures and practices globally across all subsidiaries and operations in a reasonable and appropriate way. Extensive effort will be required by registrants to understand the requirements; educate management, employees, boards and investors; onboard new employees with appropriate skill sets, human resources that are likely to be in short supply as every public company seeks to staff up; modify accounting systems, the control environment and otherwise implement processes to obtain the necessary data to make the required determinations and disclosures; and integrate a final rule into registrants' other non-accounting systems and operations.

Many issues will need to be addressed by the SEC staff, registrants and auditors in implementing final rules. Were the SEC to adopt final rules substantially similar to those proposed, the challenges would multiply exponentially. To illustrate, the Proposing Release does not specify what the SEC's expectations are for applying Staff Accounting Bulletins 99 and 108 in the context of the climate-related financial metrics. It is also uncertain how the Proposing Release comports with existing internal control frameworks and SEC definitions of material weaknesses, significant deficiencies and similar terminology and standards. Likewise, it is unclear how the Proposing Release would align with registrants' management review controls, along with auditors' quantitative materiality considerations in planning and conducting audits, which at the present time typically do not operate at a 1% precision level for every financial statement line-item.[202]

An additional two years will allow time for the SEC staff to engage in the necessary outreach and education activities, respond to questions, and provide clarifying guidance, which even large accelerated filers and their auditors will need. Likewise, a more realistic transition period would give the PCAOB an opportunity to consider any needed guidance for auditors and engage in any appropriate standard-setting on its end. In response, issuers would gain the necessary time needed to develop responsive policies, processes, systems and controls to ensure compliance with the new rules. Moreover, it would give auditors time to develop plans, processes and

[202] *See, e.g.*, A. Eilifsen and W. F. Messier, Jr., *Materiality Guidance of the Major Auditing Firms,* Auditing: A Journal of Practice & Theory (May 2015), at 3-26.

procedures to appropriately encompass the climate-related financial metrics in the audits of registrants – whether integrated or financial statement-only audits. Of course, the SEC can always allow voluntary early disclosure for those registrants desiring and able to do so.

2. The Commission should permit additional transition time for acquired businesses or assets.

The Proposed Rules do not appear to provide transitional relief for acquired assets or acquired businesses. The absence of a transition period for acquisitions places a public acquiror at several disadvantages. Without this permitted transition, for an acquisition or merger completed later in the fiscal year, a registrant would be required to include the acquired company or assets in the subsequent year's climate disclosures. This outcome would give a reporting company very little time to establish systems and controls over the acquired business or assets, gather data and prepare the necessary disclosure. Beyond the compliance challenges that rapid reporting of data on acquired businesses or assets would present, the need to report so quickly may make a public acquiror a less attractive bidder, and it may discourage certain M&A activity entirely. Public companies may also find acquiring private companies not already subject to SEC disclosure rules less attractive. We do not believe that the Proposed Rules, if adopted, should be permitted to have these kinds of unintended consequences on the marketplace for mergers and acquisitions.

Accordingly, we recommend that any final rules include a transition period of at least one year for acquired businesses or assets. The Commission permitted a similar accommodation when it adopted the conflict minerals reporting rules, permitting registrants to delay the reporting on an acquired company's products until the end of the first calendar year that begins no sooner than eight months after the closing date of the acquisition. The Commission also permits a period of up to one year from the date of an acquisition during which management may omit an assessment of an acquired business's internal controls over financial reporting from its assessment of the registrant's internal controls. A similar transition period here is warranted.

IV. THE COST-BENEFIT ANALYSIS IN THE PROPOSING RELEASE IS INADEQUATE TO JUSTIFY THE ENTIRETY OF THE PROPOSED RULES.

A. The economic analysis in the Proposing Release is incomplete and substantially underestimates compliance costs.

The Commission "has a unique obligation to consider the effect of a new rule upon 'efficiency, competition and capital formation.'"[203] The Commission's "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."[204] The Commission's economic analysis is faulty in a number of important respects and fails to support the Proposed Rules. To begin, the Commission fails to "accurately assess any potential increase or decrease" in efficiency, competition and capital formation because the Commission does not

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[203] *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c)).

[204] *Id.* (quoting *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005)).

adequately "assess the baseline level" of information disclosure under pre-existing law.[205] As James A. Overdahl, the Commission's former Chief Economist, explains, the Commission's economic analysis narrowly focuses on specific, climate-related disclosure practices, while "fail[ing] to account for the full scope of the Commission's longstanding baseline of using a principles-based approach to disclosure based on the concept of materiality."[206] By failing to adequately consider the pre-existing principles-based approach, the Commission fails to recognize that material information, including climate-related information, is already disclosed under the existing regulatory regime.[207]

The Commission has likewise failed to demonstrate that a market failure exists with respect to the current principles-based approach. "Rules are not adopted in search of regulatory problems to solve; they are adopted to correct problems with existing regulatory requirements that an agency has delegated authority to address."[208] "That is not the situation that we [face] in this case."[209] As Overdahl explains, the "proposed rule[s] depart[] from the principles-based approach for the disclosure of material information without convincing evidence of any [existing] market failure that would warrant such a departure."[210] In fact, existing voluntary disclosures, which are in addition to the mandatory disclosures required by the Commission's existing principles-based framework, are already "widely practiced," are "increasing," and are "consistent with the types of disclosures to which the SEC has [previously] shown favor."[211] The Commission rightly notes that a top priority of some investors is to require increased climate disclosures from the companies they invest in. It is incumbent on the Commission to explain why demand by those investors will not be sufficient to produce adequate disclosures, with the added benefit that this private ordering—unlike the Proposed Rules—would allow for further evolution in best practices in an area that concededly is still developing. The Proposed Rules fail to address these considerations.

The Commission has also failed to adequately consider the Proposed Rules' costs. As Overdahl details, the Commission's "analysis is incomplete and excludes several potentially significant drivers of cost related to the proposed rule."[212] Even the costs the Commission does consider are not assessed in a logical fashion. As the D.C. Circuit has explained, the failure to "view a cost at the margin[] is illogical and, in an economic analysis, unacceptable."[213] Here, the Commission has failed to consider the marginal costs and benefits of aspects of the proposal.[214] While, for example, the Commission quibbles with the accuracy of existing Scope 3 emissions estimates, the Commission fails to consider the marginal improvement that would be offered by the costly and expansive reporting proposals in light of their marginal cost. Similarly, the Commission views the costs of the Proposed Rules as whole; it does not assess the marginal cost

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[205] *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010).
[206] Overdahl Report at ¶ 11. Overdahl's Report is hereby incorporated by reference.
[207] *Id.* at ¶ 29.
[208] *N.Y. Stock Exchange LLC v. SEC*, 962 F.3d 541, 556–57 (D.C. Cir. 2020).
[209] *Id.* at 557.
[210] Overdahl Report at ¶ 26.
[211] *Id.* at ¶ 44.
[212] *Id.* At ¶ 58.
[213] *Bus. Roundtable*, 647 F.3d at 1151.
[214] Overdahl Report at ¶¶ 34, 69-70.

and benefit of each requirement in light of the marginal cost and benefit of each of the other requirements. This is not acceptable in an economic analysis.

Beyond these shortcomings, the Commission's calculations for direct costs are incomplete. By the SEC's own calculations shown in Table 4[215], the Proposed Rules will impose on companies an aggregate additional annual reporting burden of 24,689,099 internal employee hours of work to comply, and an additional annual cost for external consultants and services of $6,378,073,242. The SEC does not calculate the dollar amount for the estimated 24.7 million employee hours. Based on the $200 per hour opportunity cost for internal professional employee labor typically applied in other regulatory impact contexts, the resulting amount is $4,937,819,800 aggregate annual cost for internal labor time at affected companies to comply with the proposed new reporting requirements. This is the economic opportunity cost of taking 24.7 million hours of effort away from productive work generating revenues to cover employee compensation, contribution to fixed overhead costs and contribution to profits and redirecting those hours to compliance with a government-mandated paperwork filing requirement. Combined with the SEC's estimate of external services compliance costs of $6,378,073,242, the total annual aggregate compliance cost amounts to at least $11,315,893,042. Nowhere in its proposed regulatory analysis does the SEC demonstrate that the annual benefits ascribed to the Proposed Rules could offset such a cost sum.

There is reason to think that the direct cost could be even greater. The hours burden on which the $11.3 billion annual cost calculation is based comes from the SEC's information collection report to the Office of Information and Regulatory Affairs (OIRA) to secure approval under the Paperwork Reduction Act so that companies can legally be compelled to report information on the subject forms. The SEC and other federal agencies seldom conduct empirical surveys or audits of the reporting public to support their estimates of reporting time burdens imposed on businesses and private citizens, and thus there is no evidence that the SEC's time burden estimates have any empirical basis. There are analyses indicating that agencies have substantially underestimated the burden hours for paperwork.[216] If the SEC similarly underestimates the actual time burdens, then the Commission would have significantly undercalculated the cost of the paperwork reporting requirements. The Commission has not given adequate attention to the full ramifications of the cost impacts of the proposed rule.

B. The compressed comment period has significantly impeded the public's ability to comment on the Proposed Rules in a thorough way.

[215] Proposing Release, 87 Fed. Reg. at. 21,461/

[216] For example: (i) U.S. Government Accountability Office, *Paperwork Reduction Act: Agencies Could Better Leverage Review Processes and Public Outreach to Improve Burden Estimates*, GAO-18-381, July 2018 available at https://www.gao.gov/assets/gao-18-381.pdf; (ii) Samaha, Adam M. *Death and Paperwork Reduction*, Duke Law Journal 65, no. 2 (2015) available at https://www.jstor.org/stable/24692159 at 279-344; (iii) "Evaluating the Paperwork Reduction Act: Are Burdens Being Reduced?" Hearing Before the Committee on Small Business, United States House of Representatives, March 29, 2017 available at https://www.govinfo.gov/content/pkg/CHRG-115hhrg24759/pdf/CHRG-115hhrg24759.pdf at 7. In this hearing record Sam Batkins describes the Federal Trade Commission under-reporting its burden by a magnitude of 12; and Brady, Demian, *Increasing Complexity Brings Back Bigger Compliance Burdens*, National Taxpayers Union Foundation, April 18, 2022 available at https://www.ntu.org/library/doclib/2022/04/2022-tax-complexity.pdf.

The SEC originally posted a 510-page draft of the Proposing Release to its website after the March 21, 2022 open meeting. Shortly thereafter, it was replaced with a 506-page draft. The final version conformed to the *Federal Register*, which was published on April 11, 2022, runs 490 pages, though a redline comparison of the final document to earlier drafts reveals that the Commission not only deleted text, but also inserted new, additional justifications for the Proposed Rules. Commissioner Peirce's dissenting remarks referenced yet a different document of 534 pages in length,[217] which is presumably the draft that the commissioners reviewed in advance of the March open meeting.

The Proposing Release poses well over 700 discrete questions for commenters. It is simply not possible to address each and every one of the Commission's questions or provide the thoughtful, sophisticated analysis of the overall impacts of the Proposed Rules within 90 or even 120 days. Given the far-reaching consequences of the Proposed Rules and their likely impact on the U.S. economy for decades to come, we are uncertain why such a compressed time frame as the Commission allowed for comment was necessary.

In light of our desire to work with the SEC in pursuit of a common goal, on April 19, 2022, we submitted a request for the Commission to extend the public comment period for at least 60 more days.[218] While we appreciate the 28-day extension the SEC granted from the original deadline subsequent to our request and have done our best to make use of that time, the need was for the Commission to grant a longer comment period to afford the public adequate time to study the vast Proposing Release and to provide the public (including the Chamber and its members) a full opportunity to perform the kind of sophisticated analysis required by a rulemaking of such breadth and complexity. In our letter requesting an extension, we also noted that the Commission has simultaneously proposed a litany of other proposed rules, all with brief comment periods that overlap one another, which in total run over 1,000 pages in the *Federal Register*.

Companies, investors and other members of the public and stakeholders have been working at full capacity to digest and comment on these many outstanding proposals during a critical time when many significant developments are affecting the world and requiring considerable attention and focus. The release of so many proposed rules with overlapping comment periods has impeded the public's ability to provide thoughtful, reasoned comments within these compressed time frames. We do not understand the urgency to push through so many sweeping and transformative proposals at the same time in a way that curbs the public's ability to provide meaningful comment. Rules adopted in this way are sure to have numerous unintended consequences that will require further revision or modification in the future.

The Chamber's own efforts to gather member feedback while analyzing and responding to the Proposing Release, even with the 28-day extension, were substantially impeded by the inadequate comment period, and we were regrettably unable to take up many of the important questions included in the Proposing Release or carefully address in this letter all of the items from the Proposing Release that merit meaningful comment and input. Our silence in this letter as to

[217] Peirce Statement, *supra* note 144.

[218] The entire letter is available at https://www.sec.gov/comments/s7-10-22/s71022-20124058-280187.pdf.

any individual element of the Proposed Rules should therefore not be understood to indicate acceptance of it. Rather, our failure to comment on any particular issue is further evidence of our limited ability to digest the totality of the Proposing Release in the limited time the SEC allotted.

CONCLUSION

American businesses play a vital role in creating innovative solutions and addressing national and global challenges, including mitigating climate change. A challenge of this magnitude requires collaboration between government and the private sector to advance the best ideas and policies. The current approach employed by the Commission is too prescriptive and will not substantially improve the quality of climate-related information to be provided to investors. The Chamber has laid forth a constructive path forward for the SEC to follow to craft a more practical and durable approach to climate disclosure that builds on the important work that American businesses are already doing in this space and that better aligns with the SEC's mission and the underpinnings of the federal securities disclosure regime.

Sincerely,

Tom Quaadman
Executive Vice President
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

Annex A

[OVERDAHL REPORT ENCLOSED]

The SEC's Proposed Rule for The Enhancement and Standardization of Climate-Related Disclosures for Investors

James A. Overdahl, Ph.D., Partner, Delta Strategy Group*

June 16, 2022

* James A. Overdahl is a partner at Delta Strategy Group in Washington D.C. where he is a specialist in financial markets and the U.S. regulatory environment. He was SEC chief economist from 2007–2010. He acknowledges financial support from the Chamber of Commerce of the United States of America. All views are his own and do not necessarily reflect the views of Delta Strategy Group or the Chamber of Commerce of the United States of America.

