June 17, 2022

Mr. Gary Gensler, Chair
U.S. Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
rule-comments@sec.gov

Re: Climate-Related Disclosures RIN 3235-AM87, Release Nos. 33-11042, 34-94478 and File Number S7-20-22

Dear Chair Gensler:

Pacific Legal Foundation files this comment to object to the Commission's proposed rule, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Release Nos. 33-11042, 34-94478, 87 Fed. Reg. 21,334 (Mar. 21, 2022), *available at* https://www.sec.gov/rules/proposed/2022/33-11042.pdf. Under the pretense of improving investor access to information, the rule would instead flood the market with speculative and often-irrelevant information, that would confound, rather than aid, average investors. Indeed, the proposed rule mandates disclosures that are concededly *immaterial* to the average investor, and thus likely exceed the scope of the agency's authority. But the disclosure requirements would also include those about impossibly vague and uncertain variables, meaning that reporting issuers would rely on their best guesses. If those guesses turn out to be wrong, then the issuers face potential criminal liability. The disclosures also threaten First Amendment protections designed to protect against such consequences for compelled speech. The rule thus creates an unworkable, counterproductive, and ultimately unlawful exercise of agency authority that should be withdrawn.

STATEMENT OF INTEREST

Pacific Legal Foundation is the nation's leading public interest organization advocating, in courts throughout the country, for the defense of individual liberty and economic opportunity and against government overreach. PLF is deeply concerned about agency action that exceeds constitutional limits, particularly when it intrudes into areas of economic choice. PLF is also disturbed by the overcriminalization and the concerning trend of administrative efforts to expand criminal liability for regulatory offenses beyond the limits set out by Congress. PLF's attorneys have long been at the forefront of challenging administrative overreach and have regularly defeated unlawful agency action in the courts. As the Commission recognizes, "Accessible and usable disclosures are

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central to the SEC's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation." *Structured Disclosure at the SEC: History and Rulemaking*, https://www.sec.gov/page/osdhistoryandrulemaking. But its new proposal loses sight of these qualifiers and seeks to mandate inaccessible and ultimately useless disclosures that create unfair and unlawful burdens on reporting companies. If the agency is not willing to respect the legal restrictions on the SEC's disclosure authority, then PLF will not hesitate to have the courts enforce those limits.

RELEVANT BACKGROUND

A. THE COMMISSION HAS STATUTORY AUTHORITY TO REQUIRE ONLY CERTAIN DISCLOSURES

Congress vested the Commission with authority to require disclosures from reporting companies in both the Securities Act of 1933 and the Exchange Act of 1934.

Sections 7 and 10 of the Securities Act, 15 U.S.C. §§ 77g(a)(1), 77j, prescribe certain types of information that must be disclosed in registration statements and prospectuses, respectively, "as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors." In addition, they authorize the Commission to require the disclosure of such other information as it "may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. §§ 77g, 77j(c).

Similarly, Sections 12(b) and 13(a) of the Exchange Act, 15 U.S.C. §§ 78l(b), 78m(a), allow the Commission to require applications for registration of securities to include such information respecting the issuer's organization, financial structure, nature of business, and financial statements, and to require issuers of registered stock to keep current the information in the application or registration statement and to file periodic reports, so long as these reports contain such information as the Commission deems "necessary or appropriate in the public interest or for the protection of investors" "and to ensure fair trading in the security."

Generally, Sections 19(a) of the Securities Act and 23(a) of the Exchange Act, 15 U.S.C. §§ 77s(a), 78w(a), also vest in the Commission authority to promulgate such rules and regulations "as may be necessary" in administering the securities laws.

Finally, Section 2 of the Exchange Act, which was added to the statute in 1996, states that, for every rulemaking in which the SEC "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." 15 U.S.C. § 77b(b). "Section 2(b)

does not ask for an analysis of whether *any* rule would have an effect on competition. Rather, it asks for an analysis of whether the *specific rule* will promote efficiency, competition, and capital formation." *Am. Equity Inv. Life Ins. Co. v. S.E.C.*, 613 F.3d 166, 178 (D.C. Cir. 2010) ("*AEI*").

