



June 17, 2022

Ms. 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*

Dear Ms. Countryman:

We appreciate the opportunity to comment on the Securities and Exchange Commission's proposed amendments to its rules requiring "registrants to provide certain climate-related information in their registration statements and annual reports."<sup>1</sup> The Cato Institute is a public policy research organization dedicated to the principles of individual liberty, limited government, free markets, and peace. The opinions we express here are our own.

This proposal is broad and unprecedented. It requires disclosure of: climate-related risks; climate-related effects on strategy, business model, and outlook; board and management oversight of climate-related issues; processes for identifying, assessing, and managing climate risks; plans for transition; financial statement metrics related to climate; greenhouse gas emissions; and climate targets and goals.

The public company disclosure regime is a principles-based framework, rooted in the concept of materiality. Under this principles-based framework, companies are already required to disclose material climate change-related information.<sup>2</sup> Altering this framework to require disclosure of specific metrics, such as emissions, has the potential to harm both investors and U.S. capital markets.

Regardless of whether climate change poses an existential threat as some have said, the Commission's mandate is limited to protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.<sup>3</sup> This proposal falls outside that mandate and

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<sup>1</sup> Securities and Exchange Commission, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," SEC Release Nos. 33-11042; 34-94478; File No. S7-10-22 at 1, <https://www.sec.gov/rules/proposed/2022/33-11042.pdf> ("Notice").

<sup>2</sup> Securities and Exchange Commission, "Commission Guidance Regarding Disclosure Related to Climate Change," Rel. No. 33-9106 (2010), <https://www.sec.gov/rules/interp/2010/33-9106.pdf> ("2010 Guidance").

<sup>3</sup> See, e.g., Allison Herren Lee, "Remarks at the PRI/LSEG Investor Action on Climate Webinar," *Securities and Exchange Commission*, October 20, 2021, <https://www.sec.gov/news/speech/lee-remarks-pri/lseg-investor-action-climate-webinar-102021> ("climate change presents an existential threat to life on the planet").

outside of the Commission’s authority. Indeed, aspects of this proposal fall outside of the Constitution. But, even if the Commission had the authority to promulgate what it has proposed here, these costly disclosure requirements are not an improvement over the current disclosure framework, which already requires disclosure of material risks relating to climate change. The comments below focus on fundamental issues with the proposal that require the Commission to abandon this effort in its current form.<sup>4</sup>

## **The Commission Lacks the Authority to Promulgate These Rules**

### *Climate-Related Disclosures Are Not Authorized by Statute*

In promulgating rules, a federal agency must stay within the bounds of its statutory authority. As justification for this broad proposal for climate-related disclosure, the Commission points to its authority to require disclosure “in the public interest and for the protection of investors.”<sup>5</sup>

But such seemingly broad authorities are not without limitation, as the Supreme Court has held.<sup>6</sup> A court will look to the statutory context to determine the limits of an agency’s authority. Here, both the Securities Act of 1933 and the Securities Exchange Act of 1934 grant the Commission the power to issue disclosure rules about specific types of information closely related to a company’s value and prospects for financial success, including financial statements, core business information, information about directors and management, and a description of the securities being sold.<sup>7</sup> There are some exceptions to this general rule—such as disclosures

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<sup>4</sup> Given the breadth and complexity of the proposal, the time allowed for public comment remains insufficient to allow for meaningful comment. This proposal has been recognized as a significant revision to the Commission’s disclosure requirements. *See, e.g.*, Matthew Goldstein and Peter Eavis, “The S.E.C. moves closer to enacting a sweeping climate disclosure rule,” *New York Times*, March 21, 2022, <https://www.nytimes.com/2022/03/21/business/sec-climate-disclosure-rule.html>; Michael R. Littenberg, Marc Rotter, and Hannah Shapiro, “Ten Thoughts on the SEC’s Proposed Climate Disclosure Rules,” *Ropes & Gray*, April 12, 2022, <https://www.ropesgray.com/en/newsroom/alerts/2022/April/Ten-Thoughts-on-the-SECs-Proposed-Climate-Disclosure-Rules> (describing the proposal as “arguably the most significant new public company disclosure and compliance requirements in a generation”). Although the extension to 60 days for comment afforded additional time, this proposal when first released ran to 506 pages and sought comment on more than 200 individual topics. Sixty days is an inadequate amount of time for interested members of the public to consider how these rules will impact investors, capital formation, and market efficiency, even were this proposal the only one under consideration by the Commission at the time. This proposal, however, is part of a flurry of Commission proposals since the end of 2021, leaving market participants with even less time to analyze and comment on any particular proposal and to consider how these proposals will interact with each other. A longer comment period is necessary to provide the public with an opportunity to meaningfully participate in this regulatory process.

<sup>5</sup> Notice at 9.

<sup>6</sup> *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 161 (2000) (“an administrative agency’s power to regulate in the public interest must always be grounded in a grant of authority from Congress”).

<sup>7</sup> *See generally* Andrew N. Vollmer, “The SEC Lacks Legal Authority to Adopt Climate-Change Disclosure Rules,” Public Interest Comment, April 12, 2022, <https://www.sec.gov/comments/s7-10-22/s71022-20123525-279742.pdf> (“Vollmer Letter”); Andrew N. Vollmer, “Does the SEC Have Legal Authority to Adopt Climate-Change Disclosure Rules?” *Mercatus Center*, August 19, 2021, <https://www.mercatus.org/publications/financial-regulation/does-sec-have-legal-authority-adopt-climate-change-disclosure>.

about conflict minerals and executive compensation—but those exceptions were introduced by Congress, not by the Commission’s rulemaking.

These subject-matter limitations have led the Commission to conclude in the past that it is generally not authorized to require disclosure relating to environmental, social, or other goals except in response to a specific mandate from Congress.<sup>8</sup> This proposal, however, represents an about-face from that correct conclusion.

While the Commission disclaims an interest in “address[ing] climate-related issues more generally,” that disclaimer is inconsistent, at best, with the rule proposal.<sup>9</sup> Instead of focusing on the disclosure of information intended to allow investors to value securities, this proposal aims to incentivize behavior intended to mitigate the effects of climate change (in the eyes of certain environmental activists) and to facilitate a transition to a net-zero economy.

While asserting that the proposal is intended to “protect investors, maintain fair, orderly and efficient markets, and promote capital formation,”<sup>10</sup> the Commission at several points in the proposal explicitly suggests means by which issuers can reduce their reporting obligations by reducing their greenhouse gas emissions. For example, with respect to Scope 3 emissions, the Commission suggests that a registrant can mitigate the challenge of collecting Scope 3 data by “influenc[ing]” the activities of “its suppliers and downstream distributors to take steps to reduce those entities’ Scopes 1 and 2 emissions.”<sup>11</sup>

The Commission admits that “[t]he proposed rules may have some effects on firm behavior,” but these effects are not incidental.<sup>12</sup> Even if they were, the thumb-on-the-scale nature of these effects makes clear that the disclosure will not only change behavior—it will change behavior in a particular way. The Commission recognizes “empirical evidence” showing that firms tend to report actions that appear to be more “favorable” with respect to the

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<sup>8</sup> See Securities and Exchange Commission, “Business and Financial Disclosure Required by Regulation S-K,” SEC Release No. 33-10064; 34-77599; File No. S-7-06-16, 81 Fed. Reg. 23981, 23970 (April 22, 2016) (noting that the Commission “has determined in the past that disclosure relating to environmental and other matters of social concern should not be required of all registrants unless appropriate to further a specific congressional mandate or unless, under the particular facts and circumstances, such matters are material”); see also *National Resources Defense Council, Inc. v. SEC*, 606 F.2d 1031, 1039 (D.C. Cir. 1979) (upholding the Commission’s denial of a petition for rulemaking to require comprehensive disclosures by corporations of their environmental and equal employment policies; “the Commission contended that its authority was limited to contexts related to the objectives of the federal securities laws. And these laws, in the Commission’s view, were designed generally to require disclosure of financial information in the narrow sense only.”).