I. Executive Summary

1. The purpose of this report is to provide economic analysis to assist the United States Securities and Exchange Commission (the "SEC" or the "Commission") in its deliberations with respect to new rules proposed under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") entitled "The Enhancement and Standardization of Climate-Related Disclosures for Investors."[1]

2. Based on my review of the proposed rule, and my own experience and discussions with market participants, I have concluded that:

  a. The Commission has not sufficiently demonstrated that a market failure exists with respect to climate-related disclosures. The Commission fails to adequately support its view that a prescriptive rules-based approach to climate-related disclosures is needed to address alleged market failures.
  b. Although the Commission discusses the possibility of various types of market failures with respect to the current disclosure regime, in each case it has failed to demonstrate that such market failures actually exist in practice.
  c. The Commission's economic analysis of the proposed rule uses an inappropriately narrow baseline that focuses on topic-specific climate-related disclosure practices that fails to account for the full scope of the Commission's longstanding baseline of using a principles-based approach to disclosure relying upon the concept of materiality.
  d. The Commission's goal of creating a single unified system for disclosing climate-related information comes at the cost of foregoing an efficient evolutionary process for information discovery that comes from registrants having the choice of competing disclosure frameworks that they can join or leave voluntarily.
  e. The Commission's estimate of incremental costs associated with the proposed rule are disproportionately high relative to any conceivable incremental benefit. The Commission estimates that the cost of producing

[1] "The Enhancement and Standardization of Climate-Related Disclosures for Investors," the Securities and Exchange Commission, 17 CFR 210, 229, 232, 239, and 249, [Release Nos. 33-11042; 34-94478; File No. S7-10-22], RIN 3235-AM87, Federal Register, Vol. 87, No. 69, March 21, 2022 ("Proposing Release").

a 10-K disclosure would more than double but has failed to demonstrate that the incremental benefit exceeds this incremental cost.

f. The Commission fails to address important categories of indirect costs that are likely to result from the proposed rule.

g. The additional cost of mandated ESG disclosure, by influencing the decision of firms choosing whether to stay private or go public, will reinforce a trend in U.S. equity markets of firms that choose to go public being bigger and older than they used to be.

h. The Commission fails to adequately consider the impact of the proposed rule on efficiency, competition, and capital formation.

II. Overview of the Proposed Rule and Asserted Benefits

3. On March 21, 2022, the SEC issued for public comment amendments to its rules under the Securities Act and the Exchange Act that would require registrants to provide certain climate-related information in their registration statements and annual reports.[2]

4. The proposed rules would require a registrant to disclose information about (among other things): (1) the registrant's governance of climate-related risks and relevant risk management processes; (2) how any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term; (3) how any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; and (4) the impact of climate-related events (which, according to the Commission, include severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements. In addition, for registrants that already conduct scenario analysis, have developed transition plans, or publicly set climate-related targets or goals, the proposed amendments would require certain disclosures to enable investors to understand those aspects of the registrants' climate risk management.

[2] See Proposing Release.

5. The proposed rules also would require a registrant to disclose information about its direct greenhouse gas ("GHG") emissions (Scope 1) and indirect emissions from purchased electricity or other forms of energy (Scope 2). In addition, a registrant would be required to disclose GHG emissions from upstream and downstream activities in its value chain (Scope 3) if material or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions. According to the Proposing Release, these proposals for GHG emissions disclosures would provide investors with decision-useful information to assess a registrant's exposure to, and management of, climate-related risks and, in particular, transition risks. The proposed rules would provide a safe harbor for liability from the Scope 3 emissions disclosure and an exemption from the Scope 3 emissions disclosure requirement for smaller reporting companies. The proposed disclosures are motivated by the voluntary disclosures that some companies currently provide based on various third-party disclosure frameworks.

6. Under the proposed rule changes, accelerated filers and large accelerated filers would be required to include an attestation report from an independent attestation service provider covering Scopes 1 and 2 emissions disclosures, with a phase-in over time. The proposed rules would include a phase-in period for all registrants, with the compliance date dependent on the registrant's filer status, and an additional phase-in period for Scope 3 emissions disclosure.

III. Overview of the Use of Economic Analyses in SEC Rulemaking

7. The purpose of this report is to provide economic analysis to assist the Commission in its deliberations with respect to the proposed rule changes. I have framed my analysis using the SEC's protocol for conducting economic analyses in rulemaking[3] as well as Federal statutes requiring the SEC to consider the economic impact of its proposed rules on efficiency, competition, and capital formation.[4] I have also formed my

[3] https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[4] Section 2(b) of the Securities Act, 15 U.S.C. 77b (b), and Section 3(f) of the Exchange Act, 17 U.S.C. 78c(f) require the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Further, Section 23(a)(2) of the Exchange Act, 17 U.S.C. 78w(a)(2) requires the Commission, when making rules under the Exchange Act, to consider the impact that the rules would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act.

views based upon my own experience in assessing the economic impact of Federal rules over the past 30 years, including my experience as the SEC's Chief Economist from 2007-2010. In my role as Chief Economist, I directed the Commission's process for assessing the likely economic impact of proposed rules and rule changes. I have also based my views on information I have gathered from discussions with industry practitioners.

8. The primary purpose for conducting a rigorous assessment of the likely economic impact of any proposed rule change is to promote transparency and accountability in regulatory decisions. It is only after careful consideration of the economic impact that the Commission can determine whether there is a reasonable basis for exercising its rulemaking authority. To justify its exercise of rulemaking authority, the SEC has a duty under the Administrative Procedure Act ("APA"), as applied under the SEC's governing statutes, to adequately consider whether a regulatory action "will promote efficiency, competition and capital formation."[5] The Exchange Act additionally prohibits any rulemaking that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the statute.[6]

9. As the Commission acknowledges, the economic analysis contained in the Proposing Release is preliminary. To gain a more complete understanding of the likely economic impact of the proposed rule, the Commission has invited public comment to a set of questions. Included in these questions is an open-ended invitation for commenters to advise the Commission as to whether it has assessed all the costs and benefits to market participants who would be affected by the proposed rule.

10. With respect to the economic analyses contained in the Proposing Release, I find that the Commission's assessment of the likely economic impact of the proposed rule change is incomplete and fails to include rigorous analyses of significant questions the Commission needs to consider before concluding that there is a reasonable basis for the proposed rule changes.

[5] 15 U.S.C. §§ 78c(f), 77b(b).
[6] *Id.* § 78w(a)(2).

IV. Critique of the Content of the Economic Analysis Section Contained in the Proposing Release

A. The Baseline for the SEC's Economic Analysis Fails to Adequately Consider the Commission's Longstanding Principles-Based Disclosure Regime.

11. As described in the SEC's guidance for conducting economic analysis in rulemaking, the Commission must specify an appropriate baseline as a first step in the process of evaluating the economic consequences of a proposed rule. However, the baseline specified in the Proposing Release is inappropriate because it fails to adequately consider the full scope of the Commission's longstanding approach to principles-based disclosure of material information. Instead, the baseline specified by the Commission focuses on observed climate-related disclosure practices of firms and the use of climate-related disclosures by investors and other market participants. By using a baseline that focuses on narrow and topic-specific climate-related disclosure practices, the Commission fails to account for the full scope of the Commission's longstanding baseline of using a principles-based approach to disclosure relying upon the concept of materiality.

12. The principles-based approach to the disclosure of material information has been described as "the cornerstone" and as a "guiding principle" of the disclosure system established by the federal securities laws.[7] As Katz and McIntosh (2021a) have observed, "[t]he word 'material' was first introduced in the U.S. Securities Act of 1933, and, at least since the 1940s, the SEC has defined 'material information' in the context of financial statements as 'those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered.'"[8] Katz and McIntosh (2021b) observe that "[t]he SEC disclosure framework was designed to require reporting of information that is financially material to investors, not information that may be important at a societal level."[9]

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[7] David A. Katz and Laura A. McIntosh, "Corporate Governance Update: 'Materiality' in America and Abroad," *Harvard Law School Forum on Corporate Governance*, May 1, 2021 ("Katz and McIntosh (2021a)"), pages 1 and 4. Available at: https://corpgov.law.harvard.edu/2021/05/01/corporate-governance-update-materiality-in-america-and-abroad/.

[8] Katz and McIntosh (2021), page 1.

[9] David A. Katz and Laura A. McIntosh, "SEC Regulation of ESG Disclosures," *Harvard Law School Forum on Corporate Governance*, May 28, 2021 ("Katz and McIntosh (2021b)"), pages 1-5. Available at: https://corpgov.law.harvard.edu/2021/05/28/sec-regulation-of-esg-disclosures/.

13. Mandated materiality-based disclosures for public firms have clear but limited objectives under the securities laws. Historically, the Commission's objective for mandating the disclosure of material information has been to provide decision-useful information to a reasonable investor at a specific point in time. The Commission has always required firms to disclose financially material information about their structure, operations, and plans for the future. These disclosures are intended to protect investors and promote capital market efficiency. By using a baseline that captures only climate-related disclosure practices, the Commission is in effect suggesting that anything climate-related should be presumed to be material. However, under a principles-based approach, something that is truly material to investors would be subject to disclosure whether or not it was designated as part of a topic-specific category such as climate or environmental, social, and governance ("ESG").

14. One consequence of using a narrow, topic-specific baseline is that the resulting economic analysis will underestimate the cost of the proposed rule by failing to account for important features of the principles-based approach to the disclosure of material information. These features include: 1) the ability of a principles-based approach to evolve in order to keep pace with emerging issues; and 2) the flexibility of a principles-based approach to correct deficiencies or excesses in disclosure without the need for the Commission to continuously add to or update the underlying disclosure rules as new issues arise.[10]

15. The Proposing Release evaluates the mandated climate-related disclosures from the proposed rule relative to current climate-related disclosure practices. When examining these practices, the Commission observes variation in the intensity of disclosure, particularly when comparing practices across industries. The Commission conducted an analysis of climate-related disclosures related to business impact, emissions, international climate accords, and physical risks contained in 10-K filings submitted to the Commission between June 27, 2019, and December 31, 2020. The Commission found "…heterogeneity, both within the quantity and content of climate-related disclosures across industries…"[11] For example, the oil and gas industry had a much

[10] See, William Hinman, Director, Division of Corporation Finance, "Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks," Remarks at the 18th Annual Institute on Securities Regulation in Europe (Mar. 15, 2019), available at https://www.sec.gov/news/speech/hinman-applying-principles-based-approach-disclosure-031519.

[11] Proposing Release, page 21419; figures 4 and 5 on pages 21420 and 21421.

higher intensity score for ESG disclosure than did the interactive media and services industry or consumer retailing. The Commission's analysis is consistent with other studies showing that there is significant variation in disclosure practices for GHG emissions across various industries and that the intensity of disclosures will depend on the carbon footprint of the industries.[12]

16. The Commission also finds that a number of firms report ESG factors using third party reporting frameworks. The Commission cites the survey conducted by the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness ("CCMC") in collaboration with several other organizations ("CCMC Survey") on a sample of U.S. public companies – 436 companies across 17 industries that range from small to large in terms of market capitalization.[13] According to the survey, over half of the companies (52%) are currently publishing a corporate social responsibility ("CSR"), sustainability, ESG or similar report whose content commonly includes information regarding climate-related risks. The most frequently discussed topics in these reports are energy (74%), emissions (70%), environmental policy (69%), water (59%), climate mitigation strategy (57%), and supplier environmental policies (35%). Among the registrants that report climate-related information to the public, the majority disclose such information via external reports or company websites rather than regulatory filings. The CCMC Survey finds that about a third (34%) of the respondents disclose climate change, greenhouse gas emissions, or energy sourcing in their SEC filings information on risks. Among these firms, 82% disclose such information in the Risk Factors section, 26% in the Management Discussion and Analysis ("MD&A") section, 19% in the Description of Business section, and 4% in the Legal Proceedings section. The Commission also found that among the companies that provide climate-related disclosures, a considerable portion include some form of third-party assurance for these disclosures.[14]

17. The Commission concludes from its analysis of baseline climate-related disclosures that: "To the extent that registrants' current climate-related disclosures overlap with the proposed rules, registrants may face lower incremental compliance

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[12] Proposing Release, page 21422, footnote 764, citing research conducted by Morningstar.
[13] See "Climate Change & ESG Reporting from the Public Company Perspective (2021)," available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2021/08/CCMC_ESG_Report_v4.pdf.
[14] Proposing Release, pages 21422 and 21424.

costs."[15] However, to properly measure the incremental compliance costs, the Commission would need to compare differences in the approach to disclosure between an appropriate baseline and the proposed rule. In other words, a proper assessment of the economic consequences of the proposed rule requires an analysis of the difference between an appropriate baseline case using a principles-based disclosure regime relying on the concept of materiality versus the rules-based prescriptive disclosure requirements contained in the proposed rule.

18. A stated objective of the proposed rule is to provide investors with more consistent climate-related disclosures. The rules-based prescriptive disclosure approach described in the proposed rule is aimed at providing consistent climate-related disclosures across all registrants.[16] The Commission offers no support for the view that a rule aimed at consistency should be a stand-alone goal that will promote competition, efficiency, and capital formation. Instead, the Commission argues that "investors' demand for climate-related information is often met by inconsistent and incomplete disclosures due to the considerable variation in the coverage, specificity, location, and reliability of information related to climate risk."[17]

19. This stand-alone goal of consistency is also unsupported in the academic literature. By way of example, the academic literature in accounting favors a principles-based approach over a rules-based approach aimed at enforcing consistency. Kothari et al. (2010) supports the notion that a principles-based approach can lead to greater innovation than a rules-based approach and that this innovation is consistent with promoting efficiency.[18] Principles-based regulation also has the advantage of preserving flexibility and allowing standards to evolve in response to market forces. In addition, the academic literature on financial disclosures suggests, for example, that the enforcement of uniform disclosure standards on diverse firms could have a "constraining impact" because "in practice, firms differ and change over time."[19]

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[15] Proposing Release, page 21422.