B. PUBLIC FILERS FACE POTENTIAL CRIMINAL AND CIVIL LIABILITY FOR MATERIAL OMISSIONS OR MISREPRESENTATIONS

All public filers must file relevant disclosures with the Commission on the agency's public website—the Electronic Data Gathering, Analysis and Retrieval system (EDGAR). This includes registration statements, prospectuses, updated periodic reports, and a host of other filings related to a company's financial information. *See*, *e.g.*, 15 U.S.C. §§ 78g(a)(1), 78l(b). Prospectuses—the most detailed filings made by public reporting companies—must include information about things like the operations, financial health, stock, management, accounting, and existing material contracts of the company. *See id.* Significant changes then must be reported in periodic filings.

Currently, it is both a criminal and a civil regulatory violation under the Securities Act and the Exchange Act for any person to willfully make any untrue statement of a "material fact" or omit certain material information from any required filing. *See* 15 U.S.C. § 77k(a) (Section 11, related to registration statements); 15 U.S.C. § 77q(a) (Section 10(b), fraud generally); 15 U.S.C. § 78j(b) (Section 17, fraud under Exchange Act). Private litigants can also enforce these provisions. *See id.* To be actionable, a misrepresentation or omission must be material—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." *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162 (2d Cir. 2000) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988)). Importantly, "'[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5.'" *Stratte–McClure v. Morgan Stanley*, 776 F.3d 94, 100–01 (2d Cir. 2015) (quoting *Basic*, 485 U.S. at 239 n.17). "[A]n omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts." *Id.* at 101 (internal citations omitted).

Public filers are not just publicly traded companies. Companies that must file reports are "reporting companies." *See* 15 U.S.C. § 78l (registration requirements). These include not only large, publicly-traded companies, but also smaller issuers of securities that are not publicly traded on any exchange. Indeed, many startups become reporting companies as a step towards becoming publicly traded on an exchange, as unregistered sales of securities are forbidden. *See* 15 U.S.C. § 77e (unregistered sales of securities). Additionally, both foreign and domestic private issuers may need to file registration statements, depending on their size and businesses. *See* 17 C.F.R. §§ 230.405, 230.240.3b-4.

C. THE PROPOSED RULE WOULD IMPOSE SIGNIFICANT NEW DISCLOSURE REQUIREMENTS

The new rule "would require a registrant to disclose certain climate-related information, including information about its climate-related risks that are reasonably likely to have material impacts on its business or consolidated financial statements, and [greenhouse gas] GHG emissions metrics that could help investors assess those risks." *Proposed Rule*, 87 Fed. Reg. at 21,345. It would also require "certain climate-related financial statement metrics and related disclosure to be included in a note to a registrant's audited financial statements." *Id.*

Specifically, *all* reporting issuers would need to disclose:

• "The oversight and governance of climate-related risks by the registrant's board and management;" [*Proposed* 17 C.F.R. § 229.1501]

• "How any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term;" [*Proposed* 17 C.F.R. § 229.1502(a)]

• "How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook;" [*Proposed* 17 C.F.R. § 229.1502(b)]

• "The registrant's processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the registrant's overall risk management system or processes;" [*Proposed* 17 C.F.R. § 229.1503]

• "The impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on the line items of a registrant's consolidated financial statements and related expenditures, and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities;" [*Proposed* 17 C.F.R. § 229.1503]

and

• "The registrant's climate-related targets or goals, and transition plan, if any." [*Proposed* 17 C.F.R. § 229.1503(c)(1)]. Notably, not all of these requirements require the information at issue to be "material" to an investor.