<sup>9</sup> Notice at 10. Indeed, statements from some Commissioners who support this proposal belie a broader aim. See, e.g., Allison Herren Lee, “A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC,” *Securities and Exchange Commission*, March 15, 2021, <https://www.sec.gov/news/speech/lee-climate-change>; Caroline A. Crenshaw, “Virtual Remarks at the Center for American Progress and Sierra Club: Down the Rabbit Hole of Climate Pledges,” *Securities and Exchange Commission*, December 14, 2021, <https://www.sec.gov/news/speech/crenshaw-cap-sierra-club-20211214>.

<sup>10</sup> Notice at 10.

<sup>11</sup> Notice at 161.

<sup>12</sup> Notice at 401.

corresponding disclosures and notes that firms may “choose to change some suppliers or disengage with certain clients due to the effect that they may have on the firm’s Scope 3 emissions.”<sup>13</sup> Securities law disclosure is not meant to choose winners and losers in this manner.

The motivation for and effects of this proposal are sufficient to establish that it is not within the subject-matter authority that Congress has granted the Commission. But other characteristics of this proposal make clear that such an undertaking by the Commission requires additional Congressional authorization. First, the broad reach of these climate-related disclosures indicates that the Commission is outside of its authority by raising questions both about the Commission’s expertise to address environmental matters and about the division of responsibility with the Environmental Protection Agency (EPA) for climate-relevant regulation. The emissions reporting provisions of the proposal, for example, require more detailed disclosures for public companies than are required by the EPA, which is plainly at odds with the assignment of agency authority envisioned by Congress.<sup>14</sup>

Second, and importantly, the volume and detail of these disclosures are markedly different than the existing disclosure regime.<sup>15</sup> Not only do these perspective disclosures create a lengthy, second set of disclosures with which a company must comply, they are different from the Commission’s existing principles-based rules. As Commissioner Peirce noted, the disclosure framework requires that “[r]ather than ticking off a preset checklist based on regulators’ prognostication of what should matter, companies have to think about what is financially material in their unique circumstances and disclose those matters to investors.”<sup>16</sup> This recasting of the disclosure framework should not proceed without Congressional authorization.

Finally, the fact investors “demand” the information does not mean that it falls within the statutory bounds. The Commission’s statutory authority does not extend to requiring disclosure of all material information, regardless of subject matter.<sup>17</sup> In general, information is material if there is a substantial likelihood that a reasonable investor would consider it important or significant in deciding whether to buy or sell a security or how to vote as a shareholder.<sup>18</sup> The Commission’s current disclosure framework—which is built on the disclosure of material, financial risks—stays within those statutory boundaries by requiring the disclosure of material, financial risks related to climate.<sup>19</sup>

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<sup>13</sup> Notice at 418.

<sup>14</sup> Notice at 298.

<sup>15</sup> See Vollmer Letter at 14.

<sup>16</sup> Hester M. Peirce, “We are Not the Securities and Environment Commission – At Least Not Yet,” *Securities and Exchange Commission*, March 21, 2022, <https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321> (“Peirce Statement”).

<sup>17</sup> See Vollmer Letter at 17-20.

<sup>18</sup> See *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32, 234, 238 (1988); *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976).

<sup>19</sup> See 2010 Guidance.

The Commission draws a connection between climate-related risks and materiality, highlighting “present financial consequences that investors in public companies consider in making investment and voting decisions.”<sup>20</sup> But the “investor demand” that the Commission points to throughout the proposal provides little support for the idea that such disclosures are necessary to elucidate *financial* risks.<sup>21</sup> The Commission overwhelmingly cites the input of several major institutional investors and climate-focused initiatives as evidence of such investor demand, but this supposed demand is inextricably tied to more than financial considerations.<sup>22</sup> Most obviously, climate activists are not motivated by financial considerations in seeking climate-related disclosures, but many of the large institutional investors cited by the Commission are also conflicted, either seeking to meet climate pledges of their own or seeking to profit from pursuing what appear to be popular strategies.<sup>23</sup>

While understanding institutional demand is important, it cannot be taken as a proxy for the financial interests of the beneficial owners of mutual funds, ETFs, or retirement assets. The voices of individual investors, however, are completely overlooked by the Commission. Studies have shown that individual investors are likely not considering sustainability risks when making investment decisions and broadly view such disclosures as irrelevant.<sup>24</sup> Indeed, recent survey research found that retail investors consider financial factors (i.e., investment returns, fees, risk, and tax matters) as the most important when making investment decisions and indicate

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<sup>20</sup> Notice at 9.

<sup>21</sup> See, e.g., Notice at 14, 24, 25, and 329-330.

<sup>22</sup> See, e.g., Notice at 24 (citing “significant investor demand for information about how climate conditions may impact their investments” supported by “several major institutional investors” and climate-focused initiatives); see also Nick Grabar, “The SEC’s Climate Proposal: Top Ten Points for Comment,” Harvard Law School Forum on Corporate Governance, June 11, 2022, <https://corpgov.law.harvard.edu/2022/06/11/the-secs-climate-proposal-top-ten-points-for-comment/> (“We would urge the Commission to distinguish between types of commenters. The views of advocates and activists—while they are undoubtedly important—are not of the same kind as the view of investors and their representatives, and they do not bear equally on the Commission’s statutory mandate for the protection of investors.”); Lawrence A. Cunningham, et. al, “Comment on File No. S-7-10-22 Proposal on Climate-Related Disclosures for Investors,” April 25, 2022, <https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf>, 5 (“Yet, inexplicably, while the Proposal repeatedly cites the interests of such powerful institutions, it mentions individual investors only once in 508 pages.”).

<sup>23</sup> For example, the Commission justifies requiring Scope 1 and Scope 2 GHG emissions data disclosures on the basis that some investors have made commitments to lower their own carbon emissions, and thus require such disclosure to meet their own environmental commitments. Notice at 165. See also Jennifer J. Schulp, “Wide World of ESG: Understanding Investor Demand,” *Cato Institute*, July 28, 2021, <https://www.cato.org/blog/wide-world-esg-understanding-investor-demand>.

<sup>24</sup> See Robin Dottling and Sehoon Kim, “Sustainability Preferences Under Stress: Evidence from Mutual Fund Flows During Covid-19,” *SSRN*, May 23, 2022, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3656756](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3656756); Austin Moss, James P. Naughton, and Clare Wang, “The Irrelevance of ESG Disclosure to Retail Investors: Evidence from Robinhood,” *SSRN*, May 19, 2020, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3604847](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3604847).

that environmental aspects are the least important considerations when making decisions, falling after financial, social, and governance factors.<sup>25</sup>

These tenuous connections between climate-related disclosures and tangible financial impacts are further evidence that these proposed disclosures are not tied to financial considerations and thus within the Commission's statutory authority.<sup>26</sup>

For all these reasons, the Commission does not have the statutory authority to promulgate these proposed disclosure rules.

