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On March 21, 2022, the United States Securities and Exchange Commission (the SEC) issued a 490-page proposed rule about enhancing and standardizing climate-related disclosures for investors. If adopted, it would mandate extensive climate-related disclosures by public companies. The notice and comment period closed on June 17, 2022. The comments received by the SEC could lead it to abandon the proposed rule, make substantial changes and reopen the notice and comment period, or make modest revisions and vote on a final rule.

The proposed rule sets out what is arguably the most expansive new disclosure regime in decades. If adopted, it would require companies to disclose in registration statements and annual reports greenhouse gas emission figures, climate-related risks, company oversight processes regarding those risks, various climate-related financial statement metrics, and, if applicable, information about climate-related targets, goals, and transition plans.

The proposed rule has generated significant controversy. During the notice and comment period, the SEC was flooded with thousands of comments discussing its propriety. Many of these comments argue for and against the proposal on its merits—debating whether the proposal, if adopted, would achieve worthwhile goals and be effective—but several notable critics, including various members of Congress, governors, state attorneys general, and legal scholars, have gone further and questioned the legal viability of the proposed disclosure rules. These critics have previewed potential legal challenges that may be brought should the rule ultimately go into effect.

This article addresses one specific challenge—that the SEC lacks the authority to adopt the proposed rule, and, in particular, lacks the authority to mandate disclosure of greenhouse gas emission figures. After providing a very brief overview of the proposed rule, the article discusses Congress's grant of rule-making authority to the SEC and then turns to various arguments about the scope of that authority in the context of the proposed rule. Finally, we look at other doctrines applicable to the SEC's authority, including the "major questions" doctrine most recently relied upon by the Supreme Court in West Virginia v. EPA, 2022 BL 227045 (U.S. June 30, 2022).

The analysis below suggests that challenges to the SEC's rule-making authority would have considerable force and may very well affect the ultimate content and validity of the proposed rule.

Background

Broadly speaking, the proposed rule—"The Enhancement and Standardization of Climate-Related Disclosures for Investors"—consists of multiple lengthy discussions of the SEC's views as to the importance of the new climate disclosure regime, details of the various disclosure requirements, and an economic analysis that tries to balance the supposed costs of compliance with the benefits of the new rule.

The proposal was approved in a three-to-one vote over the dissent of Commissioner Hester Peirce. In a dissenting statement, "We are Not the Securities and Environment Commission—At Least Not Yet," Peirce criticized the proposed rule on numerous grounds. As relevant to this article, she argued that the SEC lacks authority to adopt such a rule. "Congress," she wrote, "did not give us plenary authority over the economy."

The SEC's Rule-Making Authority

Basic Principles

Several provisions of the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act) grant the SEC authority to promulgate disclosure rules that are "necessary or appropriate in the public interest or for the protection of investors." See, e.g., 15 U.S.C. §§ 77g, 78l, 78m. The Securities Act, for example, requires securities issuers to file registration statements containing certain specified information—most notably 32 items that are enumerated in Schedule A of the Act—and "such other information … as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors."

In the proposed rule, the SEC states that this "necessary or appropriate" standard grants it "broad authority" to "determine[] that disclosure of information about climate-related risks and metrics would be in the public interest and would protect investors." This authority is not unfettered—importantly, the authorizing statutes require the SEC to consider, in making a public interest determination, whether a proposed rule "will promote efficiency, competition, and capital formation." See, e.g., 15 U.S.C. § 77b(b). Yet the applicable statutory language is extremely broad, as proponents of the rule have pointed out.

Limitations

While the Securities Act and Exchange Act do not include express limiting principles, the Supreme Court "ha[s] consistently held that the use of the words 'public interest' in a regulatory statute is not a broad license to promote the general public welfare." Nat'l Ass'n for Advancement of Colored People v. Fed. Power Comm'n, 425 U.S. 662, 669 (1976). "Rather, the words take meaning from the purposes of the regulatory legislation."

Thus, in NAACP v. FPC, the Supreme Court concluded that the Federal Power Commission lacks authority to prohibit discriminatory employment practices by regulated companies. The NAACP argued that various "references to the 'public interest' in the Gas and Power Acts" authorized the commission to implement a rule barring employment discrimination, and that the agency's refusal to implement such a rule on the grounds that it lacked authority was erroneous.

The court disagreed, holding that the words "'public interest' as used in the Power and Gas Acts" were limited in meaning by "the principal purpose of those Acts" to "a charge to promote the orderly production of plentiful supplies of electric energy and natural gas at just and reasonable rates," and did not reflect a more sweeping grant of authority to "advanc[e] the public interest in general."

