Stephen M. Bainbridge (UCLA)
Jonathan Berk (Stanford)
Sanjai Bhagat (Colorado)
Bernard S. Black (Northwestern)
William J. Carney (Emory)
Lawrence A. Cunningham (GW)
David J. Denis (Pittsburgh)
Diane Denis (Pittsburgh)
Charles M. Elson (Delaware)
Jesse M. Fried (Harvard)
Sean J. Griffith (Fordham)

LAWRENCE A. CUNNINGHAM
CORRESPONDING AUTHOR
George Washington University
2000 H Street NW
Washington DC 20052
202-994-0732
lacunningham@law.gwu.edu

Jonathan M. Karpoff (Washington)
F. Scott Kieff (GW)
Edmund W. Kitch (Virginia)
Katherine Litvak (Northwestern)
Julia D. Mahoney (Virginia)
Paul G. Mahoney (Virginia)
Adam C. Pritchard (Michigan)
Dale A. Oesterle (Ohio State)
Roberta Romano (Yale)
Christina P. Skinner (Pennsylvania)
Todd J. Zywicki (George Mason)

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Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

File No. S7-10-22
Proposal on Climate-Related Disclosures for Investors

We appreciate the contributions of colleagues who have commented on the SEC's proposal for mandatory climate-related disclosure rules for public companies (the "Proposal"). In particular, we read with interest two letters analyzing whether the Proposal is within the SEC's rulemaking authority: one from a group of thirty law professors (the "Thirty Professors' Letter")[1] and another by Professor John Coates (the "Coates Letter").[2]

We are moved to offer additional thoughts because these two letters, compared to our prior letter,[3] reflect divergent understandings of the nature and factual background of the Proposal. Moreover, we believe those different understandings will likely play a role in any challenge to final rules that may be adopted pursuant to the Proposal. Illuminating those differences will therefore assist the SEC and ultimately the federal courts.

We agree with the Thirty Professors' Letter and the Coates Letter that the SEC has broad statutory authority to require disclosures for the protection of investors. We further agree that the relevant inquiry is whether a proposed disclosure requirement will protect investors, not whether it is material, although the two inquiries will generally overlap.[4] Finally, we agree that the relevance of a disclosure requirement to a social issue or to non-shareholder constituents does not demonstrate, in and of itself, that it exceeds the SEC's authority.

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[1] Letter to SEC from Thirty Law Professors (on letterhead of Jill E. Fisch & George S. Georgiev) (June 6, 2022).

[2] Letter to SEC from John Coates (June 2, 2022).

[3] Letter to SEC from Twenty-Two Law and Finance Professors (corresponding author Lawrence A. Cunningham) (April 25, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf.

[4] The SEC is required to consider whether a proposed rule "will promote efficiency, competition, and capital formation" in addition to, and not in substitution for, investor protection. Securities Act §2(b), Exchange Act §3(f).

Indeed, the two letters make a strong case that the SEC's 2010 guidance regarding climate change disclosures (the "2010 Guidance") was a valid exercise of the SEC's statutory authority.[5] The 2010 Guidance reminded issuers that several elements of the existing disclosure framework, including disclosure of the material effects of compliance with laws and regulations,[6] material pending legal proceedings,[7] and material risk factors,[8] may require disclosures relating to climate change.

An analysis of the SEC's authority to adopt the Proposal must grapple with the substantial differences between it and the 2010 Guidance. Here we find helpful a framework set out in the Coates Letter, which distinguishes disclosures about the impact of climate on a company with disclosures about the impact of a company on the climate.[9] This is a simple rubric for separating disclosures focused on investor protection from those focused on social goals.

The Proposal manifestly requires the second type of disclosure. A core element of the Proposal, one highlighted in the SEC's Fact Sheet accompanying the Proposal, is disclosure of greenhouse gas ("GHG") emissions.[10] This is a quintessential measure of a company's contribution to climate change. It is not a measure of the impact of climate change on the company.[11]

The extent of a company's GHG emissions would be directly relevant to the costs of a company's operations had Congress enacted a tax on such emissions. It has not. It would be relevant to a company's costs had Congress created a cap-and-trade system for such emissions. It has not. It would be relevant to a company's costs had Congress adopted binding nationwide GHG targets and an enforcement mechanism to achieve them. It has not. The GHG emissions disclosures, in the context of existing U.S. law, would require information about the company's impact on the environment, but not vice versa.[12]

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[5] SEC, Commission Guidance Regarding Disclosure Related to Climate Change (February 2010).

