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Big Problems with SEC Climate Disclosure Mandate

Expensive, legally thorny, and counter to the agency's historic mission

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The US Securities and Exchange Commission (SEC) is finalizing its mandatory climate disclosure rule[1] that will require publicly traded companies to provide the Commission with annual disclosures on a variety of climate and energy use-related topics. Companies will need to report how climate change risk factors influence their financial decisions, business models, locations, and projects.

The SEC's rule will impose an invasive board oversight requirement. This requires corporate boards to provide periodic disclosures of all members with environmental expertise and of whom have taken action to mitigate climate change. Regulated companies will be required to capture and report data on their direct, indirect, and value-chain produced greenhouse gas (GHG) emissions. If finalized, the rule could be the most ambitious and expensive mandate in the history of corporate finance regulation.

This 500-page rule serves as the centerpiece for the SEC's agenda on environmental, social, and governance (ESG) investing. The agency has recently proposed a host of other ESG-themed rules and rule changes as well.[2] [3]

This short study explains how the SEC's climate disclosure rule exceeds the agency's statutory authority. It also undermines the agency's existing disclosure-based framework. We will explore the potential legal risk facing the final rule, the heightened disclosure costs and work-hour burden for companies, and how members of the public and hired proxy advisers perceive mandatory climate disclosures.

Given its current strategy, the SEC is at high risk for future conflict with the legislative and judicial branches of government. The agency not only stands in defiance of Congress, it also ignores established judicial precedent by redefining the US Supreme Court's interpretation of "materiality" in corporate disclosure.

The Commission's proposed rule appears to be more heavily influenced by external non-governmental entities like the Task Force on Climate Related Financial Disclosures (TCFD) than the agency's own expert judgment. The climate disclosure rule sets a worrying precedent for regulators to force companies to expend 39 million additional hours to provide paperwork in excess of what the vast majority of investors would deem financially relevant. In short, the rule would undermine the agency's historic mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

A Scope too far

The SEC's proposed climate disclosure rule is plagued with legal conflicts, a problem illustrated by many of the public comments the agency has received. Some of those commenters have suggested that the SEC's rule will prove unworkable, in particular, over the regulation of so-called "Scope 3" emissions.[4]

1 Vanessa A. Countrymen, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," US Securities and Exchange Commission, March 2022, https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

2 Vanessa A. Countrymen, "Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices," US Securities and Exchange Commission, May 2022, https://www.sec.gov/files/rules/proposed/2022/33-11068.pdf .

3 Wendall Faria, Walter Van Dorn, Gail A. Lione, Seth K. Abrams, "Changes to the SEC Fund Names Rule Impacts ESG Investments," Dentons, September 2023, https://www.dentons.com/en/insights/alerts/2023/september/27/changes-to-the-sec-fund-names-rule-impacts-esg-investments.

4 Jon McGowan, "SEC Climate Disclosure Rule Most Likely Not Final Until 2024, Effective 2026," *Forbes*, October 2023, https://www.forbes.com/sites/jonmcgowan/2023/10/26/sec-climate-disclosure-rule-most-likely-not-final-until-2024-effective-2026/?sh=5c52421e3434.

The Commission had adopted the framework of classifying a firm's greenhouse gas emissions into three categories: Scope 1, direct emissions; Scope 2, indirect emissions from purchased electricity; and Scope 3, all emissions from suppliers and customers connected to their products. Adopting a reporting regime that includes Scope 3 emissions will require firms to report GHG emissions data from their upward and downward value chain.

This third Scope expands the SEC's regulatory reach, allowing it to demand information provided from a host of private entities partnered with the public registrant firms. These other entities are not the usual target of the Commission's regulatory powers. Such a requirement would harm many currently non-regulated suppliers, including farmers,[5] ranchers, and facility owners, simply because they do business with a registered company.

The proposed Scope 3 requirement comes with additional problems. It does not seem to account for the conflicting overlap in disclosure, such as private suppliers that contract with multiple public companies, and multiple public companies that are also themselves suppliers.[6] This undermines two stated reasons for the rule: ensuring "comparability" and "consistency" across climate disclosures.

