Climate Finance, Spring 2024
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Securities Regulation and Disclosure: Materials for Class on Tuesday April 9[2]

Securities regulation regimes have a number of objectives, but a major component of securities regulatiuon is to provide information to investors that those investors need to have to make informed investment decisions. In the US, the Securities Act of 1933 provides for disclosure of information about intitial offerings of securities, and the Securities Act of 1934 contains provisions relating to disclosure in secondary markets for public companies.[3] The statutes also contain anti-fraud rules relating to issuances of securities and transactions in securities more generally. And the SEC has adopted rules containing detailed disclosure requirements.[4]

We have already seen the idea that physical and transition issues relating to climate change may be significant for some businesses, and, where those businesses have issued securities, investors will want to know about the risks. The SEC published guidance about climate issues in 2010.[5] At that time the SEC acknowledged international and domestic developments that might have a material impact on securities issuers in the US.[6] The SEC also noted that issuers were providing climate-related information to the public through voluntary disclosures not filed with the SEC.[7] As we have seen, the Trump administration took measures to prevent the use of climate-related information in financial decision-making,[8] rather than to encourage it.

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[2] Some of the material in this document is taken from my draft paper, It's Not Easy Being Anti-Greenwashing.

[3] *See*, *e.g.*, https://www.sec.gov/about/about-securities-laws.

[4] *See* 17 CFR Part 229.

[5] *See* SEC, Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290 (Feb. 8, 2010).

[6] *See*, *e.g.*, *id.* At 6290-1.

[7] *Id*. at 6292.

[8] *See*, *e.g.*, Department of Labor, Financial Factors in Selecting Plan Investments 85 FR 72846 (Nov. 13, 2020); Department of Labor, Fiduciary Duties Regarding Proxy Voting and Shareholder Rights 85 FR 81658 (Dec. 16, 2020).

The SEC's 2022 Proposal for Climate-related Disclosures

In 2022 the SEC proposed new climate disclosure rules to "provide consistent, comparable, and reliable— and therefore decision-useful— information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments,"[9] arguing that "disclosure of information about climate-related risks and metrics would be in the public interest and would protect investors."[10] In contrast to EU rules, the SEC's proposal stated that it focused on the aim of protecting investors, rather than on any idea of achieving a more sustainable economy. Investors' inability to understand and compare the climate-related risks of investments undermines their ability to make properly informed investment decisions.

The SEC's proposal stated that its proposed climate-related disclosure scheme is based in part on the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD),[11] acknowledging that the SEC's actions are related to a broader international focus on climate–related financial disclosures. The TCFD was a group of industry experts, chaired by Michael Bloomberg, and convened by the Financial Stability Board at the request of finance ministers and central bank governors of the G20 countries. The TCFD published its final report on recommendations on climate disclosures in 2017.[12]

The proposed rules would require registrants[13] to make disclosures including about:

> The oversight and governance of climate-related risks by the registrant's board and management .. How any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term .. How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook.. The registrant's processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the registrant's overall risk management system or processes .. he impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on the line items of a registrant's consolidated financial statements and related

[9] SEC Climate-Related Disclosure Proposal at 21335.

[10] SEC Climate-Related Disclosure Proposal at 21335.

[11] SEC Climate-Related Disclosure Proposal, *supra* note ?, at 21343.

[12] Recommendations of the Task Force on Climate-related Financial Disclosures (Jun. 2017).

[13] The requirements would apply to registration statements and Annual Reports under the Exchange Act. SEC Climate-Related Disclosure Proposal at 21345.

expenditures,.. and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities...[14]

However, in many cases these disclosures would only be required where the registrant had chosen to engage in particular practices with respect to climate change.

