June 13, 2021

The Honorable Gary Gensler
Chair
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Submitted via rule-comments@sec.gov

Re: Comments on Climate Disclosure

Dear Mr. Gensler:

I am pleased to provide these comments on Climate Change Disclosures.[1]

Summary of Key Points

1. Climate Change Disclosure Would Impede the Commission's Important Mission. The important mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Mandatory climate change disclosure would impede rather than further that mission. It would affirmatively harm investors, impede capital formation and do nothing to improve the efficiency of capital markets.

2. Immaterial Climate Change "Disclosure" Would Obfuscate Rather than Inform. The concept of materiality has been described as the cornerstone of the disclosure system established by the federal securities laws. Disclosure of *material* climate-related information is already required under ordinary securities law principles and Regulation S-K. Mandatory "disclosure" of immaterial, highly uncertain, highly disputable information would obfuscate rather than inform. It will harm rather than hurt investors.

3. Climate Models and Climate Science are Highly Uncertain. There is a massive amount of variance among various climate models and uncertainty regarding the future of the climate.

4. Economic Modeling of Climate Change Effects is Even More Uncertain. There is an even higher degree of variance and uncertainty associated with attempts to model or project the economic impact of highly divergent and uncertain climate models. Any estimate of the economic impact of climate change would have to rely on highly uncertain and divergent climate model results discussed below. In addition to this high degree of uncertainty would be added an entirely new family of economic ambiguity and uncertainty. Any economic estimate of the impact of climate change would also have to choose a discount rate to arrive at the present discounted value of future costs and benefits of climate change and to estimate the future costs and benefits of various regulatory or private responses. The choice

[1] Acting Chair Allison Herren Lee, "Public Input Welcomed on Climate Change Disclosures," March 15, 2021 https://www.sec.gov/news/public-statement/lee-climate-change-disclosures#.

of discount rate is controversial and important. Estimates would need to be made of the cost of various aspects of climate change (sea level rises, the impact on agriculture, etc.). Estimates would need to be made of the cost of various remediation techniques. Guesses would need to be made about the rate of technological change. Guesses would need to be made about the regulatory, tax and other responses of a myriad of governments. Estimates would need to be made using conventional economic techniques regarding the economic impact of those changes which, in turn, would reflect a wide variety of techniques and in many cases a thin or non-existent empirical literature. Guesses would need to be made of market responses to all of these changes since market participants will not stand idly by and do nothing as markets and the regulatory environment change.

Then, after making decisions regarding all of these extraordinarily complex, ambiguous and uncertain issues, issuers would then need to assess the likely impact of climate change on their specific business years into the future – a business that may by then bear little resemblance to the issuers' existing business. Then, the Commission would need to assess the veracity of the issuers' "disclosure" based on this speculative house of cards. The idea that all of this can be done in a way that will meaningfully improve investors' decision-making is not credible.

5. The Commission Does Not Possess the Expertise to Competently Assess Climate Models or the Economic Impact of Climate Change. The Commission has neither the expertise to assess climate models nor the expertise to assess economic models purporting to project the economic impact of divergent and uncertain climate projections.

6. The Commission Has Neither the Expertise nor the Administrative Ability to Assess the Veracity of Issuer Climate Change Disclosures. The Commission does not have the expertise or administrative ability to assess the veracity, or lack thereof, of issuer "disclosures" based on firm-specific speculation regarding the impact of climate change which would be based on firm-specific choices regarding highly divergent and uncertain economic models projecting the economic impact of climate changes based on firm-specific choices regarding highly divergent and uncertain climate models.

7. Commission Resources Are Better Spent Furthering Its Mission. Imposing these requirements and developing the expertise to police such climate disclosure by thousands of issuers will involve the expenditure of very substantial resources. These resources would be much better spent furthering the Commission's important mission.

8. The Costs Imposed on Issuers Would be Large. Requiring all public companies to develop climate modeling expertise, the ability to make macroeconomic projections based on these models and then make firm-specific economic assessments based on these climate and economic models will be expensive, imposing costs that will amount to billions of dollars on issuers. These expenses would harm investors by reducing shareholder returns.

9. Climate Change Disclosure Requirements Would Further Reduce the Attractiveness of Becoming a Public Company, Harming Ordinary Investors and Entrepreneurial Capital Formation. Such requirements would further reduce the attractiveness of being a registered,

public company. They would exacerbate the decline in the number of public companies and the trend of companies going public later in their life cycle. This, in turn, would deny to ordinary (unaccredited) investors the opportunity to invest in dynamic, high-growth, profitable companies until most of the money has already been made by affluent accredited investors. It would further impede entrepreneurial access to public capital markets.

10. <u>Climate Change Disclosure Requirements Would Create a New Compliance Eco-System and a New Lobby to Retain the Requirements</u>. The imposition of such requirements would result in the creation of a new compliance eco-system and pro-complexity lobby composed of the economists, accountants, attorneys and compliance officers that live off of the revised Regulation S-K.

11. <u>Climate Change Disclosure Requirements Would Result in Much Litigation</u>. The imposition of such requirements would result in much higher litigation risk and expense as private lawsuits are filed challenging the veracity of climate disclosures. These lawsuits are virtually assured since virtually no climate models have accurately predicated future climate and the economic and financial projections based on these climate models are even more uncertain. Litigation outcomes would be as uncertain as the underlying climate science, economics and the associated financial projections. This would harm investors and entrepreneurial capital formation.

12. <u>Material Actions by Management in Furtherance of Social and Political Objectives that Reduce Returns must be Disclosed</u>. Many environmentally constructive corporate actions will occur in the absence of any government mandate or required disclosure. For example, energy conservation measures may reduce costs as well as emissions. No new laws or regulations are necessary to induce firms to take these actions. Assuming they are not utterly pointless, climate change disclosure laws presumably would be designed to induce management to take action that they would not otherwise take. To the extent management takes material actions in furtherance of social and political objectives (including ESG objectives) that reduce shareholder returns, whether induced by climate change disclosure requirements or taken for other reasons, they need to disclose that information. The Commission should ensure that they do so. Absent some drastic change in the underlying law by Congress, this principle would apply to any reduction in returns whether induced by ESG disclosures (climate change related or otherwise) or taken by management on its own initiative to achieve social and political objectives.

13. <u>Fund Managers Attempts to Profit from SRI at the Expense of Investors Should be Policed</u>. Fund management firms are generally compensated from either sales commissions (often called loads) or investment management fees that are typically based on assets under management. Their compensation is not closely tied to performance. Thus, these firms will often see a financial advantage in selling “socially responsible” products that perform no better and often worse than conventional investments. It is doubtful that this is consistent with Regulation BI. Their newfound interest in socially responsible investing should be taken with the proverbial grain of salt. The Commission should monitor their efforts to profit from SRI at the expense of investors.

14. Duties of Fund Managers Should be Clarified. The extreme concentration in the proxy advisory and fund management business is cause for concern. As few as 20 firms may exercise effective control over most public companies. The Commission should make it clear that investment advisers managing investment funds, including retirement funds or accounts, have a duty to manage those funds and to vote the shares held by the funds in the financial, economic or pecuniary interest of the millions of small investors that invest in, or are beneficiaries of, those funds and that the funds may not be managed to further the managers' preferred political or social objectives.

15. Securities Laws are a Poor Mechanism to Address Externalities. Externalities, such as pollution, should be addressed by either enhancing property rights or, in the case of unowned resources such as the air and waterways, by a regulatory response that carefully assesses the costs and benefits of the regulatory response. Securities disclosure is the wrong place to try to address externalities. Policing externalities is far outside of the scope of Commission's mission and the purpose of the securities laws.

16. Climate Change Disclosure Requirements Would Have No Meaningful Impact on the Climate. When all is said and done, climate change disclosure requirements will have somewhere between a trivial impact and no impact on climate change.

