RealClear Foundation

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By Electronic Mail
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Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: File No. S7-10-22: The Enhancement and Standardization of Climate-Related Disclosures for Investors

Submitted By: Bernard S. Sharfman and James R. Copland*

Dear Secretary Countryman,

We respectfully submit this letter as a means to bring to the Commission's attention deficiencies that we have found in its proposed rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors ("the Proposed Rule").[1] In our view, the Proposed Rule fails to comply with Congress's demand that agency actions not be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law,"[2] as interpreted by the Supreme Court to require an agency to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choices made."[3] Nor does the Proposed Rule comport with the "unique obligation" Congress has given the SEC to "to consider or determine whether an action . . . will promote efficiency, competition, and capital formation."[4] The Proposed Rule also runs afoul of the Constitution's commitment to federalism and separation of powers, both by substantially interfering with corporate governance, a creature of state law, without an express Congressional mandate,[5] and by resolving a "major question" of

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[1] Release Nos. 33-11042; 34-94478; File No. S7-10-22; RIN 3235-AM87 (conformed to Federal Register version), https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

[2] 5 U.S.C. § 706(2)(A).

[3] Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (internal quotation marks omitted).

[4] Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (2011); 15 U.S.C. § 78c(f).

[5] *See, e.g.*, Santa Fe Industries, 430 U.S. 462, 479 (1977) ("Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations . . . particularly where established state policies of corporate regulation would be overridden."); Cort v. Ash, 422 U.S. 66, 84 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law

policy clearly within the province of the legislative branch.[6] Because the Proposed Rule's disclosure requirements are not "purely factual and uncontroversial,"[7] they also implicate the First Amendment's prohibition against government-compelled speech. Although our analysis can apply more broadly to much of the Proposed Rule, we are providing comments clarifying this critique in significant detail as to two Sections of Part II of the Proposed Rule: Section G: GHG Emissions Metrics Disclosure ("Section G") and Section D: Governance Disclosure ("Section D").

I. SECTION G: GHG EMISSIONS METRICS DISCLOSURE

Our analysis of Section G focuses on how the Proposed Rule fits within the statutory requirements laid down by Congress in the Administrative Procedures Act ("APA")[8] and the securities laws.[9] We divide our analysis into three Parts. Part A focuses on the Proposed Rule's required disclosures for Scope 1 and 2 emissions, which are *not* limited by a materiality standard. Part B focuses on the required disclosures for Scope 3 emissions, which purportedly *do* face a materiality requirement. Part C focuses on deficiencies in the Proposed Rule's articulation of "investor demand" purporting to justify the need for Section G disclosures.[10]

A. Scope 1 and 2 Emissions Disclosures

In the Proposed Rule, unlike the SEC's 2010 interpretative release on climate change matters ("2010 Guidance"),[11] Scope 1 and 2 emissions disclosures are not limited by a "materiality standard." As defined in Rule 405 (a disclosures rule promulgated under the Securities Exchange Act of 1934) a materiality standard limits disclosures "to those matters to which there is a substantial likelihood that a *reasonable investor* would attach importance in determining whether to purchase the security registered."[12] The 2010 Guidance focused on the disclosure risk factors "that make an investment in the registrant speculative or risky" or "are reasonably likely to have a

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expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation").

[6] *See, e.g.*, Utility Air Regulatory Group v. EPA, 573 U. S. 302, 324 (2014); FDA v. Brown & Williamson Tobacco Corp., 529 U. S. 120, 159–160 (2000).

[7] Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 652-53 (1985); Nat'l Inst. of Family & Life Advocates v. Becerra, 138 S. Ct. 2361 (2018).

[8] 5 U.S.C. § 706(2)(A).

[9] 15 U.S.C. § 78c(f).

[10] *See* Proposed Rule, *supra* note 1, at 14, n.23 and Part I, Section C1.

[11] U.S. SEC. & EXCH. COM., *Commission Guidance Regarding Disclosure Related to Climate* Change, Release Nos. 33-9106; 34-61469 (Feb. 2, 2010). As the Proposed Rule noted, "The 2010 Guidance emphasized that if climate-related factors have a material impact on a firm's financial condition, disclosure may be required under current Item 101 (Description of Business), Item 103 (Legal Proceedings), Item 105 (Risk Factors), or Item 303 (MD&A) of Regulation S-K." *See supra* note 1, at 307.

[12] 17 C.F.R. § 230.405. This definition of materiality in the context of disclosures parallels what the U.S. Supreme Court said about materiality in the context of what needs to be disclosed in proxy materials. The U.S. Supreme Court defined material facts in the proxy context as facts for which there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *See* TSC v. Northway, 426 U.S. 438, 449 (1976).

material effect on a public company's [registrant's] financial condition or operating performance."[13] Thus, the 2010 Guidance only sought disclosure of climate-related risk disclosures that were material.

The Proposed Rule's novel non-materiality approach, a change in approach that was not explained or justified in the Proposed Rule, appears to follow from a speech made by Commissioner Allison Lee in May 2021.[14] In that speech, Lee argued that the SEC has broad authority to require such disclosures as they are "in the public interest," even if the disclosures are "not material" to a reasonable investor. She based this argument on broad wording found in the federal securities law that give the SEC authority to require disclosures as long as they are "in the public interest" and "for the protection of investors."[15] Commissioner Lee also pointed to various places in the securities laws in which a grant of SEC rulemaking authority is not immediately and expressly qualified by a materiality standard—including the prefatory language granting the Commission authority to promulgate rules and regulations requiring informational disclosures in issuer registration statements,[16] the prefatory language granting the Commission authority to promulgate rules and regulations governing issuers' required periodic reporting statements,[17] and the prefatory language granting the Commission authority to promulgate rules and regulations governing required supplemental and periodic disclosures by broker-dealers.[18]

We think Commissioner Lee's statutory reading here is overly cramped. For instance, even though the prefatory language in Section 13 of the Securities Exchange Act, codified at 15 U.S.C. § 78m(a), does not expressly point to "material" information, Congress's delineation of the information required in annual and quarterly reports in 15 U.S.C. § 78m(b)(1) clearly lists items required for a reasonable investor to make *financial* decisions regarding an investment in an issuer's securities[19]—precisely the sort of disclosures the Supreme Court has pointed to repeatedly in defining materiality under the securities laws.[20] Similar abutting textual constraints exist in the

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[13] *See supra* note 11.
[14] Allison Herren Lee, *Living in a Material World: Myths and Misconceptions about "Materiality*," U.S. SEC. & EXCH. COM. (May 24, 2021), https://www.sec.gov/news/speech/lee-living-material-world-052421 [https://perma.cc/F8FS-PF6U].
[15] *See generally* The Securities Act of 1933 and Securities Exchange Act of 1934.
[16] 15 U.S.C. § 78l(b).
[17] 15 U.S.C. § 78m(a).
[18] 15 U.S.C. § 78o(d).
[19] 15 U.S.C. § 78m(b)(1) (listing what the Commission "may prescribe" in annual and quarterly reporting as "the items or details to be shown in the balance sheet and the earnings statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer"). Nothing on this enumerated list of required disclosures comes close to the sorts of greenhouse gas disclosures that would be required under the Proposed Rule.
[20] *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988) ("materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information"); TSC Industries, Inc. v. Northway, Inc., 426 U. S. 438, 449 (1977) ("[A]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote… Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

other chapters, once a reader gets beyond the prefatory language. Moreover, Commissioner Lee's speech fails to grapple with the express, clarifying definitional command Congress added to the securities laws in 1996, which *universally requires* the Commission to consider in its rulemaking, "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[21] This Congressional addition of a prophylactic definition limiting SEC rulemaking was notably after—and implicitly incorporates[22]—the Supreme Court's 1977 and 1988 decisions in *TSC Industries* and *Basic*,[23] which articulated a materiality constraint in the federal securities laws.

Even if one were to assume that "materiality" as defined by the Supreme Court in other securities law context is not a requirement for the Commission in exercising its delegated rulemaking powers, that does not mean the SEC has the unfettered authority to require any disclosures it wants under the banner of "in the public interest." As stated by the U.S. Supreme Court: "This Court's cases have *consistently* held that the use of the words 'public interest' in a regulatory statute is not a broad license to promote the general public welfare. Rather, the words take meaning from the purposes of the regulatory legislation."[24] In this Part, we argue that the statutory language "for the protection of investors"—and the statutory requirement that the Commission's rulemaking "promote efficiency, competition, and capital formation"—place just such a limit on the SEC's legal authority when mandating non-material climate-risk disclosures.[25] The SEC cannot ignore this purpose when promulgating disclosure rules under the Acts.

1. "In the Public Interest"

Even though the term "in the public interest" is mentioned numerous times both in the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"; together the "Acts"), the Acts do not attempt to define it. Under *Chevron*,[26] the SEC's definition of an ambiguous statutory term must be given deference.[27] However, that deference, given to resolve statutory ambiguities, is still reviewable by a court and the SEC's definition can be rejected if the court has a "substantial reason for doing so."[28] As the Supreme Court has emphasized, an allusion to "public interest" in a broad statutory grant of power is not a "broad license to promote the general welfare," outside the delineated contours of a statutory scheme.[29]

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[21] National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416, 3434 (1996); *codified at* 15 U.S.C. § 77b(b); 15 U.S.C. § 78c(f).
[22] *Cf.* FDA v. Brown & Williamson Tobacco Corp., 529 U. S. 120, 156 (2000)("Under these circumstances, it is clear that Congress' tobacco-specific legislation has effectively ratified the FDA's previous position that it lacks jurisdiction to regulate tobacco.").
[23] 426 U. S. 438; 485 U.S. 224.
[24] NAACP v. FPC, 425 U.S. 662, 669 (1976).
[25] The foundation for this argument can be found in Mr. Sharfman's article, *Non-Material Mandatory Climate Change Disclosures*, 1 OHIO STATE BUS. L. J. ONLINE 1 (2021), https://moritzlaw.osu.edu/sites/default/files/2021-12/Non-Material%20Mandatory%20Climate%20Change%20Disclosures%20%28Author%20Final%20Clean%29.pdf.
[26] Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837, 844-845 (1984).
[27] SEC v. Citigroup Global Markets Inc., 673 F.3d 158, 168 (2d Cir. 2012).
[28] *Id.*
[29] NAACP, 425 U.S. at 669.

