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August 16, 2022

The Honorable Gary Gensler
Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: RIN: 3235-AM96, Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices

Dear Chair Gensler,

This letter comments on the Securities and Exchange Commission's ("SEC") proposed rule on "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices" ("the proposed rule") published in the Federal Register on June 17, 2022, at 87 Fed. Reg. at 36,654 through 36,761. The proposed rule is ostensibly aimed at a legitimate concern: "greenwashing," or the practice by which investment advisers and companies can attract investors to their products by calling them "green" (or "socially responsible" or "ethical" or "sustainable") without doing anything to justify that label. But while the proposed rule would attempt to bolster the existing law's prohibition on such misrepresentations, it is undermined by serious problems.

First, the proposed rule's vague non-definition of "ESG" and its potentially expansive application to a vast number of entities that *do not* use an ESG investment methodology mean its main effect would be to require investment advisers and companies to increase their adoption of substantive ESG practices. And because these investment advisers and companies are central to the ESG practices of their portfolio companies, the proposed rule in turn effectively regulates those companies as well without clear notice. The Supreme Court has held that due process does not permit such a result.

The proposed rule also exceeds the SEC's statutory authority. In the Investment Advisers Act of 1940 ("Advisers Act") and the Investment Company Act of 1940 ("Investment Company Act"), Congress tasked the SEC with making regulations to require investment advisers and companies to disclose material information and conflicts of interest. But imposing broad and prescriptive disclosure mandates regulating how an investment adviser or company pursues "environmental," "social," or "governance" goals is neither material, nor does it have much to do with conflicts of interest. In many cases, complying with the rule by purposely accounting for ESG factors would require investment companies and advisers to engage in conduct that clashes with their fiduciary duties. In other words, the proposed rule would require investment advisers and companies to violate the very statutes the proposed rule claims to be in service of.

Requiring highly specific disclosures of information that are not material to most investment advisers and companies or their investors might be inexplicable on its own. But in the context of the SEC's apparent aim of promoting ESG investment, the proposed rule seems to be "yet another instance of a troubling trend of not-so-subtle coercion through disclosure mandates." SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-statement-esg-052522. The effect of this proposal, as with the SEC's recently proposed climate-related risk rule, is to "introduce new pressure points that activists—or stakeholders as some prefer to call them—can use to strong-arm uncooperative funds into instituting policies more conducive to the activists' agendas or punish funds that fail to fall in line." *Id.*

The true aim of ESG movement activists is to force the adoption of an ideological suite of policies by every business—large and small—in the country. Requiring investment advisers and companies to substantively consider "environmental," "social," and governance factors in turn would pressure the millions of businesses they invest in to adopt the ESG movement's preferred policies. As a result, the proposed rule would be one of "vast economic and political significance," something the Supreme Court has explained agencies have no power to answer without a "clear statement" from Congress. *See West Virginia v. Environmental Prot. Agency*, No. 20–1530, 597 U.S. ___ (2022) (slip op., at 11). The proposed rule points to no such statement. Even if it could, a statutory grant of power that enabled such broad and amorphous rulemaking would empower the SEC to "adopt generally applicable rules of conduct governing future actions by private parties." *Gundy v. United States*, 139 S. Ct. 2116, 2133 (2019) (Gorsuch, J., joined by Roberts, C.J. and Thomas, J., dissenting). These are powers reserved for Congress, not administrative agencies, and the authorizing statues themselves would thus fail the nondelegation test.

We provide more specific comments on the proposed rule in the following discussion.

I. If Finalized, the Proposed Rule Would Be Unlawfully Vague Because It Does Not Adequately Define "ESG"

The proposed rule would be unlawfully vague because it does not define the "ESG" factors that investment advisers and companies are expected to disclose their consideration of. The proposed rule instead relies on vague platitudes. "For the purposes of this release and the proposed rules, the Commission uses the term 'ESG' to encompass terms such as 'socially responsible investing,' 'sustainable,' 'green,' 'ethical,' 'impact,' or 'good governance' to the extent they describe environmental, social, and/or governance factors that may be considered when making an investment decision. These terms, however, are not defined in the Advisers Act, the Investment Company Act, or the rules or forms adopted thereunder." 87 Fed. Reg. at 36,656 n.6.