17. Efforts to Redefine Materiality or the Broader Purpose of Business should be Opposed. Simply because some politically motivated investors seek to impose a disclosure requirement on issuers does not make such a requirement material. The effort to redefine materiality in the securities laws is part of an increasingly strident effort to redefine the purpose of businesses more generally to achieve various social or political objectives unrelated to earning a return, satisfying customers, or treating workers or suppliers fairly. This is being done under the banner of social justice; corporate social responsibility (CSR); stakeholder theory; environmental, social and governance (ESG) criteria; socially responsible investing (SRI); sustainability; diversity; business ethics; common-good capitalism; or corporate actual responsibility. The social costs of ESG and broader efforts to repurpose business firms will be considerable. Wages will decline or grow more slowly, firms will be less productive and less internationally competitive, investor returns will decline, innovation will slow, goods and services quality will decline and their prices will increase.

18. ESG Requirements will Make Management Even Less Accountable. In large, modern corporations there is a separation of ownership and control. There is a major agent-principal problem because management and the board of directors often, to varying degrees, pursue their own interest rather than the interests of shareholders. Profitability is, however, a fairly clear measure of the success or failure of management and the board. If a firm become unprofitable or lags considerably in profitability, the board may well replace management, shareholders may replace the board or another firm may attempt a takeover. Systematic implementation of regulatory ESG or CSR requirements will make management dramatically less accountable since such requirements will come at the expense of profitability and the metrics relating to success or failure of achieving ESG or

CSR requirements will be largely unquantifiable. For that matter, ESG or CSR requirements themselves tend to be amorphous and ever changing.

The Mission of the Securities and Exchange Commission

"The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[2] The statutory charge is "[w]henever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[3] These are important functions.

As discussed in detail below, incorporating climate change disclosure mandates beyond those already required under the traditional materiality standard does nothing to protect investors and, most likely, would harm investors by obfuscating material information in a blizzard of politically motivated immaterial information and by reducing returns. Furthermore, non-material climate change disclosures would impede other aspects of the tripartite SEC mission. It would harm capital formation by imposing a needless and substantial burden on small public companies and, to the extent that immaterial information based on speculation and guesses are included in disclosure documents, it may make markets less efficient. Finally, going down this path will require the Commission to expend very substantial resources to police such disclosures by thousands of issuers notwithstanding the fact that it would do nothing to further the Commission mission and would harm investors, capital formation and market efficiency. These resources would be much better spent furthering the Commission's important mission. To the extent the resources are drawn away from traditional securities enforcement functions, it would harm the Commission's mission.

Investor Protection

"Investor protection" is a central part of the SEC's tripartite mission. However, it is quite clear that many existing regulations, usually imposed in the name of investor protection, actually harm investors by increasing costs, and reducing investor returns and freedom.[4] They certainly go beyond those necessary to deter fraud and achieve reasonable, limited, scaled disclosure.

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[2] U.S. Securities and Exchange Commission, "What We Do: Introduction," http://www.sec.gov/about/whatwedo.shtml#intro.

[3] See §3(f) of the Securities Exchange Act of 1934 and §2(b) of the Securities Act of 1933.

[4] See, for example, David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www heritage.org/sites/default/files/2017-02/BG3182.pdf; *Prosperity Unleashed: Smarter Financial Regulation* (Washington, DC: Heritage Foundation, 2017), edited by Norbert J. Michel http://thf-reports.s3.amazonaws.com/2017/ProsperityUnleashed.pdf; *The Case Against Dodd–Frank: How the "Consumer Protection" Law Endangers Americans* (Washington, DC: Heritage Foundation 2016), edited by Norbert J. Michel http://thf-reports.s3.amazonaws.com/2016/The%20Case%20Against%20Dodd-Frank.pdf; *Reframing Financial Regulation: Enhancing Stability and Protecting Consumers* (Arlington, VA: Mercatus Center at George Mason University, 2016), edited By Hester Peirce And Benjamin Klutsey https://www.mercatus.org/system/files/peirce_reframing_web_v1.pdf; David R. Burton, "Securities Disclosure Reform," Heritage Foundation Backgrounder No. 3178, February 13, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3178.pdf.

A main problem is that the term "investor protection" is a very ambiguous term that can cover, at least, four basic ideas. The first is protecting investors from fraud or misrepresentation. This is a fundamental function of government. The second is providing investors with adequate information to make informed investment decisions. Although a legitimate function of the securities laws,[5] this requires policymakers to carefully balance the costs (which are typically underestimated by regulators and policymakers) and benefits (which are typically overestimated by regulators and policymakers) of mandatory disclosure.[6] Moreover, more disclosure is not always better because it enables issuers to obfuscate by drowning investors in barely relevant and immaterial information. The third is protecting investors from investments or business risks that regulators deem imprudent or ill-advised. This is commonplace is so-called "merit review" states but various federal policy initiatives have moved in this direction over the past decade. This is not an appropriate function of government and can be highly counter-productive. The fourth is protecting investor freedom of choice or investor liberty and, thereby, allowing investors to achieve higher returns and greater liquidity. This primarily requires regulators to exercise restraint, or eliminate existing regulatory barriers, both in the regulation of primary offerings by issuers and of secondary market sales by investors to other investors. In practice, this aspect of investor protection is almost entirely ignored by state and federal regulators.

Disclosure requirements have become so voluminous that they obfuscate rather than inform, making it more difficult for investors to find relevant information.[7] The average number of pages in annual reports devoted to footnotes and "Management's Discussion and Analysis" has quadrupled.[8] The number of words in corporate annual 10-Ks increased from 29,996 in 1997 to 41,911 in 2014.[9] This has undoubtedly become an even bigger problem over the past seven years.

Calls for even more disclosure relating to even more subjects will notably exacerbate the problem if implemented. Very few investors, whether professional or retail, are willing to wade through lengthy disclosure documents, often running hundreds of pages of dense legalese, available on the

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[5] For a full discussion, see David R. Burton, "Securities Disclosure Reform," Heritage Foundation Backgrounder No. 3178, February 13, 2017, https://www.heritage.org/sites/default/files/2017-02/BG3178.pdf.

[6] "Some Limits and Drawbacks of MD," section in Luca Enriques and Sergio Gilotta, "Disclosure and Financial Market Regulation," in *The Oxford Handbook on Financial Regulation*, edited by Eilís Ferran, Niamh Moloney, and Jennifer Payne (Oxford: Oxford University Press, 2015) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423768; Omri Ben- Shahar and Carl E. Schneider, "The Failure of Mandated Discourse," *University of Pennsylvania Law Review*, Vol. 159 (2011), pp. 647–749, http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2066&context=journal_articles.

[7] Troy A. Paredes, "Blinded by the Light: Information Overload and Its Consequences for Securities Regulation," *Washington University Law Quarterly*, Vol. 81 (2003), pp. 417–485, https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1287&context=law_lawreview and Troy A. Paredes, "Remarks at The SEC Speaks in 2013," U.S. Securities and Exchange Commission, February 22, 2013, http://www.sec.gov/News/Speech/Detail/Speech/1365171492408#.Ut2WJbROmM8. See also Keith F. Higgins, "Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting," U.S. Securities and Exchange Commission, April 11, 2014, http://www.sec.gov/News/Speech/Detail/Speech/1370541479332#.VItSmXt4zYg.

[8] Ernst & Young, "Now is the Time to Address Disclosure Overload," *To the Point*, No. 2012-18, June 21, 2012, https://www.lexissecuritiesmosaic.com/gateway/sec/speech/%24FILE_TothePoint_BB2367_DisclosureOverload_21June2012.pdf.

[9] Vipal Monga and Emily Chasan, "The 109,894-Word Annual Report: As Regulators Require More Disclosures, 10-Ks Reach Epic Lengths: How Much Is Too Much?" *The Wall Street Journal*, June 1, 2015 https://www.wsj.com/articles/BL-CFOB-8071.

SEC's EDGAR database[10] or multitudinous state blue sky filings in the forlorn hope that they will find something material to their investment decision that is not available elsewhere in shorter, more focused, more accessible materials. Many of these more accessible materials are, of course, synopses of both the mandated disclosure documents (usually Forms 10-K, 10-Q, or 8-K) and other voluntarily disclosed information, such as shareholder annual reports or materials provided to securities analysts by companies. But the fact that the vast majority of investors rely on these summary materials strongly implies that the legal requirements exceed what most investors find material to their investment decisions.

