United States House of Representatives
Committee on Financial Services, Subcommittee on Oversight and Investigations
"Oversight of the SEC's Proposed Climate Disclosure Rule: A Future of Legal Hurdles"

Written Testimony of George S. Georgiev
The Legality of the SEC's Proposal and Process for Climate-Related Disclosure

January 18, 2024

Chairman Huizenga, Ranking Member Green, Members of the Subcommittee:

Thank you for inviting me to testify at today's hearing. My name is George S. Georgiev, and I am a law professor at Emory University where I teach and write about corporate governance and securities law.[1] I have focused on the SEC's disclosure rulemaking process for more than 15 years, first as a practicing lawyer representing large public companies on matters of securities law compliance and, subsequently, as a legal scholar. I have published a number of academic articles on various aspects of public company regulation, and I have occasionally contributed academic insights to the SEC rulemaking process through comment letters. These include a 2021 letter responding to the SEC's request for information on climate-related disclosure[2] and a co-authored letter in 2022 analyzing the SEC's statutory authority to promulgate climate-related disclosure rules, which was signed by 30 securities law scholars.[3] My testimony today draws on this past work and on new and forthcoming research. I am here solely as a legal scholar, and I am not testifying on behalf of any group or entity.

1. Certain key aspects of the SEC's Climate-Related Disclosure Proposal remain misunderstood, which results in distorted legal analysis.

Securities law and corporate reporting are complex topics and, perhaps unsurprisingly, the public discourse on the SEC's Proposal suggests that certain key aspects of it remain misunderstood. As an initial step in providing an accurate assessment of the legal future of the SEC's Proposal, I would like to highlight several related points—most of them easily ascertainable and objective.

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[1] A detailed biography and a copy of my CV is available at: https://law.emory.edu/faculty/faculty-profiles/georgiev-profile.html.

[2] *See* George S. Georgiev, Comment Letter to the SEC on Climate Change and Other ESG Disclosure (June 22, 2021), https://ssrn.com/id=3874186.

[3] *See* Jill E. Fisch, George S. Georgiev, Donna M. Nagy & Cynthia A. Williams, Comment Letter of Securities Law Scholars on the SEC's Authority to Pursue Climate-Related Disclosure (June 6, 2022), https://ssrn.com/id=4129614.

- The SEC's Proposal is about information disclosure for purposes of capital market efficiency, investor protection, and capital formation; it cannot, and does not aim to, effectuate substantive regulation pertaining to climate change.[4]

- The fact that the information released pursuant to the rule may be of interest to non-investor constituencies (in addition to core investor constituencies) does not undermine the case for regulatory action.[5]

- Investor support for the SEC's rulemaking on climate-related disclosure is near universal.[6] Moreover, many U.S. companies, in different industries and of different sizes, have also been proponents of climate-related disclosure.[7]

- Though investor demand for climate-related disclosure is real and important, the SEC's Proposal does not depend on an assessment of the intensity of investor demand or on investors' fluctuating interest in sustainable investment products.[8]

- Because climate-related disclosure will help ensure securities price accuracy and market efficiency, it will benefit <u>both</u> retail/individual investors and larger institutional investors, regardless of their interest in or stance on climate change.[9]

- The proposed requirement to disclose greenhouse gas emissions (Scope 1, Scope 2, and Scope 3) is intended to give investors an understanding of the issuer's *transition risk*—

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[4] *See* George S. Georgiev, *The Market Essential Role of Corporate Climate Disclosure*, 56 U.C. Davis L. Rev. 2105 (2023); George S. Georgiev, *The SEC's Climate Disclosure Rule: Critiquing the Critics*, 50 Rutgers L. Rec. 101 (2022).

[5] *Id.* This point is confirmed by the written testimony of one of the witnesses at today's hearing who is otherwise opposed to the SEC's climate disclosure rule. *See* Written Testimony of Mr. Lawrence Cunningham, Special Counsel, Mayer Brown (Jan. 18, 2024), https://docs.house.gov/meetings/BA/BA09/20240118/116744/HHRG-118-BA09-Wstate-CunninghamL-20240118.pdf (noting that "the relevance of a disclosure requirement to a social issue or to non-shareholder constituents does not demonstrate, in and of itself, that it exceeds the SEC's authority").

[6] *See, e.g.*, Steven M. Rothstein, Ceres, *Analysis Shows That Investors Strongly Support the SEC's Proposed Climate Disclosure Rule* (Oct 11, 2022), https://www.ceres.org/news-center/blog/analysis-shows-investors-strongly-support-secs-proposed-climate-disclosure-rule.

[7] *See, e.g.*, Comment Letter of Business Coalitions (Dec. 12, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20152676-320437.pdf ("We work with thousands of companies—including 22% of the S&P 500—with trillions in revenue and millions of employees. Our members include apparel and footwear, communications, consumer products, energy, financial services, food and beverage, healthcare, heavy industrial and manufacturing companies, media and entertainment, real estate, retail, technology, transportation, and utilities. In our view, clear rules and comparable information on climate-related risks are a critical component for well-functioning capital markets, and thus fall directly into the purview of the SEC"); *see also* Letter from Leading Companies and Coalitions in Support of the California Climate Disclosure Legislation (Aug. 14, 2023), https://bit.ly/4aZUG8q (reflecting support from various companies).

