SEC Should Reject Climate Rules Over First Amendment Issue

By **Thomas Berry and Jennifer Schulp** (July 1, 2022)

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The U.S. Securities and Exchange Commission proposed sweeping new rules on March 21 that would impose a broad range of mandatory climate-related disclosures on publicly traded companies.[1] These disclosures include, perhaps most significantly, each company's total greenhouse gas emissions.[2]

The proposed rules have prompted objections for a range of reasons,[3] but one fundamental problem should not be overlooked: The rules likely violate the First Amendment by mandating factual disclosures that go beyond what's economically relevant for investor decisions.

As the U.S. Supreme Court explained in Riley v. National Federation of the Blind of North Carolina in 1988, the First Amendment protects "the decision of both what to say and what not to say."[4]

This First Amendment right not to speak is well established. It's why a public school can't force students to recite the Pledge of Allegiance[5] and why a state can't force drivers to carry a motto on their license plates.[6]

The Supreme Court held in 1995 that this freedom from compelled speech extends "not only to expressions of value, opinion, or endorsement, but equally to statements of fact the speaker would rather avoid," in Hurley v. Irish American Gay, Lesbian, and Bisexual Group of Boston.[7]

Of course, like many constitutional rights, this right is not absolute. In 1985, the Supreme Court acknowledged in Zauderer v. Office of Disciplinary Counsel that in some instances, the First Amendment permits mandating the disclosure of "purely factual and uncontroversial information" about a product or service.[8] The question is whether the SEC's proposed climate disclosures fall within this narrow First Amendment exception.

For three reasons, the new disclosure rules likely do not pass constitutional muster: The justifications for the disclosures are weak, the disclosures selectively advantage certain viewpoints over others, and the information that must be disclosed is not "uncontroversial."

First, the purported interests supporting the need for these new rules are unconvincing. The Supreme Court made clear in the Zauderer case that "unjustified or unduly burdensome disclosure requirements" can violate the First Amendment.[9] There's no question that the new rules are burdensome; the SEC's own proposal estimates that annual compliance costs would total $6.3 billion and average roughly half a million dollars per company.[10]

How, then, does the SEC justify imposing these new costs? The proposed rule maintains that companies can face "risks associated with a potential transition to a less carbon intensive economy."[11] On this theory, the "potential adoption of climate-related regulatory policies" by governments in the future could have a greater business impact on companies with more emissions, making emissions data potentially relevant to investors.[12]

The problem, however, is that existing SEC rules already mandate the disclosure of

information "material" to an investing decision.[13] If the risk of future regulation is concrete enough to present a real financial risk to a company, that company is already required to disclose the facts creating that risk. By definition, the proposed rules only add disclosure where the risk of financial harm is so remote as to make the disclosure not material.

Further, there are so many variables and difficulties in calculating greenhouse gas emissions that whether the disclosures themselves would even produce reliable information is an open question. In many cases, the disclosures would be not only immaterial, but downright inaccurate and unreliable, as explained by SEC Commissioner Hester Peirce in her dissenting statement titled "We are Not the Securities and Environment Commission — At Least Not Yet."[14]

This same fundamental problem of immateriality undercuts every SEC argument for why the climate disclosures are necessary from a traditional investor's perspective. The proposed rule also notes that emissions data could help investors "assess the progress" of companies "with public commitments" to reduce emissions.[15]

But if a company has made such a pledge, it already must disclose any information on its progress that would be material to investors. For companies that have not made such a pledge, the relevance of forced emissions disclosures is much less clear.

Perhaps most honestly, the SEC's proposed rule also admits that some "investors and financial institutions are working to reduce the [greenhouse gas] emissions of companies in their portfolio[s]" and that these investors need "emissions data to evaluate the progress made regarding their net-zero commitments."[16]

The new rules might well facilitate investing choices made on the basis of climate policy views rather than financial gain. But a rule designed to aid a particular view of policy-driven investing raises serious concerns of viewpoint discrimination.

As the Supreme Court observed in Riley v. National Federation of the Blind, it would be all too easy for the government to make certain groups or viewpoints look worse by selectively mandating the disclosure of unflattering facts.[17]

Suppose a law required, for example, that fundraisers for a particular candidate must "state during every solicitation that candidate's recent travel budget."[18] Or suppose that a law required supporters of "a particular government project to state at the outset of every address the average cost overruns in similar projects."[19]

While factually true, imposing such mandatory disclosures on only some candidates or projects would obviously allow the government to put its thumb on the scale of public debate, violating a core First Amendment principle.

