LEGAL MEMO

State Attorneys General Can Fight the "Woke" SEC

To: FGA Partners

From: David Craig, *Senior Legal Fellow*, Foundation for Government Accountability

Background

In keeping with the Biden administration's radical environmental agenda, the Securities and Exchange Commission (SEC) proposed an expansive, 490-page rule that requires disclosure by public companies of information that goes far beyond what has previously been required, including information related to the company's "climate-related risks."[1] This ambiguous demand by the SEC is one of the numerous costly problems with the proposed rule. The Foundation for Government Accountability (FGA) recently published a paper exposing its many perils.[2] Known as the "The Enhancement and Standardization of Climate-Related Disclosures for Investors," the rule is one of the latest salvos against the fossil fuel industry and the complex supply chain that utilizes it. The rule also further lurches the U.S. toward a social credit system, that is, using "woke" environmental, social, and governance (ESG) factors as a grading scale on which companies should succeed or fail.

Federal law generally requires disclosures conforming to the "materiality" standard, to which the SEC has adhered for decades.[3] This standard requires public companies to disclose information where "there is a substantial likelihood that a reasonable person would consider it important."[4] But the proposed rule goes far beyond requiring disclosure of material information, which not only presents an enormous burden for employers, but also threatens to obscure material information in a pile of junk disclosures.

The unprecedented level of information demanded in the proposed rule includes items like company "climate-related" risks with their actual or likely effects, the company's relevant risk management processes, company greenhouse gas emissions, and certain climate-related financial metrics. The SEC itself has estimated that the cost for a company just to comply with the new rule will be in the hundreds of thousands of dollars in the first year alone.[5] Conservative estimates are that industry-wide compliance with SEC disclosure rules will range from $3.9 billion to $10.2 billion.[6] The SEC further admits in its economic analysis that *investors* will also be "likely affected" by the rule.[7]

State attorneys general have a major role to play in fighting this insidious policy. The U.S. Supreme Court has held that "[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."[8] The proposed rule goes far beyond what the SEC is authorized by Congress to regulate, and it is aimed at putting pressure on corporations to change their behavior to conform to the Biden administration's attitudes on climatology.

Attorneys general are already winning fights against ESG

It's important to note that attorneys general are already doing important work to combat ESG. Last year, a group of state attorneys general, led by West Virginia Attorney General Patrick Morrisey, provided pointed comments to the SEC about the flawed rule.[9] Another group of attorneys general, led by former Missouri Attorney General Eric Schmitt (now a United States Senator), launched an investigation into the ESG ratings process.[10] Further, Texas Attorney General Ken Paxton is leading an investigation into ESG lending practices.[11] These actions are necessary in defending the rights of their citizens and protecting the economies of their states. All state elected officials should be vigilant against ESG policies, and even more can be done by attorneys general to defeat dangerous ESG policies.

Legal Action for State Attorneys General to Consider

The SEC's unconstitutional proposal will damage employers and state economies, but state attorneys general can help fight this unconstitutional power grab by the Biden administration.

Should the SEC's proposal go into effect, there are several legal theories under which attorneys general can file lawsuits—including First Amendment free speech claims as well as Administrative Procedure Act claims.

Attorneys general should consider these legal strategies to defend their state's authority and the rights of their citizens:

Violation of the First Amendment: *The government is unconstitutionally compelling speech*

The SEC proposal infringes on the free speech rights of corporations. As noted by SEC Commissioner Hester Peirce, "[t]he Supreme Court has made clear that corporations do enjoy protections under the First Amendment's freedom of speech clause, but also has concluded that the government is subject to lesser scrutiny—and therefore has greater leeway—when requiring companies to disclose 'purely factual and uncontroversial information.'"[12] But the ESG information that the SEC seeks to have businesses disclose is anything but "purely factual and uncontroversial." The SEC rule is extremely controversial since the agency is turning the "material" information standard for disclosure on its head, and it is clearly seeking to use disclosed information to cajole companies into compliance with leftist climate ideology edicts not authorized by Congress. The Supreme Court has held this type of speech coercion by the government unconstitutional.[13]

If the SEC goes forward with these requirements, state attorneys general should consider using their *parens patriae* (parent of the country) authority—if so authorized by state law—to bring First Amendment claims against the agency on behalf of corporations organized in their state.[14] Modern court actions have helped pave the way for such an action where a state's "quasi-sovereign" interests are involved.[15] Such an action would defend corporations against the broad negative economic consequences of coercing corporations into accepting ESG dogma to their own fiduciary peril. It would also serve to protect the state's "rightful status within the federal system" by maintaining state authority to govern corporations in its boundaries where Congress has not otherwise acted.[16]

Violation of Major Questions Doctrine: *Only Congress can authorize this rule, and it hasn't*

The quasi-sovereign interests triggered by the SEC also provide attorneys general with options to sue under the Major Questions Doctrine, particularly in light of the U.S. Supreme Court decision in *West Virginia v. EPA*.[17] In that case, the Court noted that "[i]t is presumed that Congress intends to make major policy decisions itself, not leave those decisions to agencies" and that in extraordinary cases, "something more than a merely plausible textual basis for the agency action is necessary."[18] [19]But with the proposed rule, the SEC is making *dramatic* changes to the regulatory scheme that require it to "point to clear congressional authorization to regulate in that manner," which it cannot do.[20] As such, a Major Questions Doctrine-based lawsuit is particularly appropriate for states to utilize in fighting the rule.