In this instance, we need not wrestle with how to reconcile *Chevron* deference with *NAACP*'s limitation on broad "public interest" grants of authority, given other, parallel language in the securities laws that limits SEC rulemaking to actions both "for the protection of investors" and to "promote efficiency, competition, and capital formation." These parallel requirements lead to a clear inference that the provisions of the Proposed Rule requiring non-material disclosures of greenhouse gas emissions are arbitrary and capricious violations of the APA.

2. "For the Protection of Investors"

What does "for the protection of investors" mean in the context of mandatory climate-risk disclosures? Like "in the public interest," the term "for the protection of investors" is not directly defined in the Acts. However, the meaning should be clear. The Acts were children of the 1929 stock market collapse and meant to correct the wrongs that paved the way for the Great Depression:

> The stock market crash of 1929 exposed a catalogue of corporate practices employed to deceive and discriminate against the small investor. These practices were largely instrumental in bringing on *mass financial ruin*. For years corporations had floated large quantities of unsound stocks without telling investors about the true state of their assets and earning power, or the identity of their promotors, managers, and chief stockholders. Corporate insiders, capitalizing on secret information about impending corporate action, had themselves extracted huge profits from ordinary investors by selling their own stock to the public in advance of expected price declines. Organizers of holding and investment companies, by obtaining unfair contracts or excessive payments from their operating subsidiaries, had siphoned off vast sums of subsidiary profits. In reorganizations, security conversions, and dividend declarations, the interests of small investors were often sacrificed to those of large stockholders.[30]

As noted by former Chairman Arthur Levitt, "the primacy of investor interests was present at the creation" of the SEC; investor protection is the "overriding concern" of our securities laws: [31] "[T]he foremost mission of the SEC for 62 years has been *investor protection*, and no matter how well-intentioned any additional role may be, it will inevitably distract attention from our primary focus. That's a price we can ill afford."[32]

Understanding just what investor protection means in the securities laws requires understanding the Acts in this context: the Acts were focused on protecting "investors from fraud, an unlevel informational playing field, the extraction of private benefits from the firm by firm insiders, and investors' propensity to make unwise investment decisions…."[33] Such protections made sure that investors are adequately informed of firm-specific investment risks that may impact

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[30] Unnamed author, *The Meaning of "Control" in the Protection of Investors*, 60 YALE L. J. 311, 311 (1951).
[31] Arthur Levitt, Remarks by Chairman Arthur Levitt, U.S. Sec. and Exch. Comm'n, Commonwealth Club, San Francisco, Cal. (May 17, 1996), [https://perma.cc/9T5H-JPSS]
[32] *Id.*
[33] Michael D. Guttentag, *On Requiring Public Companies to Disclose Political Spending*, 2014 COL. BUS. L. REV. 593, 619 at n.92 (2014) citing Michael D. Guttentag, *Protection from What? Investor Protection and the Jobs Act*, 13 UC DAVIS BUS. L.J. 207, 222-233 (2013).

their *financial return*.[34] Under the Acts, this is the one interest that all investors have in common.[35] And this singular interest comports with the Supreme Court's emphasis on disclosure rules cabined by materiality in making "*investment* decision[s]"—*i.e.*, disclosure of information "significant to the *trading decision* of a *reasonable* investor."[36]

3. The National Securities Markets Improvement Act of 1996 and APA Analysis

Whenever the term "in the public interest" appears in the Acts, the term "for the protection of investors" is almost always sure to follow. In 1996, Congress clarified whether the two terms are to be understood as being conjunctive ("and") or disjunctive ("or")[37]—making clear that investor protection is an additional requirement on top of a "public interest" rationale. In adding a new Section 2(b) to the Securities Act and Section 23(a)(2) to the Exchange Act, Congress not only helped to clarify this ambiguity but also articulated a third, more specific requirement the SEC must consider "in addition to" the other two:

> 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.[38]

In sum, whenever the SEC promulgates mandatory disclosures, it must consider *not only* "the public interest" *but also* "the protection of investors" *and* whether the proposed rule or regulation "will promote efficiency, competition, and capital formation." In other words, the SEC would be committing an arbitrary and capricious act, an act in violation of the APA, to promulgate mandatory disclosures based on the rationale of being "in the public interest" independent of its requirement to consider "the protection of investors" and "efficiency, competition, and capital formation."

Such analysis frames how we should consider any required disclosures related to climate change. For example, the 2010 Guidance recommends a number of disclosures that focus on firm-specific investment risks.[39] The following topics, assuming they would materially impact the reporting company's financial condition and result of operations, would require disclosure under that Guidance: the impact of climate-change legislation and regulation; international accords on climate change, such as the Paris Accord; indirect consequences of climate-change regulation, such as a reduction of demand for goods that create high levels of greenhouse gas emissions; and the physical impacts of climate change, such as severe weather, on the company's operations.[40]

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[34] Sean J. Griffith, *What's "Controversial" About ESG? A Theory of Compelled Commercial Speech under the First Amendment* at 53 (Date poste May 31, 2022) (citations omitted), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4118755.
[35] *Id.*
[36] *Basic*, 485 U.S. at 234 (citing *TSC Industries*, 426 U. S. at 448-49).
[37] *See*, Wm. Dennis Huber, *The Myth of Protecting the Public Interest: The Case of the Missing Mandate in Federal Securities Law*, 16 J. BUS. & SECURITIES L. 401, 418 (2016).
[38] Securities Act § 2(b); Exchange Act § 23(a)(2).
[39] *See supra* note 11.
[40] *Id.*

Some of these purported risks may be too inchoate or speculative to form a coherent disclosure regime, but they broadly comport with the Acts' delegation to the SEC of authority to require disclosures regarding firm-specific investment risks. What the Acts decidedly do *not* do, however, is specify or imply that disclosures "for the protection of investors" include those that are for the purpose of "expressive investor protection."[41] This is a term coined by Professor Michael Guttentag and refers to disclosures that investors would use to protect themselves from investing in securities issued by firms with attributes that investors simply find objectionable.[42] For example, disclosures on the level of Scope 1 and 2 emissions that an issuing company may produce are, by implication in the Proposed Rule, *not* necessarily material, financially, on a firm-specific basis, and thus not delimited to a reasonable investor's *financial* decision to buy or sell a given issuer's securities.

Such disclosures could, of course, empower some investors to reject investment in the securities of a company that produces carbon emissions that go beyond a certain level and help certain investment advisors structure "ESG" funds in which some investors may wish to invest.[43] But such "expressive investor protection" is not currently provided for in the Acts and therefore requiring such climate change disclosures would be an arbitrary and capricious act under the APA, absent Congressional directive. Simply put, promulgating such disclosures is not currently within the SEC's authority. For the SEC to have such authority, Congress must provide it in new legislation.

B. Scope 3 Emissions Disclosures and the "Materiality Standard"

The Proposed Rule allegedly incorporates a "materiality standard" in its required disclosures of Scope 3 emissions. Commissioner Pierce has strongly criticized this "materiality standard," saying in essence it is a "fiction."[44] We agree with Commissioner Pierce's argument and her conclusion. For a court to also come to this conclusion would mean that requiring these disclosures would be an "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[45] As a result, a court would have no choice but to vacate the Proposed Rule to the extent it requires these proposed disclosures.

However, even if this Scope 3 materiality standard was not a fiction, we still argue that the required Scope 3 disclosures are unlawful under the APA. The problem is that the SEC's application of its convoluted materiality standard to Scope 3 emissions is unmoored from the Acts under which the Congress has delegated—and cabined—SEC rulemaking authority. These purported disclosures may be "in the public interest" in some sense; just not in the sense meant by the securities laws. A "reasonable investor" may be interested in having this information *for*

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[41] *See* Guttentag, *On Requiring Public Companies to Disclose Political Spending*, *supra* note 33, at 606.
[42] *Id.*
[43] For a further discussion of the shortfalls of the purported "investor demand" benefit articulated in the Proposed Rule, *see infra* Parts I.C. and Part II.C.1.
[44] Hester M. Peirce, *We are Not the Securities and Environment Commission - At Least Not Yet*, Statement (March 21, 2022), https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321.
[45] *Id.* quoting 5 U.S.C. § 706(2)(A).

reasons other than ascertaining the financial risk of the security to be bought or sold; but the latter, not the former, is the actual nexus required by Congress in its grant of authority to the Commission. And the materiality standard as defined in the Proposed Rule, even if we take it at face value, has *nothing* to do with the actual limitation Congress put on the SEC's rulemaking authority—"for the protection of investors"—as described above; let alone "efficiency, competition, and capital formation." Unlike the 2010 Guidance, the proposed Scope 3 disclosures have nothing to do with investors being adequately informed of firm-specific investment risks, and relevance to *those risks* is the limit Congress has placed on the SEC's rulemaking authority.

If the SEC does not incorporate "for the protection of investors" into its required Scope 3 disclosures, and show adequately how those disclosures "promote efficiency, competition, and capital formation," the federal courts will determine that the SEC acted in an arbitrary and capricious manner, requiring the court to vacate these disclosures—regardless of whether or not the courts credit the Proposed Rule's novel definition of materiality. Again, for the SEC to go beyond this limitation on SEC authority, Congress must provide it in new legislation.