This is no accident. "We are not proposing to define 'ESG' or similar terms and, instead, we are proposing to require funds to disclose to investors (1) how they incorporate ESG factors into their investment selection processes and (2) how they incorporate ESG factors in their investment strategies. Is this approach appropriate? Should we seek to define 'ESG' or any of its subparts in the forms? Should we provide a non-exhaustive list of examples of ESG factors in the forms? Should we define certain types of factors as being ESG but allow funds to add additional factors to that concept if they choose? Are there any other approaches that we should take in providing guidance to funds as to what constitutes ESG?" 87 Fed. Reg. at 36,660.

As Commissioner Pierce explains, this refusal to define ESG is "wholly understandable." SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-statement-esg-052522. "Can you imagine an issue that would not fit within the ambit of at least one of those letters, based on someone's reading? Take, for example, the recent suggestion by some analysts that investments in defense stocks be added to the European Union's Social Taxonomy. Imagine trying to conjure up a definition that not only met the universe of current understanding, but was flexible enough to grow to meet the hour-by-hour expansion of just what makes up E, S, and G." *Id.*

While this is surely not the SEC's intention, *see* 87 Fed. Reg. at 36,699 ("we estimate the share of funds with names suggesting an ESG focused strategy were about 3 percent of the total number of mutual funds and ETFs, and represented approximately 1 percent of total assets at the end of 2020"), it seems this ambiguity will affect even investment advisers and companies that do not consider themselves ESG funds. *See* SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-statement-esg-052522 ("The broad sweep of this requirement will affect even advisers who do not consider themselves ESG advisers.").

This vagueness is problematic because investment advisers and companies would be subject to enforcement actions if they fail to disclose these undefined factors. 87 Fed. Reg. at 36,660, 36,687. As a result, the SEC's failure to define what it would mean for a fund to "consider" ESG could lead to various surprising and counter-intuitive outcomes. For example, the SEC raises that "funds that engage in fundamental-oriented analysis" might fall within the population of investment companies subject to the proposed rule's disclosure requirements. 87 Fed. Reg. 36,661. But "fundamental-oriented analysis," or an "investment philosophy that emphasizes the need to perform in-depth fundamental analysis," is one of the most traditional and popular strategies in investment today. *See* Benjamin Graham & David L. Dodd, *Security Analysis* xiv (Seth Klarman et al. eds., 6th ed., 2009) (with foreword by Warren Buffett). When the SEC's definition of ESG could include a strategy as traditional and widespread as fundamentals-based investing, it is seriously off-base.

The "governance" factor—the "G" in ESG—has similarly expansive potential. A fund pursuing an investment strategy that exclusively considered financial returns would be a classic example of a fund that does not consider ESG factors. But how many investment strategies that exclusively consider financial returns would not also support "good governance" and consider it a factor? *See* Paul Singer, *Efficient Markets Need Guys Like Me*, Wall St. J. (Oct. 19, 2017), https://www.wsj.com/articles/efficient-markets-need-guys-like-me-1508454427 ("The benefits of . . . replacing an ineffective management team or board may show up right away in a company's stock price, but that immediate result doesn't diminish the long-term benefits.").

Or imagine a fund that considered ESG factors as *negative* considerations in its investment strategy. The fund might, for example, employ an investment screen that reduced its exposure to companies undertaking ESG-friendly initiatives. Or the fund might consider certain non-financial factors that are not commonly affiliated with ESG, or which might even be considered opposed to ESG. *See e.g.*, American Conservative Values ETF, *Investment Thesis*, https://acvetfs.com/investment-thesis/ (last visited Aug. 11, 2022) (stating the fund "seeks to avoid ownership of companies which the Adviser determines disproportionately support liberal causes"). Would such a fund "consider" ESG in its investment strategy? It would be strange indeed for the proposed rule to require a fund expressly opposed to ESG to explain how it considers ESG in its investments.

"'I'll know it when I see it' is not a practice currently recognized in administrative law." SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-statement-esg-052522. Courts have held that vague definitions are insufficient, and if the SEC wants to make a rule it "must give a person of ordinary intelligence adequate notice of the conduct it proscribes." *Regency Air, LLC v. Dickson*, 3 F.4th 1157, 1163 (9th Cir. 2021). *See also United States v. Ancient Coin Collectors Guild*, 899 F. 3d 295, 321 (4th Cir. 2018) ("To provide notice that satisfies constitutional due process, a regulation must give the person of ordinary intelligence a reasonable opportunity to know what is prohibited so that he may act accordingly." (cleaned up)); *SEC v. Panuwat*, 2022 WL 633306 (N.D. Cal. January 14, 2022) ("It is established that a law fails to meet the requirements of the Due Process Clause if it is so vague and standardless that it leaves the public uncertain as to the conduct it prohibits. The same is true for regulations. In the absence of notice-for example, where the regulation is not sufficiently clear to warn a party about what is expected of it-an agency may not deprive a party of property by imposing civil or criminal liability. To provide adequate notice, the law or regulation must give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." (cleaned up)). The proposed rule's sweeping "definitions" do not pass this test. And, as explained below, if proper definitions were added, it would only confirm the proposed rule is far outside the SEC's statutory authority, as well.