The same holds true for disclosure rules that facilitate some versions of ethical investing but not others. If companies can be forced to disclose their emission levels simply because some people will choose not to invest in them on that basis, a host of other disclosures could be justified on alternative views of ethical investing.

Some faith-based investors would prefer not to invest in companies that engage in stem-cell research or that fund abortions or contraceptives.[20] Could the SEC mandate new disclosures on these sensitive social issues to accommodate these investors? If climate disclosures can be mandated simply to facilitate ethical investing, there is no clear limiting

principle for what other disclosures might be mandated in the future.

And this leads to the final flaw with the new rules: the inherently political nature of climate-related disclosures. Even if the mandated disclosures might be "factual," they are far from "uncontroversial."

In 2014, the U.S. Court of Appeals for the District of Columbia Circuit recognized this distinction in National Association of Manufacturers v. SEC when it struck down a similar SEC rule mandating that companies disclose whether minerals in their products came from a war-torn region of Africa.[21] The rule would have forced companies to describe some of their products as not "conflict free."[22]

But as the D.C. Circuit explained, the very requirement to make such a disclosure implied the government's view as to the morality of the businesses in question.[23] As the D.C. Circuit forcefully put it, the rule would have impermissibly forced a business "to tell consumers that its products are ethically tainted" and "confess blood on its hands."[24]

The SEC's climate disclosure mandate is similarly tinged with implicit disapproval of greenhouse gas emissions. Indeed, in multiple places, the SEC's proposed rule suggests methods by which companies can decrease their emissions.[25]

By forcing companies to condemn themselves, the rule promotes one side in a policy debate and violates the First Amendment requirement of viewpoint neutrality. Once mandatory disclosures exceed the bounds of the "uncontroversial," the government runs too much risk of using compelled speech to influence public debate.

The better course is to draw the line now and not start down this path. Opposing the climate disclosures means that future administrations won't be able to use SEC disclosure mandates to promote and advantage other preferred viewpoints.

Compelled speech is heavy medicine, and it should be imposed with care and sensitivity to ensure that the ideology of those currently in power does not influence the rules for what must be said.

Existing SEC rules mandating disclosure of "material" information have successfully drawn that line. To avoid the likelihood of a First Amendment challenge in the future, the SEC should reject the climate disclosure rules and return to the viewpoint-neutral materiality standard.

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[1] SEC Press Release, SEC Proposes Rules to Enhance and Standardize Climate-Related

Disclosures for Investors, March 21, 2022.

[2] SEC Fact Sheet, Enhancement and Standardization of Climate-Related Disclosures, March 21, 2022.

[3] See, for example, Pippa Stevens, Joe Manchin Opposes SEC Climate Disclosure Rule, Says It Targets Fossil Fuel Companies, CNBC, April 4, 2022; Ellen Meyers, Legal Debate Over SEC's Authority Clouds Climate Rule Proposal, Roll Call, May 5, 2022; Jennifer J. Schulp and William Yeatman, Climate-Risk Disclosure, Let Me Count the Ways, The Hill, June 8, 2022.

[4] Riley v. National Federation of the Blind , 487 U.S. 781, 796–97 (1988).

[5] West Virginia State Board of Education v. Barnette , 319 U.S. 624 (1943).

[6] Wooley v. Maynard , 430 U.S. 705 (1977).

[7] Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston , 515 U.S. 557, 573 (1995).

[8] Zauderer v. Office of Disciplinary Counsel , 471 U.S. 626, 651 (1985).

[9] Zauderer, 471 U.S. at 651.

[10] SEC Proposed Rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors (2022), at 373, 440–41.

[11] SEC Proposed Rule, at 55.

[12] SEC Proposed Rule, at 55.

[13] See, for example, 17 CFR § 229.101; 17 CFR § 229.103; 17 CFR § 230.408; 17 CFR § 240.12b-20.

[14] Commissioner Hester M. Peirce, Statement: We are Not the Securities and Environment Commission - At Least Not Yet, March 21, 2022.

[15] SEC Proposed Rule, at 37.

[16] SEC Proposed Rule, at 158.

[17] Riley, 487 U.S. at 797–98.

[18] Riley, 487 U.S. at 798.

[19] Riley, 487 U.S. at 798.

[20] See, for example, Lisa Smith, A Guide to Faith-Based Investing, Investopedia, last updated April 1, 2022.

[21] National Association of Manufacturers (NAM) v. SEC , 800 F.3d 518 (D.C. Cir. 2014).

[22] NAM, 800 F.3d at 530.

[23] NAM, 800 F.3d at 530.

[24] NAM, 800 F.3d at 530.

[25] See, for example, SEC Proposed Rule, at 161.