[8] *See* George S. Georgiev, *The Market Essential Role of Corporate Climate Disclosure*, 56 U.C. Davis L. Rev. 2105 (2023).

[9] *See id.*

a well established and uncontested source of business risk that will remain present irrespective of what the SEC does.[10] These emissions disclosure provisions are not reflective of a "double materiality" approach that seeks disclosure of firms' *impact* on the environment.[11]

- The SEC has sought to design a workable rule by incorporating liability safe harbors, delaying the effectiveness of certain provisions, and endorsing the use of estimates.[12] By all indications, the SEC is refining the rule further to avoid unintended consequences for various entities, including small manufacturers, farmers, and others.

2. The SEC's rulemaking process on climate-related disclosure has been deliberative, consistent with past practice, and lawful.

Developing a new disclosure rule on any topic of some complexity invariably involves challenges, and the SEC should be commended for the way it has handled the process so far. The agency's receptiveness to input from market participants, for example, has gone considerably beyond what is required by the Administrative Procedure Act (APA):

- The SEC solicited preliminary input through a request for information issued in March 2021, which generated hundreds of detailed comments.[13]
- The SEC took those comments into account and issued its Proposal in March 2022.[14]
- In response to feedback, in May 2022 the SEC extended the deadline for comment by 30 days. In practice, the comment file has remained open and substantive comments continue to be posted regularly.
- The SEC has received 4,528 individual comments to date (4,131 of them by the June 17, 2022 deadline, and 397 since then).[15]

Importantly, in the 22 months since it issued the Proposal, the SEC has accepted and conducted 372 individual meetings with a variety of market participants, industry associations, and other

[10] *See id.*, at 2127-28.
[11] *See* George S. Georgiev, *The SEC's Climate Disclosure Rule: Critiquing the Critics*, 50 Rutgers L. Rec. 101, 127 (2022).
[12] *See, e.g.*, Alexandra Thornton, *The SEC's Proposed Scope 3 Emissions Disclosure Will Not Affect Farms and Ranches*, Center for American Progress (June 6, 2022), https://www.americanprogress.org/article/the-secs-proposed-scope-3-emissions-disclosure-will-not-affect-farms-and-ranches/.
[13] *See* Allison Herren Lee, Comm'r, U.S. Sec. & Exch. Comm'n, Public Input Welcomed on Climate Change Disclosures (Mar. 15, 2021), https://bit.ly/3Vofm0T.
[14] *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11,042, Exchange Act Release No. 94,478, 87 Fed. Reg. 21,334 (proposed Mar. 21, 2022).
[15] Author's survey of public data available on the SEC's website. *See* U.S. Sec. & Exch. Comm'n, Comments for "The Enhancement and Standardization of Climate-Related Disclosures for Investors," https://bit.ly/3jolDfY (last visited Jan. 16, 2024).

stakeholders.[16] Far from a desire to get this done fast and at any cost, the high level of activity across the agency reflects the SEC's determination to *get it right*. The deliberative approach has been embraced by the Chair, the Commissioners, and the Staff, as illustrated in the following breakdown of meetings held since March 2022:

- Office of Chair Gary Gensler: 178 meetings with market participants, industry associations, and other stakeholders;
- Individual Commissioners: 140 meetings with market participants, industry associations, and other stakeholders;
- Office of the Chief Accountant: 19 meetings with market participants, industry associations, and other stakeholders;
- Division of Corporation Finance: 17 meetings with market participants, industry associations, and other stakeholders;
- Division of Economic and Risk Analysis: 12 meetings with market participants, industry associations, and other stakeholders; and
- Office of Public Engagement: 10 meetings with market participants, industry associations, and other stakeholders.

The rulemaking process has also been consistent with past practice under both Democratic and Republican administrations. For example, the rulemaking timeline—the time the SEC's Proposal has been pending—has not been excessive, particularly for a complex rule with a voluminous comment file. Moreover, it is not at all unusual that in its Proposing Release the SEC engaged with *both* investor and non-investor groups that had responded to the March 2021 request for information.[17] As a matter of practice, the SEC is expected to engage with all major points in the actual record before it and it cannot cherry-pick only the commenters it likes.

Lastly, it has been suggested that if the SEC is considering narrowing the Proposal or updating or refining its cost-benefit analysis, it would need to re-propose the rule. But to satisfy the APA's notice requirement, the proposed and final rules need not be anywhere close to identical—indeed, notice-and-comment rulemaking would be futile and wasteful if the standard for validity is overlap between the agency's proposed and final rules. The D.C. Circuit has held that "an agency's final rule need only be a *logical outgrowth* of its notice," and that "a final rule qualifies as a logical outgrowth if interested parties should have anticipated that the change was *possible*, and thus reasonably should have filed their comments on the subject during the notice-and-comment

[16] Author's survey of public data available on the SEC's website. *See* U.S. Sec. & Exch. Comm'n, Comments for "The Enhancement and Standardization of Climate-Related Disclosures for Investors"—Meetings with SEC Officials (last visited Jan. 16, 2024), https://bit.ly/3tPakTF.