Courts have taken a similar approach when interpreting the phrase "necessary or appropriate." In New York Stock Exch. LLC v. Sec. & Exch. Comm'n, the D.C. Circuit recently vacated an SEC rule which assigned 1,460 randomly selected stocks to two different test groups applying modified caps on securities exchange transaction fees or prohibiting payments of rebates to broker-dealers. 962 F.3d 541 (D.C. Cir. 2020).

The SEC argued that it had the authority to promulgate the rule under the Exchange Act's provisions empowering it "to make such rules and regulations as may be necessary or appropriate to implement the provisions of [the Act]," but the D.C. Circuit rejected this argument: "the statutory reference to 'regulations as may be necessary or appropriate'" does not give the SEC "authority to act[] as it s[ees] fit." To the contrary, the SEC may promulgate a rule only pursuant to an actual delegation of authority from Congress.

What the Critics Say

Following these lines of authority, critics of the proposed rule argue that the SEC lacks authority to adopt disclosure rules simply because it regards a matter as conducive to the public interest. Rather, the SEC's authority to adopt disclosure rules is limited to rules that address core business and financial information and enable investors to value securities and capital resources—that is, rules consistent with the purposes of the Securities Act and Exchange Act. As the D.C. Circuit has noted, SEC rules generally strive to achieve benefits that are "economic" in nature. National Ass'n of Manufacturers v. Sec. & Exch. Comm'n, 800 F.3d 518, 521–22 (D.C. Cir. 2015).

The SEC itself took this very position as recently as April 2016—a fact emphasized by opponents of the proposed rule. In a concept release seeking public comments on "modernizing certain business and financial disclosure requirements in Regulation S-K," the SEC acknowledged that "investors and interest groups" were pushing for "greater disclosure of a variety of public policy and sustainability matters, stating that these matters are of increasing significance to voting and investment decisions." *Business and Financial Disclosure Required by Regulation S-K*, 81 FR 23916-01 (April 22, 2016).

In the face of a growing call for new disclosure requirements relating to, among other things, climate impact, the SEC maintained that it lacked the authority to mandate new disclosure requirements to address "sustainability matters" and other "public policy concerns" unless those matters were "important to an understanding of a registrant's business and financial condition."

In support of this position, the SEC noted that the 32 disclosure items specified in Schedule A of the Securities Act "are largely financial in nature and were intended to help investors assess a security's value[,]" and that "[t]he Exchange Act requires similar business and financial information to be disclosed in Exchange Act registration statements and periodic reports." See also H.R Rep. No. 73-85, 73rd Cong., 1st Sess., 1933. The SEC therefore concluded that, when viewed in context, its authority to promulgate rules that are "necessary or appropriate in the public interest or for the protection of investors" was limited to the disclosure of information that is "important to an understanding of a registrant's business and financial condition."

Significantly, the SEC on occasion has developed new disclosure requirements that are, at best, tenuously related to this core business and financial purpose, but it has done so in response to a specific directive from Congress. Thus, in response to military action in the Congo, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act required the SEC to adopt disclosure rules relating to registrants' use of so-called "conflict minerals" like gold, tantalum, tin, and tungsten that are extracted from mining sites in certain specified countries.

Those disclosure rules—portions of which were vacated by the D.C. Circuit because they compelled speech in violation of the First Amendment, see *National Ass'n of Manufacturers*, 800 F.3d 518-were developed and promulgated pursuant to a specific grant of authority by Congress, not the SEC's general rule-making powers as enumerated in the Securities Act and Exchange Act. For critics of the proposed rule, the fact that Congress enacted specific legislation to authorize "conflict minerals" disclosure reinforces the conclusion that the SEC needs a specific congressional mandate to promulgate rules that exceed the SEC's more general authority to make rules concerning business and financial matters.

Public Policy or Financial Regulation?

Defenders of the proposed rule make two key arguments in support of the SEC's rule-making authority. First, they argue that critics' framing of the SEC's authority is too narrow. By granting the SEC authority to promulgate disclosure rules that are "necessary or appropriate in the public interest or for the protection of investors," Congress broadly delegated authority to the SEC to develop disclosure requirements aimed at any contemporary realities that pique significant investor interest, even if those contemporary issues are not expressly economic in nature. As SEC Chair Gary Gensler put it, "the SEC has a role to play when there's [a significant] level of demand for consistent and comparable information" by investors and issuers.

Second, supporters of the proposed rule reject the critics' fundamental premise by arguing that the required disclosures would, in fact, relate to a registrant's financial condition. The Proposed Rule does not explicitly tackle the question of whether the SEC's "broad authority" to promulgate rules in the public interest is limited to rules that require disclosure of information important to understanding a registrant's business and financial condition. Nevertheless, its discussion of the various disclosure requirements—including the requirement that registrants disclose greenhouse gas emissions data—strongly suggests that the SEC is prepared to argue that the proposed rule is, at its core, a financial regulation.