Another threat imposed by Scope 3 is that it draws legitimacy not from existing U.S. disclosure standards, but from the TCFD, a Swiss created NGO. Despite being a foreign entity, the TCFD is empowered to set, revise, and approve GHG targets for US corporations through the standards it helped outline in the climate rule. The SEC's climate disclosure rule's Regulation S-K requirements are heavily grounded in the TCFD's own disclosure-based framework. This undermines the due process rights of affected US companies forced to expend additional time, labor, and capital to meet the TCFD's demands.[7]

The adoption of a Scope 3 requirement would not merely be a marginal expansion of current reporting requirements, but would be transformative. It would establish the agency as an unsanctioned climate policy enforcer, imposing strict environmental reporting standards absent any congressional authorization or coordination with official environmental entities like the Environmental Protection Agency (EPA).

Given that the EPA already collects mandatory disclosures from companies that produce at least 5,000 metric tons or more of carbon dioxide (CO2) every year, the SEC's climate mandate is redundant.[8] It would pile disclosure-related expenses on top of recent disclosure rules passed by the European Union (EU) and California.[9]

The rule also deviates from the Commission's history of restraint on this issue. Prior to 2022, the SEC had firmly resisted outside lobbying efforts and legal challenges that called for mandatory climate disclosures. The pressure had been most intense in the early 1970s with the rise of the environmental activism movement in American politics. The SEC was sued by the National Resource Defense Council (NDRC) for what NRDC alleged to be a lack of compliance with the National Environmental Policy Act.[10] The group sued and failed in its effort to force the SEC to adopt mandatory emissions-based environmental impact disclosures.

At the time, the SEC rightly insisted that it could only compel corporations to disclose information that was "material" to investors. To qualify as material, the omission of such information must be "viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[11] The D.C. Circuit Court ruled in favor of the SEC in 1979, deeming such disclosures to be immaterial to an average investor.

The agency's first step toward issuing its own climate disclosure requirements came in the form of a guidance document issued in 2010. This was a non-binding attempt to persuade public companies to give greater consideration to climate change risk factors when preparing disclosures. However, when the enforceability of this guidance came into dispute in 2016, the agency admitted it was powerless to broadly mandate climate disclosures absent any congressional directive or update to the definition of materiality.[12]

The SEC's current climate rule now seeks to radically redefine established standards of materiality. This defies the Supreme Court's *Northway* decision, previous agency

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5 "Supplemental Comments by the American Farm Bureau Federation on SEC's Proposed Rules on the Enhancement and Standardization of Climate-Related Disclosures for Investors," US Securities and Exchange Commission, April 2023, https://www.sec.gov/comments/s7-10-22/s71022-20164335-334160.pdf.

6 Benjamin Zycher, "Why we're still waiting for the SEC climate risk disclosure rule," *Washington Examiner,* December 2023, https://www.washingtonexaminer.com/restoring-america/faith-freedom-self-reliance/why-were-still-waiting-for-the-sec-climate-risk-disclosure-rule.

7 Benjamin Zycher, "Why we're still waiting for the SEC climate risk disclosure rule," *Washington Examiner*, December 2023, https://www.washingtonexaminer.com/restoring-america/faith-freedom-self-reliance/why-were-still-waiting-for-the-sec-climate-risk-disclosure-rule. See also "The Enhancement and Standardization of Climate Disclosures for Investors," pg. 49.

8 "Mandatory Reporting of Greenhouse Gases (40 CFR part 98)," Environmental Protection Agency, August 2010, https://www.epa.gov/sites/default/files/2015-07/documents/part98factsheet.pdf. It is important to note that the EPA's rule already captures 85-90% of the total produced GHG emissions.

9 "California Enacts Landmark Climate Accountability Package Requiring Expansive Disclosure of Climate-Related Risks," Sidley Austin, October 10, 2023, https://www.sidley.com/en/insights/newsupdates/2023/10/california-enacts-landmark-climate-accountability-package.

10 *Natural Resources Defense Council, v. S.E.C,* 606 F.2d 1031, 1037 (D.C. Cir. 1979).

11 *TSC Industries, Inc. v. Northway, Inc.,* 426 US 438 (1976). See Justice Thurgood Marshall's opinion, pg. 449, which cites the definition of "materiality" as it pertains to Regulation S-K (SEC Rule 405).