The Materiality Standard

The concept of materiality has been described as "the cornerstone" of the disclosure system established by the federal securities laws.[11] The Supreme Court has held that information or facts (or omitted information or facts) are material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision.[12] The Court has also indicated that information is material if there is a substantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available.[13]

There is no definition of material or materiality in the Securities Act or the Securities Exchange Act although the term "material" is used in both many times. The Commission has defined the term "material" in its regulations and changed its definition over years, often to conform to Supreme Court holdings. The current definition found in 17 CFR § 240.12b-2 is:

> Material. The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.

The Supreme Court and regulatory definitions are fine as far as they go but they are quite general and provide little practical guidance to issuers. There is a spirited debate about whether "principles-based" or more "prescriptive," bright-line rules should govern disclosure by issuers of material information.

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[10] U.S. Securities and Exchange Commission, "[Electronic Data Gathering, Analysis, and Retrieval] EDGAR, Search Tools," https://www.sec.gov/edgar/search-and-access#.
[11] SEC Concept Release on Business and Financial Disclosure Required by Regulation S-K, April 13, 2016 at p. 33 https://www.sec.gov/rules/concept/2016/33-10064.pdf; "Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission," Committee Print 95-29, House Committee on Interstate and Foreign Commerce, 95th Congress, 1st Session, November 3, 1977 http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1977_1103_AdvisoryDisclosure.pdf.
[12] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976); *Basic Inc. vs. Levinson*, 485 U.S. 224 (1988)
[13] *Matrixx Initiatives, Inc. v. Siracusano*, 131 U.S. 1309 (2011).

There is a major effort to effectively redefine what is material to include information that is really directed at achieving various social or political objectives.[14] The effort to redefine materiality usually takes the form of saying that investors are "demanding" information relating to environmental or social matters. A closer look, however, shows that ordinary investors are demanding no such thing. It is usually politically motivated actors such as government-run pension funds or a few increasingly "woke" proxy advisory firms or investment advisors that support such disclosures.

The effective duopoly[15] in the proxy advisory business, largely a regulatory creation, means that two advisory firms can change the votes of potentially as many as 38 percent of corporate shares of public companies in the United States.[16] This raises serious concerns, particularly when paired with the high degree of concentration in the fund advisory business. For example, the top ten mutual fund advisors control approximately two-thirds of all net assets under management.[17] Mutual funds, in turn, account for about 82 percent of assets managed by registered investment companies.[18] The top 15 mutual fund advisors have assets under management (all types, foreign

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[14] See, for example, Commissioner Allison Herren Lee, "Living in a Material World: Myths and Misconceptions about "Materiality," May 24, 2021 https://www.sec.gov/news/speech/lee-living-material-world-052421?utm_medium=email&utm_source=govdelivery#_ftnref37.

[15] Institutional Shareholder Services, Inc. (ISS) [located in Rockville, MD a suburb of Washington, DC] and Glass, Lewis & Co., LLC (Glass Lewis) [located in San Francisco, CA] control about 97 percent of the proxy advisory business (61 percent for ISS and 36 percent for Glass Lewis). Egan-Jones Proxy Service, Segal Marco Advisors and ProxyVote Plus are much smaller competitors. See James K. Glassman and J. W. Verret, "How To Fix Our Broken Proxy Advisory System," Mercatus Center, George Mason University, April 16, 2013 https://www.mercatus.org/system/files/Glassman_ProxyAdvisorySystem_04152013.pdf ("Between them, ISS and Glass Lewis clients control 25 percent to 50 percent of the typical mid-cap or large-cap company's shares, according to a study by a proxy solicitation firm." (p. 20) "The proxy advisory industry was principally created by regulation. Without regulatory mandates requiring active participation in proxy votes, and without interpretative releases giving preferential treatment to investment managers who use proxy advisors, a profitable proxy advisory industry might not exist." (p. 26)); James K. Glassman and Hester Peirce, "How Proxy Advisory Services Became So Powerful," Mercatus Center, George Mason University, Policy Brief, June 18, 2014 https://www.mercatus.org/system/files/Peirce-Proxy-Advisory-Services-MOP.pdf ("But regulation is the main impetus to vote proxies — and to rely on proxy advisory firms. In the absence of regulatory encouragement to use PAs, institutional investors might rationally choose not to vote, to vote consistently with management, or to vote only on key matters." (p. 1)); David F. Larcker, Brian Tayan and James R. Copland, "The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry," *Harvard Law School Forum on Corporate Governance*, June 14, 2018 https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/. See also "Corporate Shareholder Meetings: Issues Relating to Firms That Advise Institutional Investors on Proxy Voting," Government Accountability Office, June 2007 [GAO-07-765] https://www.gao.gov/assets/gao-07-765.pdf; "Corporate Shareholder Meetings Proxy Advisory Firms' Role in Voting and Corporate Governance Practices," Government Accountability Office, November 2016 [GAO-17-47] https://www.gao.gov/assets/gao-17-47.pdf.

[16] Yonca Ertimur, Fabrizio Ferri, and David Oesch, "Shareholder Votes and Proxy Advisors: Evidence from Say on Pay," p. 3, pp. 22-23 and Table 6 of the SSRN version, *Journal of Accounting Research*, Vol. 51, No. 5, December 2013, pp. 951-996 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019239; Testimony of Thomas Quaadman, "Legislative Proposals to Examine Corporate Governance," United States Senate Committee on Banking, Housing, and Urban Affairs, June 28, 2018 https://www.banking.senate.gov/imo/media/doc/Quaadman%20Testimony%206-28-18.pdf.

[17] See data available at "All Fund Companies," https://mutualfunddirectory.org/latest-directory-ranking-here/.

[18] "Facts at a Glance," *Investment Company Factbook*, 60th Edition, Investment Company Institute (2020), p. ii https://www.ici.org/system/files/attachments/pdf/2020_factbook.pdf.

and U.S.) roughly equal to the total U.S. stock market capitalization.[19] Some of these assets under management, of course, are invested abroad. It is not clear how much. Overall, institutional investors control about 71 percent of the shares held in the United States.[20] This concentration means that an extremely small group, perhaps as few as 20 proxy advisory firms and investment fund managers can exercise effective control over most public corporations in the United States.

Fund management firms are generally compensated from either sales commissions (often called loads) or investment management fees that are typically based on assets under management. Their compensation is not closely tied to performance. Thus, these firms will often see a financial advantage in selling "socially responsible" products that perform no better and often worse than conventional investments. It is doubtful that this is consistent with Regulation BI. In any event, they can both court political favor from progressive politicians and organizations and enhance profitability from moving customers into different funds. Their new-found interest in socially responsible investing should be taken with the proverbial grain of salt. Congress, the Commission and other regulatory agencies[21] need to be make it clear that investment advisers managing investment funds or those managing retirement funds or accounts have a duty to manage those funds and vote the shares held by the funds in the financial, economic or pecuniary interest of millions[22] of small investors and not in furtherance of managers' preferred political objectives.[23]

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[19] The top fifteen mutual fund managers (ranked by net assets under management) were BlackRock, Vanguard Group, Charles Scwab, Fidelity Investments, State Street Global Advisors, PIMCO/Allianz, J.P. Morgan, Capital Group, BNY Mellon (Dreyfus), Amundi Asset Management, Prudential Investments, T. Rowe Price, Legal & General Investments, Franklin Templeton, and BofA Merrill Lynch. These 15 firms had $50.6 trillion under management (invested in all securities worldwide). The total market capitalization of the U.S. stock market on March 31, 2021 was approximately $49 trillion. See "Total Market Capitalization of Public U.S. Companies (USD, Millions)," Siblis Research https://siblisresearch.com/data/us-stock-market-value/. The Wilshire 5000 appreciated 5.5 percent between March 31 and April 27, 2021 implying a total U.S. stock market capitalization as of April 27th of about $52 trillion.

