October 22, 2019

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549–1090

Re: File Number S7–11–19 (Modernization of Regulation S–K Items 101, 103, and 105)

Dear Ms. Countryman:

I am pleased to provide these comments on the proposed rule regarding the Modernization of Regulation S–K Items 101, 103, and 105.[1]

Comments on Questions 36-39

> 36. Would our proposal to require summary risk factor disclosure if the risk factor discussion exceeds 15 pages result in improved risk factor disclosure for investors?
> 37. Is 15 pages an appropriate number of pages to trigger summary risk factor disclosure? If not, what is the appropriate page limit that should trigger summary risk factor disclosure? Is there a better alternative than a page limit to trigger summary risk factor disclosure (e.g., should we consider a word limit instead)?
> 38. If summary risk factor disclosure is triggered, should we require the summary to consist of a series of short, concise, bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky, as proposed? Should we in addition or instead limit the length of the summary disclosure (e.g., no more than one page)? Should we require the bulleted or numbered statements summarizing the risk factors to also include hyperlinks to each of the risk factors summarized?
> 39. If the risk factors discussion exceeds 15 pages, should we require a registrant to include only those risk factors that pose the greatest risk to the registrant in the first 15 pages instead of requiring it to prepare a risk factor summary?

The objective of the 15 page limit is laudatory. Disclosure requirements have become so voluminous that they obfuscate rather than inform, making it more difficult for investors to find relevant information.[2] However, the primary reason that the risk factor section of disclosure

---

[1] Modernization of Regulation S–K Items 101, 103, and 105, Proposed Rules, *Federal Register*, Vol. 84, No. 164, August 23, 2019, pp. 44358-44390 https://www.govinfo.gov/content/pkg/FR-2019-08-23/pdf/2019-17410.pdf.
[2] 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; former Commissioner Troy A. Paredes, "Remarks at The SEC Speaks in 2013," February 22, 2013 http://www.sec.gov/News/Speech/Detail/Speech/1365171492408#.Ut2WJbROmM8. See also, Keith F. Higgins (former Director, Division of Corporation Finance), "Disclosure Effectiveness," Remarks Before the American Bar Association Business Law Section Spring Meeting, April 11, 2014 http://www.sec.gov/News/Speech/Detail/Speech/1370541479332#.VItSmXt4zYg.

documents have mushroomed is litigation risk. If the price of mitigating that risk is adding a summary to the disclosure document, most issuers will do so. And then what will have been accomplished is further *lengthening* of the disclosure documents.

Comments on Question 41

> 41. Would changing the standard from the requirement to discuss the ‘‘most significant’’ factors to the “material” factors, as proposed, result in more tailored disclosure and reduce the length of the risk factor disclosure? Would changing the standard, as proposed, result in other consequences that we have not considered? If so, provide specific examples of such consequences.

Materiality is the correct standard for determining whether information should be included in disclosure documents. Thus, this rule change is sound.

Comments on Environmental, Social and Corporate Governance (ESG) and Economic Analysis

The purposes of this section is two-fold. First, it provides a very brief critique of environmental, social and corporate governance (ESG) criteria, corporate social responsibility (CSR) requirements, socially responsible investment (SRI) requirements, sustainability requirements, diversity requirements or stakeholder theory. Second, this comment provides an analytical framework that the Commission may find useful in analyzing the social welfare costs of those requirements.

<u>ESG, CSR, SRI, Sustainability, Diversity and Stakeholder Theory</u>

Sometime rhetorical obfuscation notwithstanding, the goal of proponents of ESG, CSR, SRI, sustainability requirements, diversity requirements or stakeholder theory is not to increase corporate profits but to instead alter corporate behavior by legislative, regulatory or other means in furtherance of some (or many) social or political objectives in a way that will reduce shareholder returns. Ergo, $R > R_{ESG/CSR}$ 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.

Of course, entrepreneurs are today free to form benefit corporations or benefit limited liability companies that serve a social purpose as well as the purpose of making a profit. But relatively few businesses are so organized and relatively little investor capital flows to benefit corporations or LLCs. Businesses can and do engage in philanthropy, help to improve communities and undertake other social engagement because it promotes their businesses and in management’s judgment will increase profits. Shareholder can, but very rarely do,[3] vote to instruct management to pursue various social goals even if it reduces profits.

The purpose of businesses is to deploy investors’ capital and employees’ labor in the service of consumer needs and wants with the aim of making a profit. But ESG, CSR and stakeholder theory proponents are trying to alter the very purpose of businesses. Their aim is to pursue a

[3] See, e.g., Proxy Preview, 2018 https://www.proxypreview.org/s/Proxy-Preview-2018-Final.pdf.

plethora of social objectives rather than earning profits or meeting consumer wants. This would reduce social welfare. It would make American businesses less competitive and cost workers their jobs. It would make the American economy less efficient and productive, raising prices to consumers. It would make businesses become poor stewards of scarce resources. It would make management less accountable since the metric of "success" will become extremely amorphous. It would reduce the returns to investors and have an adverse impact on the pension plans and defined contribution retirement accounts of well over a hundred million people.