12 "Business and Financial Disclosure Required by Regulation SK," US Securities and Exchange Commission, April 2016, https://www.federalregister.gov/documents/2016/04/22/2016-09056/business-and-financial-disclosure-required-by-regulation-s-k. See the following statement: "The Commission, however, has determined in the past that disclosure relating to environmental and other matters of social concern should not be required of all registrants unless appropriate to further a specific congressional mandate or unless, under the particular facts and circumstances, such matters are material."

precedent, and the agency's statutory authorization.[13] The SEC's climate rule also violates the nondelegation doctrine, specifically the "major questions doctrine,"[14] which prevents administrative agencies from publishing rules on major new topics absent direction from Congress.

All of this means the SEC will face a difficult time in court defending the legitimacy of its rulemaking authority to mandate climate disclosures. If the rule is published substantially as proposed, the SEC will also face difficulty upholding its enforcement actions within its own in-house court system. The Supreme Court has recently provided litigants with an opening to raise constitutional challenges to SEC enforcement matters before an Article III court. Under *Axon v. FTC* (2023), litigants who raise a legitimate constitutional defense against an independent agency enforcement action can now opt out of the lengthy, adjudication process before, in this example, the SEC's internal system of administrative law courts.[15]

Another constitutional standard that may support a challenge to the climate disclosure rule is the compulsion of nonmaterial information. No court has ever deemed climate-related risk factors as worthy of mandatory disclosure. The SEC cannot assume it possesses the authority to compel such information absent any legal precedent to do so.[16] For Scope 3 compliance, many private suppliers could refuse to provide proprietary information to the registrant company on grounds that the SEC's disclosure authority does not extend to unregulated entities.[17] If a private unregulated entity believes it is being forced to provide this information that it would not otherwise disclose, federal courts up to and including the US Supreme Court could reassert First Amendment protections.

The Court need only look to the DC Circuit Court's precedent in *National Association of Manufacturers v. SEC* (2016),[18] where it struck down the "conflict-free minerals" passage of the Dodd Frank Act of 2010. In this case, the court prohibited the SEC from unlawfully compelling information from companies that would have exposed their stance toward the Congolese Civil War. Similarly, the Supreme Court may invoke this standard against the present SEC on the grounds that companies would expose their political stance on climate change matters.

A billion here, six billion there

Compliance with current financial disclosure requirements is costly but already priced into the SEC's disclosure framework. Such material-based disclosure often mirrors the sort of data many investors would otherwise want to see. The SEC's proposed climate disclosure rule is not already priced into this framework, and will impose a substantial additional regulatory cost burden on public companies and their private partners.

The SEC's own estimates find that mandatory climate disclosures will increase annual compliance costs from \$3.8 billion to \$10.2 billion, a \$6.4 billion rise.[19] Some analysts figure the actual cost of the rule will be even higher when factoring in the range of indirect costs for compelling climate disclosure.[20] As many critics have suggested, the SEC paints an incomplete picture of the broader cost burden the rule will impose. One such macroeconomic estimate finds that the rule's total compliance burden for companies will translate into a \$25 billion loss in GDP by the late 2020s.[21]

[13] *TSC Industries, Inc. v. Northway, Inc.* 426 US 438 (1976), https://tile.loc.gov/storage-services/service/ll/usrep/usrep426/usrep426438/usrep426438.pdf. The SEC's climate rule directly conflicts with the Court's understanding of materiality in this case. The Court has recognized materiality as any information that would be considered substantially important by a reasonable shareholder when casting a vote during a corporate board meeting (p. 439). The SEC's rule seeks to compel climate-related information that is reasonably likely to have a material impact on business operations. Yet, climate change has never qualified as being materially relevant by the average shareholder to the extent that its omission would radically alter corporate voting. Thus, the SEC misconstrues the Supreme Court's standard of materiality with an erroneous assumption that climate-related risks carry widespread material concern that warrants mandatory disclosure.

[14] *West Virginia v. EPA* (2022), 597 US, https://www.supremecourt.gov/opinions/21pdf/20-1530_n758.pdf. The climate disclosure rule is akin to the EPA's emissions reduction standards, which the Court majority struck down as an unauthorized attempt by the agency to legislate issues of "economic and political significance."