C. The Premise of Strong Investor Demand for Section G Disclosures

According to the Proposed Rule, Section G disclosures are warranted because of a purported "investor demand" that exists for such disclosures. In reaching this conclusion, the Proposed Rule exclusively cites the wishes and desires of institutional investors and investment advisers, such as BlackRock, Vanguard, and State Street Global Advisors, who have signed up to support ClimateAction 100+, the Glasgow Financial Alliance for Net Zero, and CDP Capital Markets.[46]

The Proposed Rule characterizes the wishes and desires of these institutional investors and investment advisors as "significant investor demand for information about how climate conditions may impact their investment."[47] But the actual goals articulated by the climate-oriented entities to which the Proposed Rules point seems to be the exact opposite: *they purport to seek information about climate emissions with an eye toward how their investment decisions impact climate conditions*:

- The Climate Action 100+ is an "investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change."[48] The initiative "was formed in the wake of the 2015 Paris Agreement" and expressly seeks "greater disclosure of climate change risks and robust company emissions reduction strategies . . . to achieve the goals of the Paris Agreement."[49]

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[46] *See* Proposed Rule, *supra* note 1, at 14, n.23 and Part I, Section C1.
[47] 87 Fed. Reg. at 21,340. (emphasis added).
[48] About, Climate Action 100+, https://www.climateaction100.org/about/ (last accessed May 4, 2022).
[49] *Id.*

- The Glasgow Financial Alliance for Net Zero has as its express goal to "transform the global financial system in order to finance the investment in a net-zero economy."[50]
- CDP Capital Markets is a "global non-profit" that "aims to make environmental disclosure mainstream . . . to drive urgent action towards a climate safe, water secure future for all."[51]

The other climate groups upon which the Proposed Rule relies betray similar focus not on acquiring disclosures to assess investment performance but rather to facilitate their climate-policy goals independent of actual financial relevance to their investment portfolios.[52] In each case, the main motivation of the group does not appear to be protecting financial performance from the risks of climate change but using financial vehicles to drive companies to change policies in a direction that the group believes will reduce climate change. Climate-related financial disclosures are then just a means to an end: in creating a broad disclosure scheme, climate activists open the door to public shaming and to aggressive enforcement actions by the SEC, other agencies, state, and local officials, and in particular to private lawsuits by the plaintiffs' bar.[53]

What about the institutional investors and investment advisors themselves to which the Proposed Rule alludes? Unlike the climate activists themselves, who may want this information so that they may push the planet in a "greener" direction, the institutional investors may have less altruistic motivations for calling for these disclosures. As discussed previously, it is unlikely that the climate-related risk disclosures being called for in the Proposed Rule will have anything to do with the true value of underlying securities—and thus are not material to investors, as materiality has traditionally been understood. But requiring these disclosures *is* economically important to the financial services firms and asset managers who are calling for them—and who hold others' assets

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[50] The Glasgow Financial Alliance for Net Zero (Nov. 2021), https://assets.bbhub.io/company/sites/63/2021/11/GFANZ-Progress-Report.pdf

[51] CDP Capital Markets (2021 General Brochure), https://cdn.cdp.net/cdp-production/comfy/cms/files/files/000/004/697/original/2021_CDP_Capital_Markets_Brochure_General.pdf.

[52] The Investor Agenda, referenced on 87 Fed. Reg. at 21,340, states that its in-vestment goals are to "set a net-zero target," to achieve "net-zero emissions by 2050 or sooner," to "phase out investments in thermal coal." *Investment*, The Investor Agenda, https://theinvestoragenda.org/focus-areas/investment/ (last accessed May 4, 2022). These changes are "fundamental to the kind of society we want to see, to the planet's future, to how business operates." Paul Simpson, CDP CEO and founding partner of The Investor Agenda, *The role of investors and governments in the transition to a net zero economy: a conversation with Kwasi Kwarteng MP*, The Investor Agenda (Apr. 7, 2021), https://theinvestoragenda.org/blog/kwasi-kwarteng-mp/.

The Net Zero Asset Managers initiative, referenced on 87 Fed. Reg. at 21,340, states that it is "committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with net zero emissions by 2050 or sooner." The Net Zero Asset Managers initiative, https://www.netzeroassetmanagers.org/ (last accessed May 4, 2022).

The CERES investor network, referenced on 87 Fed. Reg. at 21,338, is "working to decarbonize six of the highest-emitting sectors. We're building a zero emissions economy by driving greater corporate ambition, transparency, and accountability for aggressive reductions in greenhouse gas emissions." Their website explains that they "work to achieve strong commitments and action from key companies and spur a competitive cascade among sector peers, including by addressing Scope 3 in-direct emissions throughout supply and value chains." They accomplish these goals through their "powerful networks" and through their sponsorship of the "influential global Climate Action 100+ initiative." *Ceres Ambition 2030*, Ceres, https://www.ceres.org/climate/ambition2030 (last accessed May 4, 2022).

[53] For a fuller discussion of the interplay between regulatory rulemaking, enforcement actions, and private plaintiff litigation, see generally JAMES R. COPLAND, THE UNELECTED: HOW AN UNACCOUNTABLE ELITE IS GOVERNING AMERICA (Encounter Books 2020), especially chapters 6 and 12.

in a fiduciary relationship. The reason is simple: these institutional investors are large investment advisers to index funds that seek standardized climate-change reporting data in order to facilitate the creation of "ESG" ratings. Such ratings in turn facilitate the creation of ESG funds that are significantly more profitable than low-cost traditional, "plain vanilla" index funds.[54] Therefore, these investment advisers must be understood by the SEC to be conflicted sources of authority for Section G disclosures.

Asset managers stand to make a good deal of money through ESG-oriented indexing. At the end of 2020, exchange-traded ESG funds had average fees of 0.2% while standard exchange-traded funds ("ETFs") that invest in U.S. large-cap stocks had a 0.14% fee on average—a relative 43% difference.[55] Even a seemingly small increase in fees can have a big impact when scaled. As Michael Wursthorn explains, "A firm managing $1 billion in a typical ESG fund, for example, would garner $2 million in annual fees versus managing the standard ETF's $1.4 million."[56] BlackRock, one of the leading proponents of climate-risk disclosures and ESG in general, has $10 trillion in assets under management.[57]

The Big Three asset managers—BlackRock, Vanguard, and State Street—together control more than $20 trillion in assets and in 95% of those public companies that make up the S&P 500, one of the Big Three is the largest shareholder.[58] The growth of these asset managers has been largely spurred by the rise of passively managed funds.[59] But while their *fiduciary duties to their customers* lie with maximizing rates of return, these asset managers' *pecuniary interests* lie in

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[54] For example, mutual funds and ETFs that track indices structured for the ESG investor can typically charge significantly higher fees than funds and ETFs that plain vanilla indices like the S&P 500. *See*, Bernard S. Sharfman, *ESG Investing under ERISA*, 38 YALE J. ON REG. BULLETIN at 127-28 (2020). *See also*, Aswath Damodaran, *The ESG Movement: The "Goodness" Gravy Train Rolls On!* (Sept. 14, 2021), https://aswathdamodaran.blogspot.com/2021/09/the-esg-movement-goodness-gravy-train.html, for an excellent diagram of the interested parties that would financially benefit by increased levels of ESG investing.

[55] Michael Wursthorn, *Tidal Wave of ESG Funds Brings Profit to Wall Street*, WALL ST. J. (Mar. 16, 2021), https://www.wsj.com/articles/tidal-wave-of-esg-funds-brings-profit-to-wall-street-11615887004.

[56] *Id.*

[57] Silla Brush & Alex Wittenberg, *BlackRock Assets Hit Record $10 Trillion, Powered by ETFs*, BLOOMBERG (Jan. 14, 2022), https://www.bloomberg.com/news/articles/2022-01-14/blackrock-s-assets-pass-10-trillion-for-the-first-time.

[58] Lucian Bebchuk & Scott Hirst, *The Power of the Big Three and Why it Matters*, forthcoming, B.U. L. REV. (2022), http://www.law.harvard.edu/faculty/bebchuk/The_Power_of_the_Big_Three_and_Why_It_Matters.pdf.

[59] That these large asset managers' portfolios are predominantly passive makes them broadly *unsuitable* to speak as authorities on the value of SEC-mandated disclosures. As noted by Fordham law professor Sean Griffith in a draft paper analyzing the First Amendment implications of the Proposed Rule:

> These passive investments . . . do not benefit from further information disclosures because they simply follow an algorithm or track an index. Indeed, if there is voice that ought not to be seriously considered in advocating further disclosures, it is the voice of fund complexes managing non-information sensitive passive investments. If institutional investors are to be considered at all on the topic of more or less disclosures, it is only the active funds—the funds that actually use and therefore benefit from disclosures—that should count.

Griffith, *What's "Controversial" About ESG? A Theory of Compelled Commercial Speech under the First Amendment*, *supra* note 34, at 49.

maximizing assets under management and increasing fees.[60] This calculus is driving asset managers to turn to higher-priced products to drive higher revenue. "Green" funds provide a suitable vessel. BlackRock, for example, pulled $68 billion into its sustainable products in 2020, representing more than 60% annual growth.[61] (Still, most investors don't seem to think it is worth paying for the added climate information. Most of BlackRock's assets reside in generic ETFs which follow passive strategies and simply track indexes like the S&P 500.[62])

Asset managers stand to gain from required ESG disclosures in another way. As Michael Baruza and his co-authors suggest in a recent law review article:

> With fee competition exhausted and returns irrelevant for index investors, signaling a commitment to social issues is one of the few dimensions on which index funds can differentiate themselves and avoid commoditization. For index funds, the threat of millennial migration to another fund is more significant than the threat of management retaliation.[63]

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[60] In the context of the voting and engagement of the Big Three investment advisers to index funds, BlackRock, Vanguard, and State Street Global Advisers, Mr. Sharfman has written:

> The Big Three exist in a super competitive industry with extremely low management fees, providing the Big Three with very little ability to spend resources on becoming informed about portfolio companies. In sum, the Big Three are not being paid to be informed, only to do as much as they can to serve the interests of beneficial investors when they vote and engage on their behalf.
>
> Conflicts arise because of their potential use of voting and engagement to enhance their market share of assets under management:
>
> Since the Big Three are generally uninformed, they cannot enhance the value of the stock market through their uninformed voting and engagement. Instead, they focus on enhancing market share. This is where they get the most 'bang for the buck'. The successful implementation of a marketing strategy, as reflected in an increased market share of a U.S. stock market currently valued at around $50 trillion, provides an opportunity for the Big Three to potentially acquire trillions of dollars of assets under management (AUM) without having to become informed. This is the business strategy that academic scholars have so far missed in their understanding of Big Three voting and engagement.
>
> For example, to support the Big Three's millennial marketing strategy, the Big Three, individually or as a group, may be tempted to vote in a way that increases market share, i.e., voting in a way that appeals to millennials, without much regard for how it may impact the value of a portfolio of stocks found in an index fund. This is because an expected small positive movement in market share will, in terms of AUM, overwhelm any expected loss in the value of an index fund or family of funds from their voting and engagement. Therefore, given the potential for such great rewards, it is argued that there is also great potential for opportunistic behavior in order to facilitate the success of this strategy.