[6] Regulation S-K, Item 101(c)(2)(i).

[7] Id. Item 103.

[8] Id. Item 105

[9] Coates Letter at page 2 ("The focus of the [Proposal] is the impact *of climate change on companies, and not vice versa*") (emphasis in original).

[10] See Proposed Item 1504 of Regulation S-K, Proposal at pages 484-490.

[11] A version of this distinction undergirds the philosophy of the Financial Economists Roundtable, the "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." https://www.financialeconomistsroundtable.com/about. See Jonathan M. Karpoff et al., What ESG-Related Disclosures Should the SEC Mandate?, 78 Financial Analysts Journal 9 (2022), https://www.tandfonline.com/doi/full/10.1080/0015198X.2022.2044718.

[12] We recognize that other countries in which a registrant operates may have adopted more stringent climate-related regulations than the United States. We see nothing in the Proposal that limits the scope of the required disclosure to information regarding the registrant's compliance with the laws of the countries in which it does business and the associated costs. Such a limitation would bring the Proposal more closely into line with the SEC's usual approach to compliance-related disclosures.

We also note that the lack of a materiality qualification for some of the proposed disclosures is relevant to whether these disclosures serve the interests of investors as opposed to other stakeholders. While data about immaterial Scope 1 or Scope 2 emissions might be useful to non-shareholder constituencies, it is more difficult to see how it will be useful to investors.

Both the Thirty Professors' Letter and the Coates Letter also argue that concerns about SEC overreach are misplaced because the Proposal requires only disclosures. As the Coates Letter expresses this point, the Proposal will not cap emissions, impose a cap-and-trade system, or force any company to shut down GHG-emitting factories.[13] The Thirty Professors' Letter notes that the Proposal does not require "particular governance structures to oversee climate risk, . . . carbon goals, [or] . . . a climate transition plan."[14]

All true. Nevertheless, the clear purpose (and certain effect) of these disclosures is to give third parties information for use in their campaigns to reduce corporate emissions, regardless of the effect on investors. The SEC itself discusses the efforts of non-profit climate change advocacy organizations as part of the background for the Proposal.[15] Those organizations aim to prevent or alleviate climate change, not to protect investors.[16] They use disclosures about transition plans, scenario analyses, internal carbon prices, and climate-related targets and goals to identify companies that aren't doing enough, in their opinion, to combat climate change. They then pressure those companies to change their operations in ways not required by existing U.S. environmental laws while pressuring institutional investors to support such changes.

Imposing substantial costs on some companies to prepare for a "potential transition to a lower carbon economy"[17] that Congress has not and may never mandate will harm investors who prioritize financial returns over social goals. To be sure, the Proposal only facilitates, rather than requires, this result. As Commissioner Peirce's dissenting statement put it, the Proposal will put the SEC's weight behind "an array of non-investor stakeholders" demanding changes in company operations.[18] We believe, however, that the SEC and the courts can and should consider predictable consequences when deciding whether the Proposal will protect investors and whether it involves a "major question" that Congress should decide.

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13 Coates Letter at page 11.

14 Thirty Professors' Letter at page 3.

15 Proposal at pages 29-31.

16 Besides the EPA, the most-cited entity in the Proposal is the Carbon Disclosure Project (see Appendix A to our April 25 letter). Its website declares that the organization's purpose is "to act urgently to prevent dangerous climate change and environmental damage." https://www.cdp.net/en/info/about-us (last visited June 15, 2022). Some scholars, including a principal author of the Thirty Professors' Letter, have prescribed rules such as are contemplated by the Proposal precisely to influence corporate behavior. See Cynthia A. Williams, Fiduciary Duties and Corporate Climate Responsibility, 74 Vanderbilt Law Review 1875 at page 1912 (2021).

17 Proposed Rule 14-02(h) of Regulation S-X, Proposal at page 471.

18 Commissioner Hester M. Peirce, We are Not the Securities and Environment Commission—At Least Not Yet (March 21, 2022).