### **The Proposed Rules Would Violate the First Amendment**

In addition to problems with the Commission's statutory authority, there is a further serious problem with the compelled disclosures rules. Because the rules would mandate disclosures that are not material to the financial performance of the securities, the rules would violate the First Amendment.

As explained below, the rules would likely be held to compel speech in violation of the First Amendment for several reasons. First, the compelled disclosures would not qualify for the lower standard of judicial scrutiny announced by the Supreme Court in *Zauderer v. Office of Disciplinary Counsel*.<sup>27</sup> Second, the rules would fail under either strict scrutiny or the intermediate scrutiny of *Central Hudson Gas & Electric Corp. v. Public Service Commission*.<sup>28</sup>

#### *The Proposed Rules Do Not Qualify for the Lower Standard of Scrutiny Set Out in Zauderer*

As the Supreme Court has explained, the First Amendment protects "the decision of both what to say and what *not* to say."<sup>29</sup> And the Supreme Court has held that the freedom from compelled speech extends "not only to expressions of value, opinion, or endorsement, but equally to statements of fact the speaker would rather avoid."<sup>30</sup>

Thus, all government-compelled disclosures of fact implicate the First Amendment and must be subject to some level of judicial scrutiny. The first question in evaluating the constitutionality of any compelled disclosure is *what* level of scrutiny.

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<sup>25</sup> FINRA Investor Education Foundation and NORC at the University of Chicago, "Investors say they can change the world, if they only knew how: Six things to know about ESG and retail investors," *FINRA Foundation and NORC at U. of Chicago*, March 2022, <https://www.finrafoundation.org/sites/finrafoundation/files/Consumer-Insights-Money-and-Investing.pdf>, 4 ("FINRA/NORC Survey").

<sup>26</sup> For example, the Commission analyzes transition risks and GHG disclosures as follows: "[g]iven the *possibility* of a transition to a lower-carbon economy, investors and other market participants *may* be concerned about registrants that have high GHG emissions since these registrants *may* be exposed to certain transition risks, such as regulations that restrict emissions or the *potential* impacts of changing consumer preferences or market conditions." Notice at 351 (emphases added).

<sup>27</sup> 471 U.S. 626 (1985).

<sup>28</sup> 447 U.S. 557 (1980).

<sup>29</sup> *Riley v. National Federation of the Blind*, 487 U.S. 781, 796–97 (1988) (emphasis in original).

<sup>30</sup> *Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston*, 515 U.S. 557, 573 (1995).

In *Zauderer*, the Supreme Court both defined the lowest level of scrutiny for compelled disclosures and set out the narrow circumstances in which that standard applies. The case concerned an Ohio regulation requiring “that an attorney advertising his availability on a contingent-fee basis disclose that clients will have to pay costs even if their lawsuits are unsuccessful.”<sup>31</sup> The Court characterized this rule as “a requirement that [an attorney] include in his advertising purely factual and uncontroversial information about the terms under which his services will be available.”<sup>32</sup>

The Court upheld this regulation as compatible with the First Amendment, holding that “an advertiser’s rights are adequately protected as long as disclosure requirements are reasonably related to the State’s interest in preventing deception of consumers.”<sup>33</sup>

For several reasons, however, this *Zauderer* “reasonably related” standard would not apply to the proposed climate-related disclosures. First, the D.C. Circuit has held that the *Zauderer* standard applies only to disclosures that are connected to “advertising or product labeling at the point of sale.”<sup>34</sup> As the D.C. Circuit noted, “the Supreme Court’s opinion in *Zauderer* is confined to advertising, emphatically and, one may infer, intentionally.”<sup>35</sup> For example, the *Zauderer* Court described the First Amendment interest at stake in that case as the attorney’s “interest in *not* providing any particular factual information in his advertising.”<sup>36</sup> And as the D.C. Circuit further observed, the Supreme Court has never applied the *Zauderer* standard in a case that “did not involve voluntary commercial advertising.”<sup>37</sup>

For all these reasons, the D.C. Circuit has held that *Zauderer* does *not* apply to annual disclosures mandated by the Commission.<sup>38</sup> Such disclosures are not made to clarify language in voluntary advertising. Nor are they made “at the point of sale of the company’s product,” a forum in which the D.C. Circuit (though not the Supreme Court) has held *Zauderer* may also apply.<sup>39</sup>

This distinction makes sense. The Supreme Court justified its lower standard of scrutiny in *Zauderer* on the rationale that advertisements with *incomplete* information may sometimes mislead by omission.<sup>40</sup> In the particular advertisement at issue in *Zauderer* itself, the attorney had not disclosed the difference between “legal fees” and “costs.” By touting an offer to charge

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<sup>31</sup> 471 U.S. at 652.

<sup>32</sup> *Id.* at 651.

<sup>33</sup> *Id.*

<sup>34</sup> *National Association of Manufacturers (NAM) v. SEC*, 800 F.3d 518, 522 (D.C. Cir. 2015).

<sup>35</sup> *Id.*

<sup>36</sup> *Zauderer*, 471 U.S. at 651 (emphasis in original).

<sup>37</sup> *NAM*, 800 F.3d at 523.

<sup>38</sup> *See id.* at 524.

<sup>39</sup> *See id.* at 524 n.14.

<sup>40</sup> *See Zauderer*, 471 U.S. at 651 (referring to “the possibility of consumer confusion or deception”) (quoting *In re R. M. J.*, 455 U.S. 191, 201 (1982)).

no “legal fees” without mentioning the separate charge for “costs,” the advertisement risked misleading “a layman not aware of the meaning of these terms of art.”<sup>41</sup>

Thus, *Zauderer*’s lower standard of scrutiny was premised on an advertiser’s relatively low First Amendment interest in a right to mislead by careful omission.<sup>42</sup> And the Supreme Court’s holding was specifically cabined to “an advertiser’s rights.” The Court therefore did not intend for the standard developed for that case to potentially extend to *any* compelled disclosure, even disclosures entirely unrelated to any potentially misleading advertisement or packaging.

And there is an additional reason why *Zauderer* would not apply to the proposed climate disclosures. The D.C. Circuit has held that *Zauderer* “requires the disclosure to be of ‘purely factual and uncontroversial information’ about the good or service being offered.”<sup>43</sup> In *Zauderer*, the Supreme Court used the phrase “purely factual and uncontroversial information” to refer to the disclosure that the attorney would charge for costs. The Supreme Court’s premise in *Zauderer* was that such a disclosure would unquestionably lend greater clarity to the attorney’s advertisements and help to “dissipate the possibility of consumer confusion or deception.”<sup>44</sup>

When a compelled statement is *not* of “purely factual and uncontroversial information,” however, this assumption no longer holds true. Statements that do not meet these criteria do not necessarily fill a gap left by a misleading omission. Thus, the fundamental justification for the more lenient review imposed in *Zauderer* would once again no longer apply.