II. The Proposed Rule Would Exceed the SEC's Statutory Authority to Require Disclosure of "Material" Information or Regulate Conflicts of Interest.

The proposed rule would also exceed the statutory authority of the Advisers Act and the Investment Company Act because it would require disclosures that are neither "material" nor related to the prevention of financial conflicts of interest that form the structure and purpose of the statutes.

A. The Proposed Rule Would Exceed the SEC's Statutory Authority to Require Disclosure of "Material" Information.

The SEC is limited to requiring disclosure of "material" information. The proposed rule relies for its statutory basis on several provisions of the Advisers Act and Investment Company Act that authorize regulation necessary or appropriate "in the public interest" or "for the protection of investors." *See* 87 Fed. Reg. at 36,741; Advisers Act, §§ 203, 204, 211; Investment Company Act §§ 8, 24, 30, 38. Although this authority does not expressly use the word "material," Supreme Court precedent and the other provisions of the Advisers Act and Investment Company Act confirm that Congress limited the SEC's disclosure power to material information.

The Supreme Court has recognized that the "public interest" is not furthered by requiring companies "simply to bury the shareholders in an avalanche of trivial information," which "is hardly conducive to informed decisionmaking" and thus would "accomplish more harm than good." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448–49 (1976). The federal courts have similarly found a materiality limit in the Advisers Act, *see, e.g.*, *SEC v. Moran*, 922 F. Supp. 867, 895–96 (S.D.N.Y. 1996) ("[T]he Advisers Act establishes a statutory fiduciary duty for investment advisers . . . to disclose all *material* facts") (emphasis added), and Investment Company Act, *see*, *e.g.*, *SEC v. Advance Growth Cap. Corp.*, 470 F.2d 40, 51 (7th Cir. 1972) ("[The Investment Company Act] makes it unlawful for any person to make an untrue statement in that report or to omit *material* facts which are necessary in order to prevent the report from being *materially* misleading.") (emphasis added). The materiality limits found by courts in the Advisers Act and the Investment Company Act are also supported by textual inferences in the statutes. Section 211 of the Advisers Act—which the proposed rule relies on for its statutory authority, 87 Fed. Reg. at 36,741—provides that the SEC "shall facilitate the provision of simple and clear disclosures to investors regarding . . . any *material* conflicts of interest." Advisers Act, § 211(h) (emphasis added). Section 30 of the Investment Company Act similarly provides that reports of investment companies to investors "shall not be misleading in any *material* respect." Investment Company Act, § 30(e) (emphasis added). By limiting the SEC's disclosure power to those types of disclosures that further the public interest and expressly authorizing material disclosures, Congress was necessarily limiting the SEC to requiring "material" information.

Federal courts have adopted the same test for "materiality" across various SEC contexts: "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." *TSC Indus*., 426 U.S. at 449; *see Moran*, 922 F. Supp. at 899 (applying the same test for Advisers Act disclosures); *Krinsk v. Fund Asset Mgmt*., Inc., 715 F. Supp. 472, 503 (S.D.N.Y. 1988) (applying the same test to Investment Company Act disclosures). Because the test looks to a reasonable *investor*, the focus must be on financial returns. "[W]hile any given shareholder may have bought securities for reasons other than or in addition to making money, it seems clear that a 'reasonable investor' is someone whose interest is in a financial return on an investment." SEC Comm'r Elad Roisman, *Can the SEC Make ESG Rules that Are Sustainable?* (June 22, 2021), https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable.

The proposed rule would improperly dispense with materiality by requiring investment advisers and companies to disclose their consideration of ESG factors whether or not that consideration is material. The proposed rule applies to investment advisers and companies that "consider one or more ESG factors," 87 Fed. Reg. at 36,660, 36,687, but imposes no requirement that this consideration be material. Investment advisers and companies that consider immaterial ESG factors would be subject to the same disclosure of that consideration as a those that consider material ESG factors. Moreover, the proposed rule would require the disclosure of greenhouse-gas emissions (GHG) whether or not it is material, 87 Fed. Reg. at 36,676. The law does not provide the SEC the authority to require these disclosures.