Only by ignoring the long and contentious history of debates over the appropriate policy response to climate change could one conclude that the Proposal is a mere "business as usual" tweak to the disclosure system.[19] We also note that investors are ill-served by rules whose costs exceed their benefits. If disclosure were free, the SEC could require disclosure of all possible risks, regardless of magnitude or probability. The SEC does not do so because it is too costly and difficult to assess all possible risks a company faces. Climate risk is especially hard to assess, creating a real danger that the Proposal's new disclosures will impose costs (including litigation costs) greater than their benefits to investors.

In sum, the Proposal is within the SEC's authority only if it will protect investors, as opposed to society, the environment, or other potentially worthy third parties. The SEC bases its affirmative conclusion largely on the advocacy of large institutional asset managers, government agencies, and non-governmental organizations seeking more climate-related information. Our April 25 letter found these arguments unpersuasive. While we agree with much of the analysis in the Thirty Professors' Letter and the Coates Letter about the SEC's authority in the abstract, we remain unpersuaded that the specific disclosures in the Proposal fit within the SEC's investor protection mandate.[20]

Additional Observations

Besides the foregoing principal areas of agreement and disagreement between our views and those set forth in the Thirty Professors' Letter and the Coates Letter, the following are additional topics on which we will agree to disagree. We believe this review will also be useful to the SEC in evaluating whether to proceed with the Proposal as drafted and to federal courts if it does so.

1. Individual Investor Demand. We do not read the Thirty Professors' Letter or the Coates Letter as taking issue with a central concern of our April 25 letter—that the publicly-expressed

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[19] See Coates Letter at page 1 (characterizing the Proposal as "not a 'transformative' surprising regulatory departure" that "would have modest effects on the economy"); Thirty Law Professors Letter at page 4 ("The Proposal's requirements are thus properly understood as core capital markets disclosure"). By contrast, a law firm analysis referred to the Proposal as "the most far-reaching company disclosure *and governance* mandate to be introduced in decades" (emphasis added). See Joseph A Hall, Margaret E. Tahyar & Ning Chiu, SEC Proposes Climate Disclosure Regime, Harvard Law School Forum on Corporate Governance (April 9, 2022), https://corpgov.law.harvard.edu/2022/04/09/sec-proposes-climate-disclosure-regime (Davis Polk & Wardwell LLP); see also Meredith Cross, et al., SEC Issues Groundbreaking Climate Disclosure Proposal (March 22, 2022) (client alert from WilmerHale: a "groundbreaking" proposal and the "most extensive, comprehensive and complicated disclosure initiative in decades").

[20] Our April 25 letter identified other shortcomings of the Proposal, including as to shareholder proposals, the supply of climate disclosure, the relation between climate practices and economic performance, the relevance of the EPA's statutory jurisdiction, the risk of encroachment on state corporate law prerogatives, the risk of violation of the First Amendment, the certain high costs versus highly speculative benefits, the impairment of investment industry competition and how compliance burdens discourage public company registrations. We continue to believe that these objections are important and provide additional reasons for the SEC to withdraw the Proposal. We also call attention to separate comment letters of two signatories to this letter and our April 25 letter: Professor Bainbridge's concerning differences between the SEC's 2010 Guidance and the Proposal (https://www.sec.gov/comments/s7-10-22/s71022-20130704-299569.pdf) and Professor Griffith's elaborating on the Proposal's vulnerability to First Amendment challenge (https://www.sec.gov/comments/s7-10-22/s71022-20130040-296591.pdf).

views of the executives of large asset managers and climate-focused organizations may not represent the best interests of retail investors, including individual direct owners, mutual fund investors, and beneficiaries of pension plans.[21] Because we draw a sharper distinction between institutional investor demand and investor protection, however, we believe the SEC should put more effort into determining whether retail investors would benefit from additional climate-related disclosures before proceeding further.

We criticized the Proposal for mentioning individual investors only once, in passing. The Coates Letter counters that the Proposal cites letters from some individual investors.[22] The Coates Letter also mentions a survey conducted by an institutional investor claiming that individuals prioritize climate information.[23] Finally, it argues that "critics have offered no robust evidence of their own showing that individual investors generally oppose disclosure about climate-related risks."[24]

The SEC, however, should both take account of the evidence that exists and fill in the gaps in the administrative record. It is well-known that institutional investors vote for environmental shareholder proposals at about twice the rate of individual investors.[25] Recent empirical research, moreover, indicates that less than 2% of mutual fund money is invested in ESG funds.[26]

There are also two relevant surveys of individual investors conducted by non-partisan institutions shortly before the Proposal was issued. The first is a survey of 1,228 retail investors conducted by NORC at the University of Chicago, an independent, non-partisan research institution, and the FINRA Investor Education Foundation. It found that individual investors prioritize return on investment and other financial factors in their investment decision-making more than any other factor.[27] Individual investors identified environmental aspects of a potential investment as the *least important consideration* compared to financial, governance, and social factors.[28] The second is a Gallup poll of 953 U.S. adult individual investors finding that most prioritized the expected rate of return and risk for potential losses over environmental and other issues.[29]

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[21] https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf.