Bernard S. Sharfman, *Looking at the 'Big Three' Investment Advisers Through the Lens of Agency*, OXFORD BUS. L. BLOG (Feb. 18, 2022), https://www.law.ox.ac.uk/business-law-blog/blog/2022/02/looking-big-three-investment-advisers-through-lens-agency. *See also*, Bernard S. Sharfman, *Opportunism in the Shareholder Voting and Engagement of the "Big Three" Investment Advisors to Index Funds*, (forthcoming, J. CORP. L., Vol. 48), https://ssrn.com/abstract=3995714.
[61] Wursthorn, *supra* note 55.
[62] *See id.*
[63] Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 USC L. REV. 1243, 1244 (2020).

In light of the obvious conflicts of interest institutional investors and investment advisors face with regard to the Proposed Rule, the one-sided nature of the investor interests articulated in the Proposed Rule is striking. The investor authority cited in the Proposed Rule exclusively represents the preferences of *institutional investors*, not the preferences of the beneficial investors and pension fund beneficiaries whose financial interests they represent, nor the individuals who do not invest through such intermediaries ("retail investors"). The interests of these 100-million-plus retail investors should be reflected in Section G disclosures,[64] not their institutional investor agents who simply manage the money of retail investors—and —whose fiduciary duties to their beneficial investors are in tension with, and arguably inversely related to their own pecuniary interests. But the Proposed Rule lacks any rigorously executed survey results that support the notion that these investors are demanding Scope 1, 2, and 3 disclosures. Without such data, the premise of great investor demand cannot be used to support the need for such disclosures–and the promulgation of a rule that requires such disclosures must be considered an arbitrary and capricious act under the APA.

(To be clear, even if the SEC could adequately demonstrate that retail investors desired Section G disclosures, this does not provide the legal grounds for the SEC to require them. As already discussed, Congress's grant of authority to the SEC to regulate "for the protection of investors" is cabined to information that will help an investor understand a company's firm-specific investment risks, from a financial perspective. Such disclosure authority does not include the providing of Scope 1, 2, and 3 information as defined in the Proposed Rule.)

II. SECTION D: GOVERNANCE DISCLOSURE

The Proposed Rule requests readers to respond to a number of questions on Section D disclosures. Our response is that we would answer a strong "no" to questions 34 to 41 on pages 98-100 of the Proposed Rule. Our response is based on the analysis provided below. We divide our analysis into four Parts. Part A makes the argument that these disclosures will cause general harm to board decision-making. Part B finds that Section D disclosures significantly interfere with the state laws that govern corporations. Moreover, they do so without express authority provided by federal statutory law. Lacking such authority, a reviewing court would be compelled to vacated these disclosures. Part C discusses how the Proposed Rule has failed to substantiate the two primary premises underlying Section D disclosures: investor demand and the speed with which we are moving to a net-zero economy. Therefore, a reviewing court would find the use of such premises to be arbitrary and capricious under the APA. Part D finds that Section D disclosures are not supported by an adequate cost-benefit analysis as required by *Business Roundtable*. This lack of analysis would cause a reviewing court to find the disclosures to be arbitrary and capricious under the APA.

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[64] INV. CO. INST., 2021 INVESTMENT COMPANY FACT BOOK 1 (2021) (Over 100 million U.S. residents currently invest in mutual funds and ETFs.), https://www.ici.org/system/files/2021-05/2021_factbook.pdf.

A. General Harm to Board and Manager Decision-Making

We believe that the proposed Section D disclosures[65] will cause general harm to the decision-making of boards of directors and managers of corporations falling under the Proposed Rule. A summary of these disclosures makes that point very apparent. They require a public company to provide "a description of the *processes* and *frequency* by which the board or board committee discusses climate-related risks," including "*how* the board is informed about climate-related risks; *how* frequently the board considers such risks" and "*whether and how* the board or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight."[66] The latter is meant to help "an investor to understand *whether and how* the board or board committee considers climate-related risks when reviewing and guiding business strategy and major plans of action, when setting and monitoring implementation of risk management policies and performance objectives, when reviewing and approving annual budgets, and when overseeing major expenditures, acquisitions, and divestitures."[67] In addition, "the proposed rule would require disclosure about *whether and how* the board sets climate-related targets or goals and *how* it oversees progress against those targets or goals, including the establishment of any interim targets or goals. Such a target might be, for example, to achieve net-zero carbon emissions for all or a large percentage of its operations by 2050 or to reduce the carbon intensity of its products by a certain percentage by 2030 in order to mitigate *transition risk*."[68]

In regard to management, "a registrant would be required to disclose, as applicable, whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, to identify such positions or committees and disclose the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise."[69] Moreover, it would also "require disclosure about the *processes* by which the responsible managers or management committees are informed about and monitor climate-related risks."[70] Finally, the Proposed Rule would require "disclosure about *whether* the responsible positions or committees report to the board or board committee on climate-related risks and *how* frequently this occurs."[71]

These disclosures, especially as they pertain to the *whether* and *how* of board decision-making, including those critical decisions that pertain to: "business strategy and major plans of action, when setting and monitoring implementation of risk management policies and performance objectives, when reviewing and approving annual budgets, and when overseeing major expenditures, acquisitions, and divestitures,"[72] make the board extremely vulnerable to second-guessing and public criticism by shareholders and investment advisers to index funds who lack the information,

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[65] Release Nos. 33-11042; 34-94478, *supra* note 1, at 93-98.
[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] *Id.*
[72] *Id.*

experience, and skill to make informed decisions. Moreover, as previously discussed, we also believe that large investment advisers to index funds with delegated shareholder voting authority will be potentially conflicted when they vote and engage with companies based on the proposed Section D disclosures.[73] The combined result would be to cool the ability of the board, the most informed locus of authority in a corporation, to make decisions that are guided by their own understanding of what is in the best interests of the company.

In addition, Section D's management disclosures puts the board in the position of having to disclose how it structures climate-risk decision-making at the management level. Such disclosures inhibit the ability of the board, with the advice of top management, to act freely in structuring the company's management decision-making processes.

If so, then Section D disclosures will significantly interfere with how a corporation is intended to be managed under state corporation law. This law, such as Delaware General Corporation Law, universally directs that the governance of a corporation, including the setting of objectives and selecting the strategies that will achieve those objectives, be concentrated in the hands of the company's board of directors.[74] Moreover, in contrast to Section D disclosures, the business judgment rule protects board decision-making from the second-guessing of disgruntled shareholders.[75] State statutory law also allows the board to designate "officers" of the corporation ("executive management").[76] This additional "locus of authority, separate from but under the control of the board, not only runs the company on a day-to-day basis but also provides the board with recommendations on what investment projects and strategies the company should proceed with and then implements them with Board approval."[77]

The reason why state corporation law takes such an approach is that channeling information into a centralized, hierarchical authority allows for the efficient management of for-profit corporations.[78] This is especially true of a large organization such as a public company. According to Nobel laureate economist Kenneth Arrow, efficiency is created in a large organization because "the centralization of decision-making serves to economize on the transmission and handling of information."[79] Moreover, "information scattered throughout a large organization must be both filtered and transmitted to a centralized authority in order for a large organization to make informed decisions and minimize error in decision-making."[80]

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[73]*See supra* Part I.C. and n.60.
[74] See Del. Code Ann. 8, § 141(a).
[75] Bernard S. Sharfman, *The Importance of the Business Judgment Rule*, 14 N.Y.U. J.L. & BUS. 27, 45–47 (2017) (summarizing rationales behind judicial reluctance to second guess managerial expertise).
[76] See Del. Code Ann. 8, § 142(a).
[77] Bernard S. Sharfman, *Activist Hedge Funds in a World of Board Independence: Creators or Destroyers of Long-Term Value*, 2015 COLUM. BUS. L. REV. 813, 838 (2015).
[78] KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 68-70 (1974).
[79] *Id.*
[80] Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 403 (2014).

This value of hierarchical authority is what corporate law scholars Michael Dooley and Stephen Bainbridge consider to be the crown jewel of corporate governance[81] and is why Bainbridge made the bold statement that the "[p]reservation of managerial discretion should always be the null hypothesis."[82]

Of course, the authority of centralized decision-making needs to be held accountable to some extent. This accountability is provided by shareholders when exercising their voting rights.[83] As stated by Frank Easterbrook and Daniel Fischel in their classic work *The Economic Structure of Corporate Law*, "The right to vote is the right to make all decisions not otherwise provided by contract—whether the contract is express or supplied by legal rule."[84] Shareholders vote on major corporate actions such as the election of corporate directors,[85] merger agreements,[86] proxy contests,[87] changes to the articles of incorporation,[88] and the election of directors at the annual meeting.[89] However, while vitally important in framing the corporation's overarching governance, these actions are extremely limited compared to the millions of decisions made annually in a public company.

The reasons for these limits on the shareholder franchise are clear, and stretch beyond information efficiencies.[90] As one of us has written in a parallel context:

> [T]he cost of monitoring managers is not the only cost of ownership. Rather, ownership costs include . . . the cost of collective decision-making, and . . . the cost of risk-bearing. The second and third forms of ownership costs are highly significant: although the cost of monitoring managers in large C-corporations with large numbers of shareholders has long been understood to be relatively high, and even though there are commonplace alternative forms of ownership, the largest for-profit enterprises overwhelmingly assume a shareholder-ownership form. . . .
>
> The fact that shareholder-owned corporations have avoided the high costs of heterogeneous collective decision-making by orienting shareholders around a single homogeneous concern, shareholder return, is profoundly important in explaining this pattern. . . .

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[81] *See, e.g.*, Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 487 (1992); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547 (2003).
[82] Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 109 (2004).
[83] Bernard S. Sharfman, *The Risks and Rewards of Shareholder Voting*, 73 S.M.U. L. Rev. 849, 851-52 (2020).
[84] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 66 (1991).
[85] DEL. CODE ANN. tit. 8, § 216(3) (2020).
[86] *Id.* § 251(c).
[87] 17 C.F.R. §§ 240.14a-1 to -104 (2020).
[88] tit. 8, § 242(b)(1).
[89] *Id.* § 211(b).
[90] *See generally* Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006) (arguing that increasing the power of shareholders to hold managers accountable, including through increased disclosure, imposes significant costs in reduced managerial authority).