Perhaps the most significant and uncertain of the proposal's requirements are the "material impact" disclosures. An issuer must "[d]escribe any climate-related risks

reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term." 87 Fed. Reg. at 21,467 [*Proposed* 17 C.F.R. § 229.1502(a)]. A registrant must also disclose how they came to these conclusions—"Describe any processes the registrant has for identifying, assessing, and managing climate-related risks [including how it] [d]etermines the materiality of climate-related risks, [and] how it assesses the potential scope and impact of an identified climate-related risk, such as the risks identified in response to § 229.1502." *Id.*

All issuers would further need to disclose greenhouse gas emission metrics, although the specific disclosures vary depending on the size of the issuer. All reporting companies must report "Scope 1 and 2 emission metrics: Both by disaggregated constituent greenhouse gases and in the aggregate, and in absolute and intensity terms." *Id.* at 21,345. Scope 1 and 2 emissions "are direct GHG emissions that occur from sources owned or controlled by the company," and "emissions primarily resulting from the generation of electricity purchased and consumed by the company," respectively. *Id.* at 21,344.

All reporting companies must also report both "direct and indirect emissions of greenhouse gases expressed in metric tons of carbon dioxide equivalent (CO2e), of which: (1) Direct emissions are GHG emissions from sources that are owned or controlled by a registrant[] [and] (2) Indirect emissions are GHG emissions that result from the activities of the registrant, but occur at sources not owned or controlled by the registrant." *Id.* at 21,466 [*Proposed* 17 C.F.R. 229.1500(h)].

Large issuers must also report "Scope 3 GHG emissions and intensity, if material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions." *Id.* at 21,345. "Scope 3 emissions are all other indirect emissions not accounted for in Scope 2 emissions." *Id.* at 21,344. The new rule would provide, "[i]f required to disclose Scope 3 emissions, identify the categories of *upstream or downstream activities* that have been included in the calculation of the Scope 3 emissions. If any category of Scope 3 emissions is significant to the registrant, identify all such categories and provide Scope 3 emissions data separately for them, together with the registrant's total Scope 3 emissions." *Id.* at 21,380 [*Proposed* 17 C.F.R. 229.1504(c)(1)] (emphasis added). This includes "[e]missions reported by parties in the registrant's value chain." *Id.* at *Proposed* § 229.1504(c)(2)(i).

As large reporting companies must disclose "material" GHG data for both their own activities and "downstream" activities, there are concerns about liability for misstatements or omissions. "When determining whether its Scope 3 emissions are material, and when disclosing those emissions, in addition to emissions from activities in its value chain, a registrant must include GHG emissions from outsourced activities

that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing." *Id.* at 21,388 [*Proposed* 17 C.F.R. § 229.1504(c), (e)(8)]. Liability attaches to any such statement if it "is an untrue statement of material fact, a statement false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or that constitutes the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud as those terms are used in the Securities Act of 1933 or the Securities Exchange Act of 1934 or the rules or regulations promulgated thereunder," and "was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." *Id.* at *Proposed* § 229.1504(f).

"Smaller reporting companies" are exempt from the Scope 3 emissions disclosure provision. *Id.* at 21,469 [*Proposed* 17 C.F.R. § 229.1504(c)(3)]. The Commission's rules define a smaller reporting company as an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) had a public float of less than $250 million; or (2) had annual revenues of less than $100 million and either: (i) no public float; or (ii) a public float of less than $700 million. *See* 17 C.F.R. §§ 229.10(f)(1), 230.405, 240.12b-2. A public float is the average aggregate value of all outstanding shares held by nonaffiliates, which can include unissued shares that have been registered. 17 C.F.R. § 229.10(f)(2)(ii)(A).

Even so, "like larger registrants, small entities would be required to disclose information about: the oversight of their boards and management regarding climate-related risks; any material impacts of climate-related risks on their consolidated financial statements, business, strategy, and outlook; their risk management of climate-related risks; climate-related targets or goals, if any; and certain financial statement metrics. In addition, like other registrants, small entities would be required to disclose their Scopes 1 and 2 emissions." *Proposed Rule*, 87 Fed. Reg. at 21,462.