The SEC's proposal also drew upon the Greenhouse Gas (GHG) Protocol, which, as we have learned, provides guidance and standards for the development of an inventory of greenhouse gas emissions, including emissions designated as scope 1 (direct emissions from sources owned or controlled by an enterprise), scope 2 (emissions from purchased or acquired energy), and scope 3 (emissions from the enterprise's entire value chain, upstream and downstream).[15] Firms would be required to disclose information about GHG emissions, including climate-related targets and transition plans, if any.[16] Information about scope 3 emissions would be required to be disclosed if material or if the firm has targets or a transition plan that include scope 3 emissions.[17] GHG emissions were characterized as:

> "important to investment decisions for various reasons, including because GHG emissions data is quantifiable and comparable across industries and can be particularly useful in conducting a transition risk analysis;... it can be used to evaluate the progress in meeting net-zero commitments and assessing any associated risks;... and it may be relevant to investment or voting decisions because GHG emissions could impact the company's access to financing, as well as its ability to reduce its carbon footprint in the face of regulatory, policy, and market constraints."[18]

The SEC's proposal discussed at length how companies might go about making disclosures about their GHG emissions. However, with respect to scope 3 emissions, and because of difficulties businesses would encounter in calculating scope 3 emissions reliably, the SEC proposed to establish a safe harbor from some forms of liability under the Federal securities laws, an exemption for smaller reporting companies, and a delayed compliance date for scope 3

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[14] SEC Climate-Related Disclosure Proposal at 21345.

[15] SEC Climate-Related Disclosure Proposal at 21344-5. *See also* The Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard, Revised edition, at https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf; Madison Condon, *What's Scope 3 Good For?*, 56 UC DAVIS L. REV. 1921 (2023).

[16] SEC Climate-Related Disclosure Proposal at 21345.

[17] SEC Climate-Related Disclosure Proposal at 21345.

[18] SEC Climate-Related Disclosure Proposal at 21373-4.

emissions data.[19]

The SEC proposal also reflected a concern to ensure the accuracy of information by means of assurance, proposing that certain issuers be required to include in their disclosures an attestation report with respect to their scope 1 and 2 emissions, and setting out minimum standards for the attestation.[20] To the extent that climate information were included in financial statements they would be subject to traditional audit requirements but emissions data would be subject to the new assurance requirements. The idea of such a requirement reflects a concern for accuracy of the information provided, but would also lead to additional compliance costs, and generated concerns about which professional service firms would benefit from the new rules.[21]

Although the proposal emphasized that the SEC was focusing on investor protection, which is entirely understandable, given that the SEC's rulemaking authority is limited by statute, critics reacted as if the SEC was in fact acting to achieve climate benefits rather than investor protection,[22] and commentators started to identify possible bases for challenge of any final rules the SEC might adopt.

Potential legal challenges range from challenges based on statutory interpretation to broader constitutional challenges. For example, with respect to statutory interpretation, some academics have argued that the investors who want climate-related financial disclosures are large institutional investors rather than "Main Street" investors,[23] which raises questions about how the courts should interpret the SEC's mandate to protect investors. Even if the SEC has the authority to require some disclosures with respect to climate change, disclosure requirements which are not clearly about investor protection and which relate to matters which are not factual and

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[19] SEC Climate-Related Disclosure Proposal at 21390.

[20] SEC Climate-Related Disclosure Proposal at 21392-21405.

[21] Hester Peirce, *We are Not the Securities and Environment Commission – At Least Not Yet* (Mar. 21, 2022) at https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321 ("Audit firms are likely to be the biggest winners, as they already have established assurance infrastructures and are familiar with SEC reporting and the proposed independence framework. The attestation mandate could be a new sinecure for the biggest audit firms, reminiscent of the one given them by section 404(b) of the Sarbanes-Oxley Act.")

[22] *See*, *e.g.*, Baker Botts, *A Review of the Reaction to the SEC's Climate -Related Disclosure Proposal and What Might Come Next* (Sep. 19, 2023) at https://www.bakerbotts.com/thought-leadership/publications/2023/september/a-review-of-the-reaction-to-the-secs-climate-related-disclosure-proposal.