[22] Coates Letter at page 15 (referring to the Proposal at page 18 and footnotes 154 and 412).

[23] Coates Letter at note 60.

[24] Coates Letter at note 58.

[25] See, e.g., PwC/Broadridge, Proxy Pulse: 2022 Proxy Season Preview 8 (Feb. 2022) ("institutional investors were more than twice as likely as retail investors to support environmental and social proposals. Only 18% of votes by retail shareholders were cast in favor of environmental and social proposals.").

[26] Jonathan Berk & Jules H. Van Binsbergen, The Impact of Impact Investing (June 10, 2022), available at https://papers.ssrn.com/abstract_id=3909166.

[27] FINRA Investor Education Foundation & NORC at the University of Chicago, Investors say they can change the world, if they only knew how: Six things to know about ESG and retail investors (March 2022).

[28] Id.

[29] See Gallup, Where U.S. Investors Stand on ESG Investing (February 23, 2022).

By contrast, Public Citizen, a consumer advocacy group, recently conducted its own poll, apparently in response to and in support of the Proposal, finding substantial individual investor demand for climate-related information.[30] Other commentators have criticized the methodology and phrasing of the questions as biased and failing to reflect the specific rules contemplated by the Proposal. In particular, the questions asked whether investors would want this information if it were *free*—ignoring the substantial costs the Proposal estimates will be incurred.[31]

It is simply a fact that large index fund managers have less to lose than their investors should the managers' environmentally motivated votes and engagement reduce the return on publicly traded equities as an asset class. There is also substantial evidence that these managers believe that cultivating an ESG-friendly image is privately beneficial. We therefore believe that it is essential that the SEC do more work to determine whether the specific disclosures called for in the Proposal would benefit retail investors. (We note in item 3 below that the SEC, and not commentators, bear the burden in this regard.)

2. Asset Pricing. We agree with the Thirty Professors' Letter and the Coates Letter on the importance of information to the market pricing of risk but disagree about the likelihood that the specific disclosures called for by the Proposal will contribute meaningfully to the market's ability to value companies. The Coates Letter cites studies showing that prices currently reflect climate risks only imperfectly.[32] The Thirty Professors' Letter asserts that "climate-related matters impact the most important aspect of any securities transaction—the price at which investors buy or sell."[33]

We are unaware of evidence that there are persistent climate-related pricing anomalies (profitable trading opportunities) under the current disclosure system that additional disclosure would eliminate. Indeed, given the enormous quantity of existing mandated and voluntary disclosure about climate risk, it would be surprising to discover significant mis-pricings that the new disclosures could correct.

Put another way, it is generally accepted that all material information is incorporated into stock prices, but that does not imply that all climate information affects stock prices. Only material climate information not already available to the market will affect stock prices. The fact that empirical research has not been able to find a relation should give the SEC pause, since a possible reason is that much climate information is not material.

3. Information. As to evidence of individual investor demand, asset pricing and other matters, we note that the SEC, not commentators or the public, bears the burden of demonstrating that a proposed rule promotes efficiency, competition, and capital formation as required by its

[30] Public Citizen, Survey Reveals Retail Investors Want SEC to Require Climate Disclosure (April 29, 2022); Public Citizen, Results of a Nationwide Survey: Retail Investors' Support for the SEC Mandating Climate-Related Financial Disclosures from Public Companies (April 28, 2022).

[31] We understand that the Society for Corporate Governance is submitting a comment letter on the Proposal with an appendix that details the shortcomings of the Public Citizen poll.

[32] Coates Letter at page 16.

