ATTORNEY GENERAL OF MISSOURI
ERIC SCHMITT

June 14, 2021

The Honorable Gary Gensler
Chairman
Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549

Re: March 15, 2021 Public Input on Climate Change Disclosures and Remarks for the Center for American Progress, *A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC*

Dear Chair Gensler,

I write to express my concerns about compelling disclosures on climate related risks that are unrelated to material risks for individual issuers, a proposal that exceeds the SEC's authority and threatens to politicize corporate disclosures. This proposed path shuns the gold standard of federal securities disclosure law (materiality), exceeds the SEC's expertise and mission, unnecessarily increases compliance costs, and violates free-speech principles. Moreover, in light of Commissioner Lee's recent public comments, this proposal appears to be an ill-advised first step in an attempt politicize the SEC as she would require "human capital disclosure to encourage the reporting of specific metrics like workforce diversity," "more specific guidance or rulemaking on board diversity," and consider "[p]olitical spending disclosure … key to any discussion of sustainability."[1] These efforts are far removed from the Commission's mission to "protect[] Main street investors," "maintain[] fair, orderly, and efficient markets, and facilitat[e] capital formation."[2]

ESG (Environmental, Social, and Governance) investing is nothing new, as activists have long attempted to inject their political and policy preferences on public companies. Earlier branding promoted "socially responsible investing" and SRI funds rose to prominence in the 1970's and 1980's opposing investments in defense firms in opposition to the Vietnam War and companies operating in South Africa during apartheid.[3] At that time, the Commission determined

[1] Allison Herren Lee, Acting Chair, Sec. & Exchange Comm'n, Remarks for the Center for American Progress, *A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC* (Mar. 15, 2021) available at https://www.sec.gov/news/speech/lee-climate-change.
[2] *What we do*, Sec. & Exchange Comm'n, https://www.sec.gov/about/what-we-do (modified Dec. 18, 2020).
[3] Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 392–93 (2020).

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that required "disclosure of information describing corporate social practices" was not appropriate. *Environmental and Social Disclosure: Notice of Commission Conclusions and Rulemaking Proposals*, 40 F.R. 51,656 at 51,656–57 (1975). The Commission explained that those "who expressed interest as investors in social disclosure stated that they would use such information in determining how to note their proxies or otherwise to act to influence management policies, rather than to make investment decisions." *Id.* at 51,664.

In the field of environmental disclosures, the Commission requires that companies disclose "environmental compliance reports which indicate that the registrant has failed to satisfy, at any time within the previous twelve months, environmental standards established pursuant to a federal statute." *Id.* at 51,663. In doing so, it noted that these disclosures may already be "material." *Id.* But the Commission rejected calls to require "comprehensive disclosure of the environmental effects of corporate activities," because investor interest was "primarily whether corporations are acting in an environmentally unacceptable manner." *Id.* at 51,662. The Commission further explained that "the costs to registrants and the administrative burdens … would be excessive"; that there was "no established, uniform method by which the environmental effects of corporate practices may be comprehensively described"; and that there is no "scientific agreement as to the harmfulness to the environment of many activities." *Id.*

These principles remain applicable today. Climate change metrics and "green" scores assist political activists in pressuring companies to change policies to meet the activists' demands. These kinds of disclosure would fuel "boycotts, demonstrations, and social media campaigns against 'brown' companies."[4] The questions for consideration underscore the large costs and administrative burdens that climate change disclosure rules would have on all issuers of securities:

- What are the advantages and disadvantages of establishing different climate change reporting standards for different industries?
- Should disclosures be tiered or scaled based on the size and/or type of registrant?
- What about a single set of global standards applicable to companies around the world?
- How should registrants disclose their internal governance and oversight of climate-related issues?

These selected questions indicate the complexity and far reaching reporting system that each issuer may be forced to navigate just to determine what disclosure rules apply to them. These do not even include issues about the scope of supply chains and what supply chain activities must be attributed to the issuer, what the EPA brands Scope 3 emissions. Scope 3 emissions "are the result of activities from assets not owned or controlled by the reporting organization, but that the organization indirectly impacts in its value chain."[5] These are "emissions of another organization" that "*often represent the majority* of an organization's [greenhouse gas] emissions."[6] In addition to the taxonomy of Scope 1 and 2 emissions, Scope 3 emissions "fall within 15 categories, though

[4]Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG* at 9, COL. L. & BUS. REV. (forthcoming 2021), included in Mahoney Comment of June 1, 2021.

[5] EPA Center for Corporate Climate Leadership, *Scope 3 Inventory Guidance*, available at https://www.epa.gov/climateleadership/scope-3-inventory-guidance.

[6] *Id.*

not every category will be relevant to all organizations."[7] Commissioner Roisman has highlighted that "the potential scope and novelty of the 'E' and certain 'S' categories" have greater potential for compliance costs and increased liability for issuers.[8] Mandatory disclosures, especially those about other companies emissions, will only increase compliance and legal costs and create significant barriers to capital for all but the most sophisticated and wealthy companies.