[17] For an overview of this critique, see Letter from Lawrence A. Cunningham, Professor of Law, George Washington University, Corresponding Author, on Behalf of Twenty-Two Professors of Law and Finance (Apr. 25, 2022), https://bit.ly/3WGj8nx (noting the Proposal's citation patterns).

period."[18] The most likely changes between the proposed rule and the final rule would be changes that narrow its scope, not ones that expand it. Ultimately, such changes would be in direct response to arguments advocated by specific commenters. The SEC's original Proposal offered multiple possible "logical outgrowths" for the rule, and over the past 22 months, commenters have engaged with these possibilities comprehensively and exhaustively.

3. **As with *all* predictive analyses of the effects of financial regulation, cost-benefit analysis of climate-related disclosure is subject to limitations. These limitations are far from insurmountable and, importantly, the quality and validity of the SEC's cost-benefit analysis cannot be assessed until the rule is finalized.**

Scholars generally agree that the idiosyncrasies of financial markets and systems make financial regulation ill-suited to the kind of pure, quantitative cost-benefit analysis that may be possible in other regulatory domains.[19] In recognition of this fact, when reviewing the SEC's costs-benefit analysis, the D.C. Circuit has held that "an agency is *not required to measure the immeasurable*, and need not conduct a rigorous, quantitative economic analysis *unless* the statute explicitly directs it to do so."[20] It is undisputed that the SEC's governing statutes do not contain such directives, but, instead, merely tell the SEC to consider whether its rulemaking will "promote efficiency, competition, and capital formation" (in addition to investor protection).[21] Importantly, Congress' choices when adopting these provisions indicate <u>broad deference</u> to the SEC's expertise and judgment: Congress did not define the terms "efficiency, competition, and capital formation," it did not specify a dominant factor, it did not prescribe how the factors should be balanced against each other (or against investor protection), and it did not require that the factors be weighted to yield a net positive outcome.[22]

The D.C. Circuit, as recently as 2022, made it clear that "an agency's duty to consider economic impacts does not necessarily require a precise cost-benefit analysis."[23] The court also echoed established caselaw stating that the SEC "need not . . . base its every action upon empirical data,

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[18] CSX Transportation, Inc. v. Surface Transportation Board, 584 F.3d 1076, 1080 (D.C. Cir. 2009) (citations omitted) (emphasis added).

[19] *See* John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 Yale L.J. 882, 1002 (2015) (noting that unlike other regulatory domains, where there are "underlying regularities that enable quantification," the structure of finance is "non-stationary" (i.e., more likely to change) because "finance is non-physical, such that technology shocks have larger and more unpredictable effects on optimal financial choices.")

[20] Nat'l Ass'n of Mfrs. v. Sec. & Exch. Comm'n, 800 F.3d 518, 552 (D.C. Cir. 2015).

[21] Securities Act § 2(b); Exchange Act § 23(a)(2). After this provision was added to the Securities Act and the Securities Exchange Act in 1996, Congress added a similar provision to the Investment Company Act of 1940 in 1999. 15 U.S.C. § 80a–2(c).

[22] *See* Jill E. Fisch, *The Long Road Back: Business Roundtable and the Future of SEC Rulemaking*, 36 Seattle U. L. Rev. 695, 713–16 (2013).

[23] NASDAQ Stock Market LLC v. SEC, 34 F.4th 1105 (D.C. Cir. 2022).

and may reasonably conduct a general analysis based on informed conjecture."[24] In the instant rulemaking, the SEC has had to strike a careful balance and it has successfully satisfied the requirements of the statutes while also avoiding speculative and unreliable estimates of *both* costs and benefits. Arguably, the agency's reluctance to estimate and speculate has applied more commonly to the rule's expected benefits and the costs of regulatory inaction, rather than to the costs of regulatory action (which were specified much more precisely). In other words, this conservative and cautious approach has been more damaging to the case "for" the rule than the case against it. Climate-related disclosure may well entail additional benefits, including benefits to efficiency and competition, that the SEC has not yet taken into account.[25]

Views on the costs and benefits of climate-related disclosure have been far from uniform. My fellow witnesses today have already suggested a few areas in which the SEC's 2022 analysis may have understated costs. Other studies, however, have found the SEC's original cost-benefit analysis to be realistic on the whole.[26] There is also compelling evidence that the costs of compliance would be trivial or even undetectable from the point of view of *public company shareholders*—the ultimate "owners" of the firms that will be subject to the rule and the ultimate "payors" of the putative compliance costs. Analysis by Professor Shivaram Rajgopal of Columbia Business School finds that:

- "The loss in market capitalization, if any, from compliance costs is likely too tiny for any outsider to detect and to separate from daily volatility in the stock returns for unrelated reasons."[27]

- Various financial accounting quirks related to net income point to an absurd result: "even a one dollar increase in compliance costs would arguably be onerous to around 40% of publicly listed firms," which implies that "a measure [i.e., net income] that is negative for 40% of the listed firms cannot serve as a defensible basis for enacting policy proposals."[28]