[23] *See*, *e.g.*, John C Coffee, Jr., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, Colum. Bus. L. Rev. 602 (2021) (asking whether retail investors and institutions have the same or different disclosure needs, given that large diversified institutional investors care more about systemic risk, and want to limit externalities that some companies impose on others, whereas other investors may have a greater taste for risk); Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, Colum. Bus. L. Rev. 840 (2021).

uncontroversial will be scrutinized by the courts to see whether they are permissible under the First Amendment.[24] An SEC rule requiring disclosures with respect to conflict minerals,[25] where Congress had instructed the SEC to promulgate regulations,[26] was found to violate the First Amendment. The SEC had not shown that a less restrictive requirement than requiring certification that minerals were conflict free would fail to achieve the objective.[27]

Congress has not specifically mandated the SEC to address issues relating to climate change,[28] and therefore any climate disclosure rules will need to be justified based on the need to protect investors, in addition to satisfying First Amendment concerns. In addition, the SEC will also face arguments that its climate disclosure rules implicate the major questions doctrine, which has been characterized as "perhaps the most important..constraint on agency power, particularly when it comes to some of the most pressing problems of our time."[29]

Climate change would seem to be eligible for consideration as a major policy issue, and was certainly not in the minds of legislators in enacting the Federal securities laws. Congress clearly intended the Securities Act of 1933 and the Securities Exchange Act of 1934 to have a broad application where necessary to protect investors, and the text of the statutes makes this clear.[30] However, it seems that the major questions doctrine may be treated as applicable even in these sorts of situation.[31] Costs associated with compliance are relevant, as are whether policies

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[24] *See*, *e.g.*, Sean J. Griffith, *What's "Controversial" About ESG? A Theory of Compelled Commercial Speech Under the First Amendment*, 101 NEB. L. REV. 876 (2022).

[25] Securities and Exchange Commission, Conflict Minerals, 77 Fed. Reg. 56274 (Sep. 12, 2012). *Cf.* Maria Maciá, *Mandatory Disclosure for Ethical Supply Chains: Market Responses to Conflict Minerals Reports*, 13 HARV. BUS. L. REV. 189, 191 (2023) (noting that those to whom disclosures are targeted do not necessarily respond as policy-makers expect). *See also*, *id.* at 195 ("These results imply that disclosures conveying a higher risk of supporting the conflict face neither shareholder nor consumer discipline, and they explain why the categorized disclosures do not show a net effect of companies reducing their support of the conflict through their supply chains.")

[26] Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, 124 Stat. 1376 (relevant parts codified at 15 U.S.C. §§ 78m(p), 78m note.

[27] National Association of Manufacturers v SEC 748 F. 3d 359 (DC Cir. 2014). *Cf.* National Association of Manufacturers v SEC 800 F. 3d 518 (DC Cir. 2015).

[28] *See*, *e.g.*, What's "Controversial" About ESG?, supra note 24, at 878.

[29] *See*, *e.g.*, Daniel T. Deacon & Leah M. Litman, *The New Major Questions Doctrine*, 109 VA. L. REV. 1009, 1012 (2023).

[30] Broad definitions of what is a "security," broad delegation of authority to the SEC to make rules necessary for the protection of investors.

[31] *See*, *e.g.*, The New Major Questions doctrine, supra note 29, at 1012 ("Even broadly worded, otherwise unambiguous statutes may not be good enough when it comes to policies the Court deems "major."")

are politically significant or controversial, and whether they are novel.[32] Climate change and disclosures of greenhouse gas emissions as a way of informing investors about implications of climate change for their investment decisions clearly implicate these criteria for the major questions doctrine.

Critics of the SEC's proposal focused on particular novel and arguably controversial features of the SEC's proposal: in particular the focus on scope 3 emissions,[33] and the new mechanisms for assurance with respect to climate disclosures. Scope 3 emissions are not clearly directly related to actual climate related risks for many issuers of securities because scope 3 emissions are relevant to transition risks—the risks that over time regulations will change to take account of high levels of scope 3 emissions.[34] For some businesses, rules in other jurisdictions are relevant to these transition risks. For example, the EU's Carbon Border Adjustment Mechanism puts a price on carbon emitted during the production of a limited range of carbon intensive goods imported into the EU, currently based on benchmarks rather than actual embedded emissions.[35]

Emissions data are arguably hard to collect over an entire value chain and, in particular where smaller businesses are components of the value chain as they are less likely than larger enterprises to be focused on collecting their emissions information. At times emissions are estimated,[36] and issues relating to the accuracy of data are significant. But this is a fast evolving area, with many different actors working on different aspects of the data issues.[37]

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[32] *Id.* at 1012-13.