[16] Proposing Release, page 21335 ("The disclosure of this information would provide consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments.").

[17] Proposing Release, page 21425.

[18] S.P. Kothari et al., "Implications for GAAP from an Analysis of positive Research in Accounting," *Journal of Accounting and Economics*, Vol. 50, 2010, pages 246-286 at page 277.

[19] Anne Beyer et al., "The Financial Reporting Environment: Review of the Recent Literature," *Journal of Accounting and Economics*, Vol. 50, 2010, pages 296-343 ("Beyer et al. (2010)") at page 319.

20. An inference from the academic literature on principles-based versus rules-based disclosure regimes is that the variation in disclosure practices observed by the Commission may simply be a reflection of a principles-based approach successfully operating in response to market forces as opposed to a market failure requiring a prescriptive, rules-based solution offered by the Commission. For example, the Commission finds that firms in the electric services and oil and gas industries "have the most ample climate-related discussion."[20] This is an indication that the principles-based approach is working successfully as these are industries where climate-related factors are more likely to have a material impact on the present value of discounted expected future cash flows. The same cannot be said for other industries, such as the interactive media industry or the consumer retailing industry.

21. The Commission emphasizes the need for a single, unified system for tracking and disclosing climate-related information. However, such a system comes at the cost of foregoing an efficient evolutionary process for information discovery that comes from registrants having the choice of competing disclosure frameworks that they can join or leave voluntarily. If climate-related disclosure is really about creating value for investors, competition is essential to producing a high-quality outcome, just as it is in the market for any other product or service.

22. The Commission asserts that investors have expressed a need for information on climate-related risks as they relate to companies' operations and financial condition.[21] The Commission cites the results of recent surveys showing that climate risks are among the most important priorities for a broad set of large asset managers. The Commission also cites the efforts of some large institutional investors to improve corporate disclosures on climate-related risks. The Commission argues that these surveys and efforts by asset managers show that there is an underproduction of climate-related disclosure under the current principles-based disclosure regime that can be remedied only by the rules-based prescriptive disclosure regime contained in the proposed rule.

23. However, not all investor surveys support the Commission's view. For example, as discussed below, a March 2022 survey from the Boston Consulting Group shows

[20] Proposing Release, page 21419.

[21] Proposing Release, pages 21424-21425.

institutional investors are not viewing climate-related risks as not one of the most pressing issues.

24. In any case, the demand for more disclosure by some investors needs to be evaluated carefully by the Commission. As former SEC commissioner Roberta Karmel observed in 1978:

> I believe we should exercise caution in applying a non-economic standard of materiality to disclosure requirements… Because some investors may want certain information in order to make an investment or voting decision does not mean that mandatory disclosure of such information would be necessary or appropriate in the public interest or for the protection of investors.[22]

25. If investors demand climate-related disclosures for non-economic reasons, then mandating such disclosures is outside the scope of the economic standard of materiality. In addition, the demand for non-economic climate-related disclosures by some asset managers may be a reflection on principal-agent issues between asset managers and underlying investors. The possibility of some asset managers having self-interested incentives that are not consistent with the interests of underlying investors is not addressed in the Proposing Release.

B. The Commission has Failed to Demonstrate a Market Failure

1. The Commission does not adequately explain why the current principles-based disclosure regime has failed

26. The Commission's guidelines for conducting economic analysis in rulemaking require that the Commission clearly identify the justification for the proposed rule. This means identifying any market failure that may be reasonably addressed by the exercise of the Commission's rulemaking authority. With respect to the proposed rule, the Commission has failed to demonstrate a market failure with respect to the current principles-based disclosure regime and has failed to clearly explain why the proposed rule is required to meet its statutory objectives. The proposed rule departs from the principles-

[22] Former SEC Commissioner Roberta Karmel, speech to the National Investor Relations Institute, New York Chapter, April 12, 1978, page 12. Available at: https://www.sec.gov/news/speech/1978/041278karmel.pdf.

based approach for the disclosure of material information without convincing evidence of any market failure that would warrant such a departure.

27. Frequently, a proposed rule will be a response to a market failure that market participants cannot solve because of collective action problems. Traditional market failures include market power, externalities, principal-agent problems (such as economic conflicts of interest), and asymmetric information. In addition to alleging certain market failures (discussed below), the Commission states its basis for the proposed rule is "to provide more consistent, comparable, and reliable information for investors…."[23]

28. The Proposing Release mentions "market failures" in two instances. In the first instance the Commission describes what it calls "key market failures with regard to disclosure," which include "(1) disclosures are not costless; (2), there are agency problems; (3) managers may inaccurately present information; and (4) investor responses may be unpredictable and non-unfirm (*sic*)."[24] In the second instance, the Commission states that the purpose of the proposed rule is to address the alleged market failures described above by providing investors "with climate-related information that is more comparable, consistent, and reliable and presented in a centralized location."[25]

29. The Proposing Release addresses the first identified alleged market failure (i.e., disclosures are not costless) by describing how, in theory, information externalities could cause an underproduction of disclosure. The Commission states: "…theoretically, in the absence of mandated disclosure requirements, registrants fully internalize the costs of disclosure but not the benefits, which may lead them to rationally under-disclose relative to what is optimal from the investors' perspective."[26] In addition, the Commission observes that: "Some studies point to the potential for substantial underreporting of material climate-related information within the current voluntary reporting regime."[27] However, the Commission stops short of affirmatively concluding that a market failure

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[23] Proposing Release, page 21338.

[24] Proposing Release, page 21426.

[25] Proposing Release, page 21428: "The proposed rules aim to address these market failures by requiring more specificity around the way registrants disclose climate-related risks and their impacts on business activities and operations in the short, medium, and long-term. By requiring comprehensive and standardized climate-related disclosures along several dimensions, including disclosure on governance, business strategy, risk management, financial statement metrics, GHG emissions, and targets and goals, the proposed rules would provide investors with climate-related information that is more comparable, consistent, and reliable and presented in a centralized location."

[26] Proposing Release, page 21426 (footnote omitted).

[27] Proposing Release, page 21428 (footnote omitted).

exists in the existing disclosure regime that would prevent material climate-related information from being disclosed. The Commission cites academic literature to suggest that the mandated disclosure contained in the proposed rule may provide the benefit of a positive externality "as more firms disclose how measures of climate risk affect their business operations, investors would gain a better understanding of how those same climate risks may affect other similar firms."[28] However, the Commission supports this claim only with vigorous assertion as opposed to rigorous analysis. Moreover, using externalities as justification for the mandate expands the definition of materiality to beyond what is relevant for investors in the particular security, as discussed further below. In addition, given that firms are already disclosing material information (as required), it is not clear from the Proposing Release what additional positive externalities the proposed rules would create.

30. The Proposing Release addresses the second identified alleged market failure (i.e., agency problems) by describing how if agency problems exist "… investors can no longer be sure if the absence of disclosure under a voluntary regime reflects good or bad news for the firm, given that some managers may have self-serving incentives."[29] The Commission asserts that agency problems are particularly pronounced with respect to climate-related disclosures due to potential conflicts between short-term profitability and long-term climate risk horizons.[30] However, the Commission offers no evidence to support this claim. The Commission concludes that "… the benefits of a mandatory reporting regime may be more pronounced in settings in which disclosure-related conflicts of interests exist between managers and shareholders."[31] However, the Commission again supports this conclusion only with vigorous assertion as opposed to rigorous analysis. In addition, the Commission has failed to provide evidence as to how extensive the claimed agency problems are with respect to climate-related disclosures.

31. The Proposing Release addresses the third identified alleged market failure (i.e., misrepresentation by managers) by describing how, under certain circumstances, managers would have an "incentive to misreport by providing disclosures with a

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[28] Proposing release, page 21429 (footnote omitted).
[29] Proposing Release, page 21426.
[30] Proposing Release, page 21427 ("Impediments to climate-related disclosures may be exacerbated due to agency problems related to potential conflicts between short-term profitability and long-term climate risk horizons.").
[31] Proposing Release, page 21426.

favorable bias, the extent of which depends on the cost of misreporting."[32] Such misreporting is often described as "cheap talk" or "greenwashing" – the set of activities conducted by firms to falsely convey to investors that their practices are aligned with environmental or other ESG principles.[33] To support this conclusion of an alleged market failure, the Commission relies on suggestions found in general theoretical research as opposed to actual practice.[34] In addition, the Commission has failed to provide any factual evidence as to how extensive a problem the intentional misrepresentation of information is with respect to climate disclosure or why the Commission's current regulations or enforcement powers are not sufficient to address the alleged issue.

32. The Proposing Release addresses the fourth identified alleged market failure (i.e., uncertain investor response) by describing how "if there are varying levels of sophistication among investors in their ability to understand disclosures, then again, some managers may be uncertain about how reports may be interpreted, leading them to abstain from some disclosures."[35] Although the Commission provides a citation to a published academic paper to support this possibility, no evidence is offered to support the conclusion that this type of market failure has actually occurred with respect to disclosure or how extensive this alleged market failure might be in practice. In addition, it is unclear how additional mandated climate-related disclosure will provide a useful remedy to the alleged market failure of investors having differing levels of sophistication and differing levels of ability to understand disclosures.

33. In addition to the alleged market failures explicitly mentioned by the Commission, the Proposing Release also addresses other climate-specific factors that exacerbate impediments to voluntary disclosure. In particular, the Commission observes that the complexity and uncertainty of climate-related factors and the multidimensional nature of the information can inhibit voluntary disclosure of climate-related risks. The Commission notes that physical and transition risks can materialize over highly uncertain time horizons that can range from the immediate future to several decades. However, such risks may not be judged by investors to be decision-useful when assessed using the present value of discounted expected future cash flows. The Commission argues that

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[32] Proposing Release, page 21426.
[33] Proposing Release, pages 21426 and 21429.
[34] Proposing Release, page 21426.
[35] Proposing Release, page 21427 (footnote omitted).

these factors give managers more discretion to communicating economic impacts and risks.[36] The Commission asserts that agency problems are particularly pronounced under such circumstances due to potential conflicts between short-term profitability and long-term climate risk horizons.[37] The Commission also argues that 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 heterogeneous and unpredictable investor responses. In this circumstance, managers may prefer to withhold applicable disclosures."[38] Although the Commission provides citations to published academic papers to support these possibilities, no evidence is offered to support the conclusion that these possible impediments to voluntary disclosure have actually occurred or how extensive these impediments might be in practice. As researchers have pointed out, the "net effects of a mandate are largely an empirical matter on which we currently do not have much research:"[39]

> Much of the prior evidence in the CSR literature focuses on the valuation and performance effects of CSR activities, not on CSR reporting. The key challenge therefore is to disentangle the reporting effects from the effects of the underlying CSR activities, especially when both are largely voluntary. In light of this dual selection problem, it is not surprising that studies on voluntary CSR reporting find more favorable results than studies on mandatory CSR reporting. Research on the latter is still relatively scarce and, if anything, focuses on traditional capital-market outcomes (and investors). Thus, aside from better identification that lets researchers separate the effects of CSR disclosures from CSR activities, <u>we need more research on whether *mandated* CSR reporting mitigates information asymmetries, forces out unfavorable CSR information, generates positive spillovers, provides market-wide cost savings, or generates comparability benefits (all of which would be central to justifying a mandate)</u>.[40]

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[36] Proposing Release, page 21427.

[37] Proposing Release, page 21427 ("Impediments to climate-related disclosures may be exacerbated due to agency problems related to potential conflicts between short-term profitability and long-term climate risk horizons.").

[38] Proposing Release, pages 21427-21428.

[39] Hans B. Christensen, Luzi Hail, and Christian Leuz, "Mandatory CSR and sustainability reporting: economic analysis and literature review" *Review of Accounting Studies*, Vol. 26, 2021, pages 1176-1248 ("Christensen, Hail, and Leuz (2021)"), page 1231.

[40] Christensen, Hail, and Leuz (2021), page 1231 (emphasis added, italics in original).

2. Topic-specific disclosure prescriptively deems ESG factors to be material when they may not be.

a) ESG factors are one set of factors among many factors that investors consider in their valuation assessments.

34. The Commission fails to show that climate-related information is often material to investors. To the extent climate-related information is relevant to an investor's decision at all, such information is just one piece of information among many other factors that inform an investment decision, such as cash flows, profitability, industry segment, company size, and the like. The Commission does not consider the incremental (marginal) value of climate-related information as compared to other available information; nor does the Commission explain why climate-related information would often be material to investors when other information, such as cash flows, profitability and industry, are likely to be much more relevant to an investment decision.

35. Objective evidence undercuts the notion that climate-related information is often material. For example, in a recently completed survey by the Boston Consulting Group of leading investment industry executives and institutions, just one in 20 (or 5%) investors polled by the consulting firm said that climate and ESG-related issues were among their three top concerns. The survey also noted "most of the investors BCG recently surveyed indicated that ESG is not currently a primary consideration in day-to-day investment decisions and recommendations."[41] This survey was concluded after the proposed rule was acted upon by the Commission and is not included as part of the Proposing Release.

36. Moreover, evidence of the retail investors' reaction to climate-related and ESG disclosure is inconsistent with the Commission's view regarding the importance of such disclosures to investors. Moss, et al. (2020) use an hourly dataset on retail investor trading positions from Robinhood Markets and find that ESG disclosures are irrelevant to retail investors' portfolio allocation decisions. The authors' conclusions, based on evidence from observed market dynamics, is inconsistent with evidence cited by the

[41] See Boston Consulting Group, "BCG Investor Perspectives Series Pulse Check #19" March 18–22, 2022, footnote 1.