[33] Thirty Professors' Letter at page 3.

organic statutes.[34] If a basis for the Proposal is that it will improve asset pricing, it is reasonable to expect the SEC to provide evidence to that effect. If the SEC has chosen to put forth meeting investor demand as a rationale for the Proposal, it is reasonable to expect it to have evidence indicating such demand emanating not only from an institutional subset of investors, but from the large base of individual investors. While we appreciate that generating requisite quantitative data can be difficult, evidence-based rulemaking remains both desirable and feasible.[35]

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Signatories[36]

Stephen M. Bainbridge
William D. Warren Distinguished Professor of Law
UCLA School of Law

Jonathan B. Berk
A.P. Giannini Professor of Finance
Stanford Graduate School of Business

Sanjai Bhagat
Provost Professor of Finance
University of Colorado

Bernard S. Black
Chabraja Professor
Northwestern University Pritzker School of Law & Kellogg School of Management

William J. Carney
Charles Howard Candler Professor Emeritus
Emory University School of Law

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[34] See e.g., Timpinaro v. SEC, 2 F.3d 453, 455 (D.C. Cir. 1993) (remanding for further cost-benefit analysis)*;* U.S. Chamber of Commerce v. SEC, 412 F.3d 133 (D.C. Cir. 2005) (same); U.S. Chamber of Commerce v. SEC, 443 F.3d 890, 893-94, 909 (D.C. Cir. 2006) (vacating rule on those grounds); American Equity Investment Life Insurance Co. v. SEC, 613 F.3d 166, 168 (D.C. Cir. 2010) (vacating a rule because the SEC "failed to properly consider the effect of the rule upon efficiency, competition, and capital formation"); Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011) (vacating a rule because, among other things, the SEC "inconsistently and opportunistically framed the costs and benefits of the rule. . . and failed to respond to substantial problems raised by commenters").

[35] See John C. Coates IV, Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications, 124 Yale Law Journal 882, at pages 892-893 (2015); see also Bruce Kraus & Connor Raso, Rational Boundaries for SEC Cost-Benefit Analysis, 30 Yale Journal on Regulation 289, at pages 298-99 (2013); Richard L. Revesz, Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation, 34 Yale Journal on Regulation 545, at pages 565-570 (2017).

[36] The expertise reflected in this letter combines finance and law. While the signatories concur with the letter's principal arguments and themes, each person is not necessarily attesting to every assertion in the letter and we limit our opinions to those within our respective areas of expertise. Institutional affiliations are supplied for identification and are not intended to suggest that we speak for our respective institutions.

Lawrence A. Cunningham [Corresponding Author]
Henry St. George Tucker III Research Professor
Founding Director, Quality Shareholders Initiative
The George Washington University Law School

David J. Denis
Roger Ahlbrandt Sr. Chair in Finance
University of Pittsburgh Katz School of Business

Diane Denis
Terrence Laughlin Chair in Finance Emeritus
University of Pittsburgh Katz School of Business

Charles M. Elson
Edgar S. Woolard Jr. Chair in Corporate Governance (ret.)
Founding Director, Weinberg Center on Corporate Governance
University of Delaware

Jesse M. Fried
Dane Professor of Law
Harvard Law School

Sean J. Griffith
T. J. Maloney Chair in Business Law
Director, Fordham Corporate Law Center
Fordham University School of Law

Jonathan M. Karpoff
Professor of Finance and Washington Mutual Endowed Chair in Innovation
University of Washington Foster School of Business

F. Scott Kieff
Fred C. Stevenson Research Professor
The George Washington University Law School
Former Commissioner, U.S. International Trade Commission

Edmund W. Kitch
Mary and Daniel Loughran Professor of Law
University of Virginia School of Law

Katherine Litvak
Professor of Law
Northwestern University Pritzker School of Law

Julia D. Mahoney
John S. Battle Professor of Law
University of Virginia School of Law.

Paul G. Mahoney
David and Mary Harrison Distinguished Professor
University of Virginia School of Law

Adam C. Pritchard
Frances & George Skestos Professor of Law
University of Michigan Law School

Dale A. Oesterle
J. Gilbert Reese Chair in Contract Law
The Ohio State University Moritz College of Law

Roberta Romano
Sterling Professor of Law
Director, Yale Law School Center for the Study of Corporate Law
Yale Law School

Christina P. Skinner
Assistant Professor of Legal Studies & Business Ethics
University of Pennsylvania Wharton School

Todd J. Zywicki
George Mason University Foundation Professor of Law
George Mason University Antonin Scalia Law School