[33] *See*, *e.g.*, What's Scope 3 Good For?, *supra* note 15.

[34] *Cf.* Hester Peirce, *We are Not the Securities and Environment Commission – At Least Not Yet* (Mar. 21, 2022) at https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321 (referring to "so-called transition risks related to conjectural climate regulation and potential legislation"

[35] Carbon Border Adjustment Mechanism, at https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en. See also Regulation (EU) 2023/956 Establishing a Carbon Border Adjustment Mechanism, OJ L 130/52 (May 16, 2023); Alessia Campolmi, Harald Fadinger, Chiara Forlati, Sabine Stillger & Ulrich J. Wagner, *Designing Effective Carbon Border Adjustment with Minimal Information Requirements. Theory and Empirics* (January 31, 2024). Available at SSRN: https://ssrn.com/abstract=4644941 or http://dx.doi.org/10.2139/ssrn.4644941 .

[36] *Id.* at 1931. This reliance on estimates is also relevant to the First Amendment issues critics have identified.

[37] *Id.* at 1934-7.

The SEC's Final Climate Disclosure Rules

On March 6, 2024, the SEC published final rules on climate-related disclosures,[38] and, as of March 13, a number of states have already filed their intention to challenge the rules.[39] The petition in Iowa v SEC in the 8th Circuit states that the petitioners "will show that the final rule exceeds the agency's statutory authority and otherwise is arbitrary, capricious, an abuse of discretion, and not in accordance with law." Legal challenges will address the issues relating to the SEC's statutory authority and are expected to invoke the major questions doctrine and the First Amendment, and challenge the SEC's cost-benefit analysis.[40]

The SEC's final climate disclosure rules do not require disclosure relating to scope 3 emissions, which has led to complaints from environmental groups. The Sierra Club wrote:

> The Sierra Club and Sierra Club Foundation, represented by Earthjustice, are considering challenging the SEC's arbitrary removal of key provisions from the final rule, while also taking action to defend the SEC's authority to implement such a rule...
>
> Even though 97% of investor comments supported the draft rule's mandatory disclosure of what are known as Scope 3 emissions, the SEC capitulated to industry pressure and meritless legal threats by eliminating those requirements from the final rule. Scope 3 emissions, which result from a company's supply chains and the use of its products, account for the largest share of most companies' greenhouse gas emissions, particularly for the most polluting industries.
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> In addition to dropping requirements for companies to report their Scope 3 emissions, the rule also weakens provisions pertaining to more direct greenhouse gas emissions (Scopes 1 and 2) by allowing companies to decide for themselves whether or not this information is "material" and thus subject to disclosure. The rule also eliminates key requirements for companies to quantify climate-related impacts to their assets and expenditures in financial statements.
>
> On the positive side, the rule requires that companies with plans addressing material transition risks disclose important details about those plans and to quantify material expenditures incurred. Numerous companies are facing material transition risks in adjusting to the rapid decarbonizing of the economy. These disclosures will help investors evaluate the seriousness of their efforts to

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[38] SEC, The Enhancement and Standardization of Climate-Related Disclosures for Investors (Mar. 6, 2024).

[39] *See*, *e.g.*, Andrew Ramonas, *Nine More States Target SEC Climate Reporting Rules in Court* , Bloomberg Law (Mar. 12, 2024).