[15] Stone Washington, "The Supreme Court's Axon decision shatters the in-house advantage of administrative law courts," OpenMarket blog, Competitive Enterprise Institute, April 2023, https://cei.org/blog/the-supreme-courts-axon-decision-shatters-the-in-house-advantage-of-administrative-law-courts/. See specifically, *Axon Enterprise, Inc. v. Federal Trade Commission*, 598 US 175 (2023).

[16] Brad Kutner, "SEC's Proposed Climate Disclosures Spark Free Speech Debate," June 17, 2022, https://www.law.com/nationallawjournal/2022/06/17/secs-proposed-climate-disclosures-spark-free-speech-debate/. According to the following passage, "Court precedent supports compelling a company to share risks associated with some investments, but climate change has yet to be specifically included in that assessment."

[17] Stone Washington, "Obscuring the SEC's climate disclosure rule may invite a host of legal problems," Regulatory Transparency Project, December 2023, https://rtp.fedsoc.org/blog/obscuring-the-secs-climate-disclosure-rule-may-invite-a-host-of-legal-problems/.

[18] *National Association of Manufacturers v. Securities and Exchange Commission*, 800 F.3d 518 (2015).

[19] *National Association of Manufacturers v. Securities and Exchange Commission*, 800 F.3d 518 (2015). See "The Enhancement and Standardization of Climate Disclosures for Investors," pg. 456. See also a study by Richard Morrision, "The SEC's Costly Power Grab," Competitive Enterprise Institute, June 2022, https://cei.org/studies/the-secs-costly-power-grab/.

[20] Matthew Winden, "The Unconsidered Costs of the SEC's Climate Disclosure Rule," July 2022, https://papers.ssrn.com/sol3/papers.cfm?abstractid=4156825. According to Winden, "the SEC only focused on direct compliance costs of firms and ignored the costs that would accrue economy-wide, including reductions in aggregate economic activity indirectly stemming from compliance, reductions in domestic business competitiveness, reductions in retail investor returns, and market inefficiency from a resulting misallocation of resources."

[21] Matthew Winden, "The Unconsidered Costs of the SEC's Climate Disclosure Rule," July 2022, https://papers.ssrn.com/sol3/papers.cfm?abstractid=4156825. See pp. 6-7.

The rule's unfactored opportunity costs would decrease the economic value for available jobs. These costs would likely freeze in place many current jobs and produced technologies, given that public companies with less available capital will be constrained by heightened regulatory compliance spending. Domestic innovation would likely suffer as a result.

Assume for the sake of argument that SEC's calculations are accurate. The average firm will pay an extra $864,864 per year for disclosures, given that approximately 7,400 public companies currently disclose to the SEC's Division of Corporation Finance (Corp-Fin). That added expense could cripple smaller firms. (Scope 3 does make some exceptions for tiny firms, but they are narrow exceptions.)

The climate disclosure rule alone will increase the internal and external workload burden across affected firms by an estimated 39 million work hours. Companies are already scrambling to hire qualified accountants and corporate attorneys to ensure they can scale this massive burden of new paperwork.[22]

In a telling admission of the scope of the rule's expected burden, the SEC itself apparently cannot finalize its climate disclosure rule without first bolstering its own staff. Within a month of proposing its climate rule, the agency asked Congress for an estimated $101 million in added funding reserved for hiring new ESG-based staff. The SEC's ESG-inspired funding request was divided across three of its divisions: Corp-Fin, Investment Management (IM), and Enforcement (ENF). The funding was intended to help prepare, implement, and enforce climate disclosures in anticipation of the rule's finalization.[23]

The SEC received less for ESG staffing that it requested from Congress in March of 2022. Across the three divisions with allotted funding for ESG projects, Enforcement filled 14 new full-time positions (11 percent of its target of 125), Investment Management filled four positions (31 percent of its target of 13), and Corporation Finance filled nine (14 percent of the requested 65).[24] This will almost certainly impair the SEC's capacity to implement the climate disclosure rule effectively.