DISCUSSION

The Commission's proposed rule should not be issued for three, related, reasons. First, by requiring disclosures of a glut of immaterial and noneconomic information about a company, the proposed rule likely exceeds the Commission's authority. By pushing for such immaterial disclosures, the Commission will bury investors in useless information that will hamper their abilities to make informed decisions. Second, this information threatens expansive liability for errors in meeting the vague disclosure standards. Third, given the uncertainty in the requirements, the proposed rule violates clear First Amendment limits on what kind of speech the government may compel.

A. THE PROPOSAL VIOLATES STATUTORY LIMITS ON SEC RULEMAKING BECAUSE IT DEMANDS VAGUE, IMMATERIAL, AND NONECONOMIC INFORMATION

The Commission may only issue a rule that is "necessary or appropriate in the public interest" and "the *specific rule* [must] promote efficiency, competition, and capital formation." *AEI*, 613 F.3d at 178. This is not an insubstantial requirement, and courts have invalidated regulations that failed to live up to these standards. *See id.* Relatedly, if the SEC fails to adequately explain why the rule meets these standards, it can be declared arbitrary and capricious. *See id.*

The Commission attempts to explain why the proposed rule meets the statutory criteria. *See Proposed Rule*, 87 Fed. Reg. at 21,445 ("Mandating that climate-related disclosures be presented in a comparable and consistent manner and in a machine-readable language (Inline XBRL) is likely to enhance the information environment for investors. In doing so, the proposed rules are expected to improve market efficiency and price discovery by enabling climate-related information to be more fully incorporated into asset prices. Improved efficiency could inform the flow of capital and allow climate-related risks to be borne by those who are most willing and able to bear them."). But even if the Commission has discharged its requirement to discuss the criteria, the statutory requirements must be met by the rule. *See AEI*, 613 F.3d at 178.

The rule does not meet the required criteria, however, because the new disclosures are so vague, confusing, and voluminous that they will hamper rather than facilitate investor understanding. *See* Commissioner Peirce, *We are Not the Securities and Environment Commission—At Least Not Yet* (Mar. 21, 2022), *available at* https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321. Indeed, the new requirements are exceedingly prolix without having anything resembling specificity. Rather than nailing down what, exactly, an issuer must report, the requirements hedge everything. Consider the requirement to disclose "[h]ow any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term." *See Proposed Rule*, 87 Fed. Reg. at 21,345. That requirement recursively references all other disclosures, while hazily demanding past and future guesses about how important they might (or might not) have been to *other* persons.

Things get even more confusing when the proposal requires issuers to somehow measure the "impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on the line items of a registrant's consolidated

financial statements and related expenditures, and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities[.]" *Id.* What, *exactly*, are "climate-related" weather events or natural conditions, versus non-climate-related weather events or natural conditions, and what happens when an issuer's understanding of the climactic causes of weather events fails to align with those of its investors (or potential investors), much less enforcement bureau staff? And how does one quantify such impacts, again, to the satisfaction of both sides of the disclosure? Keep in mind, too, that this climate-impacts reporting requirement doesn't mention materiality, which suggests that the disclosures should encompass immaterial "impacts" on line items, however measured.

And, of course, the catch-all requirement to "[d]escribe any climate-related risks *reasonably likely* to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term," *Proposed Rule*, 87 Fed. Reg. at 21,467, suffers from the double-qualified need to be *reasonably likely* to have a "material" impact. But materiality is itself circularly defined as having "a substantial likelihood that the disclosure . . . would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *See Ganino*, 228 F.3d at 162. So what is required there? Only a hypothetical reasonable investor has any idea.