> The high costs of aggregating votes along heterogeneous interests is self-evident to any observer of real-world electoral republics, as well as to anyone remotely familiar with the public-choice literature, which is predicated substantially upon the notion that it is impossible to aggregate heterogeneous interests in binary elections.[91]

State law, by limiting the ability of shareholders to participate directly in day-to-day corporate decision-making, implicitly agrees with those corporate governance commentators who fear that by giving too much decision-making authority to shareholders, "the genuine values of authority" will be destroyed.[92] When that occurs, "accountability can be understood to cross over the line to where a new and competing locus of authority is created—a locus of authority, such as uninformed shareholders, that does not benefit from the informational advantages of the original authority."[93]

As so well stated by noted corporate law scholars James Cox and Randall Thomas:

> Corporations are not democratic institutions. In a democracy, power flows from the voting populace, and it is this body that is then governed. The populace governs the procedures for selecting candidates for office so that continued service as its elected representative depends heavily on popular support to be the nominee in the election. This is not the case with the corporation. By statute, power over corporate affairs is lodged in the corporation's "governor"—the board of directors. Importantly, the source of the board's power and its legitimacy is derived from the statute and not the shareholders. In addition, the power is exercised over interested parties, such as nonvoting security holders and labor, who do not vote in the election of directors. Indeed, the spheres within which shareholders have authority are limited in number and deeply circumscribed. . . . To be sure, stockholder

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[91] James R. Copland, *Against an SEC-Mandated Rule on Political Spending Disclosure: A Reply to Bebchuk and Jackson*, 3 HARV. BUS. L. REV. 381, 392 (2013) (citations omitted). *See generally* ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) (the classic exploration of agency costs in the American corporation). *See also* KENNETH K. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (1963) (articulating Arrow's Impossibility Theorem, which holds that, given certain fairness criteria, voters facing three or more ranked alternatives cannot convert their preferences into a consistent, community-wide ranked order of preferences).

UCLA law professor Stephen Bainbridge argues that the general absence of increased shareholder voting rights in initial public offering documents *ipso facto* suggests their net efficiency; Bainbridge therefore concludes that limited shareholder voting rights should be preserved as a default rule. Stephen A. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1735–38 (2006).

Yale law professor Henry Hansmann argues that the principal reason why shareholder ownership is the dominant form of business organization is that limited shareholder voting rights minimize the costs of collective decision-making:

> Most fundamentally, political representation evidently performs poorly, relative to markets, where there is any significant conflict of interest among the participants. Or at least this seems to be the obvious conclusion to be drawn from the fact that, although there are hundreds of thousands of firms in the economy, and although these firms exhibit a diverse variety of ownership structures, including a surprisingly large number of firms in which ownership is not in the hands of investors, in virtually all cases the group of individuals to whom ownership is given is extremely homogeneous in its interests. It is extraordinarily rare to find a firm in which control is shared among individuals who have stakes in the enterprise that are at all dissimilar.

HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 288 (1996).

[92] Arrow, *supra* note 78, at 77–78.

[93] Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law supra* note 80, at 406.

> approval is required for so-called fundamental transactions, such as mergers and the sale of substantially all of the company's assets. However, these transactions must be initiated by the board of directors, which controls their timing as well as the information upon which shareholders rely in deciding whether to approve the matter.[94]

Moreover, they go on to say:

> The genius of business organizations is their efficiency, which in large measure flows from enabling individuals with very different skills, experiences, and other endowments to combine with resulting synergies. Business organization law facilitates specialization and, in doing so, accommodates the unique limitations of owners whose personal endowment and circumstances justify their status as owners but not managers of the enterprise.[95]

In sum, we find that Section D disclosures will provide a seat in the board room to uninformed and potentially conflicted third parties. The Proposed Rule has not at all adequately assessed these costs, and as such is unlikely to survive arbitrary-and-capricious review under the APA. Therefore, we strongly urge the SEC to reevaluate the potential negative impact Section D disclosures will have on board and management decision-making.

B. Interfering in the "Internal Affairs" of a Corporation

The concerns about interfering with board and management prerogatives, raised in Part II.A., are not only prudential, economic considerations highly pertinent as to judicial review of the Proposed Rule under the APA. By interfering with the internal governance of corporations without an express Congressional command, the Proposed Rule illegitimately supplants state law.[96]

The U.S. Supreme Court has repeatedly stated that the SEC does not have the authority to interfere in the governance of corporations unless Congress has provided it with *express* authority to do so: "Corporations are creatures of state law, and *investors* commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the *internal affairs* of the corporation."[97] This means that SEC actions, including required disclosures, cannot, without the express authority provided by federal statute, be used to trump the state laws that provide the parameters for corporate governance. Because the Section D disclosures implicitly override state corporate law without the express authority provided by a Congressional enactment, they should be removed from the Proposed Rule.

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[94] James D. Cox, Tomas J. Mondino & Randall S. Thomas, *Understanding the (Ir)relevance of Shareholder Votes on M&A Deals*, 69 Duke L. J. 503, 515-16 (2019).
[95] *Id.*
[96] U. S. CONST., Amdt. 10 ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people"); Gregory v. Ashcroft, 501 U. S. 452, 457 (1991) (discussing the "dual sovereignty" allocated vertically between the federal and state governments in the American constitutional scheme).
[97] Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 479 (1977) (quoting Cort v. Ash, 422 U.S. 66, 84 (1975)). *See also* Business Roundtable v. SEC, 905 F. 2d 406, 412 (D.C. Cir. 1990).

Section D disclosures usurp the decision-making authority of corporate boards and executive management, authority specifically granted to them by state corporate law, in three respects:

1) *By instructing a public company's board and executive management to move the management of climate-related risks to the fore of company priorities, and by promoting their inclusion into all types of top-level corporate decision-making.* Under state corporate law, these actions are the prerogative of the board.[98]

2) *By requiring substantial transparency on how a public company is procedurally dealing with climate-related risks.* As discussed in the prior section, these disclosures would provide uninformed shareholder activists the opportunity to put pressure on the board and executive management to change these procedures. This would create a significant shift in the balance of decision-making authority from the board to shareholders, inconsistent with state corporate law.[99]

3) *By promoting a one-size-fits-all understanding of "transition risk" by assuming that the world and U.S. economies are quickly headed toward "net zero" carbon emissions.* Again, under state corporate law, it is the board's prerogative, as advised by its executive management, to make the determination in regard to what kind of *transition risk* the company faces.[100]

Under modern conceptions of the Commerce Clause power,[101] Congress almost certainly has the authority to preempt significantly, if not wholly,[102] state corporate law, however unwise that decision might be.[103] But to date, Congress has decidedly not provided the SEC with the federal statutory authority to take these actions; no such authority is referred to in the Proposed Rule, and we could not find such authority in our own research. In sum, based on a lack of statutory authority for usurping the authority of corporate boards and managers, as delineated by state law, Section D disclosures have a good chance of being vacated by a reviewing court.

C. The Unsubstantiated Premises Underlying Section D Disclosures

Section D disclosures are based on two premises: 1) investors are seeking to invest in companies that are demonstrating significant progress in mitigating climate change and divesting in those that are not; and 2) we are rapidly moving toward a "net zero" carbon emissions economy. Neither of these premises are substantiated in the Proposed Rule.

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[98] See Del. Code Ann. 8, § 141(a).
[99] *Id.*
[100] *Id.*
[101] *Cf.* Gonzales v. Raich, 545 U.S. 1 (2005); Wickard v. Filburn, 317 U.S. 111 (1942).
[102] *Cf.* Rice v. Santa Fe Elevator Corporation, 331 U.S. 218, 221-22 (1947) (finding Congress had preempted the field related to grain warehousing, precluding even complementary state regulations of those fields, by vesting with the Secretary of Agriculture "exclusive" authority over federally licensed warehouses.
[103] *See* James R. Copland, *Senator Warren's Bizarro Corporate Governance*, ECONOMICS21.ORG (Aug. 16, 2018), https://economics21.org/warren-backwards-corporate-governance. *See generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993).

1. Investor Demand for Section D Disclosures

Similar to its approach for Section G disclosures, discussed in Part I.C., the Proposed Rule offers evidence that investors are "demanding" Section D disclosures only by pointing to the preferences of institutional investors and investment advisors, not the preferences of retail investors who actually provide the funds for institutional investors to invest. By taking into consideration the interests of investment advisers to index funds, the SEC is using a conflicted source of authority for evidence that there is great retail investor demand for Section D disclosures. Our critiques of the Proposed Rule's conception of "investor demand" as undergirding Section G disclosures applies equally in the Section D context, and is incorporated here by reference.

2. The Speed at Which We are Moving to a Net-Zero Economy

The SEC's rationale for proposing Section D disclosures also appears to be predicated on a second premise: the belief that we are quickly headed toward a net-zero carbon emissions economy, presenting all public companies with a significant *transition risk*. As articulated in the Proposed Rule:

> Transition risks would include, but are not limited to, increased costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products leading to decreased sales, prices, or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a registrant's behavior.[104]

While the Proposed Rule *alleges* that these negative impacts prompt concomitant *transition risks*, the Proposed Rule does not substantiate its premise that there will be a rapid move toward a net-zero emissions economy. Indeed, the SEC fails to present *any* type evidence, empirical or otherwise, that this rapid move toward a net-zero emissions economy is actually occurring. The Proposed Rule provides no solid evidence predicting what year the world economy—or even the U.S., the major country with perhaps the best chance of pulling off this feat—will finally be reaching an inflection point where carbon emissions will start a *sustained*, *substantial* decline on a yearly basis.[105]

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[104] *See* Proposed Rule, *supra* note 1, at 14.

[105] IEA, *Global CO2 emissions rebounded to their highest level in history in 2021* (March 8, 2022), https://www.iea.org/news/global-co2-emissions-rebounded-to-their-highest-level-in-history-in-2021. Vaclav Smil, the prominent energy expert, provides a sobering assessment of why this is so:

> And yet, so far, the only effective, substantial moves toward decarbonization have not come from any determined, deliberate, targeted policies. Rather, they have been by-products of general technical advances (higher conversion efficiencies, more nuclear and hydro generation, less wasteful processing and manufacturing procedures) and of ongoing production and management shifts (switching from coal to gas:

This dearth of actual evidence buttressing the Proposed Rule's premise of a near-term move toward a net-zero emissions economy is problematic. Our mostly efficient financial markets—the subject matter of the SEC's statutory focus—have been sending quite different signals indeed. In recent times, reducing a company's greenhouse gas emissions has proven to have nothing to do with financial success. To the contrary, the last two years have been tough for green stocks. According to the *Wall Street Journal*, in the first six months of 2021, "exchange-traded funds that track renewable-energy indexes . . . posted double-digit losses."[106] This rapid decline and other overinvestment led the Financial Crisis Observatory in Zurich to declare a "green energy bubble" last November.[107] Since then, the share prices have plummeted further: electric car manufacturer Tesla by 26%; solar panel manufacturer First Solar by 36%; electric vehicle manufacturer Fisker by 48%; and lithium battery manufacturer Quantumscape Corp by 61%. In contrast, traditional carbon-based energy stocks have been doing well. Exxon Mobil, responsible for more than 1% of global greenhouse gas emissions, is up 37% over the past six months. Chevron is up 45% in the same period.