Beyond the direct costs for implementation and for corporate disclosure, the SEC failed to consider the immense indirect repercussions of the rule. This costly disclosure mandate will likely serve as a deterrent for public market entry for many newer firms. Considering the capital that would end up being wasted on preparing disclosures that might prove to be unsatisfactory to the SEC, combined with the capital expended in court to defend against future accusations of SEC compliance violations, a private company may decide that the heightened costs and risks imposed by the rule outweigh the rewards of going public.[25]

Advocates of the rule have claimed that, despite the high expected costs, many large registrants still support its imposition.[26] They fail to acknowledge, however, that such support is self-interested and anti-competitive on the part of established firms. Well-established incumbent firms can better afford the compliance burden from such a rule, meaning that its costs will serve as a competitive moat against smaller competitors and new entrants to their respective industries. This same dynamic has been true of numerous past financial regulation efforts. [27]

Public, professional, and proxy opinion

In promulgating the rule, the SEC asserts that public and professional opinion favor such disclosure. Yet support for disclosure among these interests is mixed and complicated at best.

In polling, the strongest support for ESG initiatives can be found among young Millennial and Generation Z investors who don't prioritize financial return on investments to as great a degree as previous generations. By contrast, older Baby Boomers with more investing experience hold ESG in a much lesser regard.[28] Generation X investors are fairly split between support for and disregard of ESG. Some polls have found that a growing number of Americans desire greater corporate transparency through government-mandated climate disclosures.[29]

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22 Michael Cohn, "Financial execs need to staff up for SEC climate disclosures," *Accounting Today*, November 2023, https://www.accountingtoday.com/news/financial-execs-need-to-staff-up-to-make-sec-climate-disclosures.

23 See the SEC's FY 2023 budget request for each of the above divisions with reserved funding requests for ESG hires (totaling $101.8 million), https://www.sec.gov/files/fy-2023-congressional-budget-justification-annual-performance-plan_final.pdf.

24 Congressional Budget Justification, Annual Performance Plan Fiscal Year 2024, US Securities and Exchange Commission, 2024, https://www.sec.gov/files/fy-2024-congressional-budget-justification_final-3-10.pdf. Cross-compare with the SEC's requested funding in FY 2023.

25 John Berlau, and Joshua Rutzick, "The 20-Year Experiment Holding America Back," *The Wall Street Journal*, September 2022, https://www.wsj.com/articles/the-20-year-experiment-holding-the-u-s-back-sarbanes-oxley-corporate-reform-bush-entrepreneurs-investors-fraud-business-11659044813.

26 Stephanie Jones, "Widespread support for the SEC's proposed climate risk disclosure standards," September 13, 2022, https://blogs.edf.org/climate411/2022/09/13/widespread-support-for-the-secs-proposed-climate-risk-disclosure-standards/.

27 Rick Rouan, "Dimon says Dodd-Frank puts 'bigger moat' around JPMorgan Chase," *Columbus Business Journal*, February 2013, https://www.bizjournals.com/columbus/blog/2013/02/dimon-says-dodd-frank-puts-bigger.html.

28 Alexander Gelfand, "The ESG Generation Gap: Millennials and Boomers Split on Their Investing Goals," Stanford Business, November 2022, https://www.gsb.stanford.edu/insights/esg-generation-gap-millennials-boomers-split-their-investing-goals.

29 Jennifer Tonti, "Americans overwhelmingly support mandatory climate disclosure for US companies," Ceres, February 2022, https://com-justcapital-web-v2.s3.amazonaws.com/pdf/JUSTCapital_CorporateDisclosureStandardsSurveyReport_SSRS_Ceres_PublicCitizen_Feb2022.pdf.

More recent survey data, however, shows that Millennial and Generation Z preferences for ESG-themed investments has declined significantly just over the course of 2023.[30]

In terms of institutions, various polls found that ESG rating firms and proxy advisory companies represented the highest levels of support for climate disclosures.[31] By contrast, the lowest levels of support stemmed from the employees of affected public corporations. This suggests embrace for the SEC's rule stems primarily from ideological stakeholders and finance industry players, especially those who stand to financially benefit from the compliance burden being borne by registrant firms.