The emissions reporting requirements are even worse. All reporting companies must also report both "direct and *indirect* emissions of greenhouse gases" "from sources that are owned or *controlled* by a registrant" and "emissions that result from the activities *of the registrant*, but occur at sources not owned or controlled by the registrant." *Proposed Rule*, 87 Fed. Reg. at 21,466 (emphasis added). Apparently, this requires reports of emissions numbers that might be traceable to the registrant even if not under their control. But again, how can the issuer gather such information, and what level of causation does the Commission require? And who will decide? Then, to pile on to the uncertainty, large issuers must guess about "emissions data" from their "*upstream or downstream activities*" and "[e]missions reported by parties in the registrant's value chain." *Id*. For a large company with many steps in its value chain, gathering this information is likely impossible, and, at best, will be merely a wild guess. Even for a relatively small company, such as one with a minimal public float but a complex supply chain or manufacturing process, the burden would be astronomical. And while not every large reporting company is a Fortune 500, the compliance demands will have a life of their own.

Any investor who has bothered to read a prospectus for a large issuer already knows that existing disclosure requirements tend to overwhelm with useless information piled on top of useful information. Empirical research, moreover, shows that such information

overload likely creates worse outcomes for investors. *See* Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 Wash. U. L.Q. 417, 418–19 (2003). "A task is said to become more complicated as it involves the processing of more and more information—as the task size increases. Studies show that at some point, people become overloaded with information and make worse decisions than if less information were made available to them." *Id*. at 418. "To the extent that investors, analysts, and other securities market participants are subject to information overload, the model of mandatory disclosure that says more is better than less is incomplete and may be counterproductive." *Id*. If that's true *already*, these new requirements—which require disclosure of information far removed from financial viability—will simply overload investors at an absurd new level.

And the Commission itself has long accepted that it is not within the agency's statutory mission to demand immaterial disclosures that simply confuse the public. Well before Congress imposed the regulatory requirement that every SEC rule *both* "protect[] investors, [and] promote efficiency, competition, and capital formation," 15 U.S.C. § 77b(b), the Commission understood that disclosures should be limited to material economic considerations. For instance, in 1977 it released a report from the Advisory Committee on Corporate Disclosure, which expressed its "belief that the Commission should not mandate disclosure requirements which result in non-material information and which have as their principal objective regulation of management conduct. If the Commission perceives a need to regulate directly corporate conduct, it should request from Congress the authority to do so."[1] As former Commissioner A.A. Sommer, Jr., who led the report, later said, the Commission would exceed its regulatory authority if it were to "try to use its powers to compel disclosure concerning, for instance, social or environmental matters, hiring practices, and the like, unless it could be shown that such matters were material to investors." A.A. Sommer, Jr., *The U.S. Securities and Exchange Commission Disclosure Study*, 1 J. Comp. Corp. L. & SEC Reg. 145, 149 (1978). The Commission's report was also immensely influential, and as the Commission explained in 2016, prompted the adoption of "the first version of Regulation S-K." *Bus. & Fin. Disclosure Required by Regul. S-K*, Release No. 10064, 2016 WL 1458170, at *4 (Apr. 13, 2016). And still in 2016 the Commission restated its historical understanding "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." *Id*. at *90.

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[1] *Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission*, Comm. Print 95-29, House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st. Sess, at D- 9 (Nov. 3, 1977) *available at* https://www.wlrk.com/docs/SEC_Report_from_Advisory_Cmte_on_Corp._Disclosure-Nov._1977.pdf (Sommer Report).

