June 17, 2022

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Enhancement and Standardization of Climate-Related Disclosures for Investors (S7-10-22)

Dear Chair Gensler:

I write to express my concerns about the U.S. Securities and Exchange Commission's (SEC) notice of proposed rulemaking on carbon emissions reporting requirements for public corporations. As the former Research Director for the National Venture Capital Association, I make these comments with a high degree of expertise in public companies and U.S. public equity exchanges.

While well-intentioned, any eventual rulemaking on carbon emissions reporting requirements will be subject to a cost-benefit analysis (CBA) study conducted by the SEC. Such analyses performed by the federal government have been shown to regularly possess flaws in their execution by not meeting standard best practices of such analyses, as well as by underestimating the costs associated with proposed rules. This history of subpar CBA studies produced by federal rulemaking bodies should gravely concern both the parties that would be impacted by proposed rules as well as the rulemaking bodies themselves. Additionally, further reporting requirements for public corporations will have a damaging effect on U.S. public equity markets by increasing the potential burdens of owners and managers of private companies contemplating an initial public offering (IPO). A new carbon emissions reporting requirement would lessen the competitiveness of U.S. equity markets, encouraging companies to remain private longer and reducing the ability of ordinary Americans to share in the wealth creation of U.S. startups. I urge the commission to pause consideration of any proposed rules currently under consideration until recommendations from previous audits of government CBA studies have been fully implemented and improvements to the underestimation of costs in such studies have been made.

Problems related to the proper execution of CBA studies by federal agencies have a long history. A clear example of the extent to which federal CBA analyses can be flawed comes in the form of a review of a previous CBA study published by the SEC itself when the commission evaluated selected SEC Dodd-Frank Act rulemakings. In a report dated January 27, 2012, the SEC Office of Audits (part of the SEC Office of Inspector General) outlined the results of its review which had the objectives to "assess whether the SEC is performing cost-benefit analyses for rulemaking initiatives that are statutorily required under the Dodd-Frank Act in a consistent manner across SEC divisions and offices and in compliance with applicable federal requirements and determine whether problematic areas exist where rigorous cost-benefit analyses were not performed for rulemaking initiatives and where improvements are needed and best practices can be identified to enhance the overall methodology used to perform the cost-benefit analyses."[1]

In the 2012 report, the Office of Audits identified several "significant" issues during its review of the specific cost-benefit analyses performed for the selected rulemakings including (a) meaningful variation in the extent of quantitative discussion of benefits or costs among examined rulemakings, (b) the crucial role that economists ought to play in ensuring that cost-benefit analyses incorporate both qualitative and quantitative information, and (c) a penchant for the SEC to generally focus on discretionary components of rulemakings while ignoring rulemakings where the SEC had no discretion, thereby excluding the establishment of a "'no action' baseline" scenario against which the effects of alternative regulatory actions could be measured. In the opinion of the Office of Audits's expert, to the extent that the SEC performs cost-benefit analyses only for discretionary rulemaking activities, "the SEC may not be fulfilling the essential purposes of such analyses—providing a full picture of whether the benefits of a regulatory action are likely to justify its costs and discovering which regulatory alternative would be the most cost-effective." Finally, the review found that internal costs and benefits to the commission itself were rarely addressed in the cost-benefit analysis, possibly omitting significant costs or benefits ensuing from the Dodd-Frank Act and providing an incomplete picture of the economic impact associated with this government regulation. The findings in the Office of Audits's 2012 report follow an earlier internal review released on June 13, 2011 that found a "lack of macro-level analysis and a lack of quantitative analysis on the impact of the [Dodd-Frank Act] rules."

