June 7, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
rule-comments@sec.gov

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

Dear Ms. Countryman,

I am a Senior Fellow in Business and Economics at the Pacific Research Institute (PRI). The mission of PRI is to champion freedom, opportunity, and personal responsibility for all individuals by advancing free-market policy solutions. Since its founding in 1979, PRI has remained steadfast to the vision of a free and civil society where individuals can achieve their full potential.

The Securities and Exchange Commission is currently considering a new onerous rule that would mandate climate related disclosures: *The Enhancement and Standardization of Climate-Related Disclosures for Investors*.[1] This rule, if adopted, mandates unachievable reporting requirements, imposes costly new burdens on companies, and provides information of dubious value to investors. Investors will, consequently, be harmed should this rule be implemented.

The proposed rule does not meet SEC's purported goals

In announcing the proposed rule on March 21, 2022, Chairman Gensler claims that the proposal,

> would provide investors with consistent, comparable, and decision-useful information for making their investment decisions, and it would provide consistent and clear reporting obligations for issuers," said SEC Chair Gary Gensler. "Our core bargain from the 1930s is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures. Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions. Today's

[1] https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

> proposal would help issuers more efficiently and effectively disclose these risks and meet investor demand, as many issuers already seek to do. Companies and investors alike would benefit from the clear rules of the road proposed in this release."[2]

The proposal will not achieve the objectives summarized by the Chairman and, if implemented, will impose large costs on companies without sufficient offsetting benefits for investors.

The Proposed Reporting Requirements are Opaque, Costly, and Inaccurate

If implemented, companies would be required to conduct a specific and detailed carbon accounting that includes their Scope 1, Scope 2, and Scope 3 emissions. Scope 1 emissions result from a company's operations – the greenhouse gasses (GHG) directly emitted by the company. Roughly speaking, Scope 2 emissions are emitted by the company's suppliers and partners while Scope 3 emissions are created by the users of a company's products.

The proposed regulation will decrease investors understanding of the material risks that companies face and impose unnecessary economic costs for a myriad of reasons, which are overviewed below.

Carbon accounting is neither precise nor accurate. It is well documented and widely accepted (even among organizations in support of net zero initiatives) that carbon accounting is flawed. It is rife with inaccuracies, problems of double counting across organizations, and verifiability issues.[3] [4] These problems are amplified when trying to measure Scope 2 and Scope 3 emissions, particularly the problem of double counting actual emission reductions. Simply put, carbon accounting is not based on a well-defined and widely accepted methodology that is reproduceable across many types of organizations despite being presented as a precise exercise akin to financial accounting.

These inherent flaws will make it difficult for investors to accurately compare the reported emissions across companies and across time. Therefore, unlike financial reports that provide comparable information based on a rigorous methodology and definitions that improve investor understanding of a company's absolute and relative financial position, carbon accounting provides investors with imprecise information. It is far from clear that the forced reporting of

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[2] "SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors" U.S. Securities and Exchange Commission, 2022-46, https://www.sec.gov/news/press-release/2022-46.

[3] "Net-zero: the risks and benefits for companies pledging to save the climate" World Economic Forum, https://www.weforum.org/agenda/2022/02/net-zero-risks-benefits-climate/.

[4] See, for instance, a study that found methane emissions from oil production are 90% higher than the current EPA estimates. Maasakkers, J. D., Jacob, D. J., Sulprizio, M. P., Scarpelli, T. R., Nesser, H., Sheng, J., Zhang, Y., Lu, X., Bloom, A. A., Bowman, K. W., Worden, J. R., and Parker, R. J.: 2010–2015 North American methane emissions, sectoral contributions, and trends: a high-resolution inversion of GOSAT observations of atmospheric methane, Atmos. Chem. Phys., 21, 4339–4356, https://doi.org/10.5194/acp-21-4339-2021, 2021. https://acp.copernicus.org/articles/21/4339/2021/

emissions will improve investor understanding of the potential risks a company faces that are directly attributable to companies' emissions, let alone the implications from the emissions from their suppliers and customers. Nor will investors have clear information to compare the risks relative to other companies or how these risks are changing over time.

The proposed regulations are duplicative to current obligations. Under current regulatory obligations, companies must report all material risks to shareholders. Companies that face material risks from its emissions but fail to report this information are already legally liable for these omissions.

Most companies in the S&P 500 believe that, despite the flaws inherent to carbon accounting, it is important to report their emissions and include a carbon accounting in their relevant investment documents. Other companies take the opposite opinion and do not report their emissions. Among the companies reporting their emissions, there are important differences in how the emission information is conveyed. These differences include the depth of the accounting methodology used, particularly with respect to the inclusion of Scope 2, and Scope 3 emissions. Such variations are logical given the diverse operations across industries and the resulting differences with respect to the material risks that could arise.