Commission that retail investors respond favorably to ESG disclosures. In addition, the authors conclude that it is important to distinguish between retail and institutional investors.[42]

37. In evaluating the extent that ESG disclosures are material to investors, the Commission could have reviewed analyst reports to gauge the significance of ESG factors relative to other factors for determining the value of securities in analysts' determinations. However, the Commission failed to consider this potentially important source of evidence in its analysis of the proposed rule.[43] The proposed rule recognizes the role of analysts as intermediaries between firms and investors and regards them as "affected parties,"[44] but otherwise their role in the disclosure process is ignored. The Commission, likewise, could have employed well-known "event study" techniques to assess the price or volume responses to climate-related disclosures, but the Commission did not conduct any such analysis, even though event studies are a standard method of assessing financial materiality.

38. The Commission's failure to cite evidence showing that climate-related information is often material is unsurprising. As discussed, because climate-related information is just one factor among many other (potentially more relevant) factors, climate-related information is often not material. Moreover, to the extent climate-related information is material, such information could largely be extracted from publicly-observable information such as industry sector, company size and the like, without a need for company-specific climate reporting. In fact, in conjunction with its cost-benefit analysis and before requiring the detailed company-specific disclosure requirements of the proposal, the Commission should assess the extent to which sufficient climate-related information for investors' purposes is available from such sources. This is appropriate in

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[42] Austin Moss, James P. Naughton, and Clare Wang, "The Irrelevance of ESG Disclosure to Retail Investors: Evidence from Robinhood," May 19, 2020. Available at SSRN: https://ssrn.com/abstract=3604847 or http://dx.doi.org/10.2139/ssrn.3604847.

[43] See, for example, Jill E. Fisch, "The Role and Regulation of the Research Analyst," Research Handbook on the Economics of Corporate Law, Edgar Elgar Publishing, 2012, pages 315, 317 ("The role of the research analyst…is to provide information to the marketplace. Analysts enhance capital market efficiency by enabling stock prices to reflect information and by reducing the need for each investor individually to gather and analyze that information. … Research analysts collect information about <u>specific firms</u> and the overall market. They then package that information for use by investors in trading decisions." (emphasis added)).

[44] Proposing Release, page 21413.

part because the rule as proposed is quite costly, yet climate-related impacts are at best one among a large number of factors considered in investment decision-making.

a) The present value of ESG factors may not be material to investors if the effects of climate change are uncertain and far in the future.

39. The stock price of a firm reflects the present value of its discounted expected future cash flows. If the effects of climate change are far into the future, have a low probability of occurring, are associated with an uncertain discount rate, or if the economic effects are uncertain, the present value of such effects may not be large enough to be economically material to investors, especially when one considers that climate-related information is, if relevant, just one factor among many others in an investment decision. The Commission recognizes that "as the Supreme Court has articulated, the materiality determination with regard to potential future events requires an assessment of both the probability of the event occurring and its potential magnitude, or significance to the registrant."[45] Yet, the Proposing Release appears to bypass the requirement of materiality to the registrant by imposing a one-size-fits-all reporting mandate.

40. The Proposing Release notes, "[a]s defined by the Commission and consistent with Supreme Court precedent, a matter is material if there is a substantial likelihood that a reasonable <u>investor</u> would consider it important when determining whether to buy or sell securities or how to vote."[46] If materiality is solely focused on the information content relevant for investors, then because the current laws already require companies to disclose material information, arguably no further mandates should be required to satisfy this definition of materiality *per se*. This basic premise is recognized by researchers:

> In response to this challenge, one could consider reducing the scope of the CSR standards and focus exclusively on the information needs of investors. Under such an approach (sometimes referred to as single materiality), the standards would prescribe reporting only on CSR topics that are financially material to investors. This narrow materiality concept is consistent with the goal of giving investors the information they demand or need for decision making, assuming that they care only about the financial

[45] Proposing Release, page 21351 (footnote omitted).
[46] Proposing Release, page 21351 (emphasis added, footnote omitted).

> consequences (or NPV) of firm activities. With this assumption and goal in mind, it conceptually makes sense to narrow the scope of CSR disclosures to issues that are relevant to investors' decision making and potentially affect firms' long-term value creation. Notably, this narrow approach excludes CSR disclosures on externalities that firms impose on society. One could make an argument that this narrow approach is essentially already prescribed by the financial materiality definition of the SEC (and the FASB).[47]

41. On the other hand, if a reporting mandate goes beyond the information desired by investors that is specific to a company and instead covers a broader group of stakeholders and focuses not only on the financial consequences for investors but has a broader social goal unmoored from information relevant for investors, then such a mandate would be inconsistent with the definition of materiality put forth by the Supreme Court and apparently adopted by the SEC.

42. A key factor in determining materiality of information about future events is the discount rate applied to the present value calculation. From an individual's subjective political or moral perspective, the discount rate for future climate-related events may be low, meaning that this information would be given greater weight today. However, for investment purposes, the market-determined discount rate is appropriate in determining materiality for investors who are allocating capital today.

43. As researchers have noted, a deviation from the standard definition of materiality to a broader definition can have nontrivial tradeoffs in terms of increased compliance costs and pressures from various parties:

> The tradeoffs are nontrivial. … A broad approach with double materiality is likely to attract external pressures from various (and potentially unforeseen) parties and also requires that standard setters apply political and moral judgments about the underlying CSR activities. For these reasons, a narrow, single materiality approach could have a certain appeal for accounting standard setters and securities regulators as it is closer to their expertise. One could also argue that a narrow approach should make it easier for reporting entities to determine what type of CSR information has to be reported and, hence, has lower compliance costs.[48]

[47] Christensen, Hail, and Leuz (2021), page 1221.

[48] Christensen, Hail, and Leuz (2021), page 1222. The authors define financial materiality as single materiality and a "broader approach of informing stakeholders about corporate impacts" as double materiality. Christensen, Hail, and Leuz (2021), page 1179.

3. The Commission does not adequately address voluntary disclosure.

a) Voluntary disclosure of ESG factors has been working

44. The Commission has failed to demonstrate a market failure with respect to the current voluntary disclosure regime for ESG factors. As the Commission notes, voluntary disclosure of ESG factors has been widely practiced and has been increasing with respect to the types of disclosures. These voluntary disclosures are consistent with the types of disclosures to which the SEC has shown favor.

45. The Commission's staff reviewed 6,644 recent annual reports (Forms 10-K, 40-F, and 20-F) and found that 33% of them contained disclosures related to climate change, the majority of which discussed information related to business impact, emissions, international climate accords, and physical risks.[49] The Commission's review found that firms with "most ample climate-related discussion, on average: Electric services, oil and gas, steel manufacturing, passenger air and airfreight, and maritime transportation. The majority of the discussion is on business impact, followed by emissions, international climate accords, and physical risks."[50]

46. The Commission observed that many companies voluntarily chose to follow existing third-party reporting frameworks when developing climate-related disclosures for SEC filings or to be included in CSR, sustainability, ESG, or similar reports. For instance, the CCMC Survey finds that 59% of the respondents follow one or more such frameworks like the one developed by the Task Force on Climate-related Financial Disclosures ("TCFD").[51] The Commission notes that: "Several industry reports also document how a sizeable portion of U.S. companies report climate-related information under one or more third-party frameworks that are either fully or partially aligned with the TCFD disclosure elements."[52]

47. The Commission also cites relevant academic research showing that voluntary ESG disclosures have been increasing. For example, the Commission cited the work of Bolstad et al. (2020) who systematically reviewed Form 10-K filings from Russell 3000

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[49] Proposing Release, page 21415.
[50] Proposing Release, page 21419.
[51] Proposing Release, page 21422.
[52] Proposing Release, pages 21422-21443.

firms over the last 12 years and found that while 35% of Russell 3000 firms provided climate-related information in 2009, this figure grew to 60% in 2020, representing a significant increase. They also found that the extent of disclosure for a given report has increased. In 2009, firms mentioned climate risks 8.4 times on average in their Form 10-K. This figure grew to 19.1 times in 2020.[53]

48. The Commission also cites a number of industry and advocacy groups that show a growing trend for voluntary ESG disclosure though not necessarily through their regulatory filings. As the Commission notes, the Governance & Accountability Institute ("G&A") analyzed sustainability reports by the companies belonging to the Russell 1000 Index and found that, in 2020, 70% published sustainability reports − up from 65% in 2019 and 60% in 2018.[54] The Commission also cites a report from the CDP (formerly the Carbon Disclosure Project) finding that out of the 524 U.S. companies in their Climate High Impact Sample, 402 disclosed through the CDP system in 2021, up from 379 in 2020, and 364 in 2019. Out of the sample of reviewed companies, 22.1% (89 out of 402 companies) reported Scope 3 emissions in 2021. This reflects an increase from the previous two years, during which 18% (67 out of 379 companies) reported such information in 2020, and 17% (62 out of 364 companies) in 2019.[55]

49. The Commission concludes from its review that they "expect that the number of registrants committed to preparing climate-related disclosures will increase in the future, independently from our proposed rules."[56]

50. The significant increase in voluntary climate-related disclosures notwithstanding, the Commission appears to be conflicted about the role of voluntary disclosure. On the one hand, they allege a market failure requiring government intervention to correct. On the other hand, they argue that because of the recent trends showing steady growth in voluntary ESG disclosure − trends that the SEC concludes will continue to increase into

[53] Proposing Release, page 21421; see also Parker Bolstad, Sadie Frank, Eric Gesick, and David Victor, "Flying Blind: What Do Investors Really Know About Climate Change Risks in the U.S. Equity and Municipal Debt Markets," Hutchins Center Working Paper 67, 2020, pages 1-49.

[54] Proposing Release, page 21422, citing to "G & A Inc., Sustainability Reporting in Focus (2021)," available at https://www.gainstitute.com/research/ga-research-collection/sustainability-reporting-trends/2021-sustainability-reporting-infocus.html.

[55] Proposing Release, page 21422, citing to Letter from CDP North America (Dec. 13, 2021).

[56] Proposing Release, page 21443.

the future independently from the proposed rule – that the expected incremental costs for complying with the proposed rules will be lower for an increasing number of firms.[57]

51. By mandating climate-related disclosure and codifying its form, the SEC is short circuiting the natural evolution of disclosure standards in the private market, which will ossify developments and likely result in an inflexible and suboptimal standard. The Commission argues that "theoretically, in the absence of mandated disclosure requirements, registrants fully internalize the costs of disclosure but not the benefits, which may lead them to rationally under-disclose relative to what is optimal from the investors' perspective."[58] However, the evidence cited by the Commission with respect to trends in voluntary ESG reporting seems to contradict this view. Moreover, "what is optimal from the investors' perspective"[59] is best left for market forces to sort out and should not be subject to a reporting mandate that is driven not necessarily with the investor in mind but with a larger social goal in mind.

52. Voluntary disclosure is likely to be more helpful than mandatory disclosure when there is variation in demand across industries. The Commission's review of filings "finds significant heterogeneity, both within the quantity and content of climate-related disclosures across industries…"[60] The variation in disclosure practices observed by the Commission may simply be a reflection of a principles-based approach successfully operating in response to market forces as opposed to a market failure requiring a prescriptive, rules-based solution offered by the Commission given that it is likely that voluntary disclosures are driven by the carbon footprint of particular industries.

53. Voluntary disclosure takes several forms. Some firms may choose to disclose climate-related information in their filings with the SEC. Indeed, to the extent this information is material, there is already a requirement to supply this information in regulatory filings. As the Commission has noted, an increasing number of firms use third party reporting formats to report climate-related risks. Firms can also choose the level of disclosure to provide by choosing from among the various state disclosure requirements when making their incorporation decisions. Firms can also choose from among the

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[57] Proposing Release, page 21443.
[58] Proposing Release, page 21426.
[59] Proposing Release, page 21426.
[60] Proposing Release, page 21419.

various initial and continuous listing requirements when choosing where to list their stock – both domestically and internationally.

b) The Commission fails to address academic literature on voluntary disclosures.

54. *A priori*, it is not obvious that a mandatory disclosure regime can achieve a more effective and efficient outcome than a voluntary disclosure regime. A justification offered by the Commission for the proposed rule is that "disclosure of this information would provide consistent, comparable, and reliable—and therefore decision-useful—information to investors."[61] However, these benefits should not be enough to justify a disclosure mandate that: (1) is costly to implement with no evidence that the marginal reporting benefits exceed marginal costs; (2) can have unintended consequences for the entry and exit decision of firms; and (3) involves concerns about the revelation of proprietary information that can harm competition. The Commission has failed to address the relevant academic literature in this regard. For example, the Financial Economist Roundtable ("FER")[62] released a statement on "SEC Regulation of ESG Issues" in October 2021 which has been subsequently published in the *Financial Analysts Journal* ("FER Statement").[63] In its statement, the FER recommends "that the SEC should <u>not</u> mandate disclosure of the firm's impacts on environmental and social (E&S) outcomes."[64] In addition, the FER Statement suggests quantitative disclosures, but that these should be based on "principles-based guidance."[65] The FER Statement says: "We

[61] Proposing Release, page 21335.

[62] "The Financial Economists Roundtable (FER) is a group of senior financial economists who have made significant contributions to the finance literature and seek to apply their knowledge and experience to current policy debates. FER encourages spirited interaction and intellectual discussion around a broad range of scholarly and policy topics related to financial markets and institutions. We seek to develop careful analyses that contribute to important policy debates and decisions.
FER members meet annually to discuss a current U.S. or international policy topic related to financial markets and institutions. The FER's statements summarize the FER's consensus views of these policy issues and are intended to increase awareness and understanding of the issues among public policy makers, the financial economics profession, and the general public."
https://www.financialeconomistsroundtable.com/about (last accessed April 27, 2022).

[63] Jonathan M. Karpoff, Robert Litan, Catherine Schrand, and Roman L. Weil, "What ESG-Related Disclosures Should the SEC Mandate?" *Financial Analysts Journal*, Vol. 78, No. 2, 2022, pages 8-18 ("FER Statement"); Financial Economists Roundtable, *Statement on SEC Regulation of SEC Issues: "SEC Should Mandate ESG Disclosure Limited to Matters that Directly Affect the Firm's Cash Flow*," October 2021 (link available at https://www.financialeconomistsroundtable.com/statements/sec-should-mandate-esg-disclosure-limited-to-matters-that-directly-affect-the-firms-cash-flows; last accessed April 27, 2022).