The proposed rule asserts that emissions data "can be particularly useful in conducting a transition risk analysis," which is defined as an analysis of "the actual or potential negative impacts on a registrant's consolidated financial statements, business operations, or value chains attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks." "Transition risks" include, among other things, "increased costs attributable to climate-related changes in law or policy," "competitive pressures associated with the adoption of new technologies," and "reputational impacts … that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a registrant's behavior."

"Should a transition to a low-carbon economy gain momentum," the proposed rule posits, "registrants with higher amounts of … emissions may be more likely to face sharp declines in cash flows, either from greater costs of emissions or the need to scale back on high-emitting activities, among other reasons, as compared to firms with lower amounts of such emissions." Thus, the proposed rule suggests that a company's emissions could have a significant effect on its business and financial condition.

This defense of the SEC's authority is far from bulletproof. Critics reply that transition risks are much too attenuated and speculative to transform emissions data into information that is fundamental to a registrant's business and financial condition and thereby an appropriate subject of an SEC disclosure rule. As one commentor noted, "[t]he SEC's justification for the disclosure is that governments, regulators, or consumers *might* take action against [greenhouse gas] emissions that *might* cause a negative financial effect at the company that *might* be significant to a reasonable investor. The reliance on this series of possibilities is on top of the reliance on the uncertain and imprecise methods for calculating … emissions." Put simply, "[t]he chain connecting an undependable disclosure of … emissions to a material financial effect on the disclosing company is long and speculative."

Moreover, to the extent that transition risks are, in fact, "reasonably likely to cause reported financial information not to be necessarily indicative of future operation results or of future financial conditions," registrants are already required to disclose and analyze such risks. 17 C.F.R. § 229.303(a). The SEC made this point in 2010 when it issued guidance regarding the application of certain existing disclosure rules to climate-related issues. See *Commission Guidance Regarding Disclosure Related to Climate Change*, 75 Fed. Reg. 6,290 (Feb. 8, 2010).

Apart from the question of the SEC's authority to adopt the proposed rule, the SEC has a "unique obligation" to engage in a rigorous quantitative analysis of the "economic consequences" of a new rule, including addressing problems raised by commenters during the notice and comment period. Business Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011). In recent years, the D.C. Circuit has vacated several SEC rules on the ground that the SEC did not appropriately weigh costs and benefits. Thus, to defend the proposed rule, the SEC will need to thread the needle between asserting that the disclosure requirements are legitimately—not just speculatively—tied to registrants' financial conditions while also assuring a reviewing court that the rule is not a costly redundancy.

Additional Challenges

The SEC's justification for the proposed rule faces additional challenges. The Supreme Court's "major questions" doctrine stands for the proposition that Congress must "speak clearly if it wishes to assign to an agency decisions of vast economic and political significance." Util. Air Regul. Grp. v. E.P.A., 573 U.S. 302, 324 (2014) (internal quotation marks omitted); see also, e.g., West Virginia v. EPA, 2022 BL 227045, at *16-18 (U.S. June 30, 2022); Nat'l Fed'n of Indep. Bus. v. Dep't of Lab., Occupational Safety & Health Admin., 142 S. Ct. 661, 667 (2022) (Gorsuch, *J.*, concurring).

Although this doctrine does not change the foregoing analysis, it functionally heightens the SEC's burden by requiring it to prove that Congress's general grant of rulemaking authority "clearly" encompasses the Proposed Rule. The Supreme Court's recent major questions decisions, including in West Virginia v. EPA, 2022 BL 227045 (U.S. June 30, 2022), highlight the importance of the doctrine and suggest that the court would likely view the SEC's proposed foray into climate disclosures with some skepticism.

Further, some critics have made a separate argument about the SEC's authority to require disclosure of emissions data that dovetails with the general critique that the SEC lacks the authority to adopt the proposed rule: namely, because Congress expressly delegated authority to the Environmental Protection Agency to mandate greenhouse gas emission disclosures in the Clean Air Act, it divested the SEC of any authority that it may have otherwise had to mandate the disclosure of emissions data. This argument is likely to figure into any future challenge to a rule requiring disclosure of emissions and similar data.

Conclusion

The SEC is vigorously pursuing environmental, socioeconomic, and governance initiatives. Since issuing the proposed rule, it has approved two additional proposals that would increase disclosure requirements for funds and advisors who make environmental-related investments, and it has announced climate-related enforcement actions under the existing regulatory regime.

The proposed rule may become the crowning jewel of the SEC's environmental push, but for now it is just that—a proposed rule. The notice and comment period recently closed, and the SEC will almost certainly make changes based on the thousands of comments that it has received. Whatever form the final rule takes, it will face substantial legal challenges. The argument that the SEC lacks the authority to adopt climate disclosure rules is one that the SEC and the market should take seriously.