There is relatively little internal support for ESG disclosure among public companies that were polled. One survey from March 2022 found that only 21 percent of companies possessed an internal ESG working group or council. Less than a quarter of all public firms possessed ESG groups that prepared climate disclosures and/or pursued corporate ESG objectives.[32] A broad trend across multiple polls in recent years reveals that most companies are prepared to disclose Scope 1, only somewhat prepared to disclose Scope 2, and woefully underprepared to disclose Scope 3 emissions.[33]

Most surveys that find high levels of support for mandatory climate disclosures fail to account for consumer incentives. The polling results may be biased if respondents aren't asked whether they would sacrifice some of their own their salary to implement mandatory climate disclosures. This may fail to capture what people actually feel about forced climate disclosures. For instance, one study found that very few Americans were willing to pay a significant amount extra for sustainable products, despite otherwise professing widespread support for sustainability overall.[34]

Similarly, when Americans are asked how much they would personally pay to implement climate policy, the numbers are extremely low. A 2021 poll found that 4-in-10 Americans were unwilling to spend even $1 annually on higher gas and electricity prices to mitigate the effects of climate change.[35] These findings are broadly consistent with earlier polls going back several years, which find large percentages of Americans expressing an interest in climate policy, but a low willingness to pay for its implementation.[36]

The SEC repeatedly cites instances of major asset managers and publicly traded businesses voluntarily reporting their environmental impact via annual ESG statements. Those citations are likely accurate, but there is a significant difference between voluntary disclosures and compelled ones. The legal risks involved with potentially being found non-compliant after the fact greatly changes the incentives for firms to agree to voluntary disclosure, rather than supporting the imposition of mandatory ones.

The SEC's prescriptive[37] approach is to drive capital away from GHG-intensive firms by artificially shifting investor demand toward lower-emissions alternatives. The goal appears to be to force disfavored companies to reveal their carbon footprint or perceived neglect for sustainable stewardship, spark public backlash, and spur an investment shift toward decarbonization.

Who stands to benefit from this shift? Proxy advisory firms are well placed to benefit. These firms not only represent the primary supporters of mandatory climate disclosures, but they are also among the most effective advocates for government-imposed ESG policy.

The proxy advisory market is dominated by the duopoly of Glass Lewis and Institutional Shareholder Services (ISS), which together account for 94% of all services. Both firms consistently issue recommendations to companies in favor of adopting pro-ESG shareholder proposals. ISS has taken the lead on convincing public companies to voluntarily disclose annual sustainability reports.[38]

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30 Cork Gaines, "Millennials and Gen Z are giving up on one of their core values and investing more like boomers," Business Insider, January 11, 2024, https://www.businessinsider.com/esg-investing-strategies-millennials-gen-z-baby-boomers-compabnies-funds-2024-1.

31 Jon Raphael, Kristen Sullivan, "ESG executive survey: Preparing for high-quality disclosures," Deloitte, March 2022, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-esg-preparedness-disclosures-reporting-requirements.pdf.

32 Jon Raphael, Kristen Sullivan, "ESG executive survey: Preparing for high-quality disclosures," Deloitte, March 2022, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-esg-preparedness-disclosures-reporting-requirements.pdf.

33 Jon Raphael, Kristen Sullivan, "Sustainability action report: Survey findings on ESG disclosure and preparedness", Deloitte, December 2022, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-survey-findings-on-esg-disclosure-and-preparedness.pdf.

34 See Blue Yonder, "Blue Yonder Survey: Consumers Interest in Sustainable Products and Practices Still High," Blue Yonder Media Center, March 2023, https://media.blueyonder.com/blue-yonder-survey-consumers-interest-in-sustainable-products-and-practices-still-high/. Only 4% of those polled were willing to spend an additional 20% on green-based products than they already did.

35 "CEI National Poll," Competitive Enterprise Institute, October 14, 2021, https://cei.org/wp-content/uploads/2021/10/CEI-National-Poll-Final.pdf.

36 Valerie Volcovici, "Americans demand climate action (as long as it doesn't cost much)," Reuters, June 26, 2019, https://www.reuters.com/article/idUSKCN1TR17X/.

37 US Chamber of Commerce, "US Chamber Voices Concern with Prescriptive Approach of SEC Climate Disclosures Proposal, Will Work with SEC to Develop Clear and Workable Rules," March 2022, https://www.uschamber.com/finance/corporate-governance/u-s-chamber-voices-concern-with-prescriptive-approach-of-sec-climate-disclosures-proposal-will-work-with-sec-to-develop-clear-and-workable-rules.