B. The Proposed Rule Would Exceed the SEC's Statutory Authority to Regulate Conflicts of Interest.

When interpreting the SEC's authority to issue regulations under the Advisers Act and the Investment Company Act, courts have also looked to the "structure and purpose" of those statutes. *See Chamber of Commerce v. SEC*, 412 F.3d 133, 139 (D.C. Cir. 2005) (quoting *Burks v. Lasker*, 441 U.S. 471, 484 (1979)) (denying challenge to SEC rule because the rule "accords with 'the structure and purpose of the [Investment Company Act]'"); *Goldstein v. SEC*, 451 F.3d 873, 880–81 (D.C. Cir. 2006) (quoting *Abbott Labs. v. Young*, 920 F.2d 984, 988 (D.C. Cir. 1990) (holding the SEC's interpretation of the Advisers Act unreasonable, in part, because it conflicted with the Act's "statutory purposes.").

The structure and purpose of the Advisers Act and Investment Company Act is to prevent the non-disclosure of material financial conflicts of interest between (1) investment advisers and investment companies and (2) investment companies and their investors. *See Chamber of Commerce*, 412 F.3d at 139 (stating the "policy and purposes of [the Investment Company Act] . . . shall be interpreted . . . to eliminate conflicts of interest") (citing 15 U.S.C. § 80a–1(b)); *id.* (quoting *Burks*, 441 U.S. at 480 (internal quotations omitted) (stating the purposes of the Investment Company Act "include tempering the conflicts of interest inherent in the structure of investment companies"); *Financial Plan. Ass'n v. SEC*, 482 F.3d 481, 483 (D.C. Cir. 2007) (quoting *SEC v. Capital Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 187 (1963) ("The [Advisers Act] arose from a consensus between industry and the SEC "that investment advisers could not 'completely perform their basic function . . . unless all conflicts of interest between the investment counsel and the client were removed.'"); *Goldstein*, 451 F.3d at 880–81 (holding the SEC's interpretation the Investment Advisers Act unreasonable in part because it would create conflicts of interest between investment advisers and investment companies contrary to its "statutory purposes.").

The Advisers Act goes even further by expressly limiting the SEC's regulatory power over the disclosure of "material conflicts of interest." Section 211(g) of the Advisers Act provides "material conflicts of interest shall be disclosed" "in accordance with" rules issued by the SEC regulating the standard of conduct for investment advisers. Advisers Act, § 211(g). Section 211(h) further provides that the rules promulgated by the SEC must require the disclosure of "material conflicts of interest" and prohibit "conflicts of interest . . . that the Commission deems contrary to the public interest and the protection of investors." Advisers Act, § 211(h).

The SEC has also long predicated its rules issued under the Advisers Act and Investment Company Act on the basis of enhancing the disclosure of conflicts of interest. *See, e.g.*, Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669, 33,670 (rule issued under Advisers Act pointing to "a Congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.") (internal quotations omitted); Good Faith Determinations of Fair Value, 86 Fed. Reg. 748, 750 (rule issued under Investment Company Act was "designed to help address valuation risks, including those arising from conflicts of interest").

The proposed rule, by contrast, abandons the prevention of conflicts of interest for its purpose. Rather than enhancing the disclosure of actual or potential financial conflicts of interest between an investment adviser and an investment company, or between the directors of an investment company and its investors, the proposed rule intends to standardize an external measure of non-financial information unrelated to such conflicts of interest.

For the measures proposed under the Investment Company Act, the proposed rule does not mention conflicts of interest. The reason for its absence is plain. The disclosure of substantive ESG methodology—even to point of using of a mandatory methodology for the consideration of GHG emissions—is information about the substance of the investment company's investments. Without more, it is not information relevant to an investment adviser's or company's conflicts of interest.

As for the measures proposed under the Advisers Act, the rule purports to regulate conflicts of interest arising from adviser's reliance on related party "ESG providers," such as ESG-ratings service providers. 87 Fed. Reg. at 36,688. But unlike other Advisers Act rules that require the disclosure of financial conflicts of interest, the conflicts of interest the rule purports to target between an ESG provider are unrelated to the quality of a fund's financial information. *Compare id. with* Strengthening the Commission's Requirements Regarding Auditor Independence, 68 Fed. Reg. 6,005. Further, in the proposed rule the subject of the conflict of interest between an adviser and an ESG provider is the quality of certain *non-financial* information—namely, information relevant to ESG. For many advisers that would need to disclose this information who do not think of themselves as considering ESG factors, conflicts related to such "ESG information" would not be a material conflict of interest.

