The SEC's Final Climate Disclosure Rules: A Retrospective Review and Summary of Expected Challenges

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In this article, the authors explore potential legal challenges to the rules on climate disclosures that were adopted by the U.S. Securities and Exchange Commission.

The U.S. Securities and Exchange Commission (SEC) has adopted its highly anticipated final rules on climate disclosures. And now, the also highly anticipated legal challenges will assuredly follow. This article explores those potential legal challenges after situating the new rules within the SEC's past climate-related disclosure requirements. It also offers takeaways for navigating the new rules given an uncertain future.

The Past, Proposed, and Present Shape of the SEC's Climate Disclosure Rules

The SEC has a long history of requiring disclosures of environmental- and climate-related risks in SEC reports. Beginning in 1971, the SEC issued Release No. 33-5170, which stated that the SEC requirements "call for disclosure, if material, when compliance with statutory requirements with respect to environmental quality, e.g., various air, water and other anti-pollution laws, may necessitate significant capital outlays, may materially affect the earning power of the business, or cause material changes in registrant's business as done or intended to be done."[1]

About a decade later, in 1982, the SEC issued Release No. 33-6383, which required the disclosure of information relating to

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litigation and other business costs arising out of compliance with "federal, state, and local laws that regulate the discharge of materials into the environment or otherwise relate to the protection of the environment."[2]

Then, in 2010, the SEC issued Release No. 33-9106, which "remind[ed] registrants . . . that [certain climate-related] disclosure[s] . . . should be clear and communicate to shareholders management's view of the company's financial condition and prospects."[3]

More than a decade after the last update, on March 21, 2022, the SEC proposed new rules designed to make climate disclosures more "consistent, comparable, and reliable."[4] According to the SEC, the purpose of the new rules is to improve the disclosure requirements currently required under Release No. 33-9106 by standardizing the location and substance of information.[5] They required registrants to include certain climate-related disclosures in their registration statements and periodic filings, including information about climate-related risks that are reasonably likely to have a material impact on their business. This specifically included:

- Information about greenhouse gas emissions, including Scope 1 and Scope 2 greenhouse gas emissions and carbon intensity, and Scope 3 greenhouse gas emissions and carbon intensity, if those figures are material;[6]
- Climate-related costs, capital expenditures and reserves;
- Material risks related to climate change, including whether such risks are likely to manifest in the short, medium, or long-term; and
- Board and management oversight of climate-related risks, as well as the processes for identifying, assessing, and managing those risks.

On March 6, 2024, nearly two years after issuing its proposed rules, the SEC adopted its final climate disclosure rules.[7] The final rules were largely a win for issuers, as they scaled back many of the more controversial aspects of the proposed rules. Those changes include:

- Removing the requirement that issuers disclose Scope 3 greenhouse gas emissions;

- Requiring only large-accelerated and accelerated filers to disclose Scope 1 and Scope 2 greenhouse gas emissions—as opposed to the universal requirement in the proposed rules—and these companies need only disclose material Scope 1 and Scope 2 emissions;
- Modifying and lessening required climate-related risk disclosures; and
- Limiting governance disclosure requirements, including eliminating the requirement that companies identify relevant expertise of board members, the specific board members responsible for managing climate-related risk, and how the board sets climate-related goals.

In many respects, the SEC's final rules are a less-toothy version of California's climate disclosure rules and the European Union's Corporate Sustainability Reporting Directive (CSRD). Given the pro-ESG political climates in California and the European Union, those jurisdictions have pursued more aggressive climate-related policymaking, now reflected in the resulting regulations. For example, both California law and the EU's CSRD impose more stringent Scope 3 emission disclosure requirements and both mandate disclosures from a broader group of entities than those covered by the SEC's final climate rules. Both the CSRD and California's climate disclosure rules are set to go into effect in 2026.

The changes between the proposed and final climate rules were more significant than those to other recent SEC rules. For example, last year, the SEC issued final rules concerning cybersecurity[8] and "greenwashing," which is when an investment fund overstates the environmentally-friendly nature of its financial products.[9] In both instances, the final rules were largely consistent with their proposed version with minor changes focusing primarily on lessening compliance and monitoring requirements.[10] In contrast, the changes between the SEC's proposed and final climate rules are more significant. This is likely a result of the nearly 24,000 public comments to the proposed climate rules, at least in part.

Anticipated Legal Challenges

Although the SEC's final climate disclosure rules are not as stringent as their proposed version, they will still undoubtedly face

legal challenges stemming from a fractured political climate. The three most likely challenges are discussed in turn below.

Ultra Vires—An Unauthorized Expansion of the SEC's Statutory Rulemaking Authority

Opponents of the SEC's ESG agenda are likely to attack the SEC's statutory authority to mandate the disclosures in the final climate disclosure rules. The SEC's rulemaking powers are constrained by the express terms of Section 13(a) of the Exchange Act, its enabling statute. That section provides that the SEC's authority is limited to mandating public reporting that is "necessary or appropriate for the proper protection of investors and to insure fair dealing in the security."[11] In response to the proposed and final rules, opponents argued that the SEC exceeded this authority. Following publication of the proposed rules, sixteen state attorneys general wrote a letter to SEC Commissioner Gary Gensler, arguing that "legitimate mandatory disclosures [under Section 13(a)] are those required to protect investors from inflated prices and fraud, not merely helpful for investors interested in companies with corporate practices consistent with federally encouraged social views."[12] Representatives from ten of those states sued to block the SEC's final climate rules the same day they were adopted.[13]

The States' position is consistent with the position the SEC took during the Trump administration, when in 2016, the SEC noted that without specific congressional direction, it lacked the authority to require ESG-related disclosures.[14]

The SEC's position on its authority to promulgate ESG-related disclosure rules changed with the Biden administration. In 2022, the SEC posited that its proposed rules satisfy the requirement of its enabling statute because "this information can have an impact on public companies' financial performance or position and may be material to investors in making investment or voting decisions."[15] The SEC also underscored the new rules' link to materiality in its press release on March 6.[16] These references demonstrate the SEC's intent to situate its authority to promulgate rules mandating climate disclosures with its authority to promulgate Rule 10b-5, which prohibits buying or selling securities while concealing "a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[17]

It remains to be seen whether framing the final rules in this light will convince federal courts that the SEC acted within the bounds of its authority as provided by Section 13(a). Either way, this question will likely be a source of significant litigation.

The Major Questions Doctrine—The Issue's Importance Compels Congressional Direction

The SEC's final climate disclosure rules may also be challenged under the "major questions doctrine." This doctrine is used by courts to unwind agency action where "the history and breadth of the asserted authority and the economic and political significance of the agency's rule give courts reason to doubt that Congress meant to confer the authority in question." The Supreme Court has relied on the major questions doctrine twice in the past two years to invalidate administrative agencies' actions as outside their historical purview without clear direction by Congress.[18] Following the Court's recent invocation of the major questions doctrine, challenges to agency authority are expected to proliferate.

Challengers to the SEC's final climate disclosure rules will likely argue that they run afoul of the "major questions doctrine" by diverging from the SEC's historical practice of requiring disclosures only of financially material information. Even within the SEC, opponents of the rules have argued that, in contrast to prior disclosure rules, the rules "force[ ] investors to view companies through the eyes of a vocal set of stakeholders, for whom a com-pany's climate reputation is of equal or greater importance than a company's financial performance."[19] Litigants undoubtedly will seize on this perspective to argue that the SEC does not have the authority to dictate what issues beyond financials are (or should be) important to investors.

Notwithstanding the recent developments in this area, there are good reasons to believe the SEC's final climate disclosure rules will survive a "major questions doctrine" challenge. To start, a court may not view climate disclosures as having the same economic and political significance as mandating actions, such as transitioning power plants away from natural gas and coal. Further, there is long-standing acceptance of the breadth of the SEC's rulemaking authority. While the outcome of a major questions doctrine challenge is uncertain, its assertion by private litigants is almost guaranteed.

A First Amendment Violation—Impermissibly Compelled Speech

Lastly, First Amendment limitations on compelled speech may present another potential hurdle for the SEC's final climate disclosure rules. The "compelled speech" doctrine began in *West Virginia State Board of Education v. Barnette*,[20] when the Supreme Court held that a state board of education could not require school children to recite the Pledge of Allegiance because the government "cannot enforce unanimity of opinion on any topic." The Supreme Court addressed the application of the compelled speech doctrine to corporations in *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*.[21] Although corporations enjoy protections under the First Amendment, the Supreme Court has held that the "compelled speech" doctrine is not violated by government requirements that corporations disclose "purely factual and uncontroversial information" in their commercial speech as long as the disclosures are reasonably related to a legitimate government interest and are not "unjustified or unduly burdensome." Thus, historically, SEC disclosure requirements aimed at informing and protecting investors were viewed as compatible with First Amendment protections.

If faced with a compelled speech challenge, the SEC undoubtedly would argue that the climate disclosure requirements, like traditional financial reporting requirements, satisfy the *Zauderer* test.

First, the SEC's final rules would arguably seek only "purely factual and uncontroversial" information about the climate risks associated with an offered security.

Second, the required climate disclosures could be construed as reasonably related to the government's interest in providing investors with investment-relevant information.

Finally, the SEC's final rules may not be unduly burdensome because they do not prevent companies from expressing any climate-related message, and therefore do not chill protected speech.

There are, however, non-frivolous arguments that the climate disclosure rules are different in kind than mandatory financial disclosures and therefore run afoul of the compelled speech doctrine. In particular, challengers could argue that the rules compel companies to adopt the SEC's policy views as to climate change and the importance of climate-related risks to investors. This politically charged challenge in the context of climate disclosures might land differently than compelled disclosures of other information. There

could easily be variation by federal courts in applying the *Zauderer* test to the SEC's final climate disclosure rules.

Conclusion

Market participants will need to be agile and thoughtful about their climate-related disclosures in the coming months and years. While many market participants are well positioned to comply with the SEC's climate rules given their compliance with the European Union's climate disclosure laws and parallel preparations to comply with California's new climate-related rules, some are not. Those market participants should begin such preparations in earnest. This includes evaluating current climate-related risks, public-facing disclosures, and budgeting to ensure there are sufficient investments and resources available to comply with the new requirements. This may also include hiring third-party consultants to advise and implement compliance standards and governance models. But no matter the current level of preparation, market participants should not rely on a successful legal challenge to the SEC's final climate rules to excuse compliance. And all market participants, no matter their current level of preparation, should consider hiring experienced regulatory counsel to help them navigate what is certain to be a shifting legal landscape as state, federal, and international guidelines evolve.

Notes

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1. *See* S.E.C. Release Nos. 33-11042; 34-94478, The Enhancement and Standardization of Climate-Related Disclosures for Investors (Mar. 21, 2022) at 15 (hereinafter, the Proposed Rules) (citing S.E.C. Release No. 33-5170 (July 19, 1971)) (footnote omitted).

2. Proposed Rule at 16 (quoting Release No. 33-6383 (Mar. 3, 1982)).

3. S.E.C. Release No. 33-9106.

4. *See* SEC Release No. 33-11042 at 7.

5. *Id.* at 29-33, 293 (explaining that fragmented disclosure standards undermine transparency and that "[t]he primary benefit [of the new rule] is that . . . [it] is expected to enable investors to make more informed investment or voting decisions.").

6. Scope 1 emissions are "are direct [greenhouse gas] emissions that occur from sources owned or controlled by the Company." Proposed Rule at 39. Scope 2 emissions are "are those emissions primarily resulting from the generation of electricity purchased and consumed by the company." *Id.* Scope 3 emissions "are all other indirect emissions not accounted for in Scope 2 emissions," i.e., emissions that are "a consequence of the company's activities but are generated from sources that are neither owned nor controlled by the company." *Id.*

7. Securities and Exchange Commission, Final Rule The Enhancement and Standardization of Climate-Related Disclosures for Investors, 17 CFR 210, 229, 230, 232, 239, and 249, at https://www.sec.gov/files/rules/final/2024/33-11275.pdf.

8. *See* S.E.C. Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure Guide, https://www.sec.gov/corpfin/secg-cybersecurity.

9. *See* Press Release: SEC Adopts Rule Enhancements to Prevent Misleading or Deceptive Investment Fund Names, U.S. Securities and Exchange Commission (Sept. 20, 2023), https://www.sec.gov/news/press-release/2023-188.

10. For example, the SEC's final cybersecurity rule no longer requires disclosure of the name(s) of directors with cybersecurity expertise; allows incident disclosures on Forms 10-Q and 10-K, instead of a Form 8-K, as previously proposed; and no longer requires disclosure of "policies and procedures" for assessing, identifying, and managing material risks, as previously proposed, but rather a registrant's "processes" for doing so. *See* SEC Fact Sheet: Public Company Cybersecurity Disclosures; Final Rules, U.S. Securities and Exchange Commission, https://www.sec.gov/files/33-11216-fact-sheet.pdf. Similarly, like the final cybersecurity rule, the final greenwashing rule was largely consistent with its proposed version, with minor changes that lessened compliance and monitoring requirements. This included, for example, increasing the compliance period from 30 to 90 days in the event a fund's investment portfolio veers below the rule's prescribed limits. *See* Gensler Statement on Updates to the Names Rule, U.S. Securities and Exchange Commission (Sept. 20, 2023), www.sec.gov/news/statement/gensler-statement-names-rule-092023.

11. 15 U.S.C. § 78m(a).

12. Letter from Patrick Morrisey, Attorney General of West Virginia, to Gary Gensler, Chair of the U.S. Securities and Exchange Commission (June 14, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8915606-244835.pdf.

13. *See* State of West Virginia et al. v. U.S. Securities and Exchange Commission, No. 24-10679, Dkt. No. 1 (11th Cir.) (Petition for Review filed by ten states requesting that the Court of Appeals "declare and vacate the Com-mission's final action" because "the final rule exceeds the agency's statutory authority and . . . [is] not in accordance with law.").

14. *See* 81 Fed. Reg. at 23,970 ("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.").

15. The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,335 (Apr. 11, 2022).

16. SEC.gov, SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors.

17. 17 C.F.R. § 240.10b-5.

18. *See* Biden v. Nebraska, 600 U.S. 477 (2023) (embracing the "major questions doctrine" and holding that the EPA lacked authority to implement the Clean Power Plan, a plan promulgated to reduce carbon dioxide emissions in coal and natural gas power plants by forcing the plants to reduce or change their energy source).

19. Statement from Commissioner Hester M. Peirce, We Are Not the Securities and Environment Commission—At Least Not Yet (Mar. 21, 2022), https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321.

20. West Virginia State Board of Education v. Barnette, 319 U.S. 1178 (1943).

21. Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 651 (1985).