The rules’ climate-related disclosures arguably fail the “purely factual” prong, and certainly fail the “uncontroversial” prong. As described in more detail below, the proposed disclosures rest on towers of assumptions, which naturally undermines the reliability of any resulting disclosures. Such uncertainty is a far cry from the indisputable terms of service disclosed in *Zauderer*. To the extent that a disclosure rests on unreliable premises, it is difficult to characterize it as “purely factual” information.

Further, setting aside the problems of reliability, the disclosures are certainly not “uncontroversial.” The Supreme Court has made clear that disclosures related to politically contentious or disputed topics cannot qualify as “uncontroversial.” The Court has explained, for example, that *Zauderer* did not apply to a California law requiring certain “clinics to disclose information about state-sponsored services—including abortion, anything but an ‘uncontroversial’ topic.”<sup>45</sup>

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<sup>41</sup> *Zauderer*, 471 U.S. at 652.

<sup>42</sup> *See id.* at 651 (suggesting that factual omissions in commercial advertising may undermine the “value to consumers of the information such speech provides”).

<sup>43</sup> *American Meat Institute (AMI) v. U.S. Department of Agriculture*, 760 F.3d 18, 27 (D.C. Cir. 2014) (en banc) (quoting *Zauderer*, 471 U.S. at 651).

<sup>44</sup> *Zauderer*, 471 U.S. at 651 (quoting *In re R. M. J.*, 455 U.S. at 201 (1982)).

<sup>45</sup> *NIFLA v. Becerra*, 138 S. Ct. 2361, 2372 (2018) (emphasis removed).



Thus, when a disclosure rule forces a company to speak on a contentious and political topic, that disclosure is not “uncontroversial,” and *Zauderer* does not apply. The D.C. Circuit recognized this when it held *Zauderer* did not apply to a Commission rule mandating that companies disclose whether minerals in their products came from a war-torn region of Africa. The rule would have forced companies to describe some of their products as not “conflict free.”<sup>46</sup>

But as the D.C. Circuit explained, this rule not only forced companies to speak on a sensitive issue, it forced them to *take sides* on that issue. The very requirement to make such a disclosure implied the government’s view as to the morality of the businesses in question. As the D.C. Circuit forcefully put it, the rule would have forced a business “to tell consumers that its products are ethically tainted,” “to confess blood on its hands,” and “to publicly condemn itself.”<sup>47</sup>

Like abortion and conflict minerals, climate change is an unquestionably controversial topic.<sup>48</sup> And like the conflict mineral rule, the climate disclosure rules are similarly tinged with implicit disapproval of greenhouse gas emissions, thus forcing companies to *take a side* in that controversy. Indeed, in multiple places, the SEC’s proposed rule suggests methods by which companies can decrease their emissions.<sup>49</sup>

In sum, there are multiple sufficient reasons why *Zauderer* cannot apply to the proposed climate disclosures: They are not aimed at advertisements or the point of sale. They are so uncertain as to not be “purely factual.” And they mandate speech on a topic that is unquestionably controversial. For all these reasons, some heightened form of scrutiny above the *Zauderer* standard must apply.

#### *The Proposed Rules Would Fail to Satisfy Either Intermediate or Strict Scrutiny*

If *Zauderer* does not apply, then the disclosure rules would be subject to either “intermediate” or “strict” scrutiny. The intermediate standard for “commercial speech” was laid out by the Supreme Court in *Central Hudson Gas & Electric Corp. v. Public Service Commission*.<sup>50</sup> That standard applies to “speech proposing a commercial transaction.”<sup>51</sup> And to satisfy that standard, the government “must assert a substantial interest to be achieved” by the regulation of speech and “the regulatory technique must be in proportion to that interest.”<sup>52</sup>

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<sup>46</sup> *NAM*, 800 F.3d at 530.

<sup>47</sup> *Id.*

<sup>48</sup> See Sean J. Griffith, *What’s “Controversial” About ESG? A Theory of Compelled Commercial Speech under the First Amendment*, SSRN, May 31, 2022, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4118755](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4118755), at 57-63.

<sup>49</sup> See, e.g., Notice at 161.

<sup>50</sup> 447 U.S. 557 (1980).

<sup>51</sup> *Id.* at 562.

<sup>52</sup> *Id.* at 564.

On the other hand, a higher standard of scrutiny applies when commercial speech “is inextricably intertwined with otherwise fully protected speech.”<sup>53</sup> In that case, a court must apply the “test for fully protected expression.”<sup>54</sup> Under that test, the government may not “dictate the content of speech absent compelling necessity, and then, only by means precisely tailored.”<sup>55</sup>

If a court were required to decide which of these standards to apply to the proposed climate disclosure rules, it is likely that the court would apply the highest scrutiny. The compelled disclosures would do more than merely “propos[e] a commercial transaction.” For the same reason that disclosures related to climate change and climate policy are not “uncontroversial,” such disclosures would also be “inextricably intertwined” with speech on matters of public concern.

As the Supreme Court has explained, even factual disclosures can burden a speaker’s own message. As hypothetical examples, the Court has imagined “a law requiring a speaker favoring a particular government project to state at the outset of every address the average cost overruns in similar projects, or a law requiring a speaker favoring an incumbent candidate to state during every solicitation that candidate’s recent travel budget.”<sup>56</sup> In either case, such “factual” disclosure laws would burden the attempted message soliciting funds, and thus interfere with the speaker’s own message.

In the same way, the proposed climate disclosures would burden the speech of companies on matters of public concern related to climate change. Companies that may wish to deliver a message that they should not be considered morally culpable for “downstream” or “upstream” emissions, for example, might have that message burdened by being forced to disclose a calculation of just how much “downstream” or “upstream” emissions they have allegedly caused, under the SEC’s formula. By burdening such core political speech, and burdening one viewpoint more than another, the disclosures would likely be found to trigger strict scrutiny.

But it is likely that the disclosure rules would in any event be held to fail *both strict and* intermediate scrutiny. That is because the government interests justifying the disclosures are neither “compelling” nor even “substantial.”

First, for reasons explained earlier in this comment, the rules cannot be justified as serving a substantial interest in aiding traditional investment choices. Because existing regulations already compel material disclosures, the additional information compelled by these rules is unlikely to materially aid investors in evaluating future financial performance. Thus, the disclosures cannot further a substantial interest in the monetary gain of investors.

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<sup>53</sup> *Riley*, 487 U.S. at 796.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* at 800.

<sup>56</sup> *Id.* at 798.

This leaves a potential interest in information to further *non-financial* investment decisions. The proposed rule suggests that some “investors and financial institutions are working to reduce the [greenhouse gas] emissions of companies in their portfolios” and that these investors need “emissions data to evaluate the progress made regarding their netzero commitments.”<sup>57</sup> In other words, this passage suggests that some investors may desire such information in order to further a particular approach to so-called “ethical” investing.