[20] "ProxyPulse: 2020 Proxy Season Review," Broadridge Investor Communication Solutions and PricewaterhouseCoopers (2020), p. 4 https://www.broadridge.com/_assets/pdf/broadridge-proxypulse-2020-review.pdf.

[21] Most importantly, the Department of Labor, Employee Benefits Security Administration (regarding those retirement accounts and plans regulated under the Employee Retirement Income Security Act of 1974 (ERISA)).

[22] 15 percent of all families directly hold stock and 53 percent hold stock in some form (including retirement accounts and mutual funds). See *Survey of Consumer Finances*, 2019, Federal Reserve Board at https://www.federalreserve.gov/econres/scf/dataviz/scf/chart/#series:Directly_Held_Stocks;demographic:all;population:1;units:have and https://www.federalreserve.gov/econres/scf/dataviz/scf/chart/#series:Stock_Holdings;demographic:all;population:1;units:have.

[23] The Trump Administration took steps in this regard. See Financial Factors in Selecting Plan Investments," Final Rule, Employee Benefits Security Administration, Department of Labor, *Federal Register*, Vol. 85, No. 220, November 13, 2020 https://www.govinfo.gov/content/pkg/FR-2020-11-13/pdf/2020-24515.pdf; Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," Final Rule, Employee Benefits Security Administration, Department of Labor, *Federal Register*, Vol. 85, No. 242, December 16, 2020 https://www.govinfo.gov/content/pkg/FR-2020-12-16/pdf/2020-27465.pdf. The Biden administration appears to be poised to reverse these steps. "U.S. Department of Labor Statement Regarding Enforcement of its Final Rules On ESG Investments and Proxy Voting by Employee Benefit Plans," March 10, 2021 https://aboutblaw.com/WaM ("Until it publishes further guidance, the Department will not enforce either final rule or otherwise pursue enforcement actions against any plan fiduciary based on a failure to comply with those final rules with respect to an investment …").

Investors, of course, are free to invest in benefit corporations that explicitly have a dual purpose (both social or philanthropic and profit). Few do so. They may invest in funds that have a social as well as investment purpose. A small proportion do so. When afforded the opportunity to vote on shareholder resolutions that would instruct management to pursue social goals, very few do so.[24]

The focus of the materiality standard should remain on what investors need to know to meet their financial, economic or pecuniary objectives, not a regulator's preferred political or social objectives or those of politically motivated fund managers or proxy advisor. Congress should statutorily define materiality in terms generally consonant with Supreme Court holdings on the issue but should specifically exclude social and political objectives unrelated to investors' financial, economic or pecuniary objectives.[25] The Commission could either support such action or take similar action via rulemaking.[26]

Traditionally, the purpose of a business has been to earn a return for its owners by cost-effectively combining the capital and entrepreneurial spirit of its founders and owners with the labor and talent of its employees in a competitive environment to satisfy the wants and needs of its customers. The relationship between owners, management, workers, suppliers, and customers are (subject to certain broad constraints imposed by law) privately decided and voluntary.

The effort to redefine materiality in the securities laws is part of an increasingly strident effort to redefine the purpose of businesses more generally to achieve various social or political objectives unrelated to earning a return, satisfying customers, or treating workers or suppliers fairly. This is being done under the banner of social justice; corporate social responsibility (CSR); stakeholder theory; environmental, social and governance (ESG) criteria; socially responsible investing (SRI); sustainability; diversity; business ethics; common-good capitalism; or corporate actual responsibility.

If successful, these attempts to redefine the purpose of business would have marked adverse social consequences. To wit:

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[24] *Proxy Preview, 2020,* p. 66 https://www.proxypreview.org/2020/report-cover.

[25] In section 2 of the Securities Act Congress could define "material" as follows:

> "(20) The term "material" means, when used to qualify a requirement for the furnishing of information as to any subject, information limited to those matters regarding which there is a substantial likelihood that a reasonable investor would attach importance when –
>
> (i) evaluating the potential financial return and financial risks of an existing or prospective investment, or
>
> (ii) exercising, or declining to exercise, any rights appurtenant to securities.
>
> The term "material" does not include, when used to qualify a requirement for the furnishing of information as to any subject, information that –
>
> (i) primarily furthers non-pecuniary, non-economic or non-financial social or political goals or objectives, or
>
> (ii) primarily relates to events that –
>
> (A) involve a high degree of uncertainty regarding what may or may not occur in the distant future, and
>
> (B) are systemic, general or not issuer specific in nature.

[26] The Commission could, of course, revise 17 CFR § 240.12b-2.

- Management would be even less accountable to anyone since the metrics of success will become highly amorphous and constantly changing.
- Businesses would become less productive and less competitive. Jobs would be lost, and wages would grow more slowly.
- The return to investors can be expected to decline.
- By creating large inefficiencies in the economy and allocating resources politically, the social welfare cost of going down this road would be considerable.[27]

ESG-Related Reduced Returns Should Be Explicitly Disclosed

Many environmentally constructive corporate actions will occur in the absence of any government mandate or required disclosure. For example, energy conservation measures may reduce costs as well as emissions. No new laws are necessary to induce firms to take these actions. Assuming they are not utterly pointless, ESG disclosure laws would presumably be designed to induce management to take action that they would not otherwise take.

To the extent management takes material actions in furtherance of social and political objectives (including ESG objectives) that reduce shareholder returns, however, they need to disclose that information. The Commission should ensure that they do so. Absent some drastic change in the underlying law by Congress, this principle would apply to a reduction in returns induced by ESG disclosures or taken by management on its own initiative to achieve social and political objectives.

Securities Laws are a Poor Mechanism to Address Externalities

The economic justification for climate change disclosure mandates is that they are designed to address a negative externality. An externality is (1) a cost that is imposed on (negative externality) or (2) a benefit accorded to (positive externality) someone that is not a party to a transaction or not engaged in an action. There are countless positive and negative externalities all around us. Air pollution is a typical example of a negative externality.

There are many ways to address negative externalities. Improved property rights,[28] tort law,[29] regulation,[30] or a tax equal to the cost involuntarily imposed by the economic actor creating the externality on those "external" to the transaction.[31] A tax subsidy for politically favored interests with strong lobbies would be fairly far down the list of efficacious means of addressing the problem

[27] The broader social costs associated with ESG requirements can, in principle, be quantified. See the section heading "The Social Welfare Cost of ESG Requirements" below. See also section heading "Why Markets "Work" in David R. Burton, "Comparing Free Enterprise and Socialism," Special Report No. 213, April 30, 2019 https://www.heritage.org/sites/default/files/2019-05/SR213.pdf.

[28] In the case of air and water that are usually unowned resources, this is problematic. In other cases, this can be the solution, although transactions costs can impede a private solution. See Ronald H.Coase, "The Problem of Social Cost," *Journal of Law and Economics*, Vol. 3, October, 1960, pp. 1–44.

[29] The common law of nuisance and various more modern environmental torts.

[30] Most notably by the Environmental Protection Agency and state analogs.

[31] This is commonly known as a Pigouvian tax. See Arthur Cecil Pigou, *The Economics of Welfare* (1920 and various later editions); "Pigouvian Taxes," *The Economist*, August 19, 2017 https://www.economist.com/news/economics-brief/21726709-what-do-when-interests-individuals-and-society-do-not-coincide-fourth.

of negative externalities but there are many provisions in the Internal Revenue Code with this purpose. To achieve the desired effect, the policy designed to address the externality must be calibrated to accurately internalize the actual cost of the externality. This requires estimating the costs imposed by the externality and imposing costs in an equal and off-setting amount on the economic actor in question. Detailed scientific, cost and market information must be obtained to get this even close to right.

Trying to achieve this result through mandated disclosures by issuers is comparable to trying to score in basketball by bouncing the ball off the floor and then the backboard. It is theoretically possible, but there is a vanishingly small chance that it will achieve the desired result. And any team that tried that on a regular basis would lose. Similarly, securities laws are not the place to do environmental regulation.

It is clear that mandated climate change disclosure will have significant costs and adverse effects. Proponents of such disclosure should be required to explain how, exactly, it will have a meaningful positive impact AND why securities regulation is a more efficacious means of addressing the problem than traditional means of addressing environmental problems, some of which have been highly successful. I suggest that they will not be able to do so.