While proponents of such disclosures often frame the issue as whether the Commission has the statutory authority to require *immaterial* disclosures, that misses the thrust of the Commission's own historical insights. *See*, *e.g.*, *Comment of 30 Law Professors*, Docket No. S7-10-22, at 13 (June 6, 2022) ("The Federal Securities Laws Do Not Impose a Materiality Constraint on the Commission's Authority to Promulgate Climate-Related Disclosure Requirements"). Perhaps specific disclosure authority never requires a prerequisite of materiality. But *all* Commission rules must be for "the protection of investors, [and must] promote efficiency, competition, and capital formation." 15 U.S.C. § 77b(b). If materiality is "a substantial likelihood that a reasonable shareholder would consider it important in deciding how" to act, then *immaterial* disclosures, by definition, don't protect investors. *See Basic*, 485 U.S. at 231 (citation omitted). And the proposed rule, by its clear terms, eschews materiality for many of the new disclosures, even distinguishing the material disclosures from the immaterial. *See* Pierce, *supra* Part II. The result is a proposed rule that exceeds the agency's statutory mission under Section 77b.

Even when they deal in purportedly material information, the new disclosure requirements also differ in kind from those allowable under the Commission's authority. The existing disclosure regime focuses on the financial traits of an issuer so that investors can go into an investment decision with their eyes open. In the words of the Sommer Report, however, the new rule eschews that tradition and mandates disclosures about "soft factors"—not the core economic data that disclosures *should* encompass. Sommer Report at D-3. For example, there is a meaningful difference between existing disclosure requirements about a company's "financial information," 17 C.F.R. § 229.300, and the proposal to simply guess at direct, indirect, upstream and downstream, and owned or controlled emissions quantities. *See Proposed Rule*, 87 Fed. Reg. at 21,345. "The proposal, by contrast, tells corporate managers how *regulators*, doing the bidding of an array of non-investor stakeholders, expect them to run their companies." Peirce, *supra*. It's difficult to see how these "*specific* [requirements] promote efficiency, competition, and capital formation." *See AEI*, 613 F.3d at 178.[2]

B. THE PROPOSED RULE CREATES A TRAP TO BE SPRUNG ON DISFAVORED BUSINESSES

If, as we've seen, the proposed rule doesn't provide useful information to the investing public, then what is its purpose? The answer seems to be that it provides a powerful tool to police the market for companies of which the Commission approves—despite its

[2] Aside from violating the statutory limits, the proposed rule is also arbitrary and capricious in that the Commission hasn't adequately explained how it will meet these statutory criteria. It hasn't done so, of course, because it *can't*—the rule doesn't meet the criteria.

admitted inability to do so lawfully.

Recall that liability arises only for affirmative misstatements or omissions that are coupled with a public filer's duty to speak. *See Basic*, 485 U.S. at 239 n.17. Disclosure requirements supply the duty to speak. *See Stratte-McClure*, 776 F.3d at 102 ("This Court and our sister circuits have long recognized that a duty to disclose under Section 10(b) can derive from statutes or regulations that obligate a party to speak."). The more required disclosures there are, the more opportunities there are for liability for omissions or inaccurate statements.

It is not hard to imagine that disfavored products or industries, like fossil fuel or tobacco producers, might therefore find themselves in the agency's sights. And it is likely that a case can be made because disclosures under the rule won't always be perfectly accurate. This is true particularly for those requirements dealing with the amorphous uncertainties of the "impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on the line items of a registrant's consolidated financial statements," or all "climate-related risks *reasonably likely* to have a material impact on the registrant," "direct and *indirect* emissions of greenhouse gases" "from sources that are owned or *controlled* by a registrant," "emissions that result from the activities *of the registrant*, but occur at sources not owned or controlled by the registrant," and "emissions data" from their "*upstream or downstream activities*" and "parties in the registrant's value chain." *See Proposed Rule*, 87 Fed. Reg. at 21,345 (emphasis added). All the Commission need do is disagree with the issuer's accounting, and an enforcement action is off to the races. Perhaps the issuer will have a valid defense, but that's cold comfort to a company facing litigation that could destroy its operation or have its shareholders face plummeting stock prices as soon as the Commission files a press release announcing its lawsuit.