But the government cannot have a “substantial” interest in compelling disclosures that would further a certain view of ethical investing, because such an interest would have no limiting principle. As then-D.C. Circuit Judge Kavanaugh has noted, “it is plainly not enough for the Government to say simply that it has a substantial interest in giving consumers information. After all, that would be true of any and all disclosure requirements. That circular formulation would drain the *Central Hudson* test of any meaning in the context of compelled commercial disclosures.”<sup>58</sup> And as the Second Circuit has similarly observed, “[w]ere consumer interest alone sufficient, there is no end to the information that states could require manufacturers to disclose about their production methods.”<sup>59</sup>

A government interest in providing information for ethical investing would be no more curtailed than an interest in providing information for the sake of information, because there is no limit to the visions of “ethical” practices that different investors may have. As then-Judge Kavanaugh hypothesized, “[s]ome consumers might want to know whether their U.S.-made product was made by U.S. citizens and not by illegal immigrants. Some consumers might want to know whether a doctor has ever performed an abortion. Some consumers might want to know the political affiliation of a business’s owners. These are not far-fetched hypotheticals, particularly at the state or local level.”<sup>60</sup>

Similarly, if there were a government interest in forcing companies to disclose their emission levels simply because some people would choose not to invest in them on that basis, a host of other disclosures could be justified on alternative views of “ethical” investing. Some faith-based investors would prefer not to invest in companies that engage in stem-cell research or that fund abortions or contraceptives.<sup>61</sup> If the current Commission can claim a substantial interest in facilitating ethical climate investing, there would be no principled reason why a future Commission could not claim a substantial interest in facilitating other ideological approaches to ethical investing.

Courts will likely be reluctant to endorse a theory with such broad implications. Rather, the natural limiting principle is the one the Commission has already drawn: information material to

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<sup>57</sup> Notice at 158.

<sup>58</sup> *AMI*, 760 F.3d at 31 (Kavanaugh, J., concurring in the judgment).

<sup>59</sup> *International Dairy Foods Association v. Amestoy*, 92 F.3d 67, 74 (2d Cir. 1996).

<sup>60</sup> *AMI*, 760 F.3d at 32 (Kavanaugh, J. concurring).

<sup>61</sup> See, e.g., Lisa Smith, “A Guide to Faith-Based Investing,” *Investopedia*, last updated April 1, 2022, <https://www.investopedia.com/articles/stocks/12/investing-and-faith.asp>.

investors in making *financial* investment decisions. Because the proposed disclosure rules cannot be justified on *that* basis, they would likely fail even intermediate scrutiny and be struck down as violations of the First Amendment right against compelled speech.

### **The Proposal Will Not Result in Consistent, Comparable, and Reliable Disclosures**

Even if the Commission had the authority to promulgate these rules, the proposal will not create “consistent, comparable, and reliable—and therefore decision-useful—information” enabling investors “to make informed judgments about the impact of climate-related risks on current and potential investments.”<sup>62</sup> The Commission repeats this phrase—“consistent, comparable, and reliable”—time and again throughout the proposal and lauds it as the “primary benefit” of the proposal.<sup>63</sup> But many of the proposed disclosures will provide investors with unreliable information that, rather than helping markets to more efficiently price capital, will mislead investors, misdirect investment, and inefficiently alter company behavior.

First, many of the proposed disclosures are built on towers of assumptions, naturally undermining the reliability of any resulting disclosures. Because those assumptions will not be uniform across issuers, the information disclosed will also not be consistent or comparable.

Scope 3 emissions present the simplest illustration of this problem. The Commission acknowledges that Scope 3 emissions data is a “relatively new type of metric, based largely on third-party data,” that “[i]t may be difficult to obtain activity data from suppliers or other third parties in a registrant’s value chain, or to verify the accuracy of that information,” and that “[i]t may also be necessary to rely heavily on estimates and assumptions.”<sup>64</sup> But rather than recognizing the inherent unreliability of information gathered in such circumstances, the proposal requires issuers to disclose information about their methodologies and assumptions and about the gaps in the data—which makes clear that the resulting disclosure will be neither consistent, nor comparable.<sup>65</sup>

This same problem is repeated throughout the proposal, including through disclosures of physical and transition risks. Seeking to estimate risk to a particular company either directly from climate change or from potential changes in markets, technology, law, or policy in response to climate change is a task that rests, at best, on informed speculation. Climate science continues to evolve and is itself not uniform, and rather than relying on an issuer’s own analysis of their business prospects, these disclosures will require the engagement of “climate consulting firms” and “various software tools” to engage in climate modeling.<sup>66</sup> Because there is little consensus on these methods or models, resulting data will again be neither consistent,

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<sup>62</sup> Notice at 7.

<sup>63</sup> Notice at 293, 334.

<sup>64</sup> Notice at 173, 208.

<sup>65</sup> Notice at 208.

<sup>66</sup> Notice at 66.

nor comparable. And mandating disclosure based on shaky—or developing—theoretical foundations leads to less reliable disclosures.<sup>67</sup>

This problem is compounded when the proposal requires disclosure over the short-, medium-, and long-term.<sup>68</sup> Putting aside the fact that the securities laws are not meant to look to the “long term”—however defined—attempting to predict exposure to climate risk over the long-term is little more than speculation.<sup>69</sup>

While some companies or some industries may be better able to “see the future,” so to speak, on climate change due to obvious exposures to certain types of climate change risk, uniformly requiring disclosures of all issuers creates an avalanche of unreliable information that investors may misunderstand as being more concrete than it is. Indeed, the Commission lends support for this misunderstanding by requiring different levels of audit or assurance for a subset of this information. But no amount of outside auditing expertise can make up for the inherent unreliability of data produced from speculation and a host of assumptions.

Second, and more fundamentally, the risks that this proposal seeks to quantify may not be quantifiable. Looking again at Scope 3 emissions, this calculation, even at its most rigorous, posits nothing more than an estimation of the emissions in an issuer’s value chain. These estimations suffer from issues of double-counting and measurement errors, both within value-chains and across value-chains.<sup>70</sup> These estimates ultimately may say very little about a single firm’s exposure to risks based on greenhouse gas emissions. Reliance on these estimates also may lead to a lack of nuanced understanding about risks that are not subject to being quantified, however poorly.<sup>71</sup> Thus, investors may think they know more about a company’s climate-related risk based on these disclosures than they actually do.

While this problem is not unique to mandated disclosures—and may result with respect to any of the voluntary disclosures that are occurring—the fact that mandatory disclosures have been given the imprimatur of the Commission is especially problematic. Evolving understandings of

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<sup>67</sup> Cf. Jonathan R. Macey “Efficient Capital Markets, Corporate Disclosure, and Enron,” *Cornell Law Review* 89, 2004, <https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2947&context=clr>, 394.

<sup>68</sup> Notice at 66.

<sup>69</sup> The proposal does not define short, medium or long term, but asks for comment on whether the Commission should do so, suggesting that long-term time frame could be 10-20 years, 20-30 years, or 30-50 years. Notice at 67. None of these time frames are consistent with either the interests of an investor (even a long-term one) or the ability to predict risk exposure for an issuer.

<sup>70</sup> Within chain occurs when a firm’s scope 1 emissions are counted both by that firm and by downstream firms as scope 3 or 2 emissions. Across chain occurs when scope 1 emissions from an upstream firm are mistakenly attributed to downstream firms that make up value chains for different end-products, but nonetheless utilize the same upstream product in their production processes. See Gireesh Shrimali, “Scope 3 Emissions: Measurement and Management,” *The Journal of Impact and ESG Investing*, June 2, 2022, <https://doi.org/10.3905/jesg.2022.1.051>, 6, 24.