ESG Disclosure Would Lead to Less Management Accountability

In large, modern corporations there is a separation of ownership and control. There is a major agent-principal problem because management and the board of directors often, to varying degrees, pursue their own interest rather than the interests of shareholders. Profitability is, however, a fairly clear measure of the success or failure of management and the board. If a firm become unprofitable or lags considerably in profitability, the board may well replace management, shareholders may replace the board or another firm may attempt a takeover.

Systematic implementation of regulatory ESG or CSR requirements will make management dramatically less accountable since they will come at the expense of profitability but the metrics relating to success or failure of achieving ESG or CSR requirements will be largely unquantifiable. For that matter, ESG or CSR requirements themselves tend to be amorphous and ever changing.

Private Compliance Costs

Requiring all public companies to develop climate modeling expertise, the ability to make macroeconomic projections based on these models and then to make firm-specific economic assessments based on these climate and economic models will be expensive. As discussed in the next section, they will probably resort to hiring outside consultants. As discussed below, there is tremendous uncertainty regarding climate models and economic models projecting of the impact of climate change. There is still further uncertainty regarding issuer specific effects. The issues to be addressed are numerous and complex and have no facile answers. The climate change components of Form 10-Ks, Form 10-Qs, Form 8-Ks and other disclosure documents (including annual reports) are likely to be both voluminous and virtually useless. There is little doubt that these costs will amount to billions of dollars. The expenses associated with generating this verbiage will harm investors by reducing shareholder returns. As discussed below, litigation risk and costs would increase considerably as well.

The Creation of a New Compliance Eco-System and Pro-Complexity Lobby

The imposition of such requirements will result in the creation of a new compliance eco-system and pro-complexity lobby composed of the economists, accountants, attorneys and compliance officers that live off of the revised Regulation S-K. They will fight to preserve their multi-billion dollar business.

Litigation Risk

The imposition of such requirements will result in much higher litigation risk and expense as private lawsuits are filed challenging the veracity of climate disclosures. These lawsuits are virtually assured since virtually no climate models have accurately predicated future climate and the economic and financial projections based on these climate models are even more uncertain. Litigation outcomes will be as uncertain as the underlying climate science, economics and the associated financial projections. As discussed below, it will make becoming a public company even less attractive. This will harm investors and entrepreneurial capital formation.

Commission Expertise and Administrative Issues

The Commission does not have the expertise or administrative ability to assess the veracity, or lack thereof, of issuer "disclosures" based on firm-specific speculation regarding the impact of climate change which will be based on firm-specific choices regarding highly divergent and uncertain economic models projecting the economic impact of climate changes based on firm-specific choices regarding highly divergent and uncertain climate models. See the discussion below under the headings "The Ambiguity of Climate Science" and "The Ambiguity of the Economics of Climate Change" for a more detailed discussion of the many issues that the Commission would be required to address.

Imposing these requirements and developing the expertise to police such climate disclosure by thousands of issuers will involve the expenditure of very substantial resources. The Division of Corporate Finance currently has about 400 employees.[32] Assuming, based on World Bank data, that there are about 4,400 domestic public companies listed in the U.S. (about half of the number in 1995).[33] Assuming (heroically) that a CorpFin employee could competently evaluate the climate modeling choices, economic modeling choices and issuer specific determinations of one issuer per week, they would still mean that CorpFin would need an additional 85 employees – a more than 20 percent increase. And that assumes that all foreign issuers listing on the NYSE, Nasdaq or OTC Markets would be exempt from the requirements. If foreign issuers are subject to the same

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[32] Fiscal Year 2022 Congressional Budget Justification and Annual Performance Plan, SEC, p. 14 https://www.sec.gov/files/FY%202022%20Congressional%20Budget%20Justification%20Annual%20Performance%20Plan_FINAL.pdf#page=17.
[33] Listed Domestic Companies https://api.worldbank.org/v2/en/indicator/CM.MKT.LDOM.NO?downloadformat=excel.

requirements as U.S. issuers (which they should be), then CorpFin may have to increase its budget by 50 percent. Similar, large increases in the enforcement staff would be required.

These resources would be much better spent furthering the Commission's important mission.

Entrepreneurship and Small Public Companies

Such requirements will further reduce the attractiveness of being a registered, public company and will exacerbate the decline in the number of public companies and the trend of companies going public later in their life cycle. This, in turn, will deny to ordinary (unaccredited) investors the opportunity to invest in dynamic, high-growth, profitable companies until most of the money has already been made by affluent accredited investors.[34] It will further impede entrepreneurial access to public capital markets.

The Ambiguity of Climate Science

I am no climate science expert. Nor, I suspect, is anyone at the Commission since climate science is way outside of the Commission's lane. I do know a thing or two about modeling in an economics context. Models are typically highly dependent on a few relationships specified in their equations and parameters. A small number of assumptions about relationships and parameters drive results. For example, a model examining the impact of proposed tax policy might adopt a neoclassical view where the impact of the proposed tax changes on the user cost of capital and labor response are central (as specified in the equations) and the empirical parameters (as specified in the elasticities) governing investment and labor are key.[35] Seemingly small adjustments to elasticities (even though within the bounds established in the empirical literature) result is significantly different results. A Keynesian "macroeconomic" approach focusing on aggregate demand would yield dramatically different results, operate on different principles and lead to different policy recommendations. And so on.

Climate modeling is, in principle, no different. A small number of equations and empirical parameters drive results. Even the conventional governmental source -- the Intergovernmental Panel on Climate Change – shows massive variations in projections and shows the wide divergence in the ability of models to account for past warming[36] and the degree of warming that

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[34] David R. Burton, "Reducing the Burden on Small Public Companies Would Promote Innovation, Job Creation, and Economic Growth," Heritage Foundation Backgrounder No. 2924, June 20, 2014 https://thf_media.s3.amazonaws.com/2014/pdf/BG2924.pdf; David R. Burton, "Broadening Regulation D: Congress Should Let More People Invest in Private, High-Growth Companies," Heritage Foundation Backgrounder No. 3137. August 15, 2016 http://thf-reports.s3.amazonaws.com/2016/BG3137.pdf; David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3182.pdf.

[35] Parker Sheppard and David Burton, "How the GOP Tax Bill Will Affect the Economy," *Daily Signal*, November 17, 2017 https://www.dailysignal.com/2017/11/17/gop-tax-bill-will-affect-economy/. In this case, we used the Hall-Jorgenson user cost of capital equation, the Cobb-Douglas production function and conventional price theoretic labor market modeling.

[36] See, for instance, Byron A. Steinman, Michael E. Mann and Sonya K. Miller, "Atlantic and Pacific Multidecadal Oscillations and Northern Hemisphere Temperatures," *Science*, February 27, 2015, Vol. 347, Issue 6225, pp 988-991, https://science.sciencemag.org/content/347/6225/988#aff-1 and Joseph Majkut, "Climbing the Staircase of

is anthropogenic.[37] The worst-case concentration pathway, for example, assumes unlikely projections of coal use, high population growth, low economic growth and technological progress.[38] Using the worst-case scenario of these emissions concentration pathways as the business-as-usual scenario will mislead the private sector, policymakers, and regulators on the estimated climate impacts and costs.[39]

Once you broaden your reading to include those that do not have a financial or political interest in climate change alarmism, it becomes clear that the variance and uncertainty in climate modeling is even higher than the IPCC report indicates.[40] It is clear that various models yield dramatically different results. Explaining the details is beyond the scope of this letter and my current competence. It is also beyond the ability of DERA and others at the SEC.

The Ambiguity of the Economics of Climate Change

Any estimate of the economic impact of climate change will have to rely on the highly uncertain and divergent climate model results discussed above. In addition to this high degree of uncertainty will be added an entirely new family of economic ambiguity and uncertainty. Any economic estimate of the impact of climate change will also have to choose a discount rate to arrive at the present discounted value of future costs and benefits[41] of climate change and to estimate the future costs and benefits of various regulatory or private initiatives. The choice of discount rate is controversial and important. Estimates will need to be made of the cost of various aspects of climate change (sea level rises, the impact on agriculture, etc). Estimates will need to be made of

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Global Warming," Niskanen Center, July 27, 2016, https://www.niskanencenter.org/climbing-staircase-global-warming/ .