Multiple recommendations were made to the SEC to erase the flaws in the commission's approach to cost-benefit analysis and to improve the quality of its evaluations of government rulemakings by bringing their analyses more in line with CBA best practices. These recommendations include consideration of ways for economists to provide additional input into CBA studies to assist in including both quantitative and qualitative information to the extent possible; reconsideration of guidance that the SEC should perform economic analyses for rulemaking activities to the extent that the SEC exercises discretion and consideration of whether a pre-statute baseline should be used whenever possible; the use of a single, consistent baseline in CBA studies of their rulemakings related to a particular topic; consideration of directing rulemaking teams to (a) explicitly discuss market failure as a justification for regulatory action in the CBA studies of each rule that is based in whole or in part on perceived market failure or (b) in the absence of market failure, demonstrate a compelling social purpose that justifies regulatory action; and consideration of including internal costs and benefits in the CBA studies of rulemakings.

While the SEC Office of Audits's opinion on the commission's evaluation of rules in the Dodd-Frank Act described a number of shortcomings, one of these deficiencies warrants further comment due to its prevalence and severity in CBA studies across government agencies. Specifically, the chronic underestimation of costs in government CBA studies is troublesome and merits special consideration by rulemakers, since regular and acute underestimation of costs when performing cost-benefit analyses may consequently result in the implementation of rules that do not provide a net welfare benefit to stakeholders or broader society. Furthermore, excessive rulemaking that is believed to provide net benefits but, in actuality, imposes net costs, can have negative effects on economic agents (e.g.,

[1] "Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings," U.S. Securities and Exchange Commission, Office of Inspector General, Office of Audits, Report No 499, January 27, 2012.

households, consumers, producers) and the economy writ large in the forms of slower growth, higher prices, market inefficiency, and possibly other ways.

One prominent example of federal analysts substantially underestimating the costs of regulation is the Environmental Protection Agency's (EPA) cost-benefit analysis of the Clean Power Plan (CPP). The final version of the CPP, released by EPA in August 2015, called for reducing carbon dioxide emissions from U.S. electric generating plants by 870 million tons below 2005 levels by 2030. In that same year, the EPA estimated in a CBA study of the CPP that compliance costs, principally the higher costs of meeting future electric demand, would be less than $9 billion per year in 2030.[2] However, analysis by an impartial project group of experts found that the EPA woefully underestimated the costs that would result from implementing the CPP. According to economists at NERA Economic Consulting, depending on the tools that states would have at their disposal to achieve state-level targets outlined in the CPP, total consumer electricity-related costs associated with the CPP's implementation range anywhere from an annual average increase of $34 billion from 2017 to 2031 (relative to a baseline scenario in which the CPP is not implemented) to an average annual increase of $48 billion throughout the same period.[3]

A further example where federal agencies significantly underestimate costs in CBA studies is during analysis of transportation infrastructure projects. Each year, state and local governments analyze numerous such projects aimed at reducing highway congestion or air pollution. Decisions on which projects to undertake are supposed to be a function of objective CBA studies. However, as with the above examples from the SEC and EPA, calculating the costs and benefits of major transportation projects is technically difficult. In the case of transportation projects, cost estimates require a determination of labor and material quantities and prices, while benefit estimates require forecasting economic growth, demographic trends, and regional travel patterns.[4]

Academic researchers who have examined the track record of CBA studies of past transportation projects have found large cost overruns to be common. Flybjert, Holm, and Buhl looked at the cost estimates for 258 transportation projects valued at $90 billion built in countries around the world during the 20th century and found an average cost overrun of almost 28 percent per project. Cost overruns were largest for rail projects with such overruns equaling nearly 45 percent of original cost estimates. Fixed-link and road projects had cost overruns of 34 percent and 20 percent, respectively. The evidence suggests that transportation planners did not learn from their mistakes since the size of cost overrun errors has not decline over time, suggesting that such errors are systemic to the planning and decision-making process of transportation projects.[5]

Furthermore, the narrow scope of SEC cost-benefit analysis can also contribute to the underestimation of costs associated with rules proposed by the commission. The SEC's rules are designed to regulate capital markets and protect investors, and the commission's CBA studies appropriately attempt to account for the impact such rules will have on investors. However, these rules