[40] *See*, *e.g.*, Lesley Clark, *SEC Climate Disclosure Rule Faces Legal Gantlet*, E&E News by Politico (Mar. 11, 2024).

decarbonize operations and value chains.[41]

SEC Chairman Gensler described the final rules as follows:

First, the final rules update Regulation S-K to require disclosure of material climate-related risks faced by a company as well as any governance and processes used by the company to manage climate-related risks. In addition, if a company uses transition plans, scenario analysis, or internal carbon prices to manage a material climate-related risk, the final rules require disclosures about such use. Further, a company will be required to disclose material climate-related targets or goals (if a company has them), plans for achieving those targets or goals, and annual progress. As part of these disclosures, the final rules will require disclosures in Regulation S-K of material expenditures directly resulting from activities to mitigate climate-related risks as well as transition plans and targets or goals.
Second, the final rules will require larger registrants, specifically large accelerated filers and accelerated filers, to disclose direct emissions (Scope 1) and emissions associated with energy purchases (Scope 2) when those emissions are material. Registrants also will be required to file an attestation report with their Scope 1 and 2 emissions. Such attestation reports will improve accuracy and reliability of those metrics as well as the key assumptions, methodologies, and data sources.
In the proposal, we took a layered approach to disclosure of Scope 3 greenhouse gas emissions. While many investors today are using Scope 3 information in their investment decision making, based upon public feedback, we are not requiring Scope 3 emissions disclosure at this time.
Also, to address concerns raised by commenters, the rules will allow registrants more time to file emissions disclosures. Registrants will be allowed to file those disclosures with their second quarter report the next fiscal year.
Third, the final rules require important financial statement footnote disclosures on expenditures resulting from severe weather events. Companies will be required to disclose capitalized costs, expenses, charges, and losses as a result of such events. These disclosures will give investors insight into the financial impact on companies today and provide important context for understanding companies' forward-looking disclosures in Regulation S-K.
As the release notes, many U.S. issuers that have overseas operations may have to comply with other jurisdictions' climate disclosure rules. I think today's action is an important step for our U.S. capital markets. I think it's important to have U.S. standards to which U.S. issuers can point.
These rules will enhance the disclosures that investors have been relying on to make their investment decisions. Issuers and investors will benefit from the

[41] Sierra Club, *SEC Climate Disclosure Rule Represents Important Progress, But Falls Short on Key Metrics of Financial Risk* (Mar. 6, 2024).

consistency, comparability, and reliability of these disclosures.[42]

Commissioner Crenshaw wrote that the requirements in the rule:

"move a haphazard potpourri of public company disclosures into the Commission's well-developed and standardized filing ecosystem. Commission filings come with a greater disclosure review process, heightened liabilities for material misstatements and omissions from both our enforcement program and private lawsuits, a level of reliability and year-over-year reporting that is conspicuously absent from climate risk information today, and being able to access those disclosures in one location. Investors made clear to my colleagues and me that these provisions are of key importance. Investors need insight into a company's business, its results, and its financial condition, including material risks it faces.

To be crystal clear, though, this is not the rule I would have written. While these are important steps forward, they are the bare minimum. Ultimately today's rule is better for investors than no rule at all, and that is why it has my vote. But, while it has my vote, it does not have my unencumbered support. And, although I am loath to leave for future Commissions those obligations that I see as our responsibilities today, I'm afraid that is precisely what we are doing...

Today we require certain companies to report Scopes 1 and 2 GHG emissions—emissions directly produced by the company or that come from the energy the company purchases and uses—only if the company determines that such emissions would be material to a reasonable investor. However, users of the disclosures expressed clear support for mandatory reporting for all public issuers with no materiality qualifier.

GHG Emissions – Scope 3. Moreover, today's final rule excludes requirements to disclose Scope 3 GHG emissions, despite comments making it abundantly clear that they represent a key metric for investors in understanding climate risk, particularly transition risk. Today we remove any Scope 3 requirement—even one with a safe harbor that would have shielded issuers from liability for good faith estimates in reporting. Indeed, comments from investment advisers, pension funds, and the SEC's Investor Advisory Committee, among many others, highlight that Scope 3 remains an invaluable metric for investors. It is a comparable, quantitative metric that allows investors to measure that risk across companies, sectors, and their portfolios.