<sup>71</sup> Andrea Saltelli and Mario Giampietro, “What is wrong with evidence based policy, and how can it be improved?,” *Futures*, <http://dx.doi.org/10.1016/j.futures.2016.11.012>, 5.

climate change and a broad potential audience make it difficult to create a single, reliable, set of disclosures.<sup>72</sup> Yet, the proposal seeks to do just that.

Moreover, mandating disclosure signals to investors that they should care about climate risk—a strong signal to be sending when individual investors are less familiar with the concept.<sup>73</sup> Similarly, by making climate risk a board-level issue, this proposal signals to investors that climate-related disclosures are important ones.<sup>74</sup> But where the data is incomplete, misleading, or otherwise unreliable, risks to investors will run high.

### **The Costs of the Proposal Are Too High to Justify Its Speculative Benefits**

The Commission is required to “adequately assess the economic effects of a new rule” and must “articulate a satisfactory explanation for its action including a rational connection between the facts found and the choices made.”<sup>75</sup> Failure to do so makes promulgation of a rule “arbitrary and capricious and not in accordance with the law.”<sup>76</sup>

The costs of this proposal will be astronomical, and not solely limited to public companies. The Commission’s analysis fails to adequately address the costs of the climate-risk disclosure regime, but even the costs that the Commission does estimate outweigh the speculative benefits of the proposed prescriptive and detailed disclosure.

#### *The Commission Underestimates the Direct and Indirect Costs of the Proposal*

Under the Commission’s estimates, the cost of this proposal will be enormous: the direct cost of compliance will be approximately \$640,000 and \$530,000 in subsequent years, which presumably does not include the cost for emissions reporting that the Commission admits it cannot “fully and accurately quantify.”<sup>77</sup> The estimates of total burden of the proposal, however, are even more striking—dramatically increasing internal burden hours from approximately 19 million to 44 million and increasing external costs from approximately \$3.8 billion to \$10.2 billion.<sup>78</sup> But these numbers do not reflect an accurate account of the costs of

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<sup>72</sup> Hans Bonde Christensen, Luzi Hail, and Christian Leuz, “Economic Analysis of Widespread Adoption of CSR and Sustainability Reporting Standards,” *SSRN*, January 25, 2019, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3315673](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3315673).

<sup>73</sup> FINRA/NORC Survey at 7 (noting that “when investors are asked why they do not hold ESG investments, the most common response is related to a lack of familiarity and/or knowledge”).

<sup>74</sup> Notice at 93.

<sup>75</sup> *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quotation marks and citation omitted).

<sup>76</sup> *Id.* (citations omitted).

<sup>77</sup> Notice at 373, 379. The Commission further estimates additional costs applicable to issuers who will need to seek limited or reasonable assurance under the rules. Notice at 382-383.

<sup>78</sup> Notice at 440-441; see also Jennifer Williams-Alvarez, “Finance Teams Gear Up for Potential New SEC Climate Disclosure Rules,” *The Wall Street Journal*, June 10, 2022, <https://www.wsj.com/articles/finance-teams-gear-up-for-potential-new-sec-climate-disclosure-rules-11654857000> (describing costs to be borne by public companies in complying with the proposal).

this proposal, which would result in an even higher burden on issuers, investors, and the economy.

For example, the Commission claims that the costs of the proposal will be kept in check in part by its choice of the TCFD framework, which it claims “has been widely accepted by issuers, investors, and other market participants.”<sup>79</sup> But one of the justifications that the Commission gives for requiring disclosure is that voluntary frameworks have not resulted in sufficiently consistent disclosure. The Commission must be either overestimating the adherence to the TCFD framework for the purposes of its cost analysis or underestimating the adherence for the purpose of justifying mandatory disclosures. Correcting this either raises the cost estimate or lowers the benefits estimate, neither of which lends support to this proposal.<sup>80</sup>

The Commission also fails to consider the potential anti-competitive effects of requiring the level of detailed, prescriptive disclosure that is required by the proposal. Focusing solely on potential competition-increasing benefits of the proposal, the Commission completely ignores the consequences of requiring detailed disclosures that may provide insights into internal aspects of a company’s business, operations and strategies, including requiring information about underlying methodologies regarding climate-change issues and zip code-level details about the company’s operations.<sup>81</sup> These types of disclosures could result in the disclosure of proprietary business strategies and competitively sensitive information, thus increasing the costs of the proposal.<sup>82</sup>

Importantly, the costs of this proposal are not limited to public companies and their shareholders. Private companies will be required to provide, at a minimum, emissions information in their role as suppliers, consumers, and recipients of investment from public companies subject to the mandated reporting. The Commission’s analysis fails to address these significant costs.<sup>83</sup>

Private companies will face demands for emissions data from reporting companies. This will likely require the private company to engage in its own analysis, often requiring third-party expertise, and may result in contractual terms that could require indemnification for misstatements about carbon emissions. Another likely effect—foreshadowed by the

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<sup>79</sup> Notice at 48.

<sup>80</sup> The Commission also underestimates the distinction between voluntary disclosure and mandatory disclosure. Different levels of scrutiny and liability attach to mandatory disclosure, which will increase costs and alter a firm’s reporting and controls process, even if a company is already following the TCFD framework for voluntary disclosures.

<sup>81</sup> Notice at 397-399.

<sup>82</sup> See Matthias Breuer, Christian Leuz, and Steven Vanhaverbeke, “Reporting Regulation and Corporate Innovation,” *NBER Working Paper Series*, March 2022, [https://www.nber.org/system/files/working\\_papers/w26291/w26291.pdf](https://www.nber.org/system/files/working_papers/w26291/w26291.pdf) (examining how mandated disclosure increases proprietary costs and decreases corporate innovation for small firms).

<sup>83</sup> Whether the Commission has the authority to indirectly regulate private businesses in this manner, and whether it should do so, are separate questions. The Commission provides no authority for this wide-reaching regulation and does not consider whether such indirect regulation is a justifiable policy decision.

Commission’s own suggestions on how an issuer can streamline its own emissions reporting—is that private companies may lose the business of public companies who are not satisfied with the private company’s emissions reporting capabilities or emissions control strategies.<sup>84</sup>

These ripple effects could drive private companies who are unable to comply—regardless of their emissions levels—out of business.<sup>85</sup> It could also harm innovation, particularly in green technologies, where these rules will raise costs for start-ups.<sup>86</sup>

Besides the effect on private companies specifically, the proposal will have wider economic effects that the Commission fails to analyze. While the Commission recognizes that “if compliance costs with the proposed rules are high, this could influence the marginal firm’s decision to exit public markets or refrain from going public in the first place,” it downplays this possibility because the “pressure on private companies to disclose information on climate-related risks is rapidly escalating within the private industry.”<sup>87</sup> Of course, this ignores the role that the Commission itself is playing in requiring emissions and other climate disclosure from private companies in issuer’s value chains, but deterring companies from becoming or remaining public due to high compliance costs is itself a serious problem. Private companies are out of reach for most individual investors, and there has been demand for bringing more, higher growth companies to the public markets. This proposal may leave those individual investors with fewer choices.<sup>88</sup>

Companies that remain public may also provide worse returns for shareholders because the high costs of this proposal will function as a wealth transfer from shareholders to the consultants, lawyers and accountants who will be employed to help companies comply with the proposed rules, many of whom the Commission cites in the proposal as supporting mandatory disclosure.