[64] FER Statement, page 9 (emphasis added).

[65] FER Statement, page 14.

recommend that the SEC do not require firms to produce any particular E&S metrics. Disclosure costs increase with each additional required metric, but selecting metrics leads to the what-gets-measured-gets-managed problem, and the SEC would end up prioritizing the E&S agenda."[66]

55. The FER Statement notes that a principles-based approach could be exploited by some firms, but that investors would review the disclosures, stating: "The power of capital-market pressure to disclosure information should not be underestimated."[67]

56. The FER Statement makes the economic case that the SEC should not mandate ESG disclosure as a tool to achieve broader policy outcomes.[68] The FER Statement clarifies:

> To be clear, we do not propose that the SEC forbid disclosures of societal impacts or even discourage them. But it should not *require* such disclosures. In contrast, the SEC should require that any disclosures that firms voluntarily make about their impact on E&S matters use clearly defined E- and S-related terms. The SEC should focus on disclosures that reflect firms' cash-flow related E&S activities and risks, and put faith in the capital markets to regulate voluntary disclosure of firm's impacts on E&S outcomes. To the extent that investors need information on E&S outcomes to facilitate raising and allocating funds between competing demands, investors will punish firms that do not provide it.[69]

V. The SEC Fails to Adequately Consider the Costs Associated with the Proposed Rule

57. The Commission discusses anticipated costs from the proposed rule in the Economic Analysis section of the Proposing Release. The Commission's analysis of costs includes estimates of some direct costs contained in the section of the Proposing Release devoted to the Paperwork Reduction Act ("PRA"). Much of the analysis of costs is preliminary, as the Commission acknowledges, with several questions about costs posed for input from public commenters.

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[66] FER Statement, page 14.

[67] FER Statement, p. 14, citing for a discussion of capital market pressure and disclosure to Frank H. Easterbrook and Daniel R. Fischel, "Mandatory Disclosure and the Protection of Investors." *Virginia Law Review*, Vol. 70 No. 4, 1984, pages 669–715.

[68] FER Statement, page 16.

[69] FER Statement, pages 16-17 (emphasis in original).

58. The Commission's analysis considers both direct costs (such as compliance costs), and indirect costs (such as litigation risk and disclosure of proprietary information) associated with the proposed rule. The Commission's analysis offers a starting point for estimating costs associated with the proposed rule. However, the analysis is incomplete and excludes several potentially significant drivers of cost related to the proposed rule.

A. Direct Costs

59. With respect to direct costs, the Commission acknowledges that the proposed rules impose compliance costs of varying magnitude on registrants due to the "need to re-allocate in-house personnel, hire additional staff, and/or secure third-party consultancy services. Registrants may also need to conduct climate-related risk assessments, collect information or data, measure emissions (or, with respect to Scope 3 emissions, gather data from relevant upstream and downstream entities), integrate new software or reporting systems, seek legal counsel, and obtain assurance on applicable disclosures (i.e., Scopes 1 and 2 emissions)."[70]

60. To estimate these direct costs, the Commission reviews several sources, including industry surveys and information contained in selected comment letters received by the Commission. The Commission acknowledges that the scope of costs included in various surveys are limited and may not reflect the compliance costs likely to be faced by registrants under the proposed rule.[71] The anecdotal cost estimates estimated by selected commenters are also incomplete because they mostly pertain to costs associated with preparing voluntary disclosures under various voluntarily-selected reporting formats. However, the Commission includes these anecdotal cost estimates for reference purposes. The main inference the Commission takes from the surveys and public comments with respect to direct costs is that initial costs of preparing disclosures are likely to be higher than for ongoing costs, that incremental costs may be higher for smaller firms than for larger firms due to the fixed cost components of compliance, and that compliance costs are likely to be lower for firms that already disclose significant amounts of information on climate-related risks and use third party attestation to their disclosures. The Commission

[70] Proposing Release, page 21439.
[71] Proposing Release, page 21439.

concludes its analysis of direct costs by acknowledging that the likely magnitude of these costs is unknown and that additional information needs to be provided to the Commission through the public comment process.

61. The Commission's inference that incremental costs may be higher for smaller firms is consistent with what the Commission staff found with respect to another Commission disclosure rule that required auditor attestation: the Sarbanes Oxley 404 Internal Control and Financial Control Requirements. In the Commission's study of that rule, staff found that compliance costs vary with company size (increasing with size), compliance history, and compliance regime. Larger companies tended to incur higher compliance costs in dollar terms ("absolute cost"), while smaller companies incurred a higher cost as a fraction of asset value ("scaled cost"). The study found that some start-up costs were not scalable. Some costs are recurring fixed costs, while others were one-time start-up costs borne in the first years of compliance that tended to dissipate over time.[72] The Commission's staff study is relevant to evaluating the proposed rule because of the similar features contained in each rule.

62. The Commission's PRA estimates costs to registrants over the first six years of compliance with the proposed rule. For non-SRC registrants, the costs in the first year of compliance are estimated to be $640,000 ($180,000 for internal costs and $460,000 for outside professional costs), while annual costs in subsequent years are estimated to be $530,000 ($150,000 for internal costs and $380,000 for outside professional costs).[73]

63. For SRC registrants, the costs in the first year of compliance are estimated to be $490,000 ($140,000 for internal costs and $350,000 for outside professional costs), while annual costs in subsequent years are estimated to be $420,000 ($120,000 for internal costs and $300,000 for outside professional costs).[74]

64. The Commission acknowledges that registrants that are accelerated filers and large accelerated filers will incur additional costs in obtaining assurance of Scopes 1 and 2 emissions disclosures. The Commission estimates these costs starting with data on

[72] "Study of the Sarbanes-Oxley Act of 2002: Section 404 Internal Control over Financial Reporting Requirements," Office of Economic Analysis, U. S. Securities and Exchange Commission, September, 2009, page 2. Available online at: https://www.sec.gov/news/studies/2009/sox-404_study.pdf.
[73] Proposing Release, page 21439.
[74] Proposing Release, page 21439.

these filers' median audit fees in fiscal year 2020, which is $989,566 and $2,781,962 for accelerated filers and large accelerated filers, respectively.[75]

65. The Commission then asserts that "[t]hese costs are expected to decrease over time for various reasons, including increased institutional knowledge, operational efficiency, and competition within the market for relevant services." This assertion is offered without any analytical or empirical support.[76] In addition, this assertion ignores anecdotal evidence that market demand for ESG specialists in the fields of compliance, auditing, and legal services is likely to increase as a result of the proposed rule and other climate-related initiatives, thus likely raising the costs to firms when contracting for these services.[77]

66. The Commission also includes estimates of the incremental change in the paperwork burden of complying with various SEC disclosure requirements if the proposed rule is adopted. For example, the Commission estimates that with respect to 10-K disclosures, 8,292 firms would be affected by the proposed rules and that the "Change in Internal Burden Hours" for these firms would increase by nearly 150 percent.[78] The "External Cost Burden" for these firms is projected to rise by nearly 173 percent.[79]

67. The table below summarizes the percentage increase in the estimated internal and external burden of preparing various SEC disclosures if the proposed rule is adopted. These figures are calculated based on the numbers in PRA Table 4.[80]

[75] Proposing Release, page 21442.

[76] Proposing Release, pages 21439-21440.

[77] See, for example, "PwC planning to hire 100,000 over five years in major ESG push," available at: https://www.reuters.com/business/sustainable-business/pwc-planning-hire-100000-over-five-years-major-esg-push-2021-06-15/.

[78] Proposing Release, PRA Table 4, page 21461. The Commission estimates that the internal burden hours for preparing 10-K reports would increase from 14,188,040 hours to 35,167,837 hours. This represents a 147.87 percent increase in the internal cost burden over the current baseline.

[79] Proposing Release, PRA Table 4, page 21461. The Commission estimates that the external cost burden for preparing 10-K reports would increase from $1,893,793,119 to $5,166,632,876. This represents a 172.82 percent increase in the external cost burden over the current baseline.

[80] Proposing Release, page 21461.

Form	Percentage Increase in Aggregate Internal Burden (Hours) Over Current Burden	Percentage Increase in Aggregate External Burden ($) Over Current Burden
S-1	516.19	534.31
S-4	88.18	92.84
S-11	462.94	480.42
10	1,536.64	1,639.30
10-K	147.87	172.82
10-Q	17.83	17.95

68. The Commission's analysis of another rule, the Conflict Mineral Rule, may shed light on the Commission's current proposal. The Conflict Minerals Rule is similar to the current proposal in that it includes disclosure related to suppliers. In the Conflicts Mineral Rule, the Commission estimated startup costs in the aggregate to be between $3 billion and $4 billion with annual compliance costs ranging from $207 million to $609 million.[81] To calibrate the aggregate cost of the proposed rule with the Conflict Minerals Rule, one can look to the fact that the Commission's estimate of burden hours in the proposed rule for preparing a 10-K is 15 times higher than that estimated in the Conflicts Mineral rule. This would correspond with an aggregate cost for the proposed rule that is at least 15 times higher than for the Conflict Mineral Rule before accounting for inflation (that is, between $45 and $60 billion), although this proposal will likely be even more costly than that.

69. The large percentage increases projected for preparing Commission-mandated disclosures under the proposed rule beg the question of whether the rule will provide commensurate benefits. Current Form 10-K disclosures include the cumulative disclosure requirements of the SEC since 1934 and contain a "wealth of information" and "offer a detailed picture of a company's business, the risks it faces, and the operating and financial results for the fiscal year."[82] The disclosures include: a description of the company's business; risk factors facing the company; audited financial statements including the company's income statement, balance sheet, statement of cash flows and statement of stockholders' equity, accompanied by notes that explain the information

[81]Conflict Mineral Rule, page 240. https://www.sec.gov/rules/final/2012/34-67716.pdf.
[82] "How to Read a 10-K/10-Q," The U.S. Securities and Exchange Commission, https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/how-read.

presented in the financial statements; and management's discussion and analysis of financial condition and results of operations. The disclosures also include information about: the company's significant physical properties; significant pending lawsuits or other legal proceedings; the company's exposure to market risk, such as interest rate risk, foreign currency exchange risk, commodity price risk or equity price risk; the company's disclosure controls and procedures and its internal control over financial reporting; background and experience of the company's directors and executive officers, the company's code of ethics, and certain qualifications for directors and committees of the board of directors; the company's compensation policies and programs and how much compensation was paid to the top executive officers of the company in the past year; shares owned by the company's directors, officers and certain large shareholders, and about shares covered by equity compensation plans; and relationships and transactions between the company and its directors, officers and their family members.[83] If the internal and external burden for preparing 10-K reports is expected to more than double under the proposed rule (147.87 percent increase in internal burden and 172.82 percent increase in external burden), what is the likelihood that the magnitude of the incremental benefits resulting from the proposed rule will exceed the increase in costs that the Commission estimates? The Commission has failed to support its view that the expected marginal benefits under the proposed rule will be greater than or equal to the expected marginal cost.

70. The Commission's cost analysis fails to assess, at the margin, the breakout of costs and benefits associated with each particular disclosure element that would be required under the proposed rule. Disclosures have varying costs and varying benefits, and these must be viewed in relation to one another. If one category of information is disclosed, the disclosure of a second, related category of information may not convey much incremental information. The Commission fails to assess the marginal costs and benefits of each particular disclosure requirement, much less consider the marginal costs and benefits of each requirement when the other requirements are considered.

71. Another indicator of the economic consequences of the proposed rule can be seen by the expected hiring by firms providing attestation services. For example, as of

[83] *Id.*

October 2021, the firm PwC had 55,000 U.S. employees.[84] However, according to press reports the firm expects to hire between 25,000 and 30,000 additional U.S. staff to meet the expected demand for ESG specialists.[85] If the firm is successful in its hiring, nearly a third of its U.S. staff would be specialists in preparing or auditing ESG disclosures. Such a large increase in resources devoted to ESG services that extend beyond the traditional financial accounting and auditing services that PwC has long provided begs the question of whether investors will see a proportional increase in the benefits from ESG disclosures.

72. The academic accounting literature has also found that auditing assurance for corporate social responsibility in the US has not led to positive market effects, consistent with the conclusion that the benefits of assurance do not outweigh the costs:

> Overall, therefore, our findings support the argument that, consistent with evidence for firms from other regions, those US companies purchasing assurance on their CSR [Corporate Social Responsibility] reports appear to do so to enhance the credibility of the reporting package. However, the lack of market impacts, in conjunction with the traditional managerial focus on shareholder interests in the USA, may explain the low level of take-up on CSR report assurance, and this suggests that market perceptions regarding the link between CSR report assurance and firm value may need to be developed before the CSR report assurance market in the USA can mature.[86]
>
> If managers presume, as our evidence appears to suggest, that investors do not value CSR report assurance, they likely would see its cost as not being justifiable unless there is substantial need for enhancing the credibility of the disclosure for other reasons. If this is the case, more efforts on the part of the USA professional auditing community may be needed to legitimize the CSR assurance practice in the eyes of the market.[87]

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[84] https://www.cnbc.com/2021/10/01/pwc-says-us-employees-can-work-from-anywhere-in-the-country.html#:~:text=PwC%2C%20a%20global%20network%20of,them%20to%20work%20in%2Dperson .

[85] "PwC planning to hire 100,000 over five years in major ESG push," available at: https://www.reuters.com/business/sustainable-business/pwc-planning-hire-100000-over-five-years-major-esg-push-2021-06-15/

[86] Charles H. Cho, Giovanna Michelon, Dennis M. Patten, and Robin W. Roberts, "CSR report assurance in the USA: an empirical investigation of determinants and effects," *Sustainability Accounting, Management and Policy Journal*, Vol. 5, No. 2, 2014, pages 130-148 ("Cho et al. (2014)"), page 131.

[87] Cho et al. (2014), page 142.