"The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[4] The statutory charge is "Whenever 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."[5] Thus, nowhere in the mission of the Commission is found a reference to furthering any social, environmental or other factor. In fact, doing so is inconsistent with the Commission's charge to protect investors and promote efficiency, competition and capital formation.

Certainly, there are congressionally mandated reporting requirements that are motivated by considerations other than the Commission's core statutory charge (e.g. conflict minerals, mine safety, resource extraction and CEO pay-ratio requirements). There have been efforts, to date unsuccessful, to go further down this path (e.g. reporting on corporate political, lobbying and trade association giving). One interpretation of the human capital questions in the proposing release (questions 21-23) is that the release is seeking input on whether to go further down this path. Certainly, some commentators see it that way.[6] For the reasons stated above, doing so would be a mistake and is inconsistent with the Commission's statutory charge.

<u>Economic Analysis</u>

To the extent not pursued by businesses for the purpose of making a profit and to the extent required by government, $R > R_{ESG/CSR}$. The difference, $R - R_{ESG/CSR}$ is economically analogous to a tax. It is a reduction in return due to government requirements. 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. $Tax_{ESG/CSR}$).

<u>Excess Burden</u>

---

[4] "What We Do," Securities and Exchange Commission http://www.sec.gov/about/whatwedo.shtml#intro.
[5] See §3(f) of the Securities Exchange Act of 1934 and §2(b) of the Securities Act of 1933.
[6] See, for example, August 20, 2019 letter of Bruce Bolger, Dr. Ron B. McKinley and Lee S. Webster, International Center for Enterprise Engagement, October 4, 2019 letter of Corey Bates, CEO, Auto Connection Manassas VA, October 5, 2019 letter of Daniel H. Kolber, CEO, Intellivest Securities, Inc., October 17, 2019 letter of Thomas L. Riesenberg, Director of Legal and Regulatory Policy, Sustainability Accounting Standards Board (SASB), and October 21, 2019 letter of John Hoeppner, Head of US Stewardship and Sustainable Investments, Legal & General Investment Management.

A tax has an excess burden or deadweight loss that can be calculated.[7] By introducing a wedge ($Tax_{ESG/CSR}$) between, in this case, the gross return and the net return, ESG/CSR reduces the size the capital market and therefore output and employment.

Cost of Capital and Investment

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.[8] Introducing a new tax (in this case $Tax_{ESG/CSR}$) will reduce the expected future income stream and therefore the price of the asset. It will also cause investment to flow out of the affected sector or jurisdiction.

Incidence

Who bears the actual economic burden of the corporate income tax is an open question.[9] 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;[10] owners of all capital (again in the form of lower returns);[11] corporate customers in the form of higher prices;[12] or employees (in the form of lower wages).[13] It is, almost certainly, some

[7] 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," Chapter 21 in *Handbook of Public Economics*, Martin Feldstein and A.J. Auerbach (Editors) (North Holland: 2002); 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. Also see, for example, N. Gregory Mankiw, *Principles of Economics*, 4th Edition (2006), Chapter 8 (or many other textbooks on price theory, microeconomics, or principles of economics).

[8] See Robert E. Hall and Dale Jorgenson, "Tax Policy and Investment Behavior," *American Economic Review*, vol. 57, No. 3 (June, 1967), pp. 391-414 for the basic user cost of capital analysis with taxes. See also Dale W. Jorgenson, *Investment: Capital Theory and Investment Behavior* (The 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.victoria.ac.nz/sacl/centres-and-institutes/cpf/publications/pdfs/2015-pubs/WP04_2015_Taxation-and-User-Cost.pdf.

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

[10] 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); Julie Anne Cronin, Emily Y. Lin, Laura Power, and Michael Cooper, "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).

[11] 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.

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

[13] 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*

combination of these.[14] 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.[15] Labor's share of the corporate tax burden is potentially as high as three-quarters.[16] Thus, the cost of ESG/CSR initiatives are likely to be mostly borne by employees in the form of lower wages and benefits.

Sincerely,

David R. Burton

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 Capital Shares of the Corporate Tax Burden: International Evidence," December 2007; and Jason J. Fichtner and Jacob M. Feldman, "Why Do Workers Bear a Significant Share of the Corporate Income Tax?" in *The Hidden Cost of Federal Tax Policy*, Mercatus Center, 2015, Chapter 4, 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.

[14] It requires extreme, implausible assumptions about elasticities of demand 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.

[15] 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, 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.

[16] Ibid.