It is also important to note that while many companies report their emissions, the decision is often based on public relations needs rather than for the purpose of conveying material risks to investors. Regardless of the merits of reporting emissions information from a public relations perspective, this is a distinct issue from reporting materially relevant risks to investors. It is the latter that should be the sole purview of the SEC.

The decision to report emissions will also reflect pressure by outside public interest groups to micromanage companies' climate change policies. The attempts by outside public interest groups to micromanage emission reduction programs often leads to corporate actions that harm investors' interests. Acknowledging these potential risks, Blackrock, a supporter of corporate Environmental, Social, and Governance (ESG) initiatives, has indicated that

> having supported 47% of environmental and social shareholder proposals in 2021 (81 of 172), BIS (BlackRock Investment Stewardship) notes that many of the climate-related shareholder proposals coming to a vote in 2022 are more prescriptive or constraining on companies and may not promote long-term shareholder value.[5]

The regulations impose additional compliance costs. A detailed accounting of companies' emissions requires additional human and financial resources that increases companies' cost

[5] Williamson C "BlackRock won't back climate shareholder proposals it considers too prescriptive" *Pensions & Investments*, May 10, 2022, https://www.pionline.com/esg/blackrock-wont-back-climate-shareholder-proposals-it-considers-too-prescriptive.

structures. These expenditures only benefit investors if the informational value (e.g., the conveyance of potential risks) from the additional reporting on emissions exceed these costs.

The well documented inaccuracies inherent to carbon accounting raise serious concerns regarding the value provided by the reports. Reports that provide questionable value, but certain costs are more likely to harm investors' interest, not promote them. Importantly, these criticisms apply to the requirement to report Scope 1 emissions, which are widely recognized as the least burdensome obligation, as well as Scope 2 and Scope 3 emissions.

As emphasized in the previous section, it is essential to recognize that all companies are legally liable if they fail to report materially relevant information about their emissions. While understanding these obligations exist, many companies will still only provide summary overviews of their emissions and other companies will not report on their emissions at all. Not reporting their emissions or providing a less detailed accounting that minimizes the costs of creating the report makes sense for industries where either no information or high-level information provides investors with the necessary disclosures. A less detailed approach also makes sense in those instances where the inherent flaws of a detailed carbon accounting are the most acute.

Taken together, these realities indicate that the costs of performing a detailed carbon accounting are deemed too high relative to the value the information provides investors for many companies. Mandating a more detailed accounting forces additional costs on these companies that, given the current obligation to report all material risks, exceeds the benefits received by investors. Consequently, forcing a high-cost one-size fits all approach, even if carbon accounting were not rife with flaws, will have only one of two effects. For those firms already providing a detailed carbon accounting, the new regulations are unnecessary. For those firms not providing a detailed carbon accounting, the increased costs that result are excessive relative to the benefit provided to investors.

In other words, the regulations create a net cost for investors.

The regulation includes Scope 2 and Scope 3 emissions. The proposed regulation forces companies to track the emissions of their suppliers and customers. Such requirements directly lead to the double counting problems inherent in the carbon accounting methodology. It is simply impossible to accurately report Scope 2 and Scope 3 emissions and it is unclear how companies can obtain all the relevant information – particularly for Scope 2 emissions from private suppliers or most of their Scope 3 emissions. Without direct access to this information, when complying with the mandate to report Scope 2 and Scope 3 emissions in detail companies will have to rely on proxy information that is just as likely to provide misinformation as information. Therefore, the inclusion of Scope 2 and Scope 3 emissions raises serious risks that the companies will be providing reports that misinform investors rather than providing valuable information.

Including Scope 2 and Scope 3 emissions in the rule is also inconsistent with the SEC's mission. The purpose of the regulation must be to ensure that investors are appropriately informed of all material financial risks companies face. Based on this criterion, only the Scope 1 emissions matter. Scope 2 and Scope 3 emissions, the emissions of a firm's customers and suppliers, are outside of company's control and, most importantly, not a direct liability or a direct investor risk. Consequently, it is inappropriate for the SEC to include Scope 2 and Scope 3 emissions in this proposed rule.