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[24] *Id.* (quoting Chamber of Commerce v. SEC , 412 F.3d 133, 142 (D.C. Cir. 2005)).
[25] *See* George S. Georgiev, Comment Letter to the SEC on Climate Change and Other ESG Disclosure (June 22, 2021), https://ssrn.com/id=3874186.
[26] *See, e.g.*, ERM, Costs and Benefits of Climate-Related Disclosure Activities by Corporate Issuers and Institutional Investors (May 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20163766-333922.pdf. The ERM report indicates issuer compliance costs to be very much in line with the figures put forth by the SEC in its own economic analysis: "on average, the issuers surveyed are spending $533,000 annually on climate-related disclosure[s] [comparable to what is required in the SEC's proposal]" and this "assessment of current average annual issuer costs is similar to the SEC's estimate of $530,000 in annual issuer costs after the first year of implementation." *Id.*
[27] *See* Comment Letter of Professor Shivaram Rajgopal, Roy Bernard Kester and T.W. Byrnes Professor of Accounting and Auditing, Columbia Business School (June 12, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20130924-299962.pdf (at p. 3).
[28] *Id.*

- The rule's "modest" compliance costs "will be more than made up by even a minimal reduction in the estimation risk an investor faces in understanding the exposure of a firm to physical and transition risks associated with climate change. Such a reduction in estimation risk would likely lower the firm's cost of capital. It is particularly important to emphasize that estimation risk exists even for a firm not materially exposed to climate risk. Mandatory audited disclosures that assure an investor that a particular company is not materially vulnerable to climate risk would reduce the estimation risk and cost of capital for such a firm as well."[29]

Changes in the regulatory environment at the federal, state, and international level may well alter the cost-benefit calculus, but they do so unidirectionally and ultimately bolster the case for an SEC climate disclosure rule. As noted below, in each case, these regulatory changes either increase the rule's benefits or lower the costs of compliance. For this reason, it would be both illogical and wasteful of taxpayers' money to ask the SEC to prepare a new cost-benefit analysis and seek additional comments. Consider some of the relevant regulatory developments since March 2022:

- *Federal:* In 2022, Congress passed three pieces of legislation, two of them bipartisan, that provide extensive funding for climate-related programs: (1) the bipartisan CHIPS and Science Act ("CHIPS"), (2) the bipartisan Infrastructure Investment and Jobs Act, and (3) the Inflation Reduction Act ("IRA"). These bills were not related to climate disclosure, but they strengthened the case for such disclosure because of the massive federal spending involved (over $500 billion by 2030). Since this new federal spending will impact the financial and operational prospects of all firms across the economy, in different ways and over the course of many years, investors need to understand its effects as they make investment decisions and allocate capital. For example, firms that can reduce their greenhouse gas emissions stand to benefit under the IRA, while those that cannot reduce emissions will fare relatively worse. And as green energy becomes cheaper due to new Research and Development programs funded by the bipartisan CHIPS, firms with strong plans for decarbonization will benefit, while those reliant on fossil fuels may fare worse. These U.S. programs have spurred similar programs in other countries, which further raise the stakes for investors. Information supplied under the SEC rule will help investors distinguish among firms, take advantage of relevant investment opportunities, and mitigate new risks.[30]

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[29] *Id.*, at 10.
[30] *See* George S. Georgiev, *The Market Essential Role of Corporate Climate Disclosure*, 56 U.C. Davis L. Rev. 2105, 2129-30 (2023).

- *State:* In October 2023, California adopted three new climate-related disclosure provisions for certain entities doing business in California. An analysis using a conservative methodology found that "75% of Fortune 1000 companies will likely be required to disclose their Scope 1, 2, and 3 greenhouse gas (GHG) emissions pursuant to California SB 253; and 73% of Fortune 1000 companies will likely be required to disclose their climate risks and strategies pursuant to California SB 261."[31] To be clear, the California requirements will apply even if the SEC′s rule is struck down by a court or never adopted.

- *International:* The EU's ambitious Corporate Sustainability Reporting Directive (CSRD), adopted in November 2022, requires a wide variety of businesses, both public and private and both EU-based and international, to report detailed sustainability information following a double-materiality approach. According to estimates, the CSRD would apply to more than 10,000 non-EU companies, including approximately 3,200 U.S. companies.[32] This broad coverage is the direct result of the CSRD's capacious regulatory triggers. Unfortunately, there are no feasible steps that U.S. legislators or U.S. courts can take to block the European Union's disclosure mandates. Instead of redoing its cost-benefit analysis, the SEC's attention would be better directed at finalizing the rule and then, based on the fact that the SEC would at that point have a rule comparable to the CSRD, seek some form of regulatory relief for U.S. companies by relying on concepts of equivalence and substituted compliance.

Ultimately, the fact that opinions on the costs and benefits differ and that the regulatory environment continues to evolve highlights the importance of agency expertise. The data on the agency's engagement with market participants and other stakeholders presented in Part 3 suggests that the SEC is considering the wide range of views on costs and benefits carefully. It remains to be seen what this process will yield—we cannot and should not pre-judge its outcome. While it is of course useful to remind the SEC of its obligation to follow statutory requirements and judicial guidance, any assessment of the quality and validity of the SEC's cost-benefit analysis in this rulemaking will have to wait until the rule is finalized.