Private litigants will compound this problem and likewise exploit the rule's breadth. The Commission no doubt will promise to be on its best behavior and not misuse the proposed rule's staggering scope. But private litigants will have no such compunction, and the already thriving industry of private shareholder litigation will seize on the opportunity to attack public filers for perceived inaccuracies or omissions. Political opponents of certain industries can also plague whole classes of industries. Opportunistic litigants can simply seek nuisance settlements against profitable companies. Either way, the public interest will be subservient to the glut of private enforcement actions.

The "good faith" limitation on Scope 3 disclosures does little to mitigate this likelihood. *See Proposed Rule*, 87 Fed. Reg. at 21,469. To be sure, liability always depends on materiality and scienter. *See Ganino*, 228 F.3d at 162. And the limitation on Scope 3 disclosures

explicitly incorporates this requirement. *See Proposed Rule*, 87 Fed. Reg. at 21,469. But materiality and scienter are both fact-dependent inquiries, and thus may be resolved "as a matter of law" only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976); *see also Ganino*, 228 F.3d at 162 (A "complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance."). A litigant who seeks to exploit the breadth of the proposed rule is thus very likely to survive initial dismissal, or even summary judgment, on what may be an ultimately meritless case. This provides a powerful mechanism to coerce a settlement against a public filer who, in fact, may have done nothing wrong.

The functional realities of what this proposal seeks to do prove that it does not meet the statutory criteria that it be for "the protection of investors" or that it "promote efficiency, competition, and capital formation." *See* 15 U.S.C. § 77b(b). Instead, it is a blunt instrument that improperly skews the Commission's role as neutral regulator and empowers the agency to be a partisan enforcer of its own view of good and bad business models.

C. THE PROPOSED RULE UNCONSTITUTIONALLY MANDATES NON-FACTUAL AND CONTROVERSIAL DISCLOSURES

The Commission already knows all the problems discussed above, and it also knows that they result in a proposed rule that violates First Amendment limitations on compelled speech. As the Commission learned in an earlier rulemaking effort, the First Amendment protects public filers from being forced into such traps. If the Commission still insists on promulgating the rule, then it will once again face *vacatur* of its rule.

SEC disclosure regulations are viewed as compelled speech and are subject to some form of heightened scrutiny. *See Nat'l Ass'n of Mfrs. v. S.E.C.*, 748 F.3d 359, 371 (D.C. Cir. 2014) ("*NAM I*"), *overruled in part by Am. Meat Inst. v. U.S. Dep't of Agric.*, 760 F.3d 18 (D.C. Cir. 2014) (*en banc*), *adhered to on reh'g sub nom. Nat'l Ass'n of Mfrs v. S.E.C.*, 800 F.3d 518 (D.C. Cir. 2015) ("*NAM II*"). At a minimum, compelled commercial speech must be "purely factual and uncontroversial information." *Hurley v. Irish-Am. Gay, Lesbian and Bisexual Grp. of Boston*, 515 U.S. 557, 573 (1995). Moreover, outside the context of "commercial advertising," an entity forced to make certain disclosures "'has the right to tailor the speech, [which] applies . . . equally to statements of fact the speaker would rather avoid.'" *NAM II*, 800 F.3d at 523 (quoting *Hurley*, 515 U.S. at 573–74). And, under heightened scrutiny, the Commission must also prove "that the measure it adopted would 'in fact alleviate' the harms it recited 'to a material degree.'" *Id.* at 527 (quoting *Edenfield v. Fane*, 507 U.S. 761,

770 (1993)).

The D.C. Circuit has applied this standard to vacate a previous SEC rule requiring issuers to disclose if they used "conflict minerals." *Id*. at 530. The provision "was hardly factual and non-ideological," and so the court held it violated the First Amendment. *Id*. Notably, in conducting its analysis the court worried that a contrary conclusion might allow an agency to require disclosures *concerning global warming*. *See id*. at 528. In discussing that the "uncontroversial" aspect of the First Amendment analysis applied beyond just disputes about factual accuracy and extended to broader public controversies, the court said, "If the government required labels on all internal combustion engines stating that 'USE OF THIS PRODUCT CONTRIBUTES TO GLOBAL WARMING' would that be fact or opinion?" *Id*. Even if *factually true* such disclosures would be "controversial." *See id*.