The proposed rule is therefore an attempt by the SEC to "exercise its regulatory authority to effect a purpose beyond that of the statute from which its authority derives." *Chamber of Commerce,* 412 F.3d at 358.

III. The Proposed Rule Would Encourage Investment Companies and Advisers to Violate Their Fiduciary Duties.

Investment advisers and investment companies are fiduciaries under the Advisers Act and the Investment Company Act. These statutes require investment advisers and investment companies to act with the best interests of their client's financial returns in mind. But the proposed rule distinguishes between "ESG factors" and "financial return objectives," and encourages investment advisers and investment companies to use corporate engagement and proxy voting to achieve "ESG factor" goals at the expense of financial return objectives. As a result, the proposed rule would at least encourage—and sometimes *require*—investment advisers and investment companies to act in ways that conflict with the best interests of their clients. *See* Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2 Colum. Bus. L. Rev. 840, 875 (2021) (arguing that "ESG disclosures will exacerbate conflicts of interest between the managers of mutual funds and pension plans and their shareholders and beneficiaries," which is "in active conflict" with the SEC's "primary function[]" of "[p]rotecting investors against such conflicts").

The Advisers Act and Investment Company Act establish the fiduciary duties of investment advisers and the directors of investment companies, respectively. *See* Advisers Act, § 206, 211; Investment Company Act, § 36. Under the Advisers Act, the fiduciary duties an investment adviser owes to its clients are "based on equitable common law principles" and include traditional trust law fiduciary duties of care and loyalty. *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (quoting *Capital Gains Rsch. Bureau, Inc.*, 375 U.S. at 194). These duties "requir[e] the investment adviser to act in the best interest of its client at all times." 84 Fed. Reg. at 33,671 (internal quotations omitted) (quoting Investment Advisers Act Release No. 3060 (July 28, 2010)). For its part, the Investment Company Act establishes the fiduciary duties of the officers and directors of investment companies, along with other affiliated persons, to the investment company and its investors. *See Steadman v. SEC*, 603 F.2d 1126, 1141 (5th Cir. 1979); 17 C.F.R. § 270.12b-1 (referencing directors' "fiduciary duties under . . . under sections 36(a) and (b) of the Act"). The Investment Company Act and rules promulgated under its authority further place specific obligations on the directors of investment companies and predicate those obligations on the exercise of their fiduciary duties. *See* 17 C.F.R. § 270.12b-1; Ellen R. Drought & Pamela M. Krill, *Fiduciary Duties of Directors of Registered Investment Companies*, 24 The Investment Lawyer 5 (May 2017) (stating the Investment Company Act's specific duties placed on directors are "'read into' the fiduciary duties set forth in Section 36").

The existence of fiduciary duties for investment advisers and investment companies distinguishes the proposed rule from other attempts by the administration to advance ESG concepts by regulation. For example, the proposed rule is unlike the SEC's proposed climate-related risk disclosure rule, because that rule would apply to issuers, which do not have fiduciary duties under the applicable *federal* laws: the Securities Act of 1933 and the Securities Exchange Act of 1934. But the proposed rule applies to investment advisers and investment companies that do have fiduciary duties and makes no claim to redefine those duties. The proposed rule must therefore explain how the disclosure or consideration of ESG factors would be consistent with existing fiduciary duties under federal law. But the proposed rule makes no such attempt.

The conflict between the proposed rule and investment adviser and investment companies' fiduciary duties is threefold. First, the proposed rule operates from the unlawful basis that consideration of ESG factors must be enhanced. The trust law fiduciary duty of care generally requires reasoned analysis, which ESG factors do not necessarily supply. *See generally* Max M. Shazenbach & Robert H. Sitkoff, *ESG Investing: Theory, Evidence, and Fiduciary Principles*, 33 J. Financial Planning 42 (Oct. 2020). The trust law fiduciary duty of loyalty also generally prohibits collateral benefits such as those sought by the consideration of ESG factors. *See id*. The proposed rule's unstated and unexamined premise that the consideration of ESG factors is a valid exercise of trustee powers is therefore an unlawful basis. ESG investing theories can generally be differentiated between risk-return investing (using ESG factors to improve risk-adjusted returns) and collateral benefits ESG (using ESG factors for third-party effects). *See id*. There is little evidence that ESG investing provides risk-adjusted returns. *Id*. And because such risk-return ESG investing cannot be supported by a reasoned and well documented analysis, it also violates the fiduciary duty of care. *Id*.