The bursting of the "ESG" investing bubble is unsurprising. As Phillippe van der Beck explained, "the high realized returns to sustainable equity investing over the past decade are primarily flow-driven and should hence not be interpreted as expected returns going forward."[108] The *flow* of capital toward ESG funds—a real phenomenon, to be sure, but one substantially independent of *financial* motivation—induced large index funds to buy yet more ESG-related equities to keep pace with the incoming new capital. This flow of capital resulted, in some cases, to price pressures and thus higher realized returns on the stocks in the short term. But this is hardly a predictor of long-term success, and "the extremely large flows to ESG funds observed in recent years" actually "suggests that sustainable investments would have drastically underperformed the market in the absence of the price pressure."[109] In the long run, securities markets are liquid and ruthlessly efficient—and the Proposed Rule likely does little more than prop up a deflating bubble, harming the interests of the long-term retail investor.

Over the longer term, the inescapable fact is that global greenhouse gas emissions have continued to rise. Between 1992 and 2019 global CO2 emissions rose by 65% and CH4 by 25%.[110] Even assuming that it is possible to bend or reverse this trend, there is every reason to believe that

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> more common, less energy-intensive, material recycling) whose initiation and progress had nothing to do with any quest for reduced greenhouse gas emissions. And, as I already noted, the global impact of the recent turn toward decarbonizing electricity generation—by installing solar PV panels and wind turbines—has been completely negated by the rapid rise of greenhouse gas emissions in China and elsewhere in Asia.

Vaclav Smil, HOW THE WORLD REALLY WORKS at 182 (2022).

[106] Michael Wursthorn, *Clean Energy ETFs Take a Hit, but Money Keeps Flowing In*, WALL ST. J. (June 28, 2021), https://www.wsj.com/articles/clean-energy-etfs-take-a-hit-but-money-keeps-flowing-in-11624878181.

[107] Scott Patterson, *Clean Energy Stocks Are Down but Still Have Their Spark*, WALL ST. J. (Jan. 24, 2022), https://www.wsj.com/articles/clean-energy-stocks-are-down-but-still-have-their-spark-11643020205.

[108] Philippe van der Beck, *Flow-Driven ESG Returns*, Swiss Finance Institute Research Paper No. 21-71 at 2 (Oct. 2021).

[109] *Id.* at 3.

[110] Smil, *supra* note 105, at 192.

the move to net-zero emissions will be a slow slog, perhaps taking us a number of decades past 2050. This is simply based on an objective reading of the facts. Four key materials underpin economic prosperity for the four billion or so people who live in relative affluence,[111] and those same materials are necessarily in (hopefully) raising the living standards of the other four billion who do not: cement, steel, plastics, and ammonia.[112] Twenty-five percent of the world's carbon emissions results from the production of these four key materials.[113] Noted energy expert Vaclav Smil points out the reality of how these four critical materials will impact carbon emissions going forward in his book, *How the World Really Works*:

> During the first half of the 21st century—with slower global population growth and with stagnant or even declining counts in may affluent countries—economies should have no problems meeting the demand for steel, cement, ammonia, and plastics, especially with intensified recycling. But it is unlikely that by 2050 all of these industries will eliminate their dependence on fossil fuels and cease to be significant contributors to global CO2 emissions. This is especially unlikely in today's low-income modernizing countries, whose enormous infrastructural and consumer needs will require large-scale increases of all basic materials….
>
> *Requirements for fossil carbon have been—and for decades will continue to be—the price we pay for the multitude of benefits arising from our reliance on steel, cement, ammonia, and plastics.* And as we continue to expand renewable energy conversions, we will require larger masses of old materials as well as unprecedented quantities of materials that were previously needed in only modest amounts.[114]

To be sure, technological innovation is very likely to promote greater energy efficiency; but those new efficiencies will necessarily spur new *demand* for energy consumption—a fundamental insight articulated by Mark Mills and the late Peter Huber in their book *The Bottomless Well*: "*The more efficient our technology, the more energy we consume*. More efficient technology lets more people do more, and do it faster—and more/more/faster invariably swamps all the efficiency gains. New uses for more efficient technologies multiply faster than the old ones get improved."[115] One example that readily comes to mind is the significant energy demands that Bitcoin mining is now making on the world's electrical grid and the additional carbon emissions that it has created. It has been reported that Bitcoin mining consumes more electricity than is generated in Argentina.[116]

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[111] Homi Kharas and Kristofer Hamel, *A global tipping point: Half the world is now middle class or wealthier*, BROOKINGS (Sept. 27, 2018), https://www.brookings.edu/blog/future-development/2018/09/27/a-global-tipping-point-half-the-world-is-now-middle-class-or-wealthier/.
[112] Smil, *supra* note 105, at 76-79.
[113] *Id.*
[114] *Id.*
[115] PETER W. HUBER & MARK P. MILLS, THE BOTTOMLESS WELL: THE TWILIGHT OF FUEL, THE VIRTUE OF WASTE, AND WHY WE WILL NEVER RUN OUT OF ENERGY (2005); *see also* Mark Mills, *The "New Energy Economy": An Exercise in Magical Thinking*, MANHATTAN INSTITUTE at 18 (Mar. 2019), https://media4.manhattan-institute.org/sites/default/files/R-0319-MM.pdf.
[116] Josh Saul, *Bitcoin Power Consumption Jumped 66-Fold Since 2015, Citi Says*, BLOOMBERG GREEN (April 13, 2021, 5:59 PM), https://www.bloomberg.com/news/articles/2021-04-13/bitcoin-power-consumption-jumped-66-

But we don't have to look to new inventions and advances in technology to see how we continually find new ways to consume energy. For example, consider the enormous worldwide demand to own a sport utility vehicle or SUV, a type of passenger car that was introduced into the market back in the late 80s.[117] By 2020 there were 250 million SUVs on the road worldwide.[118] SUVs, on average, emit 25% more CO2 than a standard car.[119] According to Smil:

> Multiply that by the 250 million SUVs on the road in 2020, and you will see how the worldwide embrace of these machines has wiped out, several times over, any decarbonization gains resulting from the slowly spreading ownership (just 10 million in 2020) of electric vehicles. During the 2010s, SUVs became the second-highest cause of rising CO2 emissions, behind electricity generation and ahead of heavy industry, trucking, and aviation. If their mass public embrace continues, they have the potential to offset any carbon savings from more than 100 million electric vehicles that might be on the road by 2040![120]

This likely slow move to net-zero emissions is also reflected in the recent work of noted finance scholars, J.B. Heaton and Alon Brav, *Brown Assets for the Prudent Investor*.[121] In their work they observe that mankind's failure to deal with climate change is a significant possibility:

> What if efforts to mitigate the harmful effects of climate change are inadequate to push the economy away from its high-carbon state to a low-carbon state? While an unpopular thing to say, the possibility that the world will fail to contain climate change is not remote. Climate change is real, but a move to a low-carbon economy is mostly absent on anything like the scale needed.[122]

As a result, Heaton and Brav argue that investing in so called *brown assets* (high carbon assets) and the companies that produce them "may provide a valuable hedge against the costs of climate change in a world that failed to transition to a low carbon economy"[123] For example, investing in a portfolio of energy companies that have decided to remain focused on the production of fossil fuels and related products might be expected to generate *outsized returns*, and the surplus economic value from those returns are available to mitigate social costs attributable to climate change.

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fold-since-2015-citisays; *see also* Will Mathis, *U.S. Offshore Wind Push Set to Fall Short of Biden's 2030 Goal*, BLOOMBERG GREEN (July 28, 2021, 8:05 AM), https://www.bloomberg.com/news/articles/2021-07-28/u-s-offshore-wind-push-set-tofall-short-of-biden-s-2030-goal.
[117]Smil, *supra* note 105, at 190-191.
[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] Alon Brav & J.B. Heaton, *Brown Assets for the Prudent Investor*, 12 HARV. BUS. REV. L. ONLINE, art. 2, 2021, https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwj74t3AlPv3AhWVK30KHcgJBxYQFnoECAIQAQ&url=https%3A%2F%2Fwww.hblr.org%2Fwp-content%2Fuploads%2Fsites%2F18%2F2022%2F02%2FBrav-and-Heaton-Brown-Assets-for-the-Prudent-Investor.pdf&usg=AOvVaw3NR0RwF1vso5St81kw8Q6s.
[122] *Id.* at 3.
[123] *Id.* at 1.

We do not mean to imply that significant reduction in carbon emissions cannot occur over the next several decades. According to Smil:

> [M]ajor reductions in carbon emissions—resulting from the combination of continued efficiency gains, better system designs, and moderated consumption—are possible, and a determined pursuit of these goals would limit the eventual rate of global warming. But we cannot know to what extent we will succeed by 2050, and thinking about 2100 is truly beyond the ken. We can outline extreme cases, but in just a few decades the fan of possible outcomes becomes too wide and, in any case, the progress of any eventual decarbonization is contingent not only on our deliberate remedial actions but also on unpredictable intervening changes in national fortunes.[124]

To be clear: it is impossible to know, definitively, the potential technological innovations that may arise that could facilitate reductions in greenhouse gas emissions. But that impossibility is precisely the point: the Proposed Rule *presupposes* the *inevitability* of a relatively rapid—and in our view highly unlikely—move toward a net-zero emissions economy. It does so without empirical foundation. It asserts that undefended presumption as a key premise underlying its concept of "transition risk," unmoored from reality. And it advances that unsupported risk concept to intrude into board and management decision-making and processes, in unprecedented fashion, beyond the SEC's statutory delegation and overriding state corporate law. This has to run afoul of the SEC's statutory mandate to promote "efficiency, competition, and capital formation." It has to be "arbitrary and capricious" under the APA.