B. Indirect Costs

73. With respect to indirect costs, the Commission highlights two forms: costs incurred from increased litigation risks, and cost incurred from disclosure of proprietary information about firms' operations and/or production processes.

74. With respect to litigation risk, the Commission attributes this increased risk to the fact that the proposed climate-related disclosures may be new and unfamiliar to many registrants thus creating significant uncertainty and novel compliance challenges leading to inadvertent non-compliance that may create additional exposure to litigation or enforcement action.[88] One consequence of this increased liability and litigation risk is that insurance costs to cover the costs of potential litigation are likely to increase as a result of the requirements in the proposed rule.

75. However, other observers have argued that an increase in litigation risk may result from more than just inadvertent non-compliance risk. The uncertain and novel challenges raised by the proposal create more opportunities for plaintiffs' lawyers to file non-meritorious, nuisance suits to extract settlements. A recent *Wall Street Journal* article reports on concerns from lawyers representing corporations and investors that the proposed rule could be a potent source of securities fraud litigation. The article quotes one attorney's observation that "[t]he plaintiffs lawyers are waiting in the wings" because the complexity of the proposed rules would fuel a "dispute machine" and increase the number of avenues for aggressive plaintiffs' lawyers to file lawsuits. As an example, the article cited hypothetically the destruction of a corporate facility in California from a wildfire where plaintiffs could claim that they were misled by the company's climate risk management. The article called private securities litigation tied to the disclosures contained in the proposed rule a "lurking threat" that may not be evident quickly but could materialize down the road.[89]

76. Litigation risk applies also to auditors. The attestation requirements of the proposed rule will increase the potential for litigation aimed at auditors because of the increased scope of what auditors are being asked to do. One consequence of this

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[88] Proposing Release, page 21444.
[89] "SEC Climate Disclosure Proposal Looms as Litigation Risk," by Richard Vanderford, *The Wall Street Journal*, March 26, 2022. Available online at: https://www.wsj.com/articles/sec-climate-disclosure-proposal-looms-as-litigation-risk-11648299600.

increased liability and litigation risk is that insurance costs for auditors are likely to increase.

77. With respect to the cost resulting from disclosure of proprietary information, the Commission acknowledges that "certain provisions of the proposed rules may force registrants to disclose proprietary information."[90] The Commission observes that under the proposed rules, "registrants would be required to disclose a wide range of climate-related information, including potential impacts on its business operations or production processes, types and locations of its operations, products or services, supply chain and/or value chain. Registrants would be further required to disclose whether they have emissions-related targets and metrics or an internal carbon price, and if they do, what they are. To the extent that a registrant's business model or strategy relies on the confidentiality of such information, the required disclosures may put the registrant at a competitive disadvantage."[91]

78. The Commission notes that proprietary cost estimates are generally relevant for reporting that involves information about a firm's business operations or production processes and disclosures that are specific, detailed and process-oriented. The Commission cites relevant academic literature supporting the view that the magnitude of costs incurred from disclosing proprietary information in mandated disclosures can be significant enough to cause firms to deregister with the SEC.[92] However, the Commission merely acknowledges this possibility and says nothing more about it with respect to its evaluation of the economic consequences of the proposed rule. The Commission fails to measure the potential magnitude of this cost, an analysis that is necessary for the consideration of whether there is a reasoned basis for the Commission to exercise its rulemaking authority with respect to disclosure of climate-related risks.

79. Here, the proposed rule assumes that by requiring information producers (that is, registrants who produce valuable information as part of their operations) to publicly disclose their proprietary information to information consumers (that is, investors who

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[90] Proposing Release, page 21444 (footnote omitted).

[91] Proposing Release, page 21444.

[92] Proposing Release, page 21444. The Commission cites two academic papers supporting this view. See, e.g., Christian Leuz, Alexander Triantis, and Tracey Yue Wang, "Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations," Vol. 45, No. 2, *Journal of Accounting and Economics*, 2008, pages 181-208; Daniel A. Bens, Phillip G. Berger, and Steven J. Monahan, "Discretionary Disclosure in Financial Reporting: An Examination Comparing Internal Firm Data to Externally Reported Segment Data," *The Accounting Review* Vol. 86, No. 2, 2011, pages 417-449.

rely only on public disclosures of information), the result will be more "efficient." But the effect of the rule is likely to involve a tradeoff: even if information consumers may be better off, information producers would be worse off. This tradeoff is referred to in the economics profession as a "distributional effect" or "wealth transfer," which is not by itself efficiency enhancing. All else equal, the mandated disclosure of the proposed rule, when it involves proprietary information, will leave information producers worse off, even if information consumers benefit from the public disclosure. To conclude that the proposed rule enhances efficiency by redistributing the benefits of proprietary information from one group of investors to another group of investors would require the Commission to evaluate the welfare impact of these tradeoffs – a task which the Commission has not performed.

80. In addition to the indirect costs noted in the Proposing Release, there are other potential costs with respect to the proposed rule that are worthy of consideration by the Commission. For example, by vastly expanding the scope of disclosure requirements, there is the potential for disclosures to obfuscate rather than inform. The costs associated by this over-inclusive disclosure have been noted by the U.S. Supreme Court when Justice Thurgood Marshall wrote that "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good." Where materiality is over-inclusive, he observed, "not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decision-making."[93] Former SEC commissioner Troy Paredes has also recognized the potential costs from over-inclusive and voluminous disclosure that makes it more difficult for investors to find relevant information.[94]

81. Another potential cost associated with the proposed rule comes from the opportunity cost the Commission faces from diverting resources from other Commission objectives. Imposing these requirements and developing the expertise to monitor and enforce the climate disclosures of issuers will involve the expenditure of very substantial

[93]Cited in Katz and McIntosh (2021a), citing to TSC v. Northway https://www.wlrk.com/docs/TSC_Industries_v._Northway_Inc.pdf.

[94] Troy A. Paredes, "Blinded by the Light: Information Overload and its Consequences for Securities Regulation," *Washington University Law Quarterly*, Vo. 81, No. 2, Summer 2003, pages 417-485.

resources. Absent the rule, these resources could otherwise be devoted to furthering other aspects of the Commission's mission. To the extent that the Commission faces budget constraints, this opportunity cost should be explicitly recognized and considered in evaluating the economic consequences of the proposed rule. If the Commission requires a bigger budget to hire the specialized expertise it needs to monitor, investigate, and enforce compliance with the proposed rule, these additional costs should be explicitly accounted for in evaluating the economic consequences of the proposed rule.

82. The opportunity cost faced by the Commission may also be faced by the board of directors and the managers of companies subject to the proposed rule. The requirements of the proposed rule mean that registrants must develop the expertise necessary to comply with the mandated climate-related disclosures. This will likely involve the expenditure of substantial corporate resources that would otherwise be available to meet other corporate objectives. Absent the proposed rule, these resources would not be diverted and could otherwise be devoted to furthering higher-value corporate objectives.

83. Another indirect cost from the proposed rule is the cost associated with the risk that the Commission's disclosure requirements end up failing to be useful to investors. The Commission has considered market failure in evaluating the economic consequences of the proposed rule, but equally important is for the Commission to evaluate the risk of government failure if it turns out the Commission has acted in error. The costs of government failure include not only the costs imposed on registrants of implementing a disclosure regime that becomes dated or not useful (such as reduced stock returns), but also includes the costs borne by the Commission in the form of resources that must be reallocated to other purposes.

C. The Commission Fails to Jointly Consider the Possible Impact of Other Proposed Rules with Potentially Similar Indirect Costs

84. While the Proposing Release includes a discussion of potential indirect costs associated with the proposed rule, the Commission fails to comprehensively consider the potential unintended effects that may occur from the interaction costs resulting from the full slate of rules, including the ones discussed herein, being issued simultaneously (i.e., "knock-on effects"). In simultaneous rulemakings, the Commission is proposing several rules that will either directly impact issuers and securities markets, such as a

Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure rule[95] and a Share Repurchase Disclosure Modernization Rule.[96] The Commission cannot consider these rules in isolation because of the potential costs of regulatory accumulation, the many forms of which Mandel and Carew define.[97]

85. One type of regulatory accumulation is the interaction between regulations, in which "multiple regulations can interact in obvious or non-obvious ways that raise costs for businesses."[98] For example, the Commission is already proposing to require a number of other disclosures, from cybersecurity risks to share repurchases. Firms will need to build or revise disclosure systems or processes to address each of these new requirements, often turning to the same personnel, consultants, or contractors. Addressing all of these (and other) rules changes at once will drain resources and likely lead to confusion as systems are updated in different ways simultaneously. However, the Commission does not consider these (or any other) potential impacts that its proposed climate-related disclosure rue might have on issuers in light of its other proposed rules.

86. Further, by only considering these rules in isolation, the Commission is not providing a comprehensive picture of the compliance and other direct costs. Multiple simultaneous rule changes increase overall complexity, which in turn increases overall costs. These costs must be considered jointly and in the context of the direct costs of the proposed rules discussed here.

D. Impact of Mandated ESG Disclosure on Private Firms

87. As the Commission acknowledges, one potential consequence of the proposed rule is that the costs associated with mandated ESG disclosure will reduce the attractiveness of going public and reinforce the trend for private firms to stay private.[99]

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[95] 87 Fed. Reg. 16,590 (Mar. 23, 2022).
[96] 87 Fed. Reg. 8,443 (Feb. 15, 2022).
[97] Michael Mandel and Diana G. Carew, "Regulatory Improvement Commission: A Politically-Viable Approach to U.S. Regulatory Reform," *Progressive Policy Institute*, May 2013 ("Mandel and Carew (2013)"), pp. 1–3.
[98] Mandel and Carew (2013), p. 3.
[99] The Proposed Rule recognizes this but surmises that "it is unlikely that a significant number of firms would pursue this avoidance strategy given that it would come with significant disadvantages, such as higher costs of capital, limited access to capital markets, and limits to their growth potential." Proposing Release, page 21448. However, researchers note that "[i]t is very difficult to predict whether the described firm responses are net positive or negative from the perspective of investors, other stakeholders, or society. Stakeholder responses to CSR information can induce firm responses (or real effects) that reduce firm value

The Commission also acknowledges that the compliance costs of the proposed rules could influence the marginal firm's decision to exit public markets or refrain from going public in the first place with the intention of circumventing the proposed disclosure requirements. Firms may choose this circumvention strategy if they believe the potential compliance costs from the proposed rules outweigh the benefits of being a registered public company. However, the Commission argues that it is unlikely that a significant number of firms would pursue this circumvention strategy on the grounds that the "transparency gap" between private and public firms will be insufficiently wide to overcome the "higher costs of capital, limited access to capital markets, and limits to their growth potential"[100] for firms that choose to remain private in order to avoid incurring costly mandated ESG disclosures. Moreover, the Commission argues that the transparency gap between public and private firms is likely to narrow because "[t]he pressure on private companies to disclose information on climate-related risks is rapidly escalating within the private industry."[101]

88. The Commission's downplaying of the argument that the proposed rule will result in firms remaining private is not supported. Instead, the Commission's proposed climate-related disclosures are likely to be complex and highly costly to public issuers because of the need to build in disclosure controls and create board, management and risk processes and procedures.[102] In addition, the proposed rule is likely to add significant costs to public issuers due to the need to make investments in talent and technology in order to track and verify the required data for Scope 1 and Scope 2 disclosures. Finally, compliance with the proposed rule will require public issuers to incur costs associated with engaging specialized professionals to prepare the disclosures and to incur costs from hiring third-

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and, hence, have negative financial consequences for investors." Christensen, Hail, and Leuz (2021), page 1232.

[100] Proposing Release, page 21448.

[101] Proposing Release, page 21448.

[102] Past research has found that mandated disclosure rules can impose significant costs on companies. In studying the impact of the Sarbanes-Oxley Act, Zhang (2007) finds "U.S. firms experienced a statistically significant negative cumulative abnormal return around key SOX events. … Regression results are consistent with the non-audit services and governance provisions imposing net costs."[102] Ivy Xiying Zhang, "Economic consequences of the Sarbanes-Oxley Act of 2002," *Journal of Accounting & Economics*, Vol. 44, 2007, pages 74-115 ("Zhang (2007)"), page 74. In addition, Zhang (2007) finds that non-accelerated filers, who were able to defer the compliance of Section 404 of SOX, had significant cost savings. Zhang (2007), p. 74. Zhang (2007) does note that the study's results should be interpreted with caution (within the confines of the study's methodology and other interpretations) and does not include social benefits and costs. Zhang (2007), pages 110-111.

party attestation specialists and auditors.[103] Much of the specialized reporting and audit assurance called for would need to be outsourced to consultants, accountants, and law firms with climate-focused practices. Such requirements will likely disproportionately affect smaller firms.[104]

89. To the extent that the proposed ESG disclosure regime applies only to public issuers and not private firms, the significant costs associated with the proposed rule will likely inhibit the willingness of some private companies to go public.[105] This impact is most likely to be observed for private firms at the margin, i.e., for medium-sized, medium-growth, and maturing firms, where the added cost of going public may cause them to decide to stay private. In addition, because the proposal does not include any incremental phase-in allowance for newly public companies, some private companies could delay plans to go public.

90. The proposed climate-related mandated disclosures come on top of other additions to Commission mandated disclosures over the past decade with respect to executive compensation, cybersecurity risk, and conflict minerals. All of these mandated disclosures are costly, as firms need to hire specialized lawyers and accountants to track them and write the disclosure. To the extent that firms go private or remain private because of a widening transparency gap between public and private firms, the informational efficiency of capital markets will be negatively affected and potentially the size of the publicly traded stock market will be reduced (as the Commission acknowledges).[106]

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[103] Proposing Release, page 21437 ("The proposed rules would require the attestation report to identify the criteria against which the subject matter was measured or evaluated, the level of assurance provided, the nature of the engagement, and the attestation standard used").