Second, the proposed rule would cause investment advisers and investment companies to breach their fiduciary duties by requiring them to undertake investing processes and strategies that their clients and investors have not requested, or, in some cases, have expressly requested they not undertake. As discussed above, because of its vague non-definition of "ESG," the proposed rule would subject a wide variety of investment advisers and companies that do not view themselves as considering ESG factors to a requirement to disclose their consideration of ESG factors. 87 Fed Reg. at 36,660. If an investment adviser or company does not currently consider ESG factors but is still subject to the proposed rule's disclosure obligation, then the proposed rule would require it to increase its consideration of ESG factors—even if only to prepare the new disclosure required by the rule. *See* SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, (May 25, 2022) ("[T]his requirement will affect even advisers who do not consider themselves ESG advisers."). To the extent that the proposed rule is "not-so-subtle coercion through disclosure mandates," SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-statement-esg-052522, the mandate may substantively increase investment advisers' and companies' consideration of ESG factors, such as by increasing the resources and process required to comply with the mandate. That change in investment advisers' and companies' conduct would run afoul of their fiduciary duties under federal law. For example, if an investment company and its adviser expressly disavowed the consideration of certain ESG factors in its advisory contract, then the consideration of ESG factors caused by compliance with the proposed rule would cause the adviser to breach its advisory contract in violation of the Advisers Act.

Third, the proposed rule would require investment advisers and companies that already consider ESG factors to increase their consideration of ESG factors beyond the extent permitted by their fiduciary duties. Under trust law fiduciary duties, consideration of ESG factors is permitted only to the extent that there is no tradeoff with financial return objectives. But the proposed rule would require investment advisers and companies that consider ESG factors to specifically consider ESG factors at levels of specificity beyond that permitted by fiduciary duties. For example, an individual company's GHG emissions have no relation to financial performance—or at least no negative relation—and as a result in no way reflect the financial risk a company may bear. As a result, to the extent that the proposed rule would require the consideration of GHG emissions by investment advisers and companies, it would require violations of their fiduciary duties.

IV. The Proposed Rule is a Pretext for Activists and Asset Managers to Advance Their Agendas—and Achieve the Same Results as the SEC's Controversial Climate-Risk Proposed Rule

Why would the SEC propose such sweeping and prescriptive new rules that seem designed only to encourage investment advisors and companies to violate their fiduciary duties? Commissioner Pierce says the answer "seems to be yet another instance of a troubling trend of not-so-subtle coercion through disclosure mandates." SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-statement-esg-052522. The purpose and effect of this proposal, like the SEC's recently proposed climate-related risk rule, is to "introduce new pressure points that activists—or stakeholders as some prefer to call them—can use to strong-arm uncooperative companies into instituting policies more conducive to the activists' agendas or punish companies that fail to fall in line." *Id.* In other words, the proposed rule is merely pretext for letting activists advance their political goals by compelling companies to disclose "environmental" or "social" performance data or face divestment. And so, as in its recent proposed rulemaking on climate-related risk, the SEC is again stepping outside of its statutory authority, only this time through the pretextual backdoor of regulating certain investment companies.

As Commissioner Peirce has explained, "some of the loudest voices in favor of ESG disclosures for issuers are asset managers who advise pension funds or fund complexes." SEC Comm'r Hester M. Peirce, *Chocolate-Covered Cicadas*, July 20, 2021, https://www.sec.gov/news/speech/peirce-chocolate-covered-cicadas-072021. While the proposed rule makes little mention of who has been calling for ESG disclosures, the SEC was far more transparent in other recent rulemakings. In the proposed climate-related risk disclosure rule, for example, the SEC points almost exclusively to asset managers and climate activist groups as the ones calling for "environmental" disclosures. *See* 87 Fed. Reg. at 21,340–43 (noting, as the very first example of "growing investor demand," that "[s]everal major institutional investors, which collectively have trillions of dollars in investment under management, have demanded climate-related information . . . ." and that groups like the Net Zero Asset Managers initiative, the Glasgow Financial Alliance for Net Zero, Climate Action 100+, and CERES have all recommended these disclosures).