The regulations create inherent conflicts that could incentivize actions that raise costs or reduce profitability. Forcing companies to incorporate ESG considerations into their financial reports raise inherent conflicts of interest that undermine the value of the reported information to investors. As a January 2022 SEC document noted,

> NRSROs (nationally recognized statistical rating organizations) and their affiliates have developed and are offering an increasing number of ESG-related products and services. Development in the area has grown rapidly, and competition has increased among NRSRO and non-NRSRO providers, **leading the Staff to identify several areas of potential risk** to NRSROs. These include the risks that, in incorporating ESG factors into ratings determinations, NRSROs may not adhere to their methodologies or policies and procedures, consistently apply ESG factors, make adequate disclosure regarding the use of ESG factors applied in rating actions, or maintain effective internal controls involving the use in ratings of ESG-related data from affiliates or unaffiliated third parties. The Staff also identified the potential risk for conflicts of interest if an NRSRO offers ratings and non-ratings ESG products and services. (Emphasis added)[6]

Further, to create a connection between a company's Scope 2 and Scope 3 emissions, the rule must rely on hypotheticals that product sales could be threatened due to the emissions or energy usage actions from one of the company's suppliers or customers. The likelihood of such actions is unknowable. This argument could also apply across hundreds of issues. What are suppliers' maternity leave policies? What are their positions on unionization? Do the suppliers have unfavorable positions on unrelated social issues? It is not feasible for companies to be aware of every hypothetical outcome that could arise from working with their suppliers or customers.

More importantly, mandating a detailed accounting of companies Scope 2 and Scope 3 emissions will impact their competitive actions. The mandate will increase the consideration of emissions when choosing a supplier, which means, by definition, that fundamental business considerations such as choosing the supplier that produces the right inputs, at the right price, that meet the necessary delivery schedule, are deemphasized. By disincentivizing the creation of the most efficient supply chain possible, the mandate could have deleterious impacts on corporate costs and/or profitability.

The rule establishes environmental policies that should be decided by Congress or considered by an environmental agency. The inclusion of Scope 2 and Scope 3 emissions raise concerns that,

[6] "Staff Report on Nationally Recognized Statistical Rating Organizations" U.S. Securities and Exchange Commission, January 2022, https://www.sec.gov/files/2022-ocr-staff-report.pdf.

even if unintentional, the regulations are primarily an environmental regulation rather than a regulation geared toward ensuring efficient financial markets.

It is the legislative branch of government that is responsible for making the laws, including the laws that govern the national approach to global climate change. Consequently, the establishment of emission requirements should be left to Congress to design. Multiple Congresses have had the opportunity to pass global climate change policies such as imposing a federal carbon tax or implementing cap and trade regulations. These policies have not been implemented because they come with large economic costs. These trade-offs are inherently political questions that are appropriately addressed by the legislative branch.

While the current authority of environmental agencies to promulgate regulations addressing global climate change is debatable, there are advocates who believe agencies already have the authority to regulate greenhouse gas emissions. Even assuming this argument is correct, clearly the authority has not been delegated to the Securities and Exchange Commission. Since, as established above, there are no material risks for investors, the questions these proposed regulations address are more appropriately debated and implemented by the Environmental Protection Agency (EPA) or other environmental regulatory agency. The SEC's proposed rule is, essentially, a backdoor scheme to regulate climate change and duplicate the mandate already underway by the EPA.

The SEC's actions could have counterproductive impacts on innovations to address global climate change. As established above, the new rule imposes additional administrative costs and distorts company supply chains. Consequently, the rule is compromising the financial wellbeing of many companies. These financial costs reduce companies' resources and ability to invest in the innovations necessary to efficiently address the problems of global climate change.

There are many exciting innovations that could end up meaningfully reducing the total amount of GHG emissions. These innovations include next generation nuclear plants, enhanced battery storage to improve the reliability of wind and solar, carbon capture and storage processes that reduce the volume of emissions released, technologies that significantly improve fuel efficiency, and the development of hydrogen and alternative power sources. Whether any, or several, of these technologies will ultimately pan out is unknown. Continued investment into these (and other lesser-known innovations) is necessary to encourage the emergence of the next-generation energy sources.

Rules imposing unnecessary costs on companies will reduce the resources available to invest in the next-generation technologies without any compensating benefit for investors. Reduced investment in the next-generation technologies will delay, or potentially scuttle, the development of the innovations that will more efficiently address the problem of global climate change while imposing fewer costs on businesses and families.

Conclusion

The proposed new reporting requirements will only impact the companies who are not currently reporting their emissions or are using a less detailed approach for reporting these emissions rather than the detailed methodology the SEC proposed regulation would mandate. For these companies, the proposed regulations are imposing additional cost burdens. However, it is unlikely that the regulation creates any benefits for investors because carbon accounting is not a well-defined precise methodology, even with respect to companies' Scope 1 emissions. The logical conclusion is that where the regulation could have value, the rule is unnecessary because firms are already reporting this information. Where the rule would force a change, the rule will impose a net cost. Therefore, on net, the proposed regulation imposes net costs on investors.

Thank you for the opportunity to comment on this important issue.

Sincerely,

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