Violation of the Administrative Procedures Act: *The SEC isn't the right agency to promulgate environmental rules*

Attorneys general should also consider using *parens patriae* authority to bring a suit against the SEC under 5 U.S.C. § 706(2)(A) and § 706(2)(B), the Administrative Procedures Act (APA). Under these sections of the APA, a federal court is to set aside agency actions that are arbitrary, capricious, or an abuse of discretion (§ 706(2)(A)) or if the agency action is contrary to a constitutional right (§ 706(2)(B)). It is clear that the rule will harm states due to the aforementioned fiscal impact on state public companies and that the rule is arbitrary in nature and in excess of what the SEC is statutorily authorized to regulate. As mentioned, the SEC's actions also compel corporate speech in clear violation of the First Amendment. As such, attorneys general have a strong case against the SEC utilizing the APA.

Further, such a case should escape *Chevron* review by a court since a hallmark of *Chevron* is that "considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer."[21] Unfortunately for the SEC, Congress never gave it authority over environmental policy and practices for businesses, nor does the agency have the expertise to provide environmental regulation.[22] Because it is clear that Congress never gave the SEC authority over climate issues, it is clear that the SEC should not be given deference in the administration of ESG climate regulations.

Conclusion

If the SEC rule goes into effect, state attorneys general have a solid footing upon which to fight it in court. The Biden administration has shown that it will be a tireless force for moving the U.S. economy toward decline. But attorneys general can stand firm on the Constitution and stop them.

References

1. Securities and Exchange Commission, "The Enhancement and Standardization of Climate-Related Disclosures for Investors", Release Nos. 33-11042; 34-94478 (Mar. 21, 2022), [hereinafter *Proposed Rule*] https://www.sec.gov/rules/proposed/2022/33-11042.pdf.
2. Michael Greibrok, "The SEC's Climate-Related Disclosures Rule Puts Special Interests Ahead of Its Mission and Everyday Investors, The Foundation for Government Accountability (2023), https://thefga.org/research/sec-puts-special-interests-ahead-of-everyday-investors/.
3. Securities and Exchange Commission, "SEC Staff Accounting Bulletin: No. 99" (Aug. 12, 1999) https://www.sec.gov/interps/account/sab99.htm.
4. *Id.*
5. *See* Proposed Rule at page 373.
6. Jean Eaglesham, "Fight Brews Over Cost of SEC Climate-Change Rules," The Wall Street Journal, (May 17, 2022), https://www.wsj.cm/articles/fight-brews-over-cost-of-sec-climate-change-rules-11652779802.
7. See Proposed Rule at page 295.
8. *Santa Fe Indus. v. Green*, 430 U.S. 462, 464 (1977), (emphasis in original, quoting *Cort v. Ash*, 422 U.S. 66, 84 (1975)). https://supreme.justia.com/cases/federal/us/430/462/.
9. Letter from 24 State Attorneys General to Secretary Vanessa A. Countryman, Securities and Exchange Commission, regarding the Proposed Rule, (June 15, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131409-301574.pdf.
10. Ross Kerber, "Eighteen U.S. states join Missouri probe into Morningstar ESG, Reuters, August 17, 2022, https://www.reuters.com/world/us/eighteen-us-states-join-missouri-probe-into-morningstar-esg-2022-08-17/.
11. Texas Attorney General Ken Paxton Press Release, "Paxton Launches Investigation Into Six Major Banks For Collusion-in-Lending Practices That Potentially Violate Consumer Protection Laws, (October 19, 2022), https://www.texasattorneygeneral.gov /news/releases/paxton-launches-investigation-six-major-banks-collusion-lending-practices-potentially-violate.
12. Commissioner Hester Peirce, Securities and Exchange Commission, "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.
13. See *Nat'l Ass'n of Mfrs. v. SEC*, 800 F.3d 518, 530 (2015), "[r]requiring a company to publicly condemn itself is undoubtedly a more effective way for the government to stigmatize and shape behavior than for the government to have to convey its views itself, but that makes the requirement more constitutionally offensive, not less so." https://cite.case.law/f3d/800/518/6055335/.
14. *See Aziz v. Trump*, 231 F. Supp. 3d 23, 31 (E.D. Va. 2017), noting that in light of the holding in *Massachusetts v. EPA*, 549 U.S. 497 (2007) allowing the state to challenge the agency's failure to regulate carbon dioxide, "[a] state is not be [*sic*] barred by the Mellon doctrine from a parens patriae challenge to executive action when the state has grounds to argue that the executive action is contrary to federal statutory or constitutional law." https://casetext.com/case/aziz-v-trump-1.
15. *See Alfred L. Snapp & Son v. Puerto Rico*, 458 U.S. 592, 607 (1982) holding that a state has a "quasi-sovereign interest in the health and well-being – both physical and economic – of its residents in general" and that it "has a quasi-sovereign interest in not being discriminatorily denied its rightful status within the federal system." https://supreme.justia.com/cases/federal/us/458/592/.
16. *See Id.*
17. 142 S. Ct. 2587 (2022). https://www.supremecourt.gov/opinions/21pdf/20-1530_n758.pdf.
18. *Id*. at 2609 quoting United States Telecomms. Ass'n v. FCC, 855 F.3d 381, 419 (2017) (Kavanaugh, J., dissenting from denial of rehearing en banc).
19. *Id.* at 2609.
20. *Id*. at 2614.
21. *Chevron, U.S.A, Inc. v. NRDC, Inc*. 467 U.S. 837, 844 (1984). https://supreme.justia.com/cases/federal/us/467/837/#tab-opinion-1955635.
22. *See PDK Labs. Inc. v. DEA*, 362 F.3d 786, 798 (D.C. Cir. 2004) quoting *Arizona v. Thompson*, 281 F.3d 248, 254 (D.C. Cir. 2002) holding that "deference to an agency's interpretation of a statute is not appropriate when the agency wrongly 'believes that interpretation is compelled by Congress.'" https://law.justia.com/cases/federal/appellate-courts/F3/362/786/632840/.