Reuters Legal News

Will the SEC's proposed climate risk disclosure rules survive Supreme Court scrutiny?

By Jonathan D. Uslaner, Esq., and Will Horowitz, Esq., Bernstein Litowitz Berger & Grossmann LLP

AUGUST 5, 2022

On June 30, 2022, the Supreme Court issued a landmark opinion in *West Virginia v. EPA* that substantially limited the authority of the Environmental Protection Agency (the EPA) to regulate carbon emissions from power plants. Because the opinion concerned the proper scope of executive agency rulemaking, the decision may have profound effects on other regulatory agencies, including the Securities and Exchange Commission.

The *West Virginia* decision concerned a rule introduced by the EPA during the Obama administration regarding power plant emissions. The Court considered whether the EPA could introduce rules related to climate change without express authorization from Congress. The six-member majority of the Supreme Court held that the EPA could not.

After the Supreme Court's decision in West Virginia*, many in the legal community have argued that the SEC's proposed climate rules are doomed.*

The Court's reasoning rested on the "major question doctrine." Under that doctrine, executive agencies may enact rules relating to questions of major national significance only if they have explicit congressional authorization. The Court held that the EPA's climate change rules implicated the "major question doctrine" and required Congressional authorization for the EPA to act.

Many legal commentators wonder if the Supreme Court will next turn its attention to the Securities and Exchange Commission (SEC) and, specifically, its disclosure rules around climate change. The SEC is currently in the process of promulgating rules that would require public companies to increase their disclosures relating to climate risk.

Under the SEC's proposed rules, companies listed on U.S. stock exchanges would need to disclose the greenhouse gas emissions that they directly and indirectly cause if the emissions are "material" or included in a company-set emissions target. Emissions caused directly by a company are referred to as "Scope 1" or "Scope 2" emissions, while emissions generated by a company's supply chain are referred to as "Scope 3" emissions.

When the SEC announced its proposed disclosure rules earlier this year, the financial press hailed them as a boon for investors and the environment. The SEC's proposed climate risk rules are an important step for investor protection as climate change becomes an increasing reality. Climate risks are significant to nearly all public companies — from risks to their physical infrastructure to economic risks arising from climate-centric legislation. After the Supreme Court's decision in *West Virginia*, however, many in the legal community have argued that the SEC's proposed climate rules are doomed.

In *West Virginia*, Chief Justice John Roberts found it persuasive that Congress previously considered granting the EPA the power to enact rules on climate change, but declined to do so. Opponents of the SEC's proposed climate risk rules were quick to point out that Congress similarly rejected laws that would have required company disclosures — like those proposed in the SEC's climate change rules.

Indeed, the Climate Disclosure Acts of 2018, 2019 and 2022 — none of which were enacted — each proposed legislation that would have directed the SEC to issue rules requiring public companies to disclose their direct and indirect greenhouse gas emissions. As such, there is an argument that Justice Roberts' reasoning in *West Virginia* is directly applicable to the SEC's proposal for heightened disclosure of climate risks.

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Additionally, the Court in *West Virginia* found it persuasive, in assessing whether the EPA's proposed rule went beyond the agency's authority, that the EPA's interpretation of the Clean Air Act was at odds with its historical interpretation of the Clean Air Act.

Opponents of the SEC's proposed climate disclosure risk rules argue that the SEC's proposal similarly conflicts with the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act). Specifically, they claim that the proposed disclosure rules alter the "materiality" requirement set forth in both of these Acts.

In particular, opponents of the rules argue that requiring companies to disclose "Scope 3" emissions — i.e., pollution by companies within the regulated corporation's supply chain — goes too far. This requirement, the rules' opponents claim, modifies the "materiality" requirement of the 1933 and 1934 Acts, requiring disclosures of matters immaterial to investors.

There are compelling reasons, however, to believe the Supreme Court's reasoning in *West Virginia* will not impact the SEC's proposed climate change disclosure rules. Significantly, in enacting its climate change rule, the EPA relied on a statutory provision that is rarely used to enact rules.

By contrast, the Securities Act of 1933 and the Securities Exchange Act of 1934 are the core statutes under which the SEC promulgates rules. As SEC Chairman Gary Gensler explained in announcing the proposed climate risk disclosure rules, the SEC acted as it always had, pursuant to these statutes: requiring disclosures of publicly listed companies to protect investors.

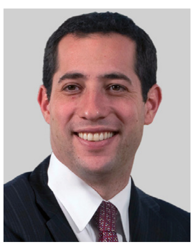
Additionally, climate change may not necessarily be considered a "major question" in the securities context. The *West Virginia* Court reasoned that Congress' silence as to whether the EPA — the primary federal agency responsible for environmental regulation — had authority to regulate climate change was evidence that the agency did not have that power.

By contrast, investor protection necessarily extends to a diverse range of topics. As such, while climate change rules may be off the table for the EPA, they may not be for the SEC. As SEC chair Gensler explained in announcing the SEC's proposed climate change rule, the principle of investor protection "applies equally to ... environmental-related disclosures" and is consistent with the SEC's historical rulemaking on environmental topics.

Over the next months, investors and public corporations will wait to see whether the SEC's proposed climate risk rules will come into force. It is possible that, in the wake of the *West Virginia* decision, Congress gives the SEC clear statutory authority to require disclosures related to climate change. However, this possibility is increasingly unlikely, given congressional deadlock and the politicization of climate issues. It is more likely that the SEC enacts the proposed rules without modification, leading to a lengthy legal challenge and, ultimately, the possibility of another decision by the Supreme Court on the scope of agency rule-making power.

Jonathan D. Uslaner is a regular contributing columnist on securities litigation for Reuters Legal News and Westlaw Today.

About the authors



Jonathan D. Uslaner (L) is a partner at **Bernstein Litowitz Berger & Grossmann LLP**, where he prosecutes class and direct actions on behalf of institutional investor clients. He is based in the firm's Los Angeles office and can be reached at jonathanu@blbglaw.com. **Will Horowitz** (R) is an associate practicing in the securities litigation department of the firm. Based in the firm's New York office, he represents institutional investor clients in securities fraud-related matters. He can be reached at will.horowitz@blbglaw.com.

This article was first published on Reuters Legal News and Westlaw Today on August 5, 2022.