We suggest that the SEC retreat from its unsupported premise that a relatively near-term shift to a net-zero economy is inevitable and instead take a more objective and reality-based understanding of *transition risk* in its Proposed Rule. A *reality-based* definition of *transition risk* might include the risk that a company will not *adapt* quickly enough to a warming climate and the resulting impact it would have on the assumptions, costs, estimates, and valuations underlying its financial statements, at least to the extent that such variables were material to a reasonable investor seeking to value financially the company's securities.[125] In other words, the reality-based *transition* risk public companies face, regarding climate change, is not failing to adapt to a quick jump to a net-zero emissions economy, but rather the inverse: inadequately adapting to the failure to move to a net-zero emissions economy, with whatever social costs that entails. (There are also, of course, material risks, direct and indirect, that a company may face from legislation, regulation, and international accords intending to address climate change; but these risks are not *transition* risks in the manner presumed in the Proposed Rule, and they fit neatly within the more limited contours of the 2010 Guidance.[126])

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[124] Smil, *supra* note 105, at 200.
[125] As observed many years ago by the famous economist Armen Alchian, in a world of uncertainty the ability to adapt to a changing business environment is an important element in the success of a company. Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950).
[126] *See* Release Nos. 33-9106; 34-61469, *supra* note 11.

3. Conclusion

Both premises underlying Section D disclosures are not substantiated in the Proposed Rule. Even if the "investor demand" premise could be substantiated, the "demand" would not be, as it must be, linked to investor protection; nor to promoting "efficiency, competition, and capital markets." The Proposed Rule's definition of *transition risk* is predicated on the unsubstantiated and extremely unlikely notion that our economy will soon transition to a world with no net carbon emissions. We thus believe a reviewing court could, and likely would, view the Proposed Rule's Section D disclosure regime to be arbitrary and capricious, requiring the regime to be vacated under the APA.

D. A Lack of an Adequate Cost-Benefit Analysis for Section D Disclosures

As explained by the D.C. Circuit in *SEC v. Business Roundtable*,[127] Congress's decision to curb the SEC's rulemaking authority with the "unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation,' imposes special burdens on the Commission to "apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation."[128] That is, the Commission has a "statutory responsibility to determine the *likely* economic consequences of" a proposed rule "and to connect those consequences to efficiency, competition, and capital formation."[129]

This statutory responsibility applies to both the costs and the benefits of Section D disclosures. While it is beyond the scope of this comment letter to do a comprehensive economic analysis of Section D disclosures, we do want to emphasize that the Proposed Rule is lacking in its economic analysis by not including an estimate of how much economic harm these disclosures will cause as a result of their interference in a public company's decision-making process—a major cost of the proposed Section D disclosures. As discussed in section A of this part, the Proposed Rule would force climate-related risks to the fore of company priorities, increase uninformed shareholder activists' voice in how a company manages climate-related risks, and impose on public companies a one-size-fits-all (and flawed) understanding of climate-related transition risks. Each of these proposed changes would move company decision-making away from the most informed locus of authority, the board of directors as advised by executive management, as long provided for by state corporate law. Instead, the Proposed Rule would foist the SEC's own substantive views on these matters onto all public companies, notwithstanding that the agency has no particularized knowledge about the internal corporate-governance affairs of any of the affected companies, let alone environmental policy. The Proposed Rule would also reorient settled state corporate law to shift corporate decision-making from boards and managers toward uniformed institutional investors and investment advisors that replicate market-index baskets rather than rely on any public disclosures whatsoever; and these investors' and advisors' principal pecuniary interests are in

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[127] 647 F.3d 1144 (2011).
[128] *Id.* at 1148 (citing 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c)).
[129] *Id.*

conflict with the average ordinary shareholder. In our opinion, significant costs will ensue and must be addressed by the SEC.

In sum, under *Business Roundtable*, until the SEC can provide a reasonable estimate of the costs of Section D disclosures on public companies, the act of promulgating these disclosures would be arbitrary and capricious under the APA, requiring the reviewing court to vacate their implementation.

III. CONSTITUTIONAL CONCERNS

The Proposed Rule is also constitutionally suspect. A full consideration of the constitutional issues with the Proposed Rule is beyond the scope of this comment letter. However, inasmuch as courts reviewing any final rule may well consider challenges raising constitutional challenges in addition to ordinary "arbitrary and capricious" review under the APA, we would like to highlight some of the most pertinent concerns here.

The Proposed Rule runs afoul of the structural constitution's commitment to federalism and separation of powers. As previously discussed in Part II.A. and Part II.B., the Proposed Rule would substantially interfere with the internal governance processes of corporations, traditionally governed by state law. The Supreme Court has been quite clear that "state law will govern the internal affairs of the corporation,"[130] and that "established state policies of corporate regulation" are not to be "overridden" by the SEC, "[a]bsent a clear indication of congressional intent" to the contrary.[131] In addition to running afoul of the constitution's vertical allocation of powers between the state and federal governments, the Proposed Rule also violates the constitution's horizontal allocation of powers among the branches of government, *i.e.*, the separation of powers. The vast sweep of the Proposed Rule on one of the most contentious policy issues of the day—climate change—would substantially resolve a major question of policy clearly within the province of the legislative branch,[132] which has hardly made a "clear statement" delegating this authority to the SEC.

The Proposed Rule's various disclosure requirements also implicate the First Amendment's prohibition against government-compelled speech. Although current Supreme Court doctrine is more permissive of government infringement of certain professional and commercial speech, with regard to compelled disclosure rules, such rules must be "purely factual and uncontroversial" and

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[130] Cort v. Ash, 422 U.S. 66, 84 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation").
[131] Santa Fe Industries, 430 U.S. 462, 479 (1977) ("Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations . . . particularly where established state policies of corporate regulation would be overridden.").
[132] *See, e.g.*, Utility Air Regulatory Group v. EPA, 573 U. S. 302, 324 (2014); FDA v. Brown & Williamson Tobacco Corp., 529 U. S. 120, 159–160 (2000).

not "unjustified or unduly burdensome"[133]—which is hardly the case for many if not most of the disclosures mandated in the Proposed Rule.[134]

The following analysis will elucidate separately the "major questions" separation-of-powers issue and the First Amendment "compelled speech" issue in further detail.

A. The Proposed Rule Resolves a "Major Question" Reserved for Congress

"The Framers of the Constitution viewed the separation of powers as the great safeguard of liberty in the new National Government."[135] The "major questions" or "major rules" doctrine is a modern judicial application of the non-delegation principle,[136] a central feature of the separation of powers.[137]

Historically, as articulated by Chief Justice Marshall in *Wayman v. Southard*, the Supreme Court allowed other branches "to fill up the details" of "general provisions" developed by Congress; but the Court insisted that "important subjects . . . be entirely regulated by the legislature itself."[138] Alongside a modern judicial view sanctioning far more sweeping Congressional power

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[133] Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 651–53 (1985); *see also* Nat'l Inst. of Family & Life Advocates v. Becerra, 138 S. Ct. 2361 (2018).
[134] *Cf.* National Assoc. of Mfrs. v. Securities & Exchange Comm'n ("NAM I") 748 F.3d 359 (2014); National Assoc. of Mfrs. v. Securities & Exchange Comm'n ("NAM II"), 800 F.3d 518 (2015).
[135] U.S. Telecom Ass'n v. FCC, 855 F.3d 381, 418 (D.C. Cir. 2017) (en banc) (Kavanaugh, J., dissenting).
[136] *See* Gundy v. U.S., 139 S. Ct. 2116, 2141–42 (2019) (Gorsuch, J. dissenting) (characterizing "major questions" doctrine as application of non-delegation principles). The doctrine is alternatively called the "major questions" doctrine, *see id.*, and "major rules" doctrine, *see* U.S. Telecom Ass'n, 855 F.3d at 417 (Kavanaugh, J., dissenting).
[137] In his influential *Commentaries on the Laws of the United States* (1833), Justice Joseph Story wrote that non-delegation of powers among the branches was "tacitly assumed . . . as a fundamental basis in the constitution of the United States."

The non-delegation principle emerged substantially in reaction to Charles I's Personal Rule—or "Eleven Years' Tyranny"—in which the English king dismissed Parliament and concentrated rulemaking in the executive. The Personal Rule ultimately underlay the English Civil War. Against this backdrop, Enlightenment thinkers and those who interpreted the law of England in the period before the American founding considered the non-delegation principle a central bulwark against government abuse. In his *Second Treatise of Civil Government* (1690), John Locke argued that the legislative power existed "only to make laws, and not to make legislators." In his *The Spirit of the Laws* (1748), Charles de Secondat, Baron de Montesquieu, explained that there could be "no liberty" where the legislative and executive powers were "united." William Blackstone's *Commentaries on the Laws of England* (1765) observed that combining "the right both of making and of enforcing laws" in a "supreme magistracy" is a feature of "all tyrannical governments."

James Madison and others imported these ideas into the new constitution. Madison echoes Blackstone in *Federalist* 47: "accumulation of all powers . . . in the same hands . . . may justly be pronounced the very definition of tyranny."

In the early years of the republic, many argued that Congress's power to delegate rulemaking was sharply circumscribed: in the Second Congress, then-Representative James Madison argued against and succeeded in defeating a proposed amendment that would have allowed the executive branch, rather than Congress, to determine the routes of postal roads. Annals of Congress, 2d Cong., 1st sess. (Dec. 17, 1791). By 1825, however, the Supreme Court had articulated a more permissive standard: "a general provision may be made and power given to those who are to act under such general provisions to fill up the details"; critically, however, "important subjects . . . must be entirely regulated by the legislature itself." Wayman v. Southard, 23 U.S. 1, 43 (1825).