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[2] Lesser, Jonathan A., "Missing Benefits, Hidden Costs: The Cloudy Numbers in the EPA's Proposed Clean Power Plan," Manhattan Institute, June 2016.
[3] "Potential Energy Impacts of the EPA Proposed Clean Power Plan," NERA Economic Consulting, October 2014.
[4] Krol, Robert, "Transportation Cost-Benefit Analysis Can Be Highly Misleading," California State University, Northridge, August 2015.
[5] Flyvjerg, Bent, Mette Skamris Holm and Soren Buhl, "Underestimating Costs in Public Works Projects," Journal of the American Planning Association, Vol. 68 (2002).

can also have spillover effects on capital market stakeholders other than investors who are not included in the commission's cost-benefit analyses. These stakeholders can include managers, employees, consumers, taxpayers, gatekeepers, and vendors. Limiting cost-benefit analyses to only evaluating the impact rules may on investors' welfare, while neglecting spillover effects to these other stakeholders, may potentially result in CBA studies that present net benefits to investors from particular rules while omitting the fact that such rules may pose a net cost to broader society.[6] The commission should adopt a more holistic approach to its cost-benefit analysis methodology to account for its rules' effects on all stakeholders in order to ensure that the commission's analyses capture total welfare effects resulting from its rules. I encourage the commission to pause consideration of further proposed rules until this more holistic approach can be incorporated into the commission's CBA methodology.

Finally, introducing another reporting requirement for public companies may have a chilling effect on IPO activity in the U.S. and damage the nation's public equity markets. Research has found that prior regulatory changes prompted by the Sarbanes-Oxley Act and the Dodd-Frank Act, which increased reporting requirements for public companies, have materially decreased the amount of U.S.-based IPO activity. For example, a 2006 survey found that year-one compliance with Section 404 of the Sarbanes-Oxley Act cost Fortune 1000 companies an average of $8.5 million. Smaller companies with a market capitalization of under $700 million faced an average year-one cost of $1.2 million.[7] Corporate revenue being correlated with market capitalization, the regulatory costs of Section 404 fall disproportionately on smaller companies. This disproportionate burden has had a clear negative impact on the willingness or ability (or both) of small companies to pursue listings on a U.S. public stock exchange. This fact is demonstrated by the sharp decline in the share of the IPO market of companies with revenues of $25 million or less following the passage and implementation of Sarbanes-Oxley: the share of such IPOs dropped from 53 percent of all IPOs in 2000 to an average of 29 percent a year from 2002 to 2007.

The regulations imposed on public companies by Sarbanes-Oxley have also weakened the global competitiveness of U.S. exchanges. This phenomenon, too, is clear from comparisons of U.S. IPO activity in the years preceding Sarbanes-Oxley versus the years immediately afterward. From 1996 to 2001, only three U.S.-domiciled companies listed their IPOs solely on a foreign exchange, representing 0.1 percent of U.S. company IPOs during that period. However, from 2002 to 2006, 28 U.S. companies conducted foreign-only IPOs (3.6 percent of U.S. company IPOs during that period) and, in the first three quarters of 2007, fifteen U.S. companies listed their IPOs solely on a foreign exchange (9.2 percent).[8] Based on this evidence, I further encourage the commission to thoroughly analyze the potential effects this proposed rulemaking on carbon emissions requirements for public corporations may have on U.S. IPO activity and the competitiveness of U.S. public equity markets prior to any implementation of the rule.

Respectfully,
Michael J. Chow

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[6] Lee, Yoon-Ho Alex, "SEC Rules, Stakeholder Interests, and Cost-Benefit Analysis," Capital Markets Law Journal, Vol. 10, No. 3 (2015).

[7] Stegemoeller, Mark A. and Kai-Hua Yu, "The Impact of Sarbanes-Oxley on IPOs and High Yield Debt Issuers," The Practitioner's Guide to the Sarbanes-Oxley Act, American Bar Association, 2008.

[8] *Ibid*.