In many cases, there is no consensus on how corporate activities affect the environment or how investors value such information. Commissioner Lee's remarks recognize that issuers face "competing and potentially conflicting demands for information" but fails to recognize those demands reflect the uncertainty of climate predictions and the lack of consensus on potential harms. Even on such heavily debated questions as to how to price the effects of one additional ton of carbon emissions, the U.S. Government's flawed 2021 estimates range from $14 to $152 in 2020, up from its 2010 projections of $6.80 to $80.70.[9] Some academics have even shown that some carbon emissions would actually benefit global GDP and cause this price to be *negative*.[10] Even solutions to automobile carbon emissions, like lithium batteries, have environmental impacts such as depriving local farmers of water and contaminating streams and the air.[11] The SEC has no expertise and is simply not positioned to evaluate the scale of threatened climate change, the quantity or quality of potential environmental impacts, and how corporate actions increase or decrease those impacts in any meaningful way.

Efforts to require specific climate-related disclosures will dilute the "gold standard" of disclosure: materiality. A statement of fact is "material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). But materiality is not determined in a vacuum; it is a fact-specific inquiry that requires weighing the "total mix" of available information. *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988). As the Business Roundtable pointed out in 2015, the materiality standard best protects investors because it filters out irrelevant information, requires companies to disclose risks specific to their operations and industries, and prevents ossification in disclosures—the materiality standard is "dynamic and respond[s] to changing circumstances."[12] Just this year we have seen how materiality forces companies to adjust to the times, disclosing

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[7] *Id.*

[8] Elad L. Roisman, Commissioner, Sec. & Exchange Comm'n, *Putting the Electric Cart before the Horse: Addressing Inevitable Costs of a New ESG Disclosure Regime* (June 3, 2021) available at https://www.sec.gov/news/speech/roisman-esg-2021-06-03.

[9] *See* Interagency Working Group on Social Cost of Greenhouse Gases, Technical Support Document at 5 (February 2021) available at https://www.whitehouse.gov/wp-content/uploads/2021/02/TechnicalSupportDocument_SocialCostofCarbonMethaneNitrousOxide.pdf; Interagency Working Group on Social Cost of Carbon, Technical Support Document at 1 (February 2010) available at https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/ for-agencies/Social-Cost-of-Carbon-for-RIA.pdf.

[10] Dayaratna, McKitrick, & Michaels, *Climate sensitivity, agricultural productivity and the social cost of carbon in FUND*, 22 Env't Econ. And Pol. Studies 433 (Jan. 18, 2020).

[11] Amit Katwala, *The spiralling environmental cost of our lithium battery addiction*, WIRED UK (Aug. 5, 2018) available at https://www.wired.co.uk/article/lithium-batteries-environment-impact.

[12] Business Roundtable, *The Materiality Standard for Public Company Disclosure: Maintain What Works*, at 7–8 (Oct. 29, 2015) available at https://s3.amazonaws.com/brt.org/archive/reports/BRT.The%20Materiality%20Standard%20for%20Public%20Company%20Disclosure.2015.10.29.pdf

material risks related to the coronavirus pandemic.[13] But requiring climate or other disclosures without regard to materiality would "bring an overabundance of information" and "lead management 'simply to bury the shareholders in an avalanche of trivial information.'" *Id.* (quoting *TSC Indus.*, 426 U.S. at 448–49. This would only burden the reasonable investor's time and attention.

Climate-related mandatory disclosures raise at least three more concerns. First, even well-intentioned mandatory disclosures impose costs and increase barriers to capital. For example, Congress requires that public companies disclose whether their products "contain minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo" to reduce extreme levels of violence in the DRC. 15 U.S.C. 78m(p). Initial implementation of the provisions was estimated to cost public companies \$3 to \$4 billion.[14] Such prohibitive costs drove public companies to avoid doing business in that region, causing an "embargo in fact on the legitimate mineral trade."[15] This rule has been criticized as "a case study in how good intentions can go awry, particularly when a compelling activist sponsored narrative substitutes for considered and timely analysis."[16] The same applies here, except a climate disclosure regime would dwarf the conflict mineral rule disclosures.

Second, adding climate related disclosures would not benefit the reasonable investor. To the extent that climate related risks or benefits are material to a company's operations or outlook, the current regulatory scheme requires disclosure. Items 101, 103, 105, and 303 on Regulation S-K reflect these potential disclosures. *See* Sec. & Exchange Comm'n, Guidance Regarding Disclosures Relating to Climate Change, Release Nos. 33-9106, 34-61469, at 12–19 (Feb. 8, 2010). The Acting Chair's claim that investor demand for environmental information is not being met in the absence of a mandatory framework has no basis in fact. It is well documented that a variety of ESG ratings firms have sprung up and companies are spending more time than ever providing this information to the public.[17] As she notes, "ESG risks and metrics now underpin many traditional investment analyses on investments of all types." As those climate-related disclosures related to a company's risk-return are generally material, there is little work to be done aside from standardizing virtue signaling. Moreover, although evidence supports that certain governance factors can have a significant effect on firm performance, environmental and social factors show mixed results and may not adequately reflect regulatory and political risk.[18]

Third, