Mandatory Disclosures and Organized Backlash: A Look at Litigation That Could Determine the Future of ESG in Investing

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Introduction

Environmental, social, and governance (ESG) topics, such as climate change, are now a regular feature of investment practices, whether purely as areas of potential financial risk or as markers by which to align one's investments with values.[1] ESG is a term describing broad buckets of topics of importance to investors ranging from environmental stewardship and climate-related risks, to labor practices and human rights issues, to board compensation and diversity, among many others.[2] The range of topics grouped under this term reflects the diversity of industries and companies in our marketplace. The topics most relevant will vary from company to company and industry to industry. Investors seek better

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1 Earthjustice, Comment Letter on the Proposed Rule on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131893-302348.pdf.

2 Paco Mengual, *Determining an Effective Regulatory Framework for Businesses to Report on the Environment, Climate, and Human Rights*, 35 PACE INT'L L. REV. 224, 227-28 (2023).

information on ESG topics for a variety of reasons, whether based on a desire to align their investments with their values or to understand the full scope of financially material risks of their investments.[3] But increased recognition of the relevance of these topics to investors has resulted in a significant backlash from industries concerned that integrating this information into investment decision making will harm them.[4]

We are in a crucial period for the future of our markets. Will investors have the benefit of better-quality information on emerging topics of concern when making their decisions, or will the market continue to operate on incomplete and inconsistent information that can mask the extent of financial risk a company or industry faces? The current legal battles debating whether and how to consider climate-related risks in investing mark this crucial fork in the road.

One such emerging topic, climate change, has dominated much of the debate over incorporating ESG into investment practices. Over the last decade and a half, much of the corporate world has publicly come to terms with the existence of climate change and started to acknowledge the power it holds over economic futures.[5] Recent reports have acknowledged the significant financial risk climate change can have on business and the financial system.[6] As

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3 *See id.* at 232-34.

4 Marti Flacks & Hannah Norman, *What Does the ESG Backlash Mean for Human Rights?*, CTR. FOR STRATEGIC & INT'L STUD. (Aug. 16, 2023), https://www.csis.org/analysis/what-does-esg-backlash-mean-human-rights [https://perma.cc/R824-H85S] (describing backlash of ESG investing in the United States and abroad).

5 *See, e.g.,* BlackRock, *Climate-Related Risks and the Low-Carbon Transition* (Jan. 2024), https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf [https://perma.cc/R36J-QYYT] (describing climate risks facing clients).

6 OFFICE OF MANAGEMENT AND BUDGET, FEDERAL BUDGET EXPOSURE TO CLIMATE RISK 1, https://www.whitehouse.gov/wp-content/uploads/2022/04/ap_21_climate_risk_fy2023.pdf [https://perma.cc/TB7P-6MT3] (climate change "will increasingly and severely impact communities, businesses, and governments"); COUNCIL OF ECONOMIC ADVISORS AND OFFICE OF MANAGEMENT AND BUDGET, CLIMATE-RELATED MACROECONOMIC RISKS AND OPPORTUNITIES, (April 4, 2022) https://www.whitehouse.gov/wp-content/uploads/2022/04/CEA_OMB_Climate_Macro_WP_2022-430pm.pdf, [https://perma.cc/2E4L-R7NM]; FINANCIAL STABILITY OVERSIGHT COUNCIL, REPORT ON CLIMATE-RELATED FINANCIAL RISK 3 (October 2021), https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf [https://perma.cc/ZF2H-AXMV] (calling climate change "an emerging threat" to financial

climate change's increasingly visible impacts enact a toll on our communities, businesses, and broader economies, it has prompted a wide range of policy, consumer, and legal responses that themselves impact businesses.[7] As these impacts grow over time, so does the importance of understanding corporate exposure to climate-related risks for markets to function properly.

Acceptance of these realities fed a growing recognition of the need to improve corporate management and disclosure of climate-related risks that fostered new corporate practices around understanding, managing, and reporting them.[8] Investors and asset managers placed increasing pressure on companies to divulge information they thought necessary to assess the financial import of such risks.[9] Major companies committed to divulging more information, and investors began to integrate that and information they gathered from other sources into their decision-making.[10]

This activity largely occurred outside the regulatory regime, allowing for experimentation but also encouraging the proliferation of approaches and tools with little oversight.[11] While major efforts to agree on general principles for climate disclosure yielded results and helped develop appropriate tools for assessment and disclosure,

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stability and noting that "climate-related impacts in the form of warming temperatures, rising sea levels, droughts, wildfires, intensifying storms, and other climate-related events are already imposing significant costs upon the public and the economy.").

7 COMMODITY FUTURES TRADING COMMISSION, MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM, 11, 19 (Sept. 9, 2020), https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf [https://perma.cc/3DA7-V95R] (Transition risks are those "associated with the uncertain financial impacts that could result from a transition to a net-zero emissions economy," including "changes in policy, technological breakthroughs, and shifts in consumer preferences and social norms." "Transition risks arise from both uncertainties and substantive changes. They include market, credit, policy, legal, technological, and reputational risks.").

8 *See generally* Hana Vizcarra, *Climate-Related Financial Risk Management and Disclosure* in GLOBAL CLIMATE CHANGE AND U.S. LAW (Michael B. Gerrard et al., eds. 2023) (describing recent developments in U.S. corporate disclosure law and policy regarding climate information).

9 *Id.* at 268.

10 *Id.*

11 *Id.* at 263 (describing how U.S. regulators have only recently begun to consider disclosure rules).

they did not lead to consistent, high-quality, and reliable disclosure practices across companies or industries.[12] Instead, the market was flooded with a confusing array of corporate commitments and voluntary disclosure regimes.[13] At the same time, demand for climate-conscious investment products and better integration of climate-related risks into traditional investment practices fostered an industry of corporate climate analysis and ratings with limited insight into their inputs.[14]

Over the years, governmental interest in this problem has waxed and waned while public and investor interest in better disclosures steadily grew.[15] However, the give-and-take of the various stakeholders could only progress climate-related disclosures so far. Without mandatory requirements to ensure widespread participation and adequate oversight, there was no reliable way to safeguard markets by fully integrating climate risks into investment decisions.[16] Corporate interests simply do not align sufficiently with detailed disclosures to support the development of definitive standards absent regulatory intervention.

Recently, many governments have turned their attention to climate-related financial risks, including corporate disclosures by enacting or proposing new requirements in significant markets across the globe.[17] Regulatory efforts in the United States have

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12 *See* Earthjustice, *supra* note 2 at 12 (describing how inadequate and unreliable disclosures could cause unnecessary market losses); *see also, e.g.*, TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (June 2017), https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf [https://perma.cc/YM4M-VEAQ] (developing generally accepted principles for corporate disclosures that have influenced voluntary and regulatory approaches in the years since they were developed but that do not provide detailed directives tailored to the legal regimes of different jurisdictions or have the ability to ensure broad compliance that would lead to necessary comparability in the market).

13 *See* Earthjustice, *supra* note 2 at 1.

14 Madison Condon, *Climate Services: The Business of Physical Risk*, 55 ARIZ. ST. L. J. 147, 151 (2023) (arguing many service providers use black box models that make it difficult to understand their analyses, something SEC disclosure requirements should help address).

15 *See id.* at 158.

16 Madison Condon, *Market Myopia's Climate Bubble*, 2022 UTAH L. REV. 63, 70-111 (2022) (describing how inadequate integration of climate risks into the marketplace has resulted in possible mispricing, raising market risk).

17 [18] *See* Eric Zhao, *Global Climate Disclosure Regimes*, HARV. L. SCHOOL ENV'T & ENERGY L. PROGRAM (Dec. 20, 2023), https://eelp.law.harvard.edu/2023/12/global-

largely lagged those in other jurisdictions.[18] However, the federal government is now taking the economic risk of climate change seriously. The SEC voted to finalize federal corporate disclosure requirements for public companies on March 6, 2024, and the rule was published on March 28.[19] Some states have taken the issue on as well. California passed two laws in 2023 that will require many companies doing business in the state to disclose their greenhouse gas emissions and submit reports on climate-related financial risk.[20]

Although information in the market has improved, we are still a long way from seeing the full potential of proper consideration of climate-related risks on the health of our markets and economy. The United States may never fully achieve the needed transparency to do so. An organized, reactionary campaign has burst onto the scene in the last few years. In dozens of states, legislatures have proposed or passed laws designed to punish asset managers who consider climate-related risks in their work and restrict state entities from considering such risks.[21] An aggressive campaign against the SEC's proposed corporate disclosure rule likely impacted the substance of the final rule, resulting in significant changes to the disclosure requirements, particularly the greenhouse gas emissions disclosures.[22] Opponents also filed a flurry of challenges to the final rule as soon as it was issued.[23] These same opponents have also asked a federal court to declare the California disclosure laws unconstitutional.[24] Challengers to climate-related disclosures seek to benefit from a federal bench and Supreme Court that is more

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climate-disclosure-regimes/#:~:text=In%20recent%20years%2C%20countries%20around,and%20climate%2Drelated%20financial%20risks [https://perma.cc/S5T5-HDN4].

18 *See* Vizcarra, *supra* note 9.

19 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668 (March 28, 2024).

20 *See infra* notes 65 - 72 and accompanying text.

21 Henry Engler, *Anti-ESG Legislation Seen Facing Uphill Struggle to Become Law*, THOMSON REUTERS (Feb. 22, 2024) https://www.thomsonreuters.com/en-us/posts/esg/anti-esg-legislation/#:~:text=61%20anti%2DESG%20bills%20remain%20pending&text=The%20bill%20would%20prohibit%20the,has%20little%20chance%20of%20passage [https://perma.cc/39P9-DAC7].

22 *See infra* Part B, pp. 6-9.

23 *See Iowa v. SEC*, No. 24-1522 and consolidated cases (8th Cir.) (consolidating 10 petitions for review filed in six Circuit Courts of Appeals).

24 *See infra* note 72 and accompanying text.

skeptical of federal regulation than it used to be.[25] The outcome of these reactionary efforts will determine whether and how the government exercises its authority to address these known financial risks that threaten companies, our markets, and economy as a whole.

Below I discuss three cases challenging the incorporation of climate-related risk into investment decisions and how these efforts could affect the consideration of all financially relevant information, including ESG factors, into investment practices.

Federal Legal Actions Designed to Limit Consideration of Climate-Related Risk in Investments

A. DOL-EBSA rules on ERISA fiduciary duties

Even the most limited of regulatory adjustments have attracted hyperbolic claims of the harms of "ESG" investing. In January 2023, a coalition of twenty-five states, a couple of energy companies, an energy industry association, and a retirement plan participant, challenged the Department of Labor's rule titled "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights."[26] This rule provides guidance to fiduciaries of the Employment Retirement Income Security Act (ERISA) covered retirement plans on how and when they can consider environmental, social, and governance issues such as climate-related risks in investment decisions and voting their proxies.[27] The rule replaced two rules promulgated by the Trump administration that departed from prior agency guidance, raising barriers to considering such information.[28]

The ERISA requires plan fiduciaries to act in the interest of participants and beneficiaries and with the exclusive purpose of

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25 *See e.g.,* Greg Stohr & Jennifer A. Dlouhy, *Supreme Court Weighs Toppling Ruling That Empowers Agencies*, BLOOMBERG L. (Jan. 17, 2024) https://news.bloomberglaw.com/us-law-week/supreme-court-weighs-overturning-ruling-that-empowers-agencies [https://perma.cc/JF9N-5ENA] (describing how Supreme Court Justices appear poised to overturn *Chevron* deference).

26 *See generally,* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 87 Fed. Reg. 73822 (Dec. 1, 2022) [hereinafter 2022 Rule); *see also Utah v. Walsh*, No. 2:23-CV-016-Z, 2023 WL 6205926, at *5 (N.D. Tex. Sept. 21, 2023) (holding that the ESG rule was not "manifestly contrary" to ERISA).

27 *See* 2022 Rule, *supra* note 27, at 73826.

28 *Id*. at 73827.

providing benefits to them, which courts interpret to refer to financial benefits, and to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man . . . would use" (these are the duties of loyalty and prudence).[29] DOL's longstanding position has been that these requirements do not prevent fiduciaries from considering other, non-financial benefits in selecting investments so long as they are used in tiebreaker situations where the investment would have an expected rate of return commensurate with other options.[30] The DOL has also recognized that when environmental, social, and governance information, including climate-related information, is financially relevant it should be considered by fiduciaries in making investment decisions without any additional limitations.[31]

The DOL issued numerous guidance documents explaining how such "collateral" economic or social benefits can be considered by plan fiduciaries. A 2015 guidance document explained that plan fiduciaries can select investments in part for their "collateral" economic or social benefits so long as they have "an expected rate of return that is commensurate to rates of return of alternative investments with similar risk characteristics."[32] This and prior guidance was intended to reassure plan fiduciaries that such economically targeted investments are not automatically at odds with their duties under ERISA.[33]

While they cannot "use plan assets to promote social, environmental, or other public policy causes at the expense of the financial interests of the plan's participants and beneficiaries" nor "accept lower expected returns or take on greater risks in order to

29 29 U.S.C. § 1104(a)(1) (2022); Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 421 (2014) ("[T]he term 'benefits' . . . must be understood to refer to the sort of *financial* benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust's beneficiaries.") (emphasis in original).

30 2022 Rule, *supra* note 27 at 73822 (" . . . [F]or years, the Department's non-regulatory guidance has recognized that, under the appropriate circumstances, ERISA does not preclude fiduciaries from making investment decisions that reflect environmental, social, or governance ('ESG') considerations, and choosing economically targeted investments ('ETIs') selected in part for benefits in addition to the impact those considerations could have on investment return").

31 *Id*. at 73825.

32 Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 86 Fed. Reg. 65135, 65135 (Oct. 26, 2015).

33 *Id.*

secure collateral benefits" fiduciaries can use such collateral benefits to decide between "otherwise equal" investment alternatives.[34] The 2015 guidance also made clear that fiduciaries could pursue investment strategies that consider ESG factors when those factors are used "solely to evaluate the economic benefits of investments."[35] A 2016 guidance document clarified that ESG topics were appropriate for proxy voting policies and investor engagement, including "the nature of long-term business plans including plans on climate change preparedness and sustainability" and "policies and practices to address environmental or social factors that have an impact on shareholder value."[36] A 2018 Field Assistance Bulletin reiterated the explanations of the 2015 and 2016 guidance and recognized that ESG issues can "present material business risk or opportunities to companies that company officers and directors need to manage" and investors should treat as "economic considerations."[37] It specified that a 401(k) plan platform's investment options can include "well managed, and properly diversified ESG-themed investment alternative."[38] However, it cautioned that "[f]iduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices," hinting at the more restrictive tone the agency would take under the new administration.[39]

In April 2019, President Trump issued an Executive Order that, among other instructions, directed the Department of Labor to determine any discernable trends in ERISA plan investments in the energy sector and to review guidance on fiduciary responsibilities

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34 *Id.* at 65135-36.

35 *Id.* at 65136.

36 Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95879, 95884 (Dec. 29, 2016).

37 Memorandum from John J. Canary, Dir. of Reguls. & Interpretations, Emp. Benefits Sec. Admin. to Mabel Capolongo, Dir. of Enforcement Regional Directors, Emp. Benefits Sec. Admin. (Apr. 23, 2018) https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01 (providing guidance to the Employee Benefits Security Administration's national and regional offices to assist in addressing questions they may receive from plan fiduciaries and other interested stakeholders about the exercise of shareholder rights and written statements of investment policy and "economically targeted investments" (ETIs)) (superseded by 85 Fed. Reg. 72846 and 85 Fed. Reg. 81658) [https://perma.cc/K7QN-FDEW].

38 *Id.*

39 *Id.*

for proxy voting to consider whether to rescind, replace, or modify it.[40] The Executive Order, titled "Executive Order —Promoting Energy Infrastructure and Energy Growth," was nominally intended to reduce permitting burdens on energy infrastructure. Guidance on how to manage defined benefit or defined contribution retirement plans does not have a direct connection to energy project permitting or development burdens. The basis for the claimed connection seems to be that considering ESG factors in investing necessarily reduces investment in fossil fuel energy projects. This idea reappears in litigation as plaintiffs partially base their standing on the perception that expected reductions in fossil fuel energy project investments will reduce taxes received for states and negatively impact energy companies.[41]

Following President Trump's Executive Order, DOL promulgated two new rules replacing the prior guidance that would lock in a more onerous interpretation of what plan fiduciaries must do when considering ESG information in investment decisions and proxy voting.[42] The rules' requirements were viewed as additional burdens that made it difficult for fiduciaries to even consider financially material climate-related risks in their investment decisions. When President Biden took office he issued his own executive order directing DOL to reconsider the two Trump-era rules and identify actions to protect savings and pensions from climate-related financial risk.[43] In December 2022, DOL promulgated a single rule that replaced the two Trump-era rules.[44] DOL explained that it replaced the prior rules because they created a "chilling effect" on the "appropriate integration of climate change and other ESG factors in investment decisions" and sowed confusion about whether ESG factors could ever be considered pecuniary (or financial) factors and put "a thumb on the scale against the consideration of ESG factors, even when those factors

40 Exec. Order No. 13868 at 84 Fed. Reg. 15495 (Apr. 10, 2019) (revoked by Exec. Order No. 13990, 86 Fed. Reg. 7037 (Jan. 25, 2021)).

41 *Utah v. Su*, App. Brief, No. 23-11097, at 61-62 (5th Cir. January 18, 2024) [hereinafter App. Brief].

42 Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72846 (Nov. 13, 2020); *see also* Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 81658, 81658 (Dec. 16, 2020).

43 Exec. Order No. 14030 at 86 Fed. Reg. 27967 (May 25, 2021).

44 *See* 2022 Rule, *supra* note 27 at 73826.

are financially material."[45]

The 2022 Rule challengers argue that it improperly allows fiduciaries to consider collateral benefits in investment decision, violating ERISA's requirement that fiduciaries act exclusively to the benefit of plan participants and beneficiaries.[46] However, Judge Kacsmaryk, a federal judge in the Northern District of Texas, disagreed. In upholding the rule, he found it "change[d] little in substance from the 2020 Rule" that plaintiffs prefer.[47] Finding it continued to limit consideration of collateral factors to tiebreaker situations, as the DOL has consistently done in guidance and rulemaking. He also notes that even the "Plaintiffs concede that ESG factors can be considered for risk-return purposes in appropriate circumstances" and that the 2020 rule that they favor "stated that failing to consider ESG-related risk-return factors could constitute a violation of the duty of prudence in some circumstances."[48] Judge Kacsmaryk found the 2022 Rule did not contradict the statutory obligation for ERISA plan fiduciaries to act "solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries."[49] He also rejected plaintiffs' claims that the rule was arbitrary and capricious in violation of the Administrative Procedure Act.[50] He found the agency sufficiently explained its reasoning for changing the 2020 rule and expressly and adequately replied to comments addressing the plaintiffs' concerns.[51]

Despite the clear ruling at the district court level, challengers have appealed to the Fifth Circuit. In their opening brief, they take on the long-standing tiebreaker provision, arguing it violates ERISA, and invoke the newly articulated major questions doctrine.[52] They argue that "[p]ursuit of collateral benefits . . . — especially ESG objectives—is the subject of intense political debate," relying on the failure of Congress to legislate on the use of

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45 *Id.* at 73825-6.

46 *Utah v. Walsh*, No. 2:23-CV-016-Z, 2023 WL 6205926, at *3 (N.D. Tex. Sept. 21, 2023).

47 *Id.* at *4.

48 *Id.*

49 29 U.S.C. § 1104(a)(1) (2022).

50 *Walsh*, No. 2:23-CV-016-Z, at *5.

51 *Id.* at *6.

52 App. Brief at 25, 36.

collateral benefits and a failed attempt to repeal the rule via Congressional Review Act resolution.[53] They argue EBSA's recognition that "no two investments are the same in each and every respect" admits an impossibility for two investments to be generally financially equivalent and thus eligible for tiebreaker considerations, that the agency improperly expanded the definition of a tie and removed recently adopted documentation requirements, and that EBSA did not consider the additional resources that sponsors and participants would need to expend to monitor fiduciaries.[54]

In their brief, DOL-EBSA responds that the 2021 rule is consistent with ERISA in that it reaffirms that fiduciaries may consider all factors relevant to risk and return in investments and that collateral factors can only be used as a tiebreaker.[55] The government outlines the long history of socially responsible investment practices and the department's consistent guidance over time that "fiduciaries can consider all factors (including ESG factors) that bear on investment risk and return, and can exercise shareholder rights in service of the plan's financial interests, but can consider collateral factors only in tightly limited circumstances consistent with prioritizing the plan's financial interests."[56] EBSA explains that it made clear in the final rule that ESG factors relevant to risk-return should be treated as any other relevant factors, neither disfavored as the rule challengers would like nor favored above other risk-return factors.[57] EBSA also explains that it made changes to language about the tiebreaker test to address a concern that the 2020 rule essentially eliminated the test and reversed various burdensome documentation and reporting requirements that were shown to have a chilling effect on prudent investment practices.[58] All of these changes ensured a consistent agency approach to the interpretation of fiduciaries' duties in relation to ESG factors, which was temporarily confused by the 2020 rule.

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53 *Id.* at 4.

54 *Id.* at 51-57.

55 *Utah v. Su*, 23-11097, Appellees' Brief at 22 (5th Cir., March 21, 2024) [hereinafter Appellees' Brief].

56 *Id.* at 6.

57 *Id.* at 17 (describing changes made in the language of the final rule to emphasize this position).

58 *Id.* at 18-19.

What is remarkable about this case is that the challengers find fault with the most unremarkable of rules. Under ERISA, ESG factors, including climate-related issues, are merely considered as any other factor that can impact risks and returns of investments otherwise, they can only be used as a tiebreaker in deciding between otherwise equally prudent investment choices. Challengers appear instead to want to single out specific issues for restriction, requiring fiduciaries to put blinders on when it comes to a wide range of financially relevant topics. This theme reappears in opposition to climate-related disclosure rules.

B. SEC's Climate Disclosure Rule and Expected Challenges

The Securities and Exchange Commission finalized new disclosure requirements on climate-related financial risks on March 6, 2024, nearly two years after releasing its proposal.[59] The Enhancement and Standardization of Climate-Related Disclosures for Investors rule requires public companies to disclose how they are identifying, managing, and planning for climate-related risks.[60] This rule is the culmination of years of work by investors and other stakeholders to get more comprehensive and comparable disclosures from companies on their physical and transition risks of climate change. It builds on the work of the Task Force on Climate-related Disclosures (TCFD) and other voluntary disclosure efforts.

The proposed rule included strong requirements for disclosure of greenhouse gas emissions (Scopes 1, 2, and 3), and would have required companies to disclose specific, disaggregated climate-related financial impacts.[61] Intensive lobbying on behalf of certain industries proved fruitful with the SEC substantially weakening these sections of the rule.[62] Among the changes made from proposal to final were scaled back greenhouse gas emissions disclosure requirements. The final rule does not require any disclosure of

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59 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668 (March 6, 2024), https://www.sec.gov/rules/2022/03/enhancement-and-standardization-climate-related-disclosures-investors [https://perma.cc/AP8M-JZ4M].

60 *Id.*

61 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334, 21345 (Apr. 11, 2022).

62 Justin Gerdes, *SEC adopts landmark — but weakened — climate disclosure rules*, THE BANKER, (Mar. 7, 2024) https://www.thebanker.com/SEC-adopts-landmark-but-weakened-climate-disclosure-rules-1709816432, [https://perma.cc/6AHV-72BF].

Scope 3 emissions (emissions from upstream and downstream in a company's supply chain) and only requires a company to include disclosures of a company's direct emissions (Scope 1) and emissions from power use (Scope 2) if it believes they are financially material.[63] The absence of across-the-board mandatory emissions disclosures will likely contribute to a growing gap in disclosure practices between U.S.-listed companies and their global peers.[64] Other changes included additional materiality qualifiers throughout the rule, and scaling back transition-related disclosure requirements in corporate financial statements.[65]

Even in its more limited form, the rule represents a long-overdue step forward. The SEC has recognized that climate-related risks can be financially material since at least 2010, but it has been unwilling or unable to coax adequate disclosures on the topic through guidance and enforcement.[66] The Commission's light touch has failed to provide investors with the information they need on the financial risks companies face due to climate change. The slow evolution of corporate climate-related disclosures stands in stark contrast to the rapidly growing awareness of the financial impact of climate-related risks.[67]

The SEC's final rule will establish a baseline expectation that companies are evaluating these risks and disclosing them in their SEC filings. Companies will need to describe board management

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63 *See id.*

64 Linda-Eling Lee, *US Firms Falls Further Behind Global Peers on Climate Disclosure*, LINKEDIN (Feb. 29, 2024), https://www.linkedin.com/pulse/us-firms-fall-further-behind-global-peers-climate-disclosure-lee-vt2qc/?trackingId=U1v9IXpCSG6YwLnqbNsLpw%3D%3D [https://perma.cc/GA79-S9H3] ("U.S.-listed companies lag their peers globally in disclosing their financially relevant climate risks. Nearly three-quarters (73%) of listed companies in developed markets outside the U.S. reported their direct (Scope 1) and indirect (Scope 2) greenhouse gas (GHG) emissions, the latest data from MSCI ESG Research shows.[1] In comparison, 45% of U.S-listed companies reported their Scope 1 and Scope 2 emissions as of the same date. While reporting of value chain (Scope 3) emissions continues to be a topic of contention, more than half (54%) of listed companies in developed markets outside the U.S. report at least some of their Scope 3 emissions, compared with 29% of U.S.-listed firms.").

65 *See* Gerdes, *supra* note 63.

66 Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290, 6291 (Feb. 8, 2010).

67 *See* Earthjustice, Comment Letter on the Proposed Rule on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131893-302348.pdf.

oversight and governance of climate-related risks; climate-related risks that have had or are reasonably likely to have a material impact on the company over the next twelve months or in the longer term; the company's process for identifying, assessing and managing material climate-related risks; actual and potential material impacts of identified risks to its strategy, business model, and outlook; the role of carbon offsets and renewable energy credits in its business strategy; internal carbon pricing used; any scenario analysis used; and its climate-related targets and transition plans, if material.[68] The final rule also includes important disclosure requirements for evaluating physical risks, such as location data, flood hazard exposure, and exposure to high water stress.[69]

In issuing its rule, the SEC emphasized the already apparent financial impacts that climate change has had on the economy, individual businesses, and our markets. The Commission notes that "climate-related risks can affect a company's business and its current and longer-term financial performance and position in numerous ways. Climate-related natural disasters can damage issuers' assets, disrupt their operations, and increase their costs."[70] Recent economic experience and the rulemaking record are full of examples of the financial implications of climate change.[71] The growing annual financial impacts to individual businesses and our economy from direct impacts or supply chain disruption due to natural disasters, substantial impacts to the insurance industry from repeated losses and resulting loss of insurance for many properties, and bankruptcies in the utility sector from increasingly dangerous wildfire seasons are just a few examples of the financial implications of the physical impacts of climate change.[72] Likewise,

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68 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668, 21716-17 (March 28, 2024).

69 *Id.* at 21693

70 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668, 21672 (March 28, 2024).

71 See Laura Gillam, *Responding to the Financial Impacts of Climate Change*, WHITE HOUSE, https://www.whitehouse.gov/omb/briefing-room/2024/04/22/responding-to-the-financial-impacts-of-climate-change/ [https://perma.cc/LP9S-JNRA].

72 *See, e.g.*, Jacques Leslie, *How Climate Change is Disrupting the Global Supply Chain*, YALE ENV'T 360, (Mar. 10, 2022), https://e360.yale.edu/features/how-climate-change-is-disrupting-the-global-supply-chain [https://perma.cc/ZR6Z-6CCA]; Jacob Bogage, *Home insurers cut natural disasters from policies as climate risks grow*, WASHINGTON POST, (Sept. 3, 2023) https://www.washingtonpost.com/business/2023/09/03/natural-disaster-climate-

shifts in consumer preferences and market demand for products and practices as well as legal, regulatory, and policy actions to address climate change can have substantial financial impacts on companies.[73]

Despite a well-developed record for the need for disclosures on these topics to address current gaps and inconsistencies in the information investors receive, the SEC's disclosure rule has faced vociferous opposition from industry (most notably from trade associations representing industrial agriculture and the oil and gas industry) and other anti-regulatory interests.[74] State attorneys general telegraphed their intention to challenge the rule mere months after the SEC released the proposal.[75] Nearly two years later, they finally have their opportunity.

State attorneys general, industry associations, and oilfield services companies filed petitions seeking to vacate the rule as soon as the SEC issued it.[76] Some of the challengers to this rule are also involved in the DOL-EBSA rule litigation and the California law litigation, among other efforts to restrict financial regulation. Contributing to a broader effort to undercut the authority of federal regulators, opponents of climate-related disclosure requirements argued in comments on the proposal that it violates companies' First Amendment rights and goes beyond the SEC's statutory authority.[77]

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insurance/ [https://perma.cc/QQ43-AU3E]; Ivan Penn, PG&E's Bankruptcy Filing Creates 'a Real Mess' for Rival Interests, THE NEW YORK TIMES, (Jan. 29, 2019) https://www.nytimes.com/2019/01/29/business/energy-environment/pge-file-bankruptcy.html [https://perma.cc/47U6-UH37].

73 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668, 21672 (March 28, 2024).

74 *See* Gerdes, *supra* note 63.

75 Avery Ellfeldt, *Up Next: West Virginia AG Targets SEC Climate Proposal*, E&E NEWS (July 1, 2022), https://www.eenews.net/articles/up-next-west-virginia-ag-targets-sec-climate-proposal/ [https://perma.cc/M57M-K84Q].

76 *See Iowa v. SEC*, No. 24-1522 and consolidated cases (8th Cir.) (consolidating 10 petitions for review filed in six Circuit Courts of Appeals). Petitions also include two cases brought by Sierra Club, Sierra Club Foundation (both represented by the author), and the Natural Resources Defense Council who argue that not only did the Commission have the authority to issue a climate-related disclosure rule, it should not have weakened the proposed emissions disclosure requirements.

77 *See, e.g.,* Chamber of Commerce, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors at 40-41, 82 (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131892-302347.pdf; Letter from Patrick Morrisey, West Virginia Attorney General, to Allison Herren Lee, Acting Chair of the Securities and Exchange Commission (Mar. 25, 2021)

In early motions requesting a stay of the rule, opponents rely on mischaracterizations of the rule, hyperbolic claims of its impacts on businesses, and misrepresentation of the Commission's intent behind the rule in order to make their arguments.

In contrast to these claims, academics, securities law experts, and former SEC officials submitted comments on the proposal outlining the strong legal basis for even the more expansive proposed rule.[78] A bipartisan group of former senior SEC officials, academics, and leading securities practitioners commented that, despite their differing policy views on the proposal, the SEC has "clear statutory authority to mandate additional climate-related disclosures for publicly traded companies."[79] They note the SEC has "long mandated public-company disclosure of environmental-related matters," "has long had authority to take regulatory action in this area," existing voluntary climate-related disclosures support the need for mandatory disclosure requirements, and that any claims that the SEC lacks authority to do so are "unwarranted."[80] Likewise, Professor John Coates, recent Acting Director for the Division of Corporation Finance, provides a detailed explanation of precedents for the style of disclosures required in the proposed rule as do the Institute for Policy Integrity's comments on statutory authority.[81]

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https://ago.wv.gov/Documents/Letter%20to%20Acting%20Chair%20Lee.pdf [https://perma.cc/Y9JU-FXRA] (asserting that strict scrutiny should apply to ESG-related disclosures. disclosures and that even if it did, "mandating companies to issue statements regarding environmental, social, and governance matters which are not material to future financial performance" is not "the least-restrictive means for investors to obtain such information."); Attorneys General of the States of West Virginia, Arizona, et al., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors at 28-29 (June 15, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131409-301574.pdf *see also* Attorneys General of the States of West Virginia, Arizona, et al., Supplemental Comments on Proposed Rule Amendments on The Enhancement and Standardization of Climate-Related Disclosures for Investors (July 13, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131409-301574.pdf; Attorney General of Texas, Comment Letter on Proposed Rule: "The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132121-302606.pdf.

78 *See* Working Group on Securities Disclosure Authority Comments on Climate-Related Disclosures for Investors (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131670-302060.pdf.

79 *Id.*

80 *Id.*

81 John Coates, Comment Letter on the Proposed Rule (June 2, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20130026-296547.pdf; The Institute for

Thirty law professors specializing in securities law and capital markets regulation submitted a comment stating that the SEC has clear statutory authority to promulgate the rule.[82] Professor George Georgiev also provides compelling arguments in response to opponents' statutory authority arguments, particularly the idea that the SEC must limit its disclosure requirements by materiality.[83] First amendment scholars, Democratic state attorneys general, and others refute opponents' interpretations of First Amendment jurisprudence, finding the rule should survive First Amendment scrutiny and the opponents' application of First Amendment principles misguided.[84] Analyses of the SEC's approach to cost benefit analysis in the proposal also undercut opponents claims of inadequacy, finding the agency conducted a robust review and that the rule's benefits are well worth the costs.[85]

Policy Integrity, Madison Condon, & Environmental Defense Fund Joint Comments on Economic Analysis for the Proposed Rule (June 17, 2022), https://policyintegrity.org/documents/IPI-EDF-Condon_SEC_Comment_Letter_(Economic_Analysis)_–_06.17.2022.pdf [https://perma.cc/4A3E-Y7FJ] (commending the SEC for conducting an analysis consistent with relevant case law) .

82 Jill E. Fisch et al., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 6, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20130354-297375.pdf.

83 George S. Georgiev, Comment Letter on The Enhancement and Standardization of Climate Related Disclosures for Investors (Mar. 28, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20121510-273502.pdf.

84 *See* Rebecca Tushnet *et al.*, Comment Letter on Proposed Rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132173-302670.pdf; Rob Bonta, California Attorney General et al., Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131887-302340.pdf; Carly Oboth, Publish What You Pay, Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors (June 17, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20132165-302662.pdf.

85 *See* Shivram Rajgopal, *Why I Support the SEC's Proposed Climate Risk Disclosure Rules*, FORBES (Jun. 12, 2022), https://www.forbes.com/sites/shivaramrajgopal/2022/06/12/why-i-support-the-secs-proposed-climate-risk-disclosure-rules/?sh=282032393021 [https://perma.cc/Y9ZF-LMPW]; *see also* The Institute for Policy Integrity, Madison Condon, & Environmental Defense Fund Joint Comments on Economic Analysis for the Proposed Rule (June 17, 2022), https://policyintegrity.org/documents/IPI-EDF-Condon_SEC_Comment_Letter_(Economic_Analysis)_–_06.17.2022.pdf [https://perma.cc/4A3E-Y7FJ] (commending the SEC for conducting an analysis consistent with relevant case law).

Far from stepping into climate policy, the SEC tightly focused its rule on identifying and disclosing climate-related financial risks that could impact investment decisions, pursuant to its mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[86] As a disclosure rule, it does not ask companies to take any particular action or change any business decisions in response to climate change.[87] Rather, it acts on the demonstrated need for better, more reliable, and comparable information for investors about the financial risks companies must navigate as a result of climate change.[88] The information shared through these disclosures can support a wide range of investment strategies whether motivated purely by concerns for financial return or a desire to align one's investments with their values. The disclosures could prove equally beneficial to investors who believe significant corporate attention and expenditures related to efforts to mitigate climate-related risks are unnecessary as those concerned failure to address such risks will hinder financial performance.

The litigation over this rule has just begun but it could have substantial implications for future efforts to meaningfully respond to emerging financial issues that impact our markets. Should opponents prevail on any number of their expected claims, it could severely restrict the SEC's ability to adapt disclosure requirements to meet the needs of investors over time. This case could reach much further than the confines of this one rule.

C. California Climate-Disclosure Laws

California is also requiring companies to disclose their climate-related financial risks. In 2023, California enacted two bills that will require companies doing business in the state with revenues over a specific threshold to disclose information about their climate-related financial risks as well as their greenhouse gas emissions.[89] The Climate Corporate Data Accountability Act (SB 253) requires

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86 *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, 89 Fed. Reg. 21668 (Mar. 28, 2024).

87 *See id.*

88 *See id.*

89 Liz Goldberg et al., *California's Sweeping Climate Disclosure Laws: Possible Impact to Asset Managers*, REUTERS (Nov. 29, 2023), https://www.reuters.com/legal/legalindustry/californias-sweeping-climate-disclosure-laws-possible-impact-asset-managers-2023-11-29/ [https://perma.cc/8M2M-YBR2].

companies doing business in California with revenues of at least $1 billion to annually report their greenhouse gas emissions—scopes 1, 2, and 3—to a third-party emissions reporting organization contracted by the California Air Resources Board (CARB).[90] About 5,300 companies are expected to meet the $1 billion reporting threshold.[91] No disclosures would be required until 2026, with Scope 3 disclosures not required until 2027.[92] The Climate-Related Risk Disclosure Act (SB 261) requires companies doing business in California with revenues of at least $500 million to biennially prepare and publish a climate-related financial risk report.[93] This law is expected to cover approximately 10,000 companies.[94] The law references the Task Force on Climate-Related Financial Disclosures as the framework for reports required starting in 2026.[95] Unlike the SEC's climate disclosure rule, these disclosures apply to private as well as publicly traded companies.[96] Such disclosures would go a long way to improving the market and the state's understanding of economic risk due to climate change impacts.

The U.S. Chamber of Commerce (also a litigant in the SEC rule case) and American Farm Bureau Federation, among others, have already sued, arguing the laws "unconstitutionally compel speech in violation of the First Amendment and seek to regulate an area that is outside California's jurisdiction and subject to exclusive federal control."[97] For a variety of procedural reasons, California has asked the court to dismiss many of the plaintiffs' claims.

The California statutes were enacted pursuant to a different authority than that the SEC exercised in issuing its rule. But they do involve some similar disclosure requirements. The claims in this case overlap with the SEC case in that plaintiffs present a First

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90 *See* CAL. HEALTH & SAFETY CODE § 38532 (West 2024).

91 CERES, Fact Sheet: California's New Climate Disclosure Framework, https://www.ceres.org/sites/default/files/Ceres%20California%E2%80%99s%20New%20Climate%20Disclosure%20Framework.pdf.

92 *See* CAL. HEALTH & SAFETY CODE § 38532 (West 2024).

93 *See* CAL. HEALTH & SAFETY CODE § 38533 (West 2024).

94 *See* CERES, Fact Sheet, *supra* note 92.

95 *See* CAL. HEALTH & SAFETY CODE § 38533 (West 2024).

96 *See* CAL. HEALTH & SAFETY CODE §§ 38532-38533 (West 2024) (defining "reporting" and "covered" entities subject to the laws as those doing business in California with a certain threshold of total annual revenue).

97 *Chamber of Commerce v. Cal. Air Res. Bd.*, 2:24-cv-00801 (C.D. Cal, Feb. 22, 2024), First Amend. Compl. at para. 1.

Amendment claim in both. Should challengers find success convincing a court that climate-related disclosures violate the First Amendment in this case or the SEC case, it could have repercussions for advocacy and regulation on a wide range of important issues, substantially limiting the ability of regulators to effectively address emerging issues.

What will these three cases tell us about the future of ESG in the U.S.?

Each of these cases could impact the ability of investors to get the climate-related information (and other ESG information) needed to effectively consider climate-related risks. All three are part of a comprehensive effort to attack agency authority and corporate disclosure requirements. Their outcomes will influence whether our markets operate on full and fair disclosure of risk information or continue to allow companies to hide the ball, causing information asymmetries that increase the possibility of destructive shocks.

The challenge against DOL's 2022 Rule provides a window into the true purpose of this anti-disclosure/anti-investor campaign. The rule itself breaks no new ground, it restates the law and corrects course from the 2020 rule that imposed obligations beyond those required by statute. The agency adjusted the rule in a number of ways between proposal and finalization in response to concerns that the 2022 Rule would go beyond what ERISA intended.[98] It requires no specific consideration of ESG issues nor disclosure of them, emphasizing ERISA's requirements to operate in the interest of plan participants and beneficiaries.[99] It simply guides fiduciaries on how and when ESG factors can play a part in their investment decisions. Yet even this modest rule invited a challenge and appeal.

Plaintiffs challenging the DOL rule hint that their interest in doing so is specifically connected to their interest in propping up certain industries in explaining why they have standing to challenge the rule.[100] Energy company plaintiffs challenging the 2022 Rule argued they had standing to do so partially because consideration of ESG factors by ERISA plans "will likely move investment away from oil and gas companies like Liberty to ESG-aligned funds."[101]

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98 *See supra*, section I. B.

99 *Id.*

100 *See infra*, notes 102-105.

101 Complaint at para. 49, *Utah v. Walsh*, Case No. 2:23-cv-00016, Doc. 1 (N.D. Tex,

The energy industry trade association plaintiff asserted the 2022 Rule harms it because "asset managers, large institutional investors, and other ERISA plan managers make investment decisions or pursue an agenda that discriminates against the oil and natural gas sector based on nonpecuniary factors and politicized ESG criteria."[102] State plaintiffs argued they would suffer diminished tax revenues from retirement distributions and that as states with significant oil and gas industries, they would suffer reduced revenue from oil and gas extraction due to decreased investment in the industries as a result of the 2022 rule.[103] These statements indicate the oil and gas industry itself believes it will lose out in a market properly informed of the financial risks associated with climate change impacts.

The petitioners in the two anti-disclosure cases similarly appear to have a broader target than the disclosure requirements they are challenging. They seek to fundamentally change how the law views benign disclosure requirements designed to improve regulatory oversight or inform the market. Adoption of the petitioners' views of the First Amendment would severely undercut the ability of the SEC to correct information gaps in the market and prevent companies from manipulating information to avoid investment declines. Should they prevail on their statutory authority and major questions doctrine claims, they would limit the tools regulators have to address important new investment risks as they arise.

Conclusion

Each of these legal efforts attacks the fundamentals of a healthy, functioning open market. An adverse decision on climate disclosure rules would result in a continued information asymmetry between companies and investors on the true scope of financial risks companies face. An adverse decision on the DOL-EBSA rule could potentially force ERISA plan fiduciaries to ignore certain categories of information that impact risk and return and the interests of plan participants seeking retirement fund options that align with their values.

The market works best when important information is not hidden from it. Informed investors are less likely to face the sudden

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Amarillo Div., Jan. 26, 2023).

102 *Id*. at para. 53.

103 *Id*. at paras. 60 and 62.

prospect of a significant change of circumstances for the companies in which they invest due to a climate-related event if they have the ability to consider how well companies are managing those risks.

The legal challenges in these three matters build on a legal strategy employed by the Trump administration, particularly at the EPA, to limit federal agency regulatory authority without enacting new legislation. The Trump administration utilized rulemakings to reinterpret statutes so that they could constrain future agency action. They did not always win in court but, coupled with an aggressive effort to change the makeup of the federal courts, they laid the groundwork for what we are seeing today in challenges against the Biden administration's rulemakings. The efforts to keep ESG factors out of investing and to oppose disclosures needed to fully assess current and emerging risks are part of the broader anti-regulatory agenda playing out in federal courts.

These three cases will affect the future ability of investors to consider ESG factors in their decision-making as well as, more generally, the ability of regulators to address emerging threats under their purview. Stay tuned for the decisions to learn whether these effects will be for better or worse for the future of informed investment decision making.