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[31] *See* Comment Letter of Americans for Financial Reform Education Fund et al. (Oct. 26, 2023), https://www.sec.gov/comments/s7-10-22/s71022-282039-689422.pdf.

[32] *See* Elena Philipova, Director, Sustainable Finance, Data & Analytics, London Stock Exchange Group, How Many Companies Outside the EU are Required to Report Under Its Sustainability Rules? (June 2, 2023), https://www.lseg.com/en/insights/risk-intelligence/how-many-non-eu-companies-are-required-to-report-under-eu-sustainability-rules; *see also* Dieter Holger, *At Least 10,000 Foreign Companies to be Hit by EU Sustainability Rules*, Wall St. J. (Apr. 5, 2023), https://bit.ly/3LutQuv.

4. The statutory language, relevant legislative history, judicial pronouncements, and the SEC's rulemaking practice all support the SEC's authority to promulgate climate-related disclosure rules.

As I have argued elsewhere, including in joint work with Professors Jill Fisch, Donna Nagy, and Cynthia Williams,[33] Congress has structured federal securities regulation as principally disclosure-based, instructing the SEC to regulate the capital markets through an extensive disclosure regime for publicly traded companies. Even a narrow reading of the legislative history of the original securities laws supports the SEC's authority to pursue the Proposal because climate-related matters impact the most important aspect of any securities transaction—*the price* at which investors buy or sell. Congress was particularly focused on valuation matters, among others, when it adopted the Securities Act in 1933: Congress' intent was to create an information-generating regime "designed to reach items of distribution profits, watered values, and hidden interests . . . [of] indispensable importance in appraising the soundness of a security," which contains "items indispensable to any accurate judgment upon the value of the security."[34]

In 2018, then-Chairman Jay Clayton described the SEC's disclosure system as "powerful, far reaching, dynamic and ever evolving" and noted that "as stewards of this . . . system, a key responsibility of the SEC is to ensure that the mix of information companies provide to investors facilitates well-informed decision making."[35]

The historical record confirms that former Chairman Clayton's description was apt. In the nine decades since Congress gave it this authority, the SEC has adjusted and refined its disclosure requirements continuously in response to market, technological, and economic developments. For example:

- The SEC has adopted detailed disclosure rules on executive compensation, related-party transactions, asset-backed securities, and certain technical industry-specific

[33] *See* Jill E. Fisch, George S. Georgiev, Donna M. Nagy & Cynthia A. Williams, Comment Letter of Securities Law Scholars on the SEC's Authority to Pursue Climate-Related Disclosure (June 6, 2022), https://ssrn.com/id=4129614; Jill E. Fisch, George S. Georgiev, Donna Nagy & Cynthia Williams, *Climate Change, West Virginia v. EPA, and the SEC's Distinctive Statutory Mandate*, 47 Admin. & Reg. L. News 9 (2021-2022). This Part 4, as well as Parts 5 and 6, draw extensively from these prior works and from material presented in my other articles cited here.

[34] House Report on Securities Act, H.R. Rep. No. 85, 73d Cong., 1st Sess. 3 (1933).

[35] Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at Meeting of the Investor Advisory Committee (Dec. 13, 2018), https://bit.ly/3wV4UnB.

items, without a specific congressional mandate or authorization and, also, without having to defend the rules in court.[36]

- The March 2022 Proposal is by no means the SEC's first foray into environmental and climate-related disclosure. To the contrary, the SEC's long history of requiring environmental disclosures dates back more than five decades. Since the 1970s, the disclosure regime has included rules pertaining to environmental matters, including environmental litigation, environmental loss contingencies, and so on.[37]

- In 2020 (and while under Republican control), the SEC adopted a disclosure rule regarding human capital management (HCM) after finding that new economic conditions and investor demand warrant such an action.[38] It is worth noting that both the House and the Senate had been contemplating HCM disclosure mandates since early 2019,[39] but no one argued that the SEC was required to await congressional authorization before proceeding with or finalizing its own rulemaking; such an argument is similarly misplaced in the context of the current Proposal.

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[36] *See* Jill E. Fisch, George S. Georgiev, Donna M. Nagy & Cynthia A. Williams, Comment Letter of Securities Law Scholars on the SEC's Authority to Pursue Climate-Related Disclosure (June 6, 2022), https://ssrn.com/id=4129614.

[37] In a 1971 release issued during the Nixon Administration, the SEC highlighted the requirement that public companies disclose material matters involving the environment, among others. In 1973, the SEC mandated disclosure of various environmental proceedings, and in 1976 it required disclosure about capital expenditures relating to environmental compliance. The refinement of environmental disclosure rules continued during the 1980s. In parallel, the SEC and accounting standard-setters developed detailed rules on the treatment of contingent environmental liabilities, as well as rules about disclosure and accrual of environmental obligations upon future asset retirement. The SEC's high-profile releases on MD&A disclosure also referenced environmental matters. In 1993, the SEC issued detailed guidance addressing accounting and disclosure issues relating to environmental loss contingencies. Most recently, in 2010, the SEC provided additional guidance on climate-change developments that were required to be disclosed under SEC rules, noting the variety of ways in which climate change could affect firms' operations or results. As this brief history reveals, market and business developments have, over time, changed both the importance of environmental disclosures and the practicality of requiring such disclosures. *See id*.