38 Share Action, "Voting Matters 2022 Report," Share Action, 2022, https://shareaction.org/reports/voting-matters-2022/general-findings#figure3.

Much of ISS and Glass Lewis's pro-ESG bent is connected to selling their ESG-based solutions and other products.[39] The firms issue ratings that affect the financial future of firms, but then also sell their consulting services on how to optimize their scores, creating a potential conflict of interest.[40]

Proxy advisory firms are nowhere mentioned in the SEC's proposed rule, but their fingerprints are all over the document. For instance, Glass Lewis's 2021 policy prospectus says the firm "will generally recommend in favor of shareholder resolutions requesting that companies provide enhanced disclosure on climate-related issues, such as requesting that the company undertake a scenario analysis or report that aligns with the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD")."[41] This resembles similar language used by the SEC to justify its own proposed climate disclosure rule.

Conclusion

The SEC's proposed climate disclosure rule presents an expensive regulatory hurdle for public companies to overcome in 2024. The rule will greatly increase the costs associated with filing corporate disclosures, while raising the likelihood that companies become the target of SEC enforcement action for improper filing. Many companies will struggle mightily to expend an average of $864,864 when preparing and filing these climate disclosures. Firms will be forced to hire armies of lawyers, accountants, and ESG experts for the rule's estimated 39 million additional hours of paperwork.

Beyond the rule's severe cost burden lies the immense difficulty in quantifying how climate change will affect a company's foreseeable financial risks in the first place. This will breed an inconsistent process that will run contrary to the SEC's goal for streamlining ESG reporting.

The SEC's perception that climate change presents a material concern for investors directly conflicts with existing US Supreme Court precedent that suggests otherwise. In its current form, the climate rule's Scope 3 mandate will compel unregulated private companies to disclose sensitive GHG emissions data to their registrant firm partners. This backdoor regulation will likely be deemed by a reviewing court to compel information that is financially immaterial and politically incriminating.

On the flipside, companies sued by the SEC for noncompliance over the climate rule possess the right to launch countersuits against the agency in an Article III court on constitutional or procedural grounds.

The SEC's rule appears to draw much heavier influence from foreign-based proxy advisory firms than from domestic voices. Actual domestic support for the rule is currently more assumed than demonstrated.

In its current form, the SEC's proposed climate disclosure rule will lead to expanded red tape, huge compliance costs, and lawsuits, and little meaningful disclosure. Thus, the SEC should reconsider implementing the rule. It should leave climate policy to the EPA and focus on collecting disclosures of financially relevant information. If some investors are concerned about how a firm's decisions impact the surrounding environment, they can advocate for access to that information from particular firms as shareholder activists, or take their money elsewhere.

About the author

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[39] Consumer's Research, "Defeating the ESG Attack on the American Free Enterprise System: An Overview of the Corporate Proxy System for Oversight & Litigation Efforts," February 2023, https://consumersresearch.org/documents/defeating-esg/. See the following quote from pg. 19-20: "The value of these [ESG] products depend on companies continued commitment to environmental and social goals—a matter that ISS and Glass Lewis deal with directly in their proxy advisory services when they advise investors on how to vote on thousands of ESG-focused shareholder proposals. This gives ISS and Glass Lewis a financial motive to use their proxy advisory services to promote their ESG-related services."

[40] Scott Shepard, "The Profoundly Partisan Ways of Proxy Advisory Firms," Free Enterprise Project, July 20, 2023, https://nationalcenter.org/ncppr/2023/07/20/scott-shepard-the-profoundly-partisan-ways-of-proxy-advisory-firms/.

[41] See "Glass Lewis Policy Guidelines Updates," Glass Lewis, 2021, pg. 37, https://www.glasslewis.com/wp-content/uploads/2021/01/Global-Summary-of-Policy-Guideline-Updates-2021.pdf?hsCtaTracking=0bc16c01-c817-4278-86dd-474ffa09c9e4%7C159fed3d-47f6-47ca-bef9-a269b46a9cab.

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