Overall, investor commenters described how they use GHG emissions data to inform their financial decisions to buy, sell, or hold securities. For example, one large pension fund expressed clear support for mandatory reporting of Scope 1,

[42] SEC Chair Gary Gensler, Statement on Final Rules Regarding Mandatory Climate Risk Disclosures (Mar. 6, 2024) at https://www.sec.gov/news/statement/gensler-statement-mandatory-climate-risk-disclosures-030624 (footnotes omitted).

Scope 2, and Scope 3 (subject to a materiality qualifier) and described how climate-risk information permeates their investment analysis and decision-making across their $450 billion portfolio of state employee retirement funds. They noted that assessing the climate-related risks of their portfolio is conducted across active, passive, fundamental, quantitative, and factor-based strategies and within each of these strategies climate risk is assessed at the individual security level as well as at the aggregated portfolio level. In other words, the use of these data mirrors the use of other key risk metrics and are fundamentally important to investors.

Expenditures. Also absent from the rule is expenditure reporting. The initial proposal contained requirements to provide line item disclosures in the financial statements related to, and financial estimates and assumptions impacted by, transition activities. These proposed provisions were met with overwhelming investor support as they would provide better transparency and disclosure in the financial statement reporting. These disclosures would provide: insight into publicly stated targets, goals, or plans that hundreds of US public companies have made; a reference for investors to gauge whether qualitative discussions on climate risks are reflected in expenditures, estimates, and assumptions; and, generally, they provide a degree of visibility into financial reporting for which investors have been advocating in this context, and in others, for years.Today's recommendation adopts an unnecessarily limited version of these disclosures...

And why? One posited critique of the proposed rule was that the Commission lacks the authority to enact a rule requiring the disclosure by public issuers of climate risk. I disagree.

The Commission has clear authority under the Securities Act and the Exchange Act to require disclosures that are in the public interest and for the protection of investors, as today's rule is. This well-established authority has been consistently relied upon, and affirmed and reaffirmed across dozens of disclosure rulemakings over multiple decades. And, this authority would have supported a more robust rule. The adopting release (as well as the comment file) details our numerous statutory authorities and the many disclosures we have promulgated based upon those authorities. I will not re-hash in great detail the work the staff has already done, but there are two noteworthy points I would like to highlight.

First, our public company disclosure regime is meant to be updated as markets innovate and investor demand changes. For example, in response to calls from investors, the Commission has updated disclosure requirements through rulemaking to include information about executive compensation, environmental protection law compliance and related litigation risk, legal proceedings, the background and qualifications of directors and how the board monitors and oversees risks, more detailed plans of operations for companies issuing securities for the first time, and a description of the registrant's human capital resources which was enacted in 2020, among other disclosures. It is our obligation to respond to investors as the information needed to better assess the fundamental

value of the securities they research, buy, sell and hold evolves or changes. The Commission today is moving forward with a disclosure rule in response to well-demonstrated need for consistent, comparable, and reliable information. This rule responds to demands presented by investors and the market, in a manner consistent with our practices in the past.

Second, SEC rules have consistently required disclosure of risks, even when the metrics related to those risks are labeled by some as not strictly financial, such as the GHG emissions discussed above. Yet here too we have heard the argument that this agency does not have authority to require disclosure of information related to greenhouse gases because such data are not financial metrics. Once again, our actions are entirely consistent with existing precedent. Executive compensation, environmental protection law compliance, governance disclosures risk, and other disclosures mentioned above, are prime examples of this. Cumulatively, these non-financial metrics provide investors with information that they can use to assess the overall state of an issuer. Likewise, disclosure of GHG emissions provides information that helps investors understand the current and potential financial risks a company faces.

Given our clear authority, rolling back the proposal is a missed opportunity. It remains my great hope that a future Commission will rise to the occasion and enact more fulsome disclosure requirements, in furtherance of our mandate and investor demand."[43]

[43] Commissioner Caroline Crenshaw, A Risk by Any Other Name: Statement on the Enhancement and Standardization of Climate-Related Disclosures (Mar. 6, 2024) at https://www.sec.gov/news/statement/cresnshaw-statement-mandatory-climate-risk-disclosures-030624 (footnotes omitted).