[38] *See* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Modernizing the Framework for Business, Legal Proceedings and Risk Factor Disclosures (Aug. 26, 2020), https://bit.ly/3GS8YJD ("From a modernization standpoint, today, human capital accounts for and drives long-term business value in many companies much more so than it did 30 years ago. Today's [new] rules reflect that important and multifaceted shift in our domestic and global economy."); *see also* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at Meeting of Investor Advisory Committee (Mar 28, 2019), https://bit.ly/3t51w8x (noting that "the historical approach of disclosing only the costs of compensation and benefits often is not enough to fully understand the value and impact of human capital on the performance and future prospects of an organization"). All five commissioners agreed on the materiality of human capital matters and supported enhanced disclosure in this area, despite some disagreement about the format of the new disclosure requirement, which resulted in a split vote. *See* George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 TUL. L. REV. 639, 718-22 (2021).

[39] *Id.*, at 683-85.

Each of the above disclosure requirements was adopted in reliance on Congress' original grant of authority to the SEC, without any additional statutory authorization. Importantly, at no time has Congress legislatively overridden the SEC's novel or enhanced disclosure requirements, even though it has amended the securities laws on multiple occasions since the 1930s.

In addition to formal disclosure rules, the SEC has also developed a practice of providing real-time disclosure guidance, which in most cases results in substantially enhanced disclosure. The topics of such guidance have included "Year 2000" (Y2K) risks, the impact of the Eurozone crisis and Brexit, and, more recently, the Covid-19 pandemic and Russia's war on Ukraine.[40] In line with the SEC's historical approach, the Proposal on climate-related disclosure simply mandates the release of objective information and does not seek to establish substantive operational requirements. Recall that the SEC is not setting GHG emission limits, calculating carbon trading prices, drawing up climate transition plans, or setting climate resilience standards for businesses. Indeed, the SEC is not aiming to address climate change any more than it was trying to solve a geopolitical crisis (Russia's war on Ukraine) or a global health crisis (the Covid-19 pandemic) when it required public companies to disclose the risks and operational and financial impacts of these critical events for the benefit of investors and markets.

Importantly, the federal courts have also affirmed the broad scope of the SEC's rulemaking authority:

- The D.C. Circuit has stated that "rather than casting disclosure rules in stone, Congress opted to rely on the discretion and expertise of the SEC for a determination of what types of additional disclosure would be desirable."[41]

- The D.C. Circuit has also noted that "the Commission has been vested by Congress with broad discretionary powers to promulgate (or not to promulgate) rules requiring disclosure of information beyond that specifically required by statute."[42]

- The D.C. Circuit has explained that "the Commission's task [is] a peculiarly difficult one, requiring it to find a path between the views of the parties to the rulemaking polarized in support of the broadest disclosure or in opposition to any disclosure, to

[40] *See* Jill E. Fisch, George S. Georgiev, Donna M. Nagy & Cynthia A. Williams, Comment Letter of Securities Law Scholars on the SEC's Authority to Pursue Climate-Related Disclosure (June 6, 2022), https://ssrn.com/id=4129614.
[41] Nat. Res. Def. Council, Inc. v. SEC, 606 F.2d 1031, 1045 (1979).
[42] *Id.*

interpret novel statutory commands, and to make decisions against the background of rapidly changing conditions."[43]

- The D.C. District Court has noted: "These statutes grant the SEC broad rulemaking authority. The language of the acts suggests that the SEC is empowered to exercise its informed discretion about which information will be required to be disclosed in the various corporate filings."[44] As part of the same proceedings, the D.C. District Court urged the SEC to "develop a [factual] record" and "imaginatively exercise its authority and expertise."[45]

Consistent with these judicial pronouncements, no court has invalidated an SEC rule for overstepping the SEC's disclosure authority. This is despite the SEC's active rulemaking spanning nine decades and despite the fact that, as is often the case with economic regulation, many of the SEC's rules were initially resisted by the regulated entities and other interested parties.[46] It should be emphasized that if Congress had objected to the SEC's approach, it could have easily intervened. Congress has amended the Securities Act and the Exchange Act on multiple occasions since the 1930s,[47] so it has had ample opportunity to reconsider the broad authority it delegated for disclosure-based rules, or to constrain the SEC's power to require disclosures about new topics. It has not found it necessary to do so. To the contrary, Congress has emphasized the importance of agency delegation with respect to disclosure matters. In the bipartisan Sarbanes-Oxley Act of 2002, for example, in addition to prescribing specific items, Congress also mandated that public companies should disclose "on a rapid and current basis" such information about "material changes in [their] financial condition or operations" as the SEC determines "necessary or useful for the protection of investors and in the public interest."[48]

5. The SEC's long, active, and uncontested history of disclosure rulemaking since the 1930s also undermines the validity of legal objections stemming from the Major Questions Doctrine.