[104] "The constraining impact of uniform disclosure standards on diverse firms must be considered. Naturally, it is easier to derive optimal disclosure standards in an economy of identical and stable firms. However, in practice, firms differ and change over time (with respect to their underlying economics and the materiality threshold used to determine disclosure). In order to improve our understanding of accounting standards, it is important that we consider how optimal disclosure regulation is designed when such regulation applies to a diverse set of firms." Anne Beyer, Daniel A. Cohen, Thomas Z. Lys, and Beverly R. Walther, "The financial reporting environment: Review of the recent literature," *Journal of Accounting and Economics*, Vol. 50, 210, pages 296-343, page 319.

[105] Gao, Wu, and Zimmerman (2009) find that small firms were incentivized to not go over the threshold that allowed them to stay as non-accelerated filers. Feng Gao, Joanna Shuang Wu, and Jerold Zimmerman, "Unintended Consequences of Granting Small Firms Exemptions from Securities Regulation: Evidence from the Sarbanes-Oxley Act," *Journal of Accounting Research*, Vol. 47, No. 2, 2009, pages 459-506.

[106] Proposing Release, page 21448.

91. The additional cost of mandated climate-related disclosure, by influencing the decision of firms choosing whether to stay private or go public, will reinforce a trend in US equity markets of firms that choose to go public being bigger and older than they used to be. Smaller private companies may choose to stay private until they become large enough or profitable enough so that they can afford the additional cost of mandated climate-related disclosure. This means that when companies become public, they will be slower growing than they used to be. In 1997, there were 174 tech IPOs with a mean and median market capitalization of $264 million and $113 million, respectively.[107] In 2021, there were 118 tech IPOs with mean and median market caps of $6.3 billion and $3 billion, respectively.[108] This trend, which will be reinforced by the added cost of going public as a result of mandated climate-related disclosure rules, is for fewer IPOs and for IPOs to include bigger companies with less growth ahead of them.

92. To the extent that the costs imposed by the proposed rule reinforces this trend, the SEC would work against its own initiatives aimed at trying to reduce the cost of raising capital by going public and making markets more accessible to ordinary investors. Increasing the burden on public companies directly conflicts with the goal of the 2012 JOBS Act and other legislation that seeks to increase the number of publicly traded companies. This incentive for firms to remain private could inhibit capital formation and decrease the aggregate amount of corporate disclosure, contrary to the SEC's mandates to facilitate capital formation and efficient markets. To the extent that the costs associated with mandated disclosures contained in the proposed rule reinforce the trend of firms going public later in their life cycle, fast-growing companies will be private and ordinary investors will be harmed because they will be denied the opportunity to invest in high-growth companies. These investment opportunities will be unavailable to ordinary investors who will be unable to invest in these firms until most of the money has already been made by affluent accredited investors.

93. The net result of the impact of the proposed rule on the decision to go public or stay private is that it will change the types of companies that go – or remain – public. One type of company will appeal to ESG investors and will go public. Companies that do not appeal to ESG investors may go or stay private. The net result is that companies

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107 https://site.warrington.ufl.edu/ritter/files/IPOs-Tech.pdf.

108 https://site.warrington.ufl.edu/ritter/files/IPOs-Tech.pdf.

whose climate risks may be most worrying to investors could end up being the ones who will not be disclosing them under an SEC-mandatory disclosure regime. A reporting mandate "therefore would likely widen the gap between public and private firms, both in terms of CSR activity and CSR transparency. Indeed, one concern is that harmful CSR activities could shift from public to private firms."[109] Under such a scenario, "observable CSR performance by publicly traded firms could increase, yet aggregate CSR in the entire economy could improve less or even decrease."[110] Similarly, under a stringent mandate environment for businesses, firms may choose to locate abroad with "unclear net effects on global CSR performance" and list their shares outside of the United States.[111]

E. Costs for Private Firms

94. Private firms will also need to care about mandated ESG disclosure even if they are not registrants. The mandated disclosure of Scope 3 emissions means that all the emissions in a registrant's value chain, including by customers and suppliers will need to be disclosed.[112] If a public company's customers and suppliers are private companies, the Commission requires the public company to work "with its suppliers and downstream distributors to take steps to reduce those entities' Scopes 1 and 2 emissions," so that it can report its Scope 3 emissions.[113] The emissions of suppliers (i.e., "upstream emissions") include emissions attributable to goods and services that the registrant acquires, the transportation of goods (for example, to the registrant), and employee business travel and commuting. The emissions of customers (i.e., "downstream emissions") include the use of the registrant's products, transportation of products (for example, to the registrant's

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[109] Christensen, Hail, and Leuz (2021), page 1218.
[110] Christensen, Hail, and Leuz (2021), page 1218.
[111] Christensen, Hail, and Leuz (2021), page 1218.
[112] Proposing Release, page 21374. The Commission proposed requiring disclosure of emissions from supplier companies because "[o]ver the last few years, a number of studies have shown that firms try to reduce their local carbon footprints by outsourcing their carbon emissions to suppliers in states or countries with weaker environmental policies." Proposing Release, page 21435. "Subjecting these climate-related disclosures to reasonable assurance pursuant to an audit would require the auditor to assess the risk of material misstatement related to the estimates and judgments, including through evaluation of the method of measurement and reasonableness of the assumptions used, and to understand management's risk management processes, including the accuracy of the proposed disclosure, thereby alleviating possible concerns about the data's reliability and comparability, and improving investor confidence in such disclosure." Proposing Release, page 21433 (footnotes omitted).
[113] Proposing Release, page 21377. "We also recognize that obtaining the data necessary to calculate a registrant's Scope 3 emissions might prove challenging since much of the data is likely to be under the control of third parties." Proposing Release, page 21412.

customers), end of life treatment of sold products, and investments made by the registrant.[114]

95. The Commission also argues that there is a trend in private markets for the leading firms to develop a standard set of metrics for tracking their portfolio companies' ESG progress. The Commission argues that "pressure on private companies to disclose information on climate-related risks is rapidly escalating within the private industry, hence diminishing the potential incentive for registrants to go private in order to avoid climate-related disclosure requirements."[115] However, an alternate interpretation of this trend that the Commission observes is that private firms are currently voluntarily choosing their own ESG disclosure levels to meet the needs of their investors. A study from the Boston Consulting Group on private equity argues that private firms are looking to existing ESG frameworks in order to develop ESG metrics consistent enough to establish meaningful benchmarks but flexible enough to allow room for continuous improvement.[116]

96. Although the direct cost of ESG disclosure is borne by the public market registrant, it will likely have economic consequences for private firms as well. The Commission acknowledges these consequences but argues that these additional costs are welcome because they favor the adoption of the proposed rule on the grounds that the resulting costs to private firms will diminish the "transparency gap" between public and private firms and will reduce the potential incentive for registrants to go private in order to avoid climate-related disclosure requirements. The Commission's argument ignores the plain fact that additional costs will be borne by private firms as a result of the proposed rule. The economic consequences of the costs likely to be incurred by private firms are completely ignored in the Proposing Release.

VI. The SEC Fails to Adequately Consider Reasonable Alternatives

97. The Proposing Release provides a list of 14 "reasonable alternatives" to the proposed rule.[117] Although the Commission identifies tradeoffs that might be involved if

[114] Proposing Release, page 21374.
[115] Proposing Release, page 21448.
[116] https://www.bcg.com/en-us/publications/2021/private-equity-convergence-on-esg-data.
[117] Proposing Release, pages 21448-21452.

any particular alternative were adopted, the Proposing Release does not provide any analysis to evaluate these tradeoffs to determine whether any of the alternatives provides a lower-cost means of meeting some of the Commission's objectives. Overall, the Commission fails to adequately consider the alternatives it lists and fails to consider additional reasonable alternatives.

98. Among the 14 alternatives discussed in the Proposing Release, there is a discussion of scenario analysis. The Commission notes that scenario analysis is beneficial to investors because it allows them to assess a range of potential threats and opportunities.[118] Scenario analysis could help investors assess issues that have high uncertainty by evaluating the impact on and the resiliency of the registrant under multiple plausible future scenarios. However, the Commission dismisses scenario analysis on the grounds that the methodologies "continue to advance and develop, which may pose significant challenges for some registrants" which the Commission argues are "undue burdens."[119] The fact that a promising technology is seen as evolving appears to support arguments made in favor of voluntary disclosure being flexible enough to evolve as conditions warrant. The Commission fails to discuss the possibility of using scenario analysis as a voluntary option for registrants that would choose to use the approach.

99. The Commission also discusses the possibility of climate-related disclosures being furnished as opposed to being filed.[120] The Commission notes that "[t]his may also benefit some registrants as their Scopes 1 and 2 emissions disclosures would not be automatically incorporated into Securities Act registration statements and thereby not be subject to Section 11 liability."[121] However, the Commission rejects this alternative on the grounds that there is a possibility that reduced liability may lead to the applicable disclosures being perceived as less reliable by investors.[122] This appears to be a tradeoff worthy of further analysis rather than rejection on the basis of a possibility that this may happen. It also bears repeating that to the extent the information is material, it should be disclosed under current law.

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[118] Proposing Release, page 21449.
[119] Proposing Release, page 21449.
[120] Proposing Release, page 21449.
[121] Proposing Release, page 21449.
[122] Proposing Release, page 21449. Also at page 21429: "by requiring this information to be *filed* with the Commission as opposed to posted on company websites or *furnished* as exhibits to regulatory filings, the proposed rules are expected to improve the reliability of information..."

100. There are other alternatives in the Proposing Release that are summarily rejected without any rigorous analysis being applied to determine whether the alternatives could provide lower cost means for achieving the Commission's objectives.

101. The Commission argues that agency problems present a market failure that makes voluntary reporting unreliable, thus requiring prescriptive mandated disclosure.[123] However, if agency problems are indeed causing a market failure, there are alternative means of addressing these problems such as encouraging means for management and shareholders to achieve an alignment of interests through compensation contracts.

102. One alternative has recently been proposed by the FER. The FER suggests that firms that disclose their ESG rating information voluntarily using a third-party disclosure framework should include "information about the raters, factors used in the rating, and weights on the factors."[124]

103. Finally, the Commission may wish to acknowledge that their objectives may be met more cost-effectively by other means besides securities laws. For example, climate-related outcomes may be more cost-effectively supervised by the Environmental Protection Agency.

VII. The Commission Fails to Adequately Consider the Impact of the Proposed Rule on Efficiency, Competition and Capital Formation

To justify its exercise of rulemaking authority, the SEC has a duty under the Administrative Procedure Act ("APA"), as applied under the SEC's governing statutes, to adequately consider whether a regulatory action will promote efficiency, competition and capital formation. I find that the Commission fails to adequately consider the impact of the proposed rule on efficiency, competition and capital formation.

A. Efficiency

104. The Commission argues that the proposed rule will promote efficiency. The Commission's argument is conditional on climate-related information being relevant for asset prices, i.e., if climate-related information is relevant for asset prices then the

[123] Proposing Release, page 21426.

[124] Jonathan M. Karpoff, Robert Litan, Catherine Schrand, and Roman L. Weil, "What ESG-Related Disclosures Should the SEC Mandate?" *Financial Analysts Journal*, Vol. 78, No. 2, 2022, pages 9-18, available online at: https://doi.org/10.1080/0015198X.2022.2044718.

proposed rule could improve market efficiency and price discovery by enabling climate-related information to be more fully incorporated into asset prices. The Commission then bootstraps this conditional argument to further claim that improved efficiency resulting from the proposed rule "could inform the flow of capital and allow climate-related risks to be borne by those who are most willing and able to bear them."[125]

105. However, the Commission's argument could also be applied to current principles-based disclosure practices or to voluntary disclosures practices which have the advantage over rules-based prescriptive disclosure mandates in that the practices are flexible and able to evolve in order to provide investors with any decision-useful material information. Rules-based prescriptive disclosure mandates are subject to the risk of locking in registrants to ossified disclosure requirements that fail to disclose information that is truly useful to investors as financial conditions evolve.

106. The Commission's discussion of efficiency focuses on the informational efficiency of asset prices. But as noted above in Sections IV and V, the proposed rule contains features that may impact efficiency in other ways. As the Commission has noted, "certain provisions of the proposed rules may force registrants to disclose proprietary information."[126] Disclosure of proprietary information may improve the informational efficiency of equity prices but can be harmful to efficiency in other respects.

107. The proposed rule assumes that requiring information producers (i.e., registrants who produce valuable information as part of their operations) to publicly disclose their proprietary information to information consumers (i.e., investors who rely only on public disclosures of information) will lead to a more "efficient" outcome. But the effect of the rule is likely to involve a tradeoff: while information consumers may be better off, information producers will likely be worse off. This tradeoff is referred to in the economics profession as a "distributional effect" or "wealth transfer," which, is not by itself efficiency enhancing. All else equal, the mandated disclosure of the proposed rule, when it involves proprietary information, will leave information producers worse off, even if information consumers benefit from the public disclosure. To conclude that the proposed rule enhances efficiency by redistributing the benefits of proprietary

[125] Proposing Release, page 21445 (footnote omitted).
[126] Proposing Release, page 21444 (footnote omitted).

information from one group to another group would require the Commission to evaluate the welfare impact of these tradeoffs – a task which the Commission has not performed.

108. The Commission also argues that the proposed rule could promote efficiency by reducing systemic risk. The Commission argues that "the financial system could be destabilized also by potentially rapid and unexpected losses to carbon-intensive assets caused by a disorderly transition to a low-carbon economy or a shift in the market's perception of climate risks."[127] The Commission then argues that "[a] more efficient allocation of capital brought about the disclosure required by the proposed rules could reduce the probability and magnitude of disorderly price corrections or dislocations, thereby strengthening financial system resilience."[128] However, the Commission has failed to analyze the cost-effectiveness of addressing systemic risk with securities disclosure requirements rather than through other means or by other regulators. In any case, risks to systemically-important firms significant enough to cause the dislocations that concern the Commission are likely risks that would be disclosed under the current principle-based disclosure regime.