[37] *Climate Change 2014 Synthesis Report*, Intergovernmental Panel on Climate Change https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf See, for example, "The Representative Concentration Pathways," (p. 57); "Box 2.3, Models and Methods for Estimating Climate Change Risks, Vulnerability and Impacts," (pp. 58-59); "Table 2.1, Projected Change in Global Mean Surface Temperature and Global Mean Sea Level Rise for the Mid- and Late 21st Century, Relative to the 1986–2005 Period," (p. 60); "Cumulative Total Anthropogenic CO2 Emissions from 1870 (GtCO2)," (p. 63); "Table 2.2, "Cumulative Carbon Dioxide (CO2) Emission Consistent with Limiting Warming to Less than Stated Temperature Limits at Different Levels of Probability, Based on Different Lines of Evidence," (p. 64). The updated sixth version of the Synthesis Report is due for release in 2022.

[38] Justin Ritchie and Hadi Dowlatabadi, "Why Do Climate Change Scenarios Return to Coal?" *Energy*, December 2017, Vol. 140, Part 1, pp 1276-1291, https://www.sciencedirect.com/science/article/abs/pii/S0360544217314597.

[39] Pielke, Roger and Ritchie, Justin, "Systemic Misuse of Scenarios in Climate Research and Assessment," April 21, 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3581777.

[40] Steven E. Koonin, *Unsettled: What Climate Science Tells Us, What It Doesn't, and Why It Matters*, Chapter 4, "Many Muddled Models," (Dallas, TX: BenBella Books, 2021); Bjorn Lomborg, *False Alarm: How Climate Change Panic Costs Us Trillions, Hurts the Poor, and Fails to Fix the Planet*, (New York: Basic Books, 2020); Pat Michaels and Chip Knappenberger, *Lukewarming: The New Climate Science that Changes Everything*, (Washington: Cato Institute, 2016); Benjamin Zycher, Resident Scholar, American Enterprise Institute, Statement before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Hearing on the "21st Century Economy: Protecting the Financial System from Risks Associated with Climate Change" March 18, 2021 https://www.banking.senate.gov/imo/media/doc/Zycher%20Testimony%203-18-21.pdf; Kevin Dayaratna, Ross McKitrick and David Kreutzer, "Empirically Constrained Climate Sensitivity and the Social Cost of Carbon," *Climate Change Economics*, Vol. 8, No. 2, 2017, pp. 1-12 https://econpapers.repec.org/article/wsiccexxx/v_3a08_3ay_3a2017_3ai_3a02_3an_3as2010007817500063.htm.

[41] There are some benefits. For example, large portions of Northern areas such as Canada, Russia and Scandinavia would presumably become suitable for agriculture.

the cost of various remediation techniques. Guesses will need to be made about the rate of technological change. Guesses will need to be made about the regulatory, tax and other responses of a myriad of governments. Estimates will need to be made using conventional economic techniques regarding the economic impact of those changes which, in turn, will reflect a wide variety of techniques and in many cases a thin or non-existent empirical literature. Guesses will need to be made of market responses to all of these changes since market participants will not stand idly by and do nothing as markets and the regulatory environment change.

Then, after making decisions regarding all of these extraordinarily complex, ambiguous and uncertain issues, issuers will then need to assess, on some undetermined basis, the likely impact of climate change on their specific business years into the future – a business that may by then bear little resemblance to the issuer's existing business. Then, the Commission will need to assess the veracity of the issuer's "disclosure" based on this speculative house of cards. The idea that all of this can be done in a way that will meaningfully improve investors' decision-making over what is currently available to them is not credible. People, including investors, are going to disagree about the future because the future is highly uncertain. To deny this evident fact is folly.

It is important to note at this point that every securities transaction reflects a disagreement about the future. The buyer of a security believes that the security in question represents the best addition to the investor's portfolio possible out of all of the other vast number of options available. Otherwise, they would not buy the security but would buy something else. The seller disagrees. The seller wants to deploy his capital elsewhere.[42] This is unavoidable. The objective of the Commission should be to improve the information available to investors so that markets become more efficient and allocate capital better. Building a house of cards built on one guess, estimate or speculation after another after another ad infinitum is not going to improve our capital markets.

The Social Costs of ESG

The broader social costs associated with ESG requirements can, in principle, be quantified. This section provides an analytical framework that may be useful in analyzing the social welfare costs of ESG requirements.

To the extent ESG objectives are not pursued by businesses for the purpose of making a profit, $R > R_{ESG/CSR}$, where R is the rate of return on investment in the absence of ESG, CSR, sustainability requirements, diversity requirements, or stakeholder theory implementation, and $R_{ESG/CSR}$ is the rate of return after implementation of those requirements. The difference, $R - R_{ESG/CSR}$, is economically analogous to a tax. It is a reduction in return due to the pursuit of ESG objectives. Thus, $R - R_{ESG/CSR} = Tax_{ESG/CSR}$. This means that various techniques used in public finance to analyze the social welfare impact of taxes may be used to quantitatively analyze the social welfare cost of these provisions (i.e., $Tax_{ESG/CSR}$).

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[42] Obviously, in limited circumstances the seller will be liquidating the securities for consumption purposes rather than reinvestment.

A tax has an excess burden or deadweight loss that can be calculated.[43] By introducing a wedge ($Tax_{ESG/CSR}$) between, in this case, the gross return and the net return, ESG/CSR reduces the size of the capital market and therefore output and employment. In a well-functioning market, the price of a capital asset should be equal to the present value of the expected future income stream generated by the asset net of taxes and depreciation.[44] Introducing a new tax (in this case $Tax_{ESG/CSR}$) would reduce the expected future income stream, and therefore, the price of the asset. It would also cause investment to flow out of the affected sector or jurisdiction.

Who bears the actual economic burden of the corporate income tax is an open question.[45] The analysis of who bears the burden of $Tax_{ESG/CSR}$ would be the same. One thing is certain: It cannot be corporations. A corporation is a legal fiction, and legal fictions do not pay taxes—people pay taxes. The corporate tax could be borne by corporate shareholders in the form of lower returns;[46] owners of all capital (again in the form of lower returns);[47] corporate customers in the form of higher prices;[48] or employees (in the form of lower wages).[49] It is, almost certainly, some

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[43]Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy* (June 1962), pp. 215–240; Alan J. Auerbach and James R. Hines, "Taxation and Economic Efficiency," in Martin Feldstein and A. J. Auerbach, eds., *Handbook of Public Economics* (Amsterdam: North Holland, 2002); and John Creedy, "The Excess Burden of Taxation and Why It (Approximately) Quadruples When the Tax Rate Doubles," New Zealand Treasury *Working Paper* No. 03/29, December 2003, https://treasury.govt nz/sites/default/files/2007-10/twp03-29.pdf. See also, for example, N. Gregory Mankiw, *Principles of Economics*, 4th ed. (Boston: Cengage Learning, 2006), chapter 8 (or many other textbooks on price theory, microeconomics, or principles of economics).

[44]See Robert E. Hall and Dale Jorgenson, "Tax Policy and Investment Behavior," *American Economic Review*, Vol. 57, No. 3 (June 1967), pp. 391–414. This section covers the basic user cost of capital analysis with taxes. See also Dale W. Jorgenson, *Investment: Capital Theory and Investment Behavior* (Cambridge, MA: MIT Press, 1996), and John Creedy and Norman Gemmell, "Taxation and the User Cost of Capital: An Introduction," New Zealand Treasury *Working Paper* No. 04/2015, March 2015, https://www.wgtn.ac nz/cpf/publications/pdfs/2015-pubs/WP04_2015_Taxation-and-User-Cost.pdf.

[45]In the economics literature, this question is usually phrased as, "What is the incidence of the corporate income tax?"