The June 2022 Supreme Court decision in *West Virginia v. EPA* has led some commentators to raise an additional concern, arguing that the Proposal runs afoul of the Major Questions Doctrine (MQD). As the Court explained, the MQD applies when an agency "claims to discover in a long-

[43] *Id.*, at 1057.
[44] Nat. Res. Def. Council, Inc. v. SEC, 389 F. Supp. 689, 695 (D.D.C. 1974).
[45] *Id.*
[46] As noted in Part 6, courts have, on occasion, invalidated SEC rules for other reasons.
[47] *See, e.g.*, JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE (2003).
[48] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 409, 116 Stat. 745, 791.

extant statute an unheralded power . . . representing a transformative expansion in [its] regulatory authority."[49] The Court concluded that the EPA's regulatory approach in that case "effected a 'fundamental revision of the statute, changing it from [one sort of] scheme of . . . regulation' into an entirely different kind."[50]

As Professors Fisch, Nagy, Williams and I argued shortly after the release of the decision, in contrast to the Court's characterization of the EPA's actions in that case, the SEC's Proposal does not entail an expansion of its regulatory authority, let alone a "transformative expansion." The Proposal is limited to the SEC's traditional regulatory function: mandating that publicly traded companies include in their SEC filings certain new disclosures determined by the agency to be relevant to investor trading decisions and the exercise of shareholder voting rights. In other words, the Proposal does not constitute the exercise of "an unheralded power," but, rather, the exercise of a power that was explicitly authorized by Congress and that has always been the core part of the SEC's regulatory role.[51] Importantly, the grants of congressional authority in the 1930s were specific—authority over the disclosure regime in the interest of market efficiency; the SEC is not relying on authorizations containing "modest words," "vague terms," or any "subtle devices."[52]

As we noted, the entire statutory structure of federal securities regulation is based on mandating the provision of standardized and comparable information about publicly traded companies to the capital markets, and the original securities laws explicitly established the authority of the SEC to enact disclosure requirements to protect those markets and market participants. Such policy determinations clearly involved policy questions, but those were asked and answered by Congress in the 1930s. The SEC, in turn, has exercised its disclosure authority consistently—and without legislative override—in the nearly ninety years that followed. The SEC has now done so once more with the Proposal on climate-related disclosure.[53]

6. The SEC's approach to materiality in this rulemaking is sound, consistent with current law and past practice, and likely to mitigate both issuers' compliance costs and investors' research costs.

The concept of materiality is fundamental to securities law, but its meaning—and the way it is operationalized—is always contingent on context. As is well known, the Supreme Court has noted

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[49] West Virginia v. EPA, 142 S. Ct. 2587, 2610 (2022).
[50] *Id.*, at 2612.
[51] *See* Jill E. Fisch, George S. Georgiev, Donna Nagy & Cynthia Williams, *Climate Change, West Virginia v. EPA, and the SEC's Distinctive Statutory Mandate*, 47 Admin. & Reg. L. News 9 (2021-2022).
[52] *See* West Virginia v. EPA, 142 S. Ct. 2587, 2609 (2022) (quoting Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 468 (2001)) (setting out criteria which cause an agency decision to require MQD scrutiny).
[53] *See id*.

that information is material if there is a "substantial likelihood that a reasonable [investor] would consider it important" in making an investment or voting decision; as the Court explained, "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."[54]

The Court's succinct articulation of materiality is certainly helpful as a general matter, but it is crucial to remember that when it put forward this articulation, the Court was addressing the question of whether an issuer, at some specified point in the past, had *a legal duty to disclose* particular information, under a particular set of circumstances and in light of the applicable regulatory framework. In other words, the Court's materiality test applies to an *ex post* liability determination, not to an *ex ante* policy choice by a regulator. When it engages in disclosure rulemaking, the SEC invariably has to make *ex ante* policy choices. Courts often struggle with materiality and liability determinations even with the benefit of hindsight and with evidence of price impact. The policymaking context is even more uncertain, and the *ex post* liability test cannot function as a self-executing and forward-looking disclosure criterion. The SEC, therefore, enjoys broad deference in operationalizing materiality.

This is borne out by the historical record. When the D.C. Circuit has struck down SEC rules, it has been for failure to carry out adequate cost-benefit analysis,[55] and never due to a finding that the challenged rule lacked materiality. It is instructive that none of the hundreds of disclosure rules the SEC has promulgated since the 1930s has been challenged in court on materiality grounds; this corpus includes many rules adopted pursuant to the SEC's broad delegated authority (rather than prescriptive SEC mandates),[56] as well as various rules on environmental and climate matters.[57] Importantly, the D.C. Circuit has not ruled that cost-benefit analysis requires an assessment of materiality. The closest the D.C. Circuit has come to considering materiality in the context of SEC

[54] *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (defining materiality in the context of a proxy fraud action under Rule 14a-9); Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (adopting the *TSC Industries* materiality formulation in the context of securities fraud actions under Rule 10b-5). *See also* George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. Rev. 602, 620-25 (2017) (examining the content of the materiality standard, various approaches to applying it, and the associated challenges).