B. Competition

109. With respect to the impact of the proposed rule on competition, the Commission focuses on one dimension of competition, that of similarly-situated firms that are presumably competing in the same product market. With respect to this form of competition, the Commission argues that "[m]ore standardized reporting should also reduce investors' costs for acquiring and processing climate-related information by facilitating investors' analysis of a registrant's disclosure and assessing its climate-related risks against those of its competitors."[129] The Commission also argues that "[o]verall, we expect that by standardizing reporting practices, the proposed rules would level the playing field among firms, making it easier for investors to assess the climate-related risks of a registrant against those of its competitors."[130]

110. However, there are other dimensions to competition that the Commission fails to consider. For example, the Commission fails to consider the impact of the proposed rule

[127] Proposing Release, page 21446 (footnote omitted).
[128] Proposing Release, page 21446 (footnote omitted).
[129] Proposing Release, page 21446.
[130] Proposing Release, page 21446.

on the competition for voluntary disclosure of information. Currently, there is a vibrant market for ESG disclosure with registrants able to select from a menu of competing formats that meet the demands of various investors for ESG information.

111. By mandating climate-related disclosure and codifying its form, the SEC runs the risk of short circuiting the natural evolution of disclosure standards in the private market, which will potentially ossify disclosure to an inflexible and suboptimal standard. If so, the Commission's claim with respect to competition would work in reverse, that is, competition between firms would be impaired.

112. The proposed rule may also impact the competition between listing venues for initial public offerings. One way listing venues compete is through the type and amount of public disclosure they require of issuers before listing their shares. Competition between domestic listing venues would be affected if this dimension of competition is superseded by mandated disclosure by the Commission. In addition, competition between U.S. listing venues and foreign listing venues would likely be impacted by mandated disclosure in the U.S. that may impact where issuers choose to publicly list their shares.

C. Capital Formation

113. With respect to capital formation, the Commission argues that mandatory ESG disclosures could reduce the cost of capital to firms because "[m]ore comparable, consistent, and reliable climate-related disclosures could reduce information asymmetries, both among investors and between firms and their investors."…"In the first case, less information asymmetry among investors could mitigate adverse selection problems by reducing the informational advantage of informed traders. This is likely to improve stock liquidity (i.e., narrower bid-ask spreads), which could attract more investors and reduce the cost of capital. In the second case, less information asymmetry between firms and their investors could allow investors to better estimate future cash flows, which could reduce investors' uncertainty, as well as the risk premium they demand, thus lowering the costs of capital."[131]

114. The first part of the Commission's argument on information asymmetry with respect to the size of the bid ask spread is misplaced. The role of information asymmetry

[131] Proposing Release, page 21447 (footnote omitted).

and adverse selection in the formation of the bid ask spread is well known and refers not to corporate disclosure but to information about order flow faced by market making firms and other intermediaries. In that context, an informed trader is someone who has information about large, market moving order flow such as a large institution or an inside trader. The adverse selection that impacts the bid ask spread derives from market makers facing the risk of trading in the open market with other traders who have superior information about pending order flow or significant market moving news. Because market makers face the risk of having their open orders hit by order flow from traders with superior information, they mitigate this risk by adjusting their quotes (i.e., the bid-ask spread) or by reducing latency in order to revise quotes quickly. The trading context is not relevant to information disclosures about ESG. The impact of information asymmetries on the bid ask spread is much more likely to be caused by information about order flow as opposed to mandated ESG disclosures.

115. With respect to the Commission's argument that less information asymmetry between firms and their investors could reduce investors' uncertainty and lower the cost of capital, this claim applies equally to voluntary disclosure. To the extent that firms can lower their cost of capital through disclosure, this benefit would also apply to firms under a voluntary disclosure regime since it is in the firm's best interest to obtain a lower cost of capital. In fact, the academic literature cited by the Commission to support its claim on how the proposed rule could aid capital formation comes from results obtained from research on voluntary disclosure.

116. The Commission fails to consider other impacts of the proposed rule on capital formation. For example, as previously discussed, the proposed rule may cause private firms to stay private longer and delay becoming public if they ever become public at all. Or, as the Commission has acknowledged, public firms could choose to become private as a result of the proposed rule.

117. The additional cost of mandated ESG disclosure, by influencing the decision of firms choosing whether to stay private or go public, will reinforce a trend in U.S. equity markets of firms that choose to go public being bigger and older than they used to be. To the extent that the costs imposed by the proposed rule reinforces this trend, the Commission would work against its own initiatives aimed at trying to reduce the cost of raising capital by going public and making markets more accessible to ordinary investors.

Increasing the burden on public companies directly conflicts with the goal of the 2012 JOBS Act and other legislation that seeks to increase the number of publicly traded companies. This incentive for firms to remain private could inhibit capital formation and decrease the aggregate amount of corporate disclosure, contrary to the SEC's mandates to facilitate capital formation and efficient markets.

Respectfully submitted,

James A. Overdahl

James A. Overdahl, Ph.D.

June 16, 2022

Delta Strategy Group
600 Pennsylvania Avenue SE Suite 300 Washington, DC 20003 T 202.547.3035

JAMES A. OVERDAHL, PH.D.
PARTNER

Dr. Overdahl is a specialist in financial markets and the U.S. regulatory environment. Prior to joining Delta Strategy Group as a partner in August 2013, Dr. Overdahl provided advisory and expert witness services through NERA Economic Consulting. Dr. Overdahl's financial regulatory experience includes three years as Chief Economist for the US Securities and Exchange Commission (SEC) and five years as Chief Economist for the US Commodity Futures Trading Commission (CFTC). He is experienced in preparing expert reports and in serving as a testifying expert in matters involving complex financial litigation. In his positions at the SEC and CFTC, Dr. Overdahl testified before each Commission. He also testified before Congress on behalf of the SEC and CFTC, and provided staff support and briefings for members of the President's Working Group on Financial Markets.

While serving as Chief Economist of the SEC from 2007 to 2010, Dr. Overdahl directed the SEC's Office of Economic Analysis where he served as principal economic advisor on policy, rulemaking, and litigation support and supervised the SEC's economics program. He advised the Commission on a wide range of policy matters, including, credit default swaps and other OTC derivatives, OTC clearing, algorithmic trading and related market structure issues, securities lending, short selling, and new products. In addition, he advised the Commission and other government agencies on several matters related to the financial crisis of 2008. He also advised the Commission on investigation matters, enforcement proceedings, civil monetary penalties, disgorgement, and fair-fund distribution plans.

While serving as Chief Economist of the CFTC from 2002 to 2007, Dr. Overdahl directed the CFTC's Office of the Chief Economist. He advised the Commission on policy matters related to exchange-traded futures and options, OTC derivatives (particularly energy derivatives), commodity price speculation, risk management and hedging, new products and markets, algorithmic trading, position limits, clearing, commodity index investing, hedge funds, and error trade policies. He also advised the Commission on enforcement matters related to commodity price manipulation and the alleged false reporting of natural gas transactions by several entities. In addition, he advised the Commission on restitution and civil monetary penalties.

Dr. Overdahl has also served as a Senior Financial Economist for the Risk Analysis Division of the US Office of the Comptroller of the Currency (OCC). He performed on-site assessments of risk measurement models, including Monte Carlo simulation models, historical simulation models, variance-covariance models and stress testing models, employed by Tier 1 dealer banks, and assessments of model validation procedures within the risk management units of money center banks, of compliance with the Value-at-Risk requirements of the Basel Market Risk Capital Rule, and of the effectiveness of hedging and risk measurement techniques used to manage market risk in securitization conduits.

Prior to joining the OCC, Dr. Overdahl served as a Financial Economist in the CFTC's Division of Economic Analysis and the SEC's Office of Economic Analysis. He has taught as an Adjunct Professor of Finance at George Washington University, the University of Maryland, Johns Hopkins University, Georgetown University, Virginia Tech, and George Mason University. Dr. Overdahl also served as Assistant Professor of Finance at the University of Texas at Dallas School of Management.

Dr. Overdahl has published extensively in leading economics and finance journals, including the *Journal of Business, Journal of Law and Economics, Journal of Financial and Quantitative Analysis*, *Journal of Futures Markets*, *Journal of Derivatives,* and *Journal of Alternative Investments,* and has contributed numerous chapters to published volumes on finance and economics. In addition, he has co-edited and co-authored, with Robert Kolb, four books in multiple editions including *Financial Derivatives: Pricing and Risk Management* and *Futures, Options, and Swaps*.

EDUCATION

Ph.D., Economics, Iowa State University, Ames, IA, 1984.

B.A., Economics, St. Olaf College, Northfield, MN, 1980.

CURRENT POSITION

Partner, Delta Strategy Group, Washington, DC, August 2013–Present.

PRIOR POSITION

Vice President, Securities and Finance Practice, National Economic Research Associates, Inc., April 2010 – August 2013, and Affiliated Industry Expert, August 2013–Present.

GOVERNMENT POSITIONS

Chief Economist and Director of the Office of Economic Analysis, U.S. Securities and Exchange Commission, Washington, D.C. 2007-2010.

Served as principal economic advisor on policy, rulemaking, and litigation support. Supervised the economics program with a professional staff of approximately 40 Ph.D. economists, analysts, and consultants. Testified before the Commission and before Congress on behalf of the Commission. Provided staff support for President's Working Group on Financial Markets and for other interagency groups related to financial market reform and market developments.

Chief Economist and Director of the Office of the Chief Economist, U.S. Commodity Futures Trading Commission, Washington, D.C. 2002-2007.

> Director of the CFTC's Office of the Chief Economist. Supervised the CFTC's economics program utilizing a staff of professional economists and support personnel performing economic research, policy analysis, expert testimony, education, and outreach (including congressional briefings). Served on the Commission's Executive Management Council. Testified before the Commission and before Congress on behalf of Commission. Provided staff support and briefings for members of the President's Working Group on Financial Markets on issues related to derivative markets and hedge funds.

Senior Financial Economist, Risk Analysis Division, Office of the Comptroller of the Currency, Washington D.C. 1995-2002.

> Performed assessments of risk measurement models, valuation models, model validation procedures, and compliance with the Value-at-Risk requirements of the Basel Market Risk Capital Rule.

Senior Financial Economist, Research Section, Division of Economic Analysis, Commodity Futures Trading Commission, Washington D.C. 1992-1995.

> Conducted empirical research on policy issues before the Commission relating to exchange-traded and privately-negotiated derivative instruments. Assisted the CFTC's Division of Enforcement both in developing economic evidence and in devising civil monetary penalties for use in CFTC enforcement proceedings. Assisted the Commission's Administrative Law Judges in devising sanctions.

Senior Financial Economist, Office of Economic Analysis, U.S. Securities and Exchange Commission, Washington D.C. 1989-1992.

> Served as in-house economic consultant to the SEC's Division of Market Regulation on issues involving derivative instruments and capital markets. Assisted the SEC's Division of Enforcement in the development of economic evidence for use in civil cases brought before the Commission. Assisted U.S. Attorney's Office in developing evidence for criminal cases resulting from SEC referrals to the Justice Department.

ACADEMIC POSITIONS

Adjunct Professor, University of Maryland, 2003-2007.

Adjunct Professor, George Washington University, 2002-2007.

Adjunct Professor, Johns Hopkins University, 2001.

Adjunct Professor, School of Business, Georgetown University, 1994-1995.

Adjunct Professor, School of Business Administration, George Mason University, Fairfax, Virginia, 1991-1994.

Adjunct Professor, Pamplin College of Business, Virginia Polytechnic Institute, Falls Church Virginia, 1990.

Assistant Professor of Finance, School of Management, The University of Texas at Dallas, 1984 - 1989.

PRIVATE POSITIONS

Consultant, Strategic Petroleum, Inc., Dallas, TX (a joint venture between the principals of Chicago Research and Trading and Tradelink, LLC). 1988-1989.

Applied option pricing theory to valuation decisions concerning drilling and abandonment of operating wells. Validated models used to analyze arbitrage strategies involving spot crude oil and exchange-traded crude oil futures and options.

LITIGATION AND ENFORCEMENT MATTERS

Dr. Overdahl has consulted on more than 50 enforcement matters before the CFTC and SEC over a 20-year period. He has performed work on establishing materiality of misstatements or omissions in disclosures surrounding the issuance of securities, estimating damages in issuer penalty cases, 10b-5 cases, insider trading, and commodity price manipulation. He has worked on matters involving the alleged false reporting of transactions to index providers in the natural gas industry, price manipulation in thinly traded cash markets with related futures markets, bidding misbehavior surrounding auctions of treasury debt, counterparty duties in over-the-counter derivatives transactions, alleged manipulation of propane and gasoline products, mutual fund late trading, valuation of swap contracts, calculation of margin amounts, dilution of mutual fund and hedge fund assets. He also assisted the U.S. Attorney's Office in developing evidence for criminal cases resulting from SEC referrals to the Justice Department, and he assisted the Division of Enforcement at both the SEC and CFTC in devising sanctions and evaluating settlement terms. He also has worked on evaluating fair-fund distribution plans. In private practice he has worked on matters involving alleged short-sale price manipulation, swap valuation, insider trading, futures block transactions, and market manipulation.

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Board and Advisory Positions

Board of Directors, Futures Industry Association (Public Director). (2016-2018).

Center for the Study of Financial Regulation, Mendoza College of Business, University of Notre Dame. (2011-present).

SEC Historical Society Advisory Board (2013-2016)

Congressional Testimony

"Implementing Dodd-Frank: A Review of the CFTC's Rulemaking Process," United States House of Representatives, Committee on Agriculture, Subcommittee on General Farm Commodities and Risk Management, April 13, 2011.

"The Costs of Implementing the Dodd-Frank Act: Budgetary and Economic," United States House of Representatives, Committee on Financial Services, Oversight and Investigations Subcommittee, March 30, 2011.

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PUBLICATIONS

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Financial Derivatives, Third Edition (With Robert Kolb), Wiley Publishers, New York: 2003.

B. Journal Articles and Book Chapters

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"The Exercise of Anti-Spoofing Authority in U.S. Futures Markets: Policy and Compliance Consequences," with Kwon Park, *Futures and Derivatives Law Report*, Volume 36, Issue 5, May, 2016.

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C. Other

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