And why are these managers so interested in mandating disclosures of information? They are likely looking out for their own interests: either their personal desires to virtue signal about how companies should be run, or a desire to make it harder for investors to determine whether asset managers are actually doing their jobs. "[P]ension plan fiduciaries and fund managers—who are humans susceptible to pressure from peers, personally held values, employees, and others—may be making voting and investment decisions based on their own self-interest rather than in the interest of the funds they manage. . . . Mandating the disclosure of ESG metrics, to the contrary, could provide agents (whether corporate officers or fund managers) with an out if their performance lags." SEC Comm'r Hester M. Peirce, *Chocolate-Covered Cicadas*, July 20, 2021, https://www.sec.gov/news/speech/peirce-chocolate-covered-cicadas-072021; *see* Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2 Colum. Bus. L. Rev. 840, 875 (2021) (arguing that "ESG disclosures will exacerbate conflicts of interest between the managers of mutual funds and pension plans and their shareholders and beneficiaries," which is "in active conflict" with the SEC's "primary function[]" of "[p]rotecting investors against such conflicts").

While the proposed rule does not explicitly require a portfolio company to disclose ESG information, it provides activists with one more means by which they can pressure a company, namely, through its main investors. "Forcing ESG-Focused funds to make good faith estimates of a portfolio company's greenhouse gas emissions, when they cannot get such data from 'non-reporting portfolio companies,' will in turn play a coercive role. This time the coercion will be on companies to disclose greenhouse gas emissions so that funds will invest in them without the burden of greenhouse gas guessing (and subsequent enforcement second-guessing)." SEC Comm'r Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-statement-esg-052522. When faced with the prospect of divestment, many companies will feel compelled to disclose even if disclosures are not technically required. For GHG emissions, this is just another route to the same disclosures the SEC has illegally sought via its climate-risk regulation.

In sum, while the SEC speciously frames the proposed rule as being just about investment advisers and investment companies, it really operates by changing the behavior of registrants. In that way, the proposed rule is essentially just a different mechanism to require much of the same information as the SEC's controversial (and undoubtedly illegal) climate-related risk disclosure proposed rule. Accordingly, the proposed rule is illegal for all the same reasons the climate-related risk disclosure proposed rule is, including that it vastly undercounts costs, fails to provide adequate notice to affected parties, and violates the First Amendment. *See* Letter of Amb. C. Boyden Gray to SEC Chair Gary Gensler (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20133906-303832.pdf. And, as discussed next, the proposed rule also violates the major-questions and nondelegation doctrines.

V. The Proposed Rule Violates the Major-questions Doctrine and the Nondelegation Doctrine

Even if there were some doubt about the SEC's authority to enact the proposed rule, the major-questions doctrine confirms that the Advisers Act and Investment Company Act do not give the SEC the power to require such disclosures and cause such dramatic changes in behavior for American businesses.

The major-questions doctrine requires Congress to "speak[] clearly" when it delegates "powers of 'vast economic and political significance'" to an agency. *Ala. Ass'n of Realtors v. Dep't of Health & Hum. Servs.*, 141 S. Ct. 2485, 2489 (2021). As the Supreme Court recently reaffirmed in its decision in *West Virginia v. Environmental Prot. Agency,* when "agencies assert[] highly consequential power beyond what Congress could reasonably be understood to have granted," or "discover in a long-extant statute an unheralded power representing a transformative expansion of [] regulatory authority," "there is every reason to hesitate before concluding that Congress meant to confer" the power claimed. No. 20–1530, 597 U.S. ___ (2022) (slip op., at 20) (internal quotations and citations omitted).

While the SEC claims that the proposed rule would impose few costs owing to the small number of funds that adopt ESG focused strategies, *see* 87 Fed. Reg. at 36,699 ("we estimate the share of funds with names suggesting an ESG focused strategy were about 3 percent of the total number of mutual funds and ETFs, and represented approximately 1 percent of total assets at the end of 2020"), the vague nature of the SEC's ESG definition means that almost every asset manager might find themselves subject to the rule, *see* Section I, *supra; see also* 87 Fed. Reg. at 36,699 ("According to one commenter, today virtually all asset managers have incorporated ESG considerations to some degree, or have plans to do so, across their investment strategies."). And because almost every asset manager will be impacted, so too will almost every portfolio company. *See* Section IV, *supra*.