[55] *See* Bus. Roundtable v. SEC, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (invaliding SEC proxy access rule mandated by the Dodd-Frank Act); *see also* Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 177–79 (D.C. Cir. 2009) (invalidating SEC rule on fixed index annuities); Chamber of Commerce v. SEC, 412 F.3d 133, 142–44 (D.C. Cir. 2005) (invaliding SEC rule imposing director independence requirements on mutual funds).

[56] *See, e.g.*, Asset-Backed Securities Disclosure and Registration, Securities Act Release No. 33-9638, Exchange Act Release No. 72982, 79 Fed. Reg. 57,184, 57,186 (Sept. 24, 2014) (adopting new rules because "the financial crisis highlighted that investors and other participants in the securitization market did not have the necessary information and time to be able to fully assess the risks underlying asset-backed securities and did not value asset-backed securities properly or accurately"); Executive Compensation and Related Person Disclosure, Exchange Act Release No. 54302A (Aug. 29, 2006), 71 Fed. Reg. 53,158 (Sept. 8, 2006).

[57] *See supra* Part 4.

disclosure rulemaking has been to find that the SEC is entitled to deference in its determination on the materiality (or lack thereof) of particular topics: During the 1970s, the Natural Resources Defense Council challenged the SEC's refusal to pursue disclosure rulemaking in response to its petition, which the SEC had justified on the grounds that the non-disclosed information was not material; the D.C. Circuit sided with the SEC.[58]

What does this mean for the potential vulnerability of the SEC's climate-related disclosure rule to challenges based on materiality? Such challenges are unlikely to succeed because here, as in prior rulemakings, the SEC has been guided by the *general materiality* of a subject matter (the impact of climate change on the operations and prospects of public companies) and has worked to develop an information-generating framework to elicit accurate, consistent, and decision-useful disclosure with a focus on the informational needs of the "reasonable investor." As is customary, the SEC has used its judgment to determine what items should be covered, whether and how individual disclosure requirements should incorporate materiality qualifiers (which require issuers to perform particularized materiality testing), and so on. In the case of the climate-related disclosure rule, the SEC had the benefit of the extensive technical work done by the Task Force on Climate-Related Financial Disclosures, which has included participation from U.S. financial regulators during both Republican and Democratic administrations.

More specifically, the SEC's Proposal strikes a reasonable and appropriate balance between two types of disclosure items: those that do not incorporate a materiality qualifier and those that do. Each type has advantages and disadvantages and each entails trade-offs for the two most relevant constituencies here—issuers and investors. Materiality-qualified disclosure requirements may appear attractive due to their flexibility, but they can also be very time- and resource-intensive because issuers must engage in particularized materiality testing of each piece of information in order to determine whether they have a legal duty to disclose. This can be a difficult and, even for the most diligent issuer, uncertain process: materiality testing requires the issuer to make predictive judgments about the relative "importance" that a hypothetical "reasonable investor" would attach to particular information, both now and at some unspecified point in the future, even after the facts on the ground have changed. By contrast, complying with a specific disclosure item that is presumed to be material entails no such guesswork and uncertainty. Issuers often find this option appealing, even if it means that they may sometimes need to disclose information that has a low likelihood of being material.

[58] *See* Nat. Res. Def. Council, Inc., v. SEC, 606 F.2d 1031 (D.C. Cir. 1979). Note, of course, that the SEC is not bound by a policy judgment it made during the 1970s, and that the economy, market fundamentals, investor preferences, and other factors have changed since then.

The investor perspective also entails tradeoffs. Materiality-qualified items may yield information that is more focused, but there is an inherent risk that the issuer would under-disclose, whether inadvertently or deliberately, which can distort market pricing and investor decisions. Materiality-qualified items also result in information gaps and in information that is not standardized, which makes it all the more difficult to compare issuers. At the same time, all investment decisions are relative—whether to allocate capital to Issuer A or Issuer B—so such comparisons are crucial. Ultimately, disclosure rule design is a difficult process and the best way to approach is to do exactly what the SEC has been doing: solicit and weigh the feedback of multiple market participants. No SEC disclosure rule is set in stone and, when warranted, the SEC will have the opportunity to make iterative improvements to the climate-related disclosure rule after adoption.

Conclusion

The available evidence suggests that the SEC's work on climate-related disclosure—both the substance of the Proposal and the rulemaking process—has been in compliance with relevant legal requirements and longstanding historical practice. The Proposal is well tailored and the final rule may be even more so. The SEC's process has been meticulous and deliberative. In the end, the validity of the rulemaking will depend on who and what is covered by the final rule and on the analytical justifications underpinning the agency's policy judgments.

Looking ahead, the most serious concern for U.S. companies will be the proliferation of overlapping climate-related disclosure requirements and the expansive scope of the EU's disclosure framework. An effective SEC rule that is not bogged down in litigation offers the best—and, likely, the only—chance for providing U.S. companies with regulatory relief based on principles of equivalence or substituted compliance.