As discussed, the proposed disclosures are neither "factual" nor "non-ideological," and therefore cannot pass First Amendment muster. *See id*. The entire rule deals in an exceedingly controversial and ideological issue—the *appropriateness* of corporate action as it relates to climate change. *See* Pierce, *supra* Part VI (The Proposed Rule's "regulatory complexity is designed to push capital allocation toward politically and socially favored end[.]"). Indeed, many of the rule's proponents tout its tendency to leave "companies [that] lag their industries in cutting carbon emissions . . . vulnerable to pressure campaigns from investors and the public" as the chief selling point. *See* Maxine Joselow & Douglas MacMillan, *The SEC Proposed a Landmark Climate Disclosure Rule. Here's What to Know*, Washington Post (Mar. 21, 2022), *available at* https://www.washingtonpost.com/business/2022/03/21/sec-climate-change-rule/. And the proposal demands disclosures about highly debatable and complex matters, such as the "impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on the line items of a registrant's consolidated financial statements," or all "climate-related risks *reasonably likely* to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term," "direct and *indirect* emissions of greenhouse gases" "from sources that are owned or *controlled* by a registrant" and "emissions that result from the activities *of the registrant*, but occur at sources not owned or controlled by the registrant," and even "emissions data" from "*upstream or downstream activities*" and "parties in the registrant's value chain." *Proposed Rule*, 87 Fed. Reg. at 21,345 (emphasis added). That there is no consensus for how to measure, much less evaluate and disclose, such information is proof that it is not strictly *factual*. *See id*. at 21,341 ("Despite increasing investor demand for information about climate-related risks and strategies, many investors maintain that they cannot obtain the consistent, comparable, and material information that they need to properly inform their investment or voting decisions."). Every one of the proposed disclosures requires

significant judgment on the part of the reporting company, and a value assessment of how serious the emissions in its entire supply chain might be, and what, if any, impact those emissions *might* have on climate change, and how climate change, in the abstract, *might* affect the company's bottom line. If simply disclosing that a company engaged in business with "conflict minerals" was too controversial and uncertain to pass First Amendment review, then certainly the proposed rule fails as well. *See NAM II*, 800 F.3d at 530.

The proposal is also not narrowly tailored to get at what the Commission professes to care about. The proposal insists that it "would provide consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments." *Proposed Rule*, 87 Fed. Reg. at 21,335. But as we've seen, the required disclosures would not be consistent, comparable, or reliable, given their vague and overbroad requirements. For instance, instead of just providing measurable metrics about issues like energy consumption or direct greenhouse gas emissions, the proposal meanders into speculation about the entire supply chain's emissions, all possible contributors to climate change, and even weather events that may, or may not, result directly or indirectly from climate change. *See Proposed Rule*, 87 Fed. Reg. at 21,345. As Commissioner Pierce put it, "How could this proposal thus elicit comparable, consistent, and reliable disclosure on these topics?" Pierce, *supra* Part III. The proposed requirements are not narrow in any meaningful sense, and thus they violate the First Amendment.

CONCLUSION

Commissioner Pierce concluded that the proposed rule embodied the SEC's "revised mission [of]: 'protection of stakeholders, facilitating the growth of the climate-industrial complex, and fostering unfair, disorderly, and inefficient markets.'" Pierce, *supra*. She was undoubtedly correct. The proposal does not serve the statutory requirements limiting the Commission's power and instead is a transparent effort to push social policy and expose companies to endless potential liability. The Commission doesn't have the authority for this enterprise, and, indeed, its attempt would violate cherished First Amendment liberties. The Commission should withdraw the proposal before the courts are forced to step in.

Sincerely,

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