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<sup>84</sup> See, e.g., Megan Haines, Todd, O. Maiden, Ben H. Patton, and Jennifer A. Smokelin, “The SEC’s proposed climate change rule: impact on private companies,” *ReedSmith*, March 24, 2022, <https://www.ehslawinsights.com/2022/03/the-secs-proposed-climate-change-rule-impact-on-private-companies/>; Shawn Panson, “What the SEC proposed climate disclosures may mean for private companies,” *GreenBiz*, June 1, 2022, <https://www.greenbiz.com/article/what-sec-proposed-climate-disclosures-may-mean-private-companies>.

<sup>85</sup> See, e.g., Tyler Olson, “SEC’s proposed ESG rule will leave small farms in the lurch, lawmakers from both parties say,” *FOXBusiness*, May 26, 2022, <https://www.foxbusiness.com/politics/sec-proposed-esg-rule-leave-small-farms-lurch-lawmakers-both-parties>.

<sup>86</sup> See, e.g., Charles K. Whitehead, “Is Now the Right Time to Mandate Costly Climate Disclosure?,” *The CLS Blue Sky Blog* <https://clsbluesky.law.columbia.edu/2022/03/29/is-now-the-right-time-to-mandate-costly-climate-disclosure/> (“The upshot is that the new Climate Rules will impose higher costs on private and public companies that are pursuing early-stage low-carbon technologies precisely at a time when we need to be able to efficiently fund and grow those and future businesses.”).

<sup>87</sup> Notice at 404-05.

<sup>88</sup> See Jennifer J. Schulp, “Let’s Not Backtrack on Loosening ‘Accredited Investor’ Rules,” *MarketWatch*, January 29, 2021, <https://www.cato.org/commentary/lets-not-backtrack-loosening-accredited-investor-rules>; Jennifer J. Schulp, “IPOs, SPACs, and Direct Listings, Oh My!,” *Real Clear Policy*, May 21, 2021 <https://www.cato.org/commentary/ipos-spacs-direct-listings-oh>.



### *The Commission Fails to Consider the Administrative Burden of The Proposal*

Besides underestimating the direct and indirect costs of the proposal, the Commission altogether fails to consider the administrative burden faced by the agency. As noted by Commissioner Lee, the proposal reflects a “watershed moment,” in which the Commission is taking on “one of the most momentous risks to face capital formation since the inception of this agency.”<sup>89</sup> Given these “momentous” stakes, the agency should explain how this discretionary rulemaking would affect its capacity to execute its existing workload.

There are reasons to be worried about the costs to the agency, both in terms of its resources and institutional integrity. Along these lines, several commentators have argued that the proposed measure would engender “mission creep” at the Commission.<sup>90</sup> At the very least, Commissioner Pierce is incontrovertibly correct when she states that the proposal “takes [the Commission] outside of our statutory jurisdiction and expertise” and into areas more traditionally associated with the Environmental Protection Agency, such as emissions accounting, climate modeling, and environmental policy assessment.<sup>91</sup>

Of course, the SEC does not have unlimited resources. In fact, the agency’s budget has been especially strained ever since passage of the Dodd-Frank Act, which added considerably to the agency’s responsibilities. For example, Dodd-Frank set deadlines for more than 400 mandatory rulemakings and scores of studies.<sup>92</sup> In practice, the Commission has honored these deadlines primarily in the breach—in the first year, the Commission missed 54 of 66 of its date-certain duties.<sup>93</sup> When faced with bipartisan criticism from Capitol Hill for its woeful deadline performance, the Commission has defended itself by citing a lack of resources.<sup>94</sup>

The agency’s resource constraints continue to the present. Just last May, Chairman Gensler told congressional appropriators that, “The SEC has not grown to meet the needs of the 2020s.”<sup>95</sup> He further observed that Commission staff decreased by about 4 percent over the last four

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<sup>89</sup> Allison Herren Lee, “Shelter from the Storm: Helping Investors Navigate Climate Change Risk,” *Securities and Exchange Commission*, March 21, 2022, <https://www.sec.gov/news/statement/lee-climate-disclosure-20220321>.

<sup>90</sup> Monique Beals, “GOP attorneys general push back against SEC climate change disclosure initiative,” *The Hill*, June 16, 2022, <https://thehill.com/policy/energy-environment/3526742-gop-attorney-generals-push-back-against-sec-climate-change-disclosure-initiative/> (describing letter from Attorneys General); Richard J. Schinder, “Mission Creep at the SEC,” *City Journal*, April 5, 2022, <https://www.city-journal.org/sec-climate-policy-mission-creep>.

<sup>91</sup> Peirce Statement.

<sup>92</sup> See Securities and Exchange Commission, “Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act,” accessed June 16, 2022, <https://www.sec.gov/spotlight/dodd-frank.shtml> ) (providing data on deadline performance).

<sup>93</sup> Mark Schoeff, Jr., “Missed Dodd-Frank deadlines pile up on eve of anniversary,” *Investment News*, October 13, 2011, <https://www.investmentnews.com/missed-dodd-frank-deadlines-pile-up-on-eve-of-anniversary-37636>.

<sup>94</sup> Rob Garver, “SEC Chief says agency is badly underfunded,” *The Fiscal Times*, February 21, 2014, <https://www.thefiscaltimes.com/Articles/2014/02/21/SEC-Chief-Says-Agency-Badly-Underfunded>.

<sup>95</sup> Ted Knutson, “SEC stretched thin, chair tells congressional appropriators,” *Forbes*, May 26, 2022, <https://www.forbes.com/sites/tedknutson/2021/05/26/sec-stretched-thin-chair-tells-congressional-appropriators/?sh=1a08d8525406>.

years, with a decline in the Enforcement Division of 6 percent.<sup>96</sup> While Chair Gensler’s most recent budgetary request sought more resources, that request focused primarily on bringing the Commission back to 2016 budgetary levels, which are no way sufficient to meet the administrative burden of implementing this “watershed” proposal.<sup>97</sup>

Because the climate disclosure proposal is resource-intensive, its implementation would exacerbate the agency’s existing budget problems. It’s not just that the agency would have to oversee the massive data demands made of registrants, although that is an obvious concern. More troublingly, the proposal fails to resolve several crucial uncertainties, which will lead to administrative headaches for the agency after the rule takes effect.

Although there are several important, yet unresolved, uncertainties in the proposal,<sup>98</sup> the risk of unintended consequences is greatest with respect to the “materiality qualifier” for disclosure requirements of a registrant’s Scope 3 emissions. Out of recognition that reporting these emissions is “more difficult,” the Commission requires disclosure of Scope 3 emissions only if they’re material to the registrant’s business.<sup>99</sup>

Because Scope 3 emissions are costly to report, a great deal rides on whether these emissions are material for a large or accelerated filer. Yet the agency offers no meaningful guidance for this crucial determination. Rather, the proposal merely points to the traditional formulation of materiality.<sup>100</sup> The problem is that the traditional formulation of materiality, with its focus on investment returns, does not speak to the novel materiality of Scope 3 emissions, which is instead a function of climate modeling and speculation about environmental policy.