Even if a smaller number of funds were covered by the proposed rule, the number of such firms affected would still be large enough that the vast majority of portfolio companies would feel compelled to change their disclosures and behavior to satisfy those ESG funds regardless of what other funds do—and the damage will have been done. In for a penny, in for a pound. At that point it makes little difference precisely how many funds are covered by the proposed rule. Portfolio companies cannot act one way for covered funds and a different way for non-covered funds.

The coerced disclosure of GHG emissions alone is enough to make this rule one of "vast economic and political significance." Such disclosures would directly or indirectly affect listed companies and every single link in those companies' supply and distribution chains, right down to the everyday customer. In the proposed climate-related risk disclosure rule, the SEC estimated some $15.3 billion in compliance costs over the first five years, and over $3.5 billion in the first year alone. 87 Fed. Reg. at 21,439.

But as statutory authority for this effective market makeover, the SEC only gestures to a handful of provisions of a few acts with no further elaboration. No statute provides the SEC with such power to remake American industry in the SEC's favored image, let alone through the trickery of a backdoor requirement like the proposed rule suggests. In short, there is no "clear statement from Congress" that would satisfy the major-questions doctrine.

The Court in *West Virginia* also explained, "[w]hen an agency has no comparative expertise in making certain policy judgments, . . . Congress presumably would not task it with doing so." 597 at __ (slip op., at 25) (quoting *Kisor v. Wilkie*, 139 S.Ct. 2400, 2418 (2019)). Indeed, "[s]kepticism may be merited when there is a mismatch between an agency's challenged action and its congressionally assigned mission and expertise." *Id.* at __ (slip op., at 15) (Gorsuch, J. concurring). Congress gave the SEC a limited and focused mission: to regulate trade in financial products as such. But the SEC has no "comparative expertise" in climate, and Congress has specifically assigned this authority to another agency—the EPA—a fact that even the SEC tacitly acknowledges. This means that there is a strong presumption that Congress did not grant the SEC authority to mandate GHG emissions disclosures even from investment companies that purport to account for "environmental" matters in their investment decisions. This presumption is in no way rebutted by the Advisers Act or Investment Company Act.

Finally, if the authorizing statutes *did* permit the SEC to require disclosure of such broad and open-ended information for purposes of reshaping American industry, they would violate the nondelegation doctrine because the Executive (really, a so-called independent agency, which only heightens the violation) would have carte blanche to require information from companies without any hint of a truly meaningful limitation imposed by Congress. The original understanding of nondelegation prohibited any transfer of Congress's vested legislative powers to another entity. *See Gundy*, 139 S. Ct. at 2135–37 (Gorsuch, J., joined by Roberts, C.J. and Thomas, J., dissenting); *see also* Letter of Amb. C. Boyden Gray to SEC Chair Gary Gensler at 60 (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20133906-303832.pdf. If the statutory grant of power to the SEC is so broad and amorphous that the SEC can label almost anything as "in the public interest" and thereby demand disclosures on it for the purpose of changing businesses' climate-related actions, then the SEC has the power to "adopt generally applicable rules of conduct governing future actions by private parties," *Gundy*, 139 S. Ct. at 2133 (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting), and therefore fails the original understanding of the nondelegation test.

The proposed rule would also violate the more modern intelligible-principle test. The intelligible-principle test permits an agency to undertake legislative action if Congress provided an "intelligible principle." *J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394, 409 (1928). Under that test, Congress still must "clearly delineate[ ]" the "boundaries of th[e] delegated authority." *Skinner v. Mid-Am. Pipeline Co.*, 490 U.S. 212, 214 (1989). What suffices as an intelligible principle will vary based on "the extent and character" of the power sought to be delegated, *Mistretta v. United States*, 488 U.S. 361, 372 (1989), and "the degree of agency discretion that is acceptable varies according to the scope of the power congressionally conferred," *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 475 (2001). In the proposed rule, the SEC invokes "the public interest" as supposed congressional authority to compel broad disclosures of social and environmental information from nearly every asset manager, in turn effectively regulating the environmental, climate, and social policies of nearly every company and individual in the country. If the SEC can give itself this near-limitless power over corporate and individual behavior, then there are no meaningful statutory "boundaries" on the SEC's power, which means it lays claim to the power to do this very same backdoor regulation of any and every topic.

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For all the reasons detailed above, the proposed rule would be illegal. The SEC should withdraw the proposed rule rather than continue with this rulemaking.