For further historical discussion, see Copland, *The Unelected*, *supra* note 53, at chapter 1.
[138] 23 U.S. at 43.

to regulate than assumed in the republic's earlier years,[139] however, the Supreme Court has not, since the New Deal era, directly invoked the non-delegation doctrine to overturn as unconstitutional an enactment of Congress.[140] But the Court *has* insisted that "Congress must *clearly* authorize" an administrative agency to promulgate "major agency rules of great economic and political significance."[141] Examples in which the Supreme Court embraced this principle include:[142]

- In *MCI v. AT&T*, the Supreme Court struck down a rule promulgated by the Federal Communications Commission that would have exempted entirely from rate-filing requirements certain telephone companies, which the Court characterized as "a whole new regime of regulation . . . which may well be a better regime but is not the one that Congress established."[143]

- In *FDA v. Brown & Williamson Tobacco*,[144] the Supreme Court blocked the Food and Drug Administration's effort to assert its regulatory authority over tobacco products; citing *MCI*, the Court emphasized that for "a decision of such economic and political significance," Congress "could not have intended to delegate" its decision in "cryptic fashion."[145]

- In *Utility Air Regulatory Group v. EPA*,[146] the Supreme Court struck down a rule promulgated by the Environmental Protection Agency that would "radically expand" the agency's powers to regulate greenhouse gases as air pollutants, which "would bring about an enormous and transformative expansion in EPA's regulatory authority without clear congressional authorization."

The Supreme Court is currently considering another challenge to EPA rulemaking involving greenhouse gases in the power sector, *West Virginia v. EPA*.[147] At oral argument, "the major

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[139] *See* Gonzales v. Raich, 545 U.S. 1 (2005); Wickard v. Filburn, 317 U.S. 111 (1942).

[140] *Cf.* Mistretta v. United States, 488 U.S. 361 (1989)(declining to invoke the non-delegation doctrine to declare unconstitutional portions of the Sentencing Reform Act of 1984); A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935)(unanimously invalidating portions of the National Industrial Recovery Act of 1933 as unconstitutional delegations of Congressional power to the executive).

There is some reason to believe that the Supreme Court may, in an appropriate case, revisit its non-delegation jurisprudence. In *Gundy v. U.S.*, 139 S. Ct. 2116 (2019), three of the current justices on the Court joined an opinion arguing that part of the 2006 Sex Offender Registration and Notification Act unconstitutionally delegated legislative power to the executive branch, *id.* at 2131–48 (Gorsuch, J., dissenting). A fourth justice asserted he would be "willing to reconsider" the Court's post-New Deal non-delegation standards in an appropriate case, if a Court majority were willing to do so. *Id.* at 2131 (Alito, J., concurring in the judgment). Those four justices remain on the Court, now joined by justices Kavanaugh and Barrett.

[141] U.S. Telecom Ass'n, 855 F.3d at 419–20 (Kavanaugh, J., dissenting)(collecting cases).

[142] *Cf. also, e.g.*, Gonzales v. Oregon, 546 U.S. 243 (2006)(holding that the Attorney General's decision to de-register certain physicians from prescription drug-writing authority under the Controlled Substances Act "is inconsistent with the design of" the Controlled Substances Act).

[143] MCI Telecommunications Corp. v. American Telephone & Telegraph Co., 512 U.S. 218, 234 (1994).

[144] 529 U.S. 120 (2000).

[145] *Id.* at 160.

[146] 573 U.S. 302 (2014).

[147] No. 20-1530; *see* 985 F.3d 914 (D.C. Cir. 2021).

questions doctrine was raised repeatedly," with a focus on "whether Congress has delegated [the EPA's asserted] authority, and whether (due to the major questions doctrine) the Court should disfavor an interpretation that would substantially broaden the EPA's authority."[148]

Thus, the Court should imminently shed light on its current thinking about the major questions doctrine, particularly applied to the context of greenhouse-gas emissions. If the Court again cabins the EPA's regulatory authority in this area, it obviously implicates the SEC's asserted authority here. Regardless of how the Court decides *West Virginia*, it is obvious that the SEC, unlike the EPA, was never tasked by Congress with overseeing *environmental* concerns *at all*; and that the Proposed Rule would put the SEC, "which is not expert in these matters," in the position of reviewing "climate models and assumptions underlying companies' metrics and disclosures about progress toward meeting climate targets."[149] Such a position is clearly a major expansion of agency authority, beyond the agency's expertise, unauthorized by a clear statement of Congress. The courts are quite unlikely to allow the Commission to assume such an expanded agency role, assuming that the major-question principles elucidated in other recent Supreme Court decisions survive *West Virginia* intact.

B. The Proposed Rule Compels Speech in Violation of the First Amendment

The First Amendment's protections clearly apply to corporate speech.[150] That said, the First Amendment's reach with regard to *commercial speech* is more "limited" than in other contexts.[151] A form of "intermediate scrutiny" applies to *restraints* on commercial speech.[152] A lesser standard yet applies to *compelled* government speech in the professional or corporate context.[153] Indeed, the SEC's very disclosure regime itself principally involves compelled government speech—based upon the Congressional judgment that such disclosures are in the public interest; protect investors; and promote efficiency, competition, and capital formation.[154]

Critically, however, the Supreme Court's precedents limiting the First Amendment's reach in the context of government-compelled commercial and professional disclosures hinge on the government disclosure rules involving "purely factual and uncontroversial information."[155]

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[148] Jonathan B. Adler, *Supreme Court Digs into Statutory Details More than Standing or Nondelegation in West Virginia v. EPA*, REASON.COM, Jan. 28. 2022, *at* https://reason.com/volokh/2022/02/28/supreme-court-digs-into-statutory-details-more-than-standing-or-nondelegation-in-west-virginia-v-epa/.
[149] Peirce, *supra* note 44.
[150] *Cf.* Citizens United v. FEC, 558 U.S. 310 (2010).
[151] Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 771–72 (1976).
[152] Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of NY, 447 U.S. 557 (1980).
[153] Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 652-53 (1985); Nat'l Inst. of Family & Life Advocates v. Becerra, 138 S. Ct. 2361 (2018).
[154] *Cf.* 15 U.S.C. § 77b(b); 15 U.S.C. § 78c(f).
[155] Zauderer, 471 U.S. at 642 (permitting regulation of commercial advertising requiring disclosure of "purely factual and uncontroversial information"); Becerra, 138 S. Ct. at 2372 (finding Free Speech violation when regulation required disclosure of "information about state-sponsored services—including abortion, anything but an 'uncontroversial' topic").

The Circuit courts remain split on *Zauderer*'s reach. *Compare* National Ass'n of Manufacturers v. S.E.C., 800 F.3d 518, 528–29 (D.C. Cir. 2015); Dwyer v. Cappell, 762 F.3d 275, 283 (3d Cir. 2014); Handsome Brook Farm v.

Applying this principle to securities regulation, the D.C. Circuit struck down as unconstitutional the SEC's "conflict minerals" rule[156]—notwithstanding Congress's express authorization to craft one.[157] The Court observed:

> [W]hether a product is "conflict free" or "not conflict free" – [is] hardly "factual and non-ideological". . . . Products and minerals do not fight conflicts. The label "[not] conflict free" is a metaphor that conveys moral responsibility for the Congo war. It requires an issuer to tell consumers that its products are ethically tainted, even if they only indirectly finance armed groups. An issuer, including an issuer who condemns the atrocities of the Congo war in the strongest terms, may disagree with that assessment of its moral responsibility. And it may convey that "message'" through "silence." By compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment.[158]

Public attitudes about climate change may or may not rise to the moral dimensions as do beliefs on abortion or wars in Africa, but the subject is surely not "uncontroversial."

We need not for purposes of this comment letter spell out the particular limits of First Amendment doctrine.[159] We do not at all think that the First Amendment conflicts with the vast majority of ordinary corporate disclosures required under our securities laws. But we are quite confident that the Proposed Rule implicates important First Amendment principles.

Humane Farm Animal Care, 700 Fed.App'x 251, 258 (4th Cir. 2017); Public Citizen Inc. v. Louisiana Attorney Disciplinary Bd., 632 F.3d 212, 227 (5th Cir. 2011); Entm't Software Ass'n v. Blagojevich, 469 F.3d 641, 652–53 (7th Cir. 2006); Milavetz, Gallop & Milavetz, P.A. v. U.S., 541 F.3d 785, 795-96 (8th Cir. 2008); U.S. v. Wegner, 427 F.3d 840, 850 (10th Cir. 2005); Tillman v. Miller, 1996 WL 767477 (N.D. Ga.) at 2-3 *with* American Meat Institute v. U.S. Dep't of Agriculture, 760 F.3d 18, 27 (D.C. Cir. 2014); Pharmaceutical Care Management Association v. Rowe, 429 F.3d 294, 310 (1st Cir. 2005); National Elec. Mfrs. Ass'n v. Sorrell, 272 F.3d 104, 115 (2d Cir. 2001); Discount Tobacco City & Lottery, Inc. v. U.S., 674 F.3d 509, 530 (6th Cir. 2012); CTIA - The Wireless Ass'n v. City of Berkeley, 854 F.3d 1105, 1117, (9th Cir. 2017); American Beverage Ass'n v. City and Cnty. of San Francisco, 871 F.3d 884, 892 (9th Cir. 2017).

Justice Thomas has called on the Court to reexamine *Zauderer*. Milavetz, Gallop & Milavetz, P.A. v. United States, 559 U.S. 229, 255–56 (2010) (Thomas concurring). Of course, *Zauderer*'s "relaxed" approach to "government-mandated disclosures," *id.*, *limits* the First Amendment's reach. If *Zauderer* does not apply, the First Amendment's limitations on government-compelled disclosures are *higher*.

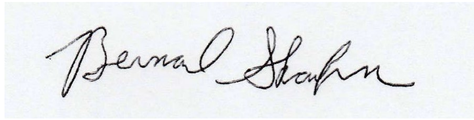
[156] Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518 (D.C. Cir. 2015); *see* Conflict Minerals, 77 Fed. Reg. 56,274 (Sept. 12, 2012) (codified at 17 C.F.R. §§ 240, 249b).

[157] *See* 15 U.S.C. § 78(m).

[158] Nat'l Ass'n of Mfrs., 800 F.3d at 527.

[159] We note that Professor Sean Griffith has attempted to elucidate a rule for adjudicating compelled speech questions under *Zauderer* in the context of the subject matter of this Proposed Rule. *See* Griffith, *supra* note 34. We incorporate that paper here by reference for the Commission's consideration, without endorsing in whole or part the professor's broader legal and policy claims.

Very truly yours,



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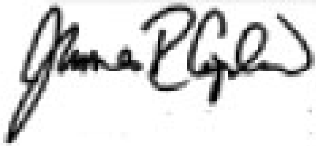
Bernard S. Sharfman



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James R. Copland