[46]Government estimators are among the few who cling to the view that shareholders bear most of the burden. Joint Committee on Taxation, "Modeling the Distribution of Taxes on Business Income," JCX–14–13, October 16, 2013, https://www.jct.gov/publications.html?func=download&id=4528&chk=4528&no_html=1 (25 percent labor), and Julie Anne Cronin et al., "Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology," *National Tax Journal*, March 2013, https://www.ntanet.org/NTJ/66/1/ntj-v66n01p239-62-distributing-corporate-income-tax.pdf (18 percent labor).

[47]The non-corporate sector can be affected because competition will eventually cause wages, prices, and after-tax returns in the corporate *and* non-corporate sectors to be the same. For a more detailed explanation, see Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, Vol. 70, No. 3 (June 1962), pp. 215–240.

[48]The focus of the economics profession to date has been almost exclusively the impact on capital and labor rather than customers.

[49]Arnold C. Harberger, "The ABCs of Corporation Tax Incidence: Insights into the Open-Economy Case," in *Tax Policy and Economic Growth* (Washington, DC: American Council for Capital Formation, 1995); Arnold C. Harberger, "The Incidence of the Corporation Income Tax Revisited," *National Tax Journal*, Vol. 61, No. 2 (June 2008), pp. 303–312, http://www ntanet.org/NTJ/61/2/ntj-v61n02p303-12-incidence-corporation-income-tax.pdf; Matthew H. Jensen and Aparna Mathur, "Corporate Tax Burden on Labor: Theory and Empirical Evidence," *Tax Notes*, June 6, 2011, https://www.aei.org/wp-content/uploads/2011/06/Tax-Notes-Mathur-Jensen-June-2011.pdf; Kevin A. Hassett and Aparna Mathur, "A Spatial Model of Corporate Tax Incidence," American Enterprise Institute, December 1, 2010, https://www.aei.org/wp-content/uploads/2011/10/-a-spatial-model-of-corporate-tax-incidence_105326418078.pdf; Robert Carroll, "The Corporate Income Tax and Workers' Wages: New Evidence from the 50 States," Tax Foundation *Special Report* No. 169, August 3, 2009, https://taxfoundation.org/corporate-income-tax-and-workers-wages-new-evidence-50-states/; Desai Mihir, Fritz Foley, and James Hines, "Labor and

combination of these.[50] The economics profession has changed its thinking on this issue several times over the past four decades, but the latest —and highly plausible —consensus is that workers probably bear *more than half* of the burden of the corporate income tax because capital is highly mobile.[51] Labor's share of the corporate tax burden is potentially as high as three-quarters.[52] Shareholders (investors) probably bear most of the remainder.[53] Initially (i.e., in the short run), the impact on shareholder returns would be greater. Adjustments take time. In the long run, ESG requirements ($Tax_{ESG/CSR}$) would have a disproportionately negative impact on labor due to capital factor mobility.

Responses to Specific Questions for Consideration

Request for Input 1. How can the Commission best regulate, monitor, review, and guide climate change disclosures in order to provide more consistent, comparable, and reliable information for investors while also providing greater clarity to registrants as to what is expected of them? Where and how should such disclosures be provided? Should any such disclosures be included in annual reports, other periodic filings, or otherwise be furnished?

Response 1. The focus of Regulation S-K and disclosure requirements should be to require disclosures that are material to investment decisions. The materiality standard should remain focused on what investors need to know to meet their financial, economic or pecuniary objectives, not a regulator's preferred political or social objectives or those of politically motivated fund managers or proxy advisor. Congress should statutorily define materiality in terms generally consonant with Supreme Court holdings on the issue but should specifically exclude social and political objectives unrelated to investors' financial, economic or pecuniary

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Capital Shares of the Corporate Tax Burden: International Evidence," December 2007, http://piketty.pse.ens.fr/files/Desaietal2007.pdf; and "Why Do Workers Bear a Significant Share of the Corporate Income Tax?" in Jason J. Fichtner and Jacob M. Feldman, "The Hidden Cost of Federal Tax Policy," 2015, https://www.mercatus.org/system/files/Fichtner-Hidden-Cost-ch4-web.pdf. For a contrary view, see Kimberly A. Clausing, "In Search of Corporate Tax Incidence," *Tax Law Review*, Vol. 65, No. 3 (2012), pp. 433–472, http://ssrn.com/abstract=1974217.

[50]It requires extreme, implausible assumptions about elasticities of demand for, or supply of, factors for this not to be the case. Alan J. Auerbach, "Who Bears the Corporate Tax? A Review of What We Know," National Bureau of Economic Research *Working Paper* No. 11686, October 2005, http://www nber.org/papers/w11686.pdf; William M. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax," Department of the Treasury, Office of Tax Analysis, *OTA Paper* No. 101, December 2007, https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-101.pdf; and Stephen J. Entin, "Tax Incidence, Tax Burden, and Tax Shifting: Who Really Pays The Tax?" Heritage Foundation *Center for Data Analysis Report* No. 04–12, November 5, 2004, http://s3.amazonaws.com/thf_media/2004/pdf/cda04-12.pdf.

[51]In a competitive market, capital will flow from jurisdictions with a relatively low expected after-tax return to jurisdictions with a relatively high expected after-tax return until the expected after-tax returns are equal. Social and legal barriers reduce labor mobility relative to capital mobility. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax"; William C. Randolph, "International Burdens of the Corporate Income Tax," Congressional Budget Office *Working Paper* 2006–09, August 2006, https://cbo.gov/sites/default/files/cbofiles/ftpdocs/75xx/doc7503/2006-09.pdf; and R. Alison Felix, "Passing the Burden: Corporate Tax Incidence in Open Economies," Federal Reserve Bank of Kansas City, October 2007, https://www.kansascityfed.org/Publicat/RegionalRWP/RRWP07-01.pdf.

[52]Ibid.

[53]As opposed to non-corporate capital and customers.

objectives.[54] The Commission could either support such action or take similar action via rulemaking.[55]

Many environmentally constructive corporate actions will occur in the absence of any government mandate or required disclosure. For example, energy conservation measures may reduce costs as well as emissions. No new laws are necessary to induce firms to take these actions. Assuming they are not utterly pointless, ESG disclosure laws would presumably be designed to induce management to take action that they would not otherwise take.

To the extent management takes material actions in furtherance of social and political objectives (including ESG objectives) that reduce shareholder returns, however, they need to disclose that information. The Commission should ensure that they do so. Absent some drastic change in the underlying law by Congress, this principle would apply to a reduction in returns induced by ESG disclosures or taken by management on its own initiative to achieve social and political objectives.

Request for Input 2. What information related to climate risks can be quantified and measured? How are markets currently using quantified information? Are there specific metrics on which all registrants should report (such as, for example, scopes 1, 2, and 3 greenhouse gas emissions, and greenhouse gas reduction goals)? What quantified and measured information or metrics should be disclosed because it may be material to an investment or voting decision? Should disclosures be tiered or scaled based on the size and/or type of registrant)? If so, how? Should disclosures be phased in over time? If so, how? How are markets evaluating and pricing externalities of contributions to climate change? Do climate change related impacts affect the cost of capital, and if so, how and in what ways? How have registrants or investors analyzed risks and costs associated with climate change? What are registrants doing internally to evaluate or project climate scenarios, and what information from or about such internal evaluations should be disclosed to investors to inform investment and voting decisions? How does the absence or presence of robust carbon markets impact firms' analysis of the risks and costs associated with climate change?

Response 2. See the discussion above under the headings "The Ambiguity of Climate Science," "The Ambiguity of the Economics of Climate Change," "Commission Expertise and Administrative Issues," "Securities Laws are a Poor Mechanism to Address Externalities,"

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[54] In section 2 of the Securities Act Congress could define "material" as follows:

> "(20) The term "material" means, when used to qualify a requirement for the furnishing of information as to any subject, information limited to those matters regarding which there is a substantial likelihood that a reasonable investor would attach importance when –
>
> (i) evaluating the potential financial return and financial risks of an existing or prospective investment, or
> (ii) exercising, or declining to exercise, any rights appurtenant to securities.
>
> The term "material" does not include, when used to qualify a requirement for the furnishing of information as to any subject, information that –
>
> (i) primarily furthers non-pecuniary, non-economic or non-financial social or political goals or objectives, or
> (ii) primarily relates to events that –
>
> (A) involve a high degree of uncertainty regarding what may or may not occur in the distant future, and
> (B) are systemic, general or not issuer specific in nature.

