June 17, 2022

Dear Chairman Gensler,

The Pelican Institute is the leading free-market think tank in Louisiana. Within the Institute, the Pelican Center for Justice is a public-interest law firm dedicated to challenging government overreach and barriers to human flourishing in the courts. We write to comment on the Securities and Exchange Commission (SEC) recently proposed rule requiring public companies to make mandatory climate change disclosures.[1] Such an effort poses a variety of statutory and Constitutional problems that will invite legal challenge on behalf of those affected in our region, particularly disfavored industries such as oil and gas that provide jobs and opportunities in Louisiana.

Purpose and Practice of the SEC

The SEC identifies its mission as "protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation."[2] The Exchange Act of 1934 established the agency and provides its statutory justification.

Public companies have long been required to report "material risks" in a variety of filings. A fact has been deemed to be material in Supreme Court precedent "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote" on proxy matters.[3]

The Proposed Rule

The Obama Administration's SEC noted in guidance that public companies might also need to disclose material "climate-related" risks. The new proposed rule extends this concept of "materiality" considerably to mandate:

- Disclosure of the emissions companies generate at their own facilities, vetted by an independent auditing firm for larger companies.
- Disclosure of indirect emissions produced by a company's suppliers and customers if they are "material" to investors or included in the company's climate targets.
- For companies that have made public pledges to reduce their carbon footprint, a requirement to detail how they intend to meet their goal and to share relevant data.
- Disclosure of a company's reliance on carbon offsets, which some climate activists view with skepticism, to meet their emissions reduction goals.
- If a company uses an internal price on carbon it would need to share information about the price and how it is set.

[1] Proposed rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors (sec.gov) available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf.
[2] SEC.gov | What We Do available at https://www.sec.gov/about/what-we-do.
[3] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

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These requirements are a significant expansion of any traditional view of materiality and invite legal challenges under the Administrative Procedure Act and the First Amendment.

First Amendment Challenge

"Securities" reporting speech is still speech protected by the Constitution and mandatory government disclosures implicate compelled speech concerns. *See Nat'l Ass'n of Mfrs. v. SEC*, 748 F.3d 359 (D.C. Cir. 2014) (NAM I); affirmed on rehearing, *Nat'l Ass'n of Mfrs. v. SEC*, 800 F.3d 518 (D.C. Cir. 2015) (NAM II). Climate disclosure rules must therefore satisfy commercial speech intermediate scrutiny (at the least) under the *Central Hudson* test, which requires:

- A substantial government interest that is
- Directly and materially advanced by the regulation; and
- That the regulation is narrowly tailored.

A substantial government interest?

The substantial government interest here is ostensibly to meet a surge in investor demand to know more about climate related risks in potential investments as those risks supposedly increase in materiality with time. The ulterior motive of ESG advocates is largely to force companies to report climate related information to create a cycle of punishment or reward towards "good" and "bad" companies.

The problem is, neither of these governmental interests have garnered the support of the legislative branch of government. Stretching back to the Senate's unanimous rejection of the Kyoto Protocol lies a long list of failed efforts at climate-change legislation. In the absence of legislative support, activists have turned to the regulators. But the failure of duly elected policymakers to agree on any of this diminishes the idea of a substantial government interest in these efforts.

The other problem is the great contradiction at the heart of this rulemaking venture: companies already have to reveal material risks, and the SEC has no authority to force them to reveal non-material risks. Prior activist efforts to sue companies into revealing climate information under current securities laws have not proved successful.

Directly and materially advanced by the regulation?

Some have questioned whether this proposed regulation will actually have any impact on climate change, pointing to the failures of other programs like the Paris Accords that have not led to discernible advancement in emission reduction goals. Similarly, what level of risk to report at will be rife with challenges. As the Competitive Enterprise Institute has pointed out,

> policymakers and disclosing entities would need to consider which of several climate models to use to guide their estimates, what level of climate sensitivity to increases in greenhouse gases concentrations they will assume, and the predicted future greenhouse gas increases over the next several decades. These are variables about which there is significant debate among professional physicists and climatologists. Asking accountants and

> compliance attorneys to guess which are the "correct" values might produce more content to disclose, but is unlikely to produce the "decision relevant" data that is the goal of this proceeding.[4]

There's no evidence that this regulation will directly advance the purported government interest.

The regulation is narrowly tailored?
Is there a more narrowly tailored approach to achieving the goal? One obvious alternative is to continue a system of voluntary climate disclosures that currently exists. Companies that believe it important to disclose information about climate, emissions, and the like will do so, and concerned investors can reward them with investments.

Such an approach reveals a contradiction in the rationale for this entire effort: the increased demand for climate disclosures that supposedly requires this new rule would, if it actually existed, create more voluntary climate disclosures from public companies over time in a free market without the rule. Public companies respond to legitimate investor demands.

This obvious alternative suggests the regulation is not narrowly tailored at all.

Prior Problematic Example

The Dodd-Frank Act sought to require public companies to disclose whether or not they were free of "conflict minerals" from the conflict raging in the Democratic Republic of Congo. A legal challenge in the D.C. Circuit led to that portion of the law and the SEC rule that followed being struck down as unconstitutional compelled speech. The court noted,

> To read *Wall Street Publishing* broadly would allow Congress to easily regulate otherwise protected speech using the guise of securities laws. Why, for example, could Congress not require issuers to disclose the labor conditions of their factories abroad or the political ideologies of their board members, as part of their annual reports? Those examples, obviously repugnant to the First Amendment, should not face relaxed review just because Congress used the "securities" label.

Nat'l Ass'n of Mfrs. v. SEC, 409 U.S. App. D.C. 210, 223, 748 F.3d 359, 372 (2014).

Instead of heeding the court's clear analysis, the SEC is essentially seeking to "require issuers to disclose" all manner of non-material information in service of a one-sided political agenda and doing so without even the pretense of statutory authority.

Once again, courts are not likely to look kindly on such an effort, and the Pelican Center for Justice will be ready to challenge such government overreach should an unconstitutional rule be implemented.

[4] CEI Response to Questions for Consideration available at https://cei.org/wp-content/uploads/2021/06/SEC_climate_disclosure_20210315_questions_for_consideration_20210611.pdf.