Without guidance from the Commission, reporting of Scope 3 emissions will be inconsistent. The resultant turmoil will necessitate an enforcement response by the agency, in order to harmonize the registrants’ disparate decision-making regarding the materiality qualifier for Scope 3 emissions disclosure requirements. Yet using enforcement to establish a coherent framework would prove costly to the agency. As the proposal explains, these determinations are highly fact-specific.<sup>101</sup> That is, these decisions must be made on a case-by-case basis based on idiosyncrasies of the registrant’s business conditions.

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<sup>96</sup> *Id.*

<sup>97</sup> Gary Gensler, “Testimony at Hearing before the Subcommittee on Financial Services and General Government U.S. House Appropriations Committee,” *Securities and Exchange Commission*, May 17, 2022, <https://www.sec.gov/news/testimony/gensler-testimony-fsgg-subcommittee>.

<sup>98</sup> Take, for example, the requirement for disclosure of material climate risks. Under the traditional formulation, disclosure is required (*i.e.*, material) if there is a “substantial likelihood” that a reasonable investor would consider it important. Under the proposal’s novel formulation, disclosure is required where the information is “reasonably likely” to have a material impact on the registrant’s business. What’s the difference between “reasonably likely” and a “substantial likelihood”? The SEC doesn’t say.

<sup>99</sup> See Notice at 160.

<sup>100</sup> *Id.* at 162.

<sup>101</sup> *Id.* at 174 (recognizing that “whether Scope 3 emissions are material would depend on the particular facts and circumstances, making it difficult to establish a ‘one size fits all’ standard”).

The Commission’s regulatory history bears out these concerns over the proposal’s potential to crowd out other priorities. According to the agency, the proposal “builds on the Commission’s previous rules and guidance on climate-related disclosures, which date back to the 1970s.”<sup>102</sup> But the proposal makes no mention that in 1975, the Commission rejected “comprehensive disclosure of environmental effects of corporate activities” because, inter alia, “the administrative burdens involved in the proposed disclosure would be excessive ... [and] largely incapable of verification.”<sup>103</sup> Ultimately, the SEC abandoned its 1970s-era push for “qualitative materiality” because the agency wanted to focus its limited resources on the “fundamentals of securities law enforcement” instead of “securities enforcement esoterica.”<sup>104</sup>

*The Benefits Recognized By The Commission Are, At Most, Marginal Improvements Over Already Occurring Disclosure*

To outweigh the enormous costs of this proposal, the benefits expected should be significant. Yet, the benefits to which the Commission points do not meet that high bar.

The Commission acknowledges both that climate-risk disclosure has “generally increased” since 2010 and that the Commission’s rules, as further explained by the Commission’s 2010 guidance, require disclosure of material climate risk information.<sup>105</sup>

In fact, climate disclosure has been occurring voluntarily at a high rate.<sup>106</sup> As of 2019, 90% of the companies in the S&P 500 were publishing a sustainability report.<sup>107</sup> This represents consistent and rapid growth from 2011, where only 20% of the companies in the S&P 500 were providing such reporting.<sup>108</sup> While reporting coverage has increased, the information provided also has become “more sophisticated, mature, and decision-useful for investors and other important stakeholders.”<sup>109</sup> These reports are the result of demand from a variety of stakeholders—activists, employees, customers, etc.—and may not be geared toward a company’s financial performance.

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<sup>102</sup> Notice at 13.

<sup>103</sup> See Securities and Exchange Commission, “Environmental and Social Disclosure,” 40 Fed. Reg. 51656, 51662-63, November 6, 1975.

<sup>104</sup> Kenneth Noble, “The Dispute over the S.E.C.,” *New York Times*, Apr. 21, 1982, <https://www.nytimes.com/1982/04/21/business/the-dispute-over-the-sec.html>.

<sup>105</sup> Notice at 21.

<sup>106</sup> See Jennifer J. Schulp, “Public Comments on the Request for Public Input on Climate Change Disclosures,” *Cato Institute*, June 11, 2021, <https://www.cato.org/public-comments/public-comments-request-public-input-climate-change-disclosures>.

<sup>107</sup> “2020 Flash Report S&P 500: Trends on the Sustainability Reporting Practices of S&P 500 Index Companies.” *Governance & Accountability Institute*, July 16, 2020. [http://www.ga-institute.com/fileadmin/ga\\_institute/images/FlashReports/2020/G\\_A-Flash-Report-2020.pdf](http://www.ga-institute.com/fileadmin/ga_institute/images/FlashReports/2020/G_A-Flash-Report-2020.pdf) (“2020 Flash Report”); A different survey indicates that 98% of the largest companies in the United States published a sustainability report in 2020. Richard Threlfall, et. al, “The KPMG Survey of Sustainability Reporting 2020.” *KPMG*, December 2020, <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf>.

<sup>108</sup> 2020 Flash Report.

<sup>109</sup> *Id.*

The Commission, though, already has rules that require disclosures geared towards a company's financial performance. As Commissioner Peirce noted, "[u]nder these existing rules, companies are already disclosing matters such as the risk of wildfires to property, the risk of rising sea levels, the risk of rising temperatures, and the risk of climate-change legislation or regulation, when those risks are material to the company's financial situation."<sup>110</sup>

The proposal, then, must provide some benefit not provided by the existing rules. That benefit purportedly comes from the production of "consistent, comparable, and reliable" information, which the Commission asserts the current framework has not produced.<sup>111</sup> This claim itself is a bit suspect, as there is little evidence that material information is not being disclosed pursuant to the 2010 guidance. Indeed, recent inquiries by the Division of Corporation Finance questioning issuers' climate disclosure have largely returned statements from issuers noting that information not disclosed was not material.<sup>112</sup> But, as explained above, this proposal will not produce consistent, comparable, and reliable disclosures. Even if it were to do so, this improvement comes at an exceedingly high cost that is not justified by the marginal benefits of information gleaned from prescriptive disclosures that threaten to flood investors with immaterial information.

\* \* \*

Thank you for the opportunity to comment on these proposed rule amendments, and we are happy to answer any questions or further engage on this topic.

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<sup>110</sup> Peirce Statement.


<sup>111</sup> Notice at 296 (The Commission asserts that the 2010 guidance has "not resulted in the consistent and comparable information about climate-related risks that many investors have stated that they need in order to make informed investment or voting decisions.").

<sup>112</sup> See Avery Ellfeldt, "SEC gets aggressive in demanding climate data," *E&E News*, May 12, 2022, <https://www.eenews.net/articles/sec-gets-aggressive-in-demanding-climate-data/>.

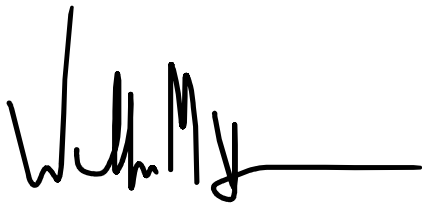
Sincerely,

A handwritten signature in black ink, appearing to read 'J. Schulp', with a stylized, cursive script.

Jennifer J. Schulp  
Director of Financial Regulation Studies  
Center for Monetary and Financial Alternatives

A handwritten signature in black ink, appearing to read 'Thomas A. Berry', with a cursive script.

Thomas A. Berry  
Research Fellow  
Robert A. Levy Center for Constitutional Studies

A handwritten signature in black ink, appearing to read 'William Yeatman', with a cursive script.

William Yeatman  
Research Fellow  
Robert A. Levy Center for Constitutional Studies