[55] The Commission could, of course, revise 17 CFR § 240.12b-2.

"Private Compliance Costs," "The Creation of a New Compliance Eco-System and Pro-Complexity Lobby," and "Litigation Risk."

Request for Input 3. What are the advantages and disadvantages of permitting investors, registrants, and other industry participants to develop disclosure standards mutually agreed by them? Should those standards satisfy minimum disclosure requirements established by the Commission? How should such a system work? What minimum disclosure requirements should the Commission establish if it were to allow industry-led disclosure standards? What level of granularity should be used to define industries (e.g., two-digit SIC, four-digit SIC, etc.)?

Response 3. See the discussion above under the headings "Investor Protection," "The Materiality Standard" and "ESG-Related Reduced Returns Should Be Explicitly Disclosed."

Request for Input 4. What are the advantages and disadvantages of establishing different climate change reporting standards for different industries, such as the financial sector, oil and gas, transportation, etc.? How should any such industry-focused standards be developed and implemented?

Response 4. Obviously, the impact of climate change is going to vary by industry and issuer. The actual impact is highly uncertain. The focus should remain on what is material and ordinary securities law principles should apply. See discussion above under the headings "Investor Protection," "The Materiality Standard," "ESG-Related Reduced Returns Should Be Explicitly Disclosed," "The Ambiguity of Climate Science," "The Ambiguity of the Economics of Climate Change," "Commission Expertise and Administrative Issues," and "Securities Laws are a Poor Mechanism to Address Externalities."

Request for Input 5. What are the advantages and disadvantages of rules that incorporate or draw on existing frameworks, such as, for example, those developed by the Task Force on Climate-Related Financial Disclosures (TCFD), the Sustainability Accounting Standards Board (SASB), and the Climate Disclosure Standards Board (CDSB)? Are there any specific frameworks that the Commission should consider? If so, which frameworks and why?

Response 5. In general, the Commission should get out of the business of farming out its regulatory work to opaque and non-responsive "self-regulatory organizations" that are not subject to the due process guarantees and Administrative Procedure Act protections afforded when regulation is conducted by government.[56] Doing so is a way for the Commission to avoid the intractable, highly contentious and highly political work that mandatory climate change disclosure would entail.

Request for Input 6. How should any disclosure requirements be updated, improved, augmented, or otherwise changed over time? Should the Commission itself carry out these tasks, or should it adopt or identify criteria for identifying other organization(s) to do so? If the latter, what organization(s) should be responsible for doing so, and what role should the Commission play in governance or funding? Should the Commission designate a climate or ESG disclosure standard

[56] See, for example, David R. Burton, "Reforming FINRA," Heritage Foundation Backgrounder No. 3181, February 1, 2017 https://www heritage.org/sites/default/files/2017-02/BG3181.pdf.

setter? If so, what should the characteristics of such a standard setter be? Is there an existing climate disclosure standard setter that the Commission should consider?

Response 6. In general, the Commission should get out of the business of farming out its regulatory work to opaque and non-responsive "self-regulatory organizations" that are not subject to the due process guarantees and Administrative Procedure Act protections afforded when regulation is conducted by government. Doing so is a way for the Commission to avoid the intractable, highly contentious and highly political work that mandatory climate change disclosure would entail.

Request for Input 7. What is the best approach for requiring climate-related disclosures? For example, should any such disclosures be incorporated into existing rules such as Regulation S-K or Regulation S-X, or should a new regulation devoted entirely to climate risks, opportunities, and impacts be promulgated? Should any such disclosures be filed with or furnished to the Commission?

Response 7. See discussion above under the headings "Investor Protection," "The Materiality Standard," "ESG-Related Reduced Returns Should Be Explicitly Disclosed," "The Ambiguity of Climate Science," "The Ambiguity of the Economics of Climate Change," "Commission Expertise and Administrative Issues," and "Securities Laws are a Poor Mechanism to Address Externalities."

Request for Input 8. How, if at all, should registrants disclose their internal governance and oversight of climate-related issues? For example, what are the advantages and disadvantages of requiring disclosure concerning the connection between executive or employee compensation and climate change risks and impacts?

Response 8. They should be governed by traditional materiality disclosure requirements.

Request for Input 9. What are the advantages and disadvantages of developing a single set of global standards applicable to companies around the world, including registrants under the Commission's rules, versus multiple standard setters and standards? If there were to be a single standard setter and set of standards, which one should it be? What are the advantages and disadvantages of establishing a minimum global set of standards as a baseline that individual jurisdictions could build on versus a comprehensive set of standards? If there are multiple standard setters, how can standards be aligned to enhance comparability and reliability? What should be the interaction between any global standard and Commission requirements? If the Commission were to endorse or incorporate a global standard, what are the advantages and disadvantages of having mandatory compliance?

Response 9. I see no reason to effectively outsource the securities disclosure requirements in U.S. capital markets to the European Union.

Request for Input 10. How should disclosures under any such standards be enforced or assessed? For example, what are the advantages and disadvantages of making disclosures subject to audit or another form of assurance? If there is an audit or assurance process or requirement, what organization(s) should perform such tasks? What relationship should the Commission or other existing bodies have to such tasks? What assurance framework should the Commission consider requiring or permitting?

Response 10. See discussion above under the heading "Commission Expertise and Administrative Issues."

Request for Input 11. Should the Commission consider other measures to ensure the reliability of climate-related disclosures? Should the Commission, for example, consider whether management's annual report on internal control over financial reporting and related requirements should be updated to ensure sufficient analysis of controls around climate reporting? Should the Commission consider requiring a certification by the CEO, CFO, or other corporate officer relating to climate disclosures?

Response 11. Given the massive uncertainty regarding climate science modeling and the even greater uncertainty regarding the economic and financial effects of climate change, such certification is unwarranted. If, however, it is implemented the same standards and penalties should apply to government officials that issue reports relating to climate change and associated economic effects.

Request for Input 12. What are the advantages and disadvantages of a "comply or explain" framework for climate change that would permit registrants to either comply with, or if they do not comply, explain why they have not complied with the disclosure rules? How should this work? Should "comply or explain" apply to all climate change disclosures or just select ones, and why?

Response 12. "Comply or explain" would be less bad, but only marginally so, than an absolute mandate. It would be largely regarded as a requirement.

Request for Input 13. How should the Commission craft rules that elicit meaningful discussion of the registrant's views on its climate-related risks and opportunities? What are the advantages and disadvantages of requiring disclosed metrics to be accompanied with a sustainability disclosure and analysis section similar to the current Management's Discussion and Analysis of Financial Condition and Results of Operations?

Response 13. See above.

Request for Input 14. What climate-related information is available with respect to private companies, and how should the Commission's rules address private companies' climate disclosures, such as through exempt offerings, or its oversight of certain investment advisers and funds?

Response 14. Ordinary securities law principles should apply. There should be no additional requirements imposed on private companies.

Request for Input 15. In addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental, social, and governance, or ESG, matters. Should climate-related requirements be one component of a broader ESG disclosure framework?

How should the Commission craft climate-related disclosure requirements that would complement a broader ESG disclosure standard? How do climate-related disclosure issues relate to the broader spectrum of ESG disclosure issues?

<u>Response 15</u>. The potential adverse social consequences of ESG disclosure are large. See the discussion above under the headings “The Social Costs of ESG,” “ESG-Related Reduced Returns Should Be Explicitly Disclosed,” “Securities Laws are a Poor Mechanism to Address Externalities,” “Entrepreneurship and Small Public Companies,” “ESG Disclosure Would Lead to Less Management Accountability,” “The Creation of a New Compliance Eco-System and Pro-Complexity Lobby,” “Litigation Risk,” and “Private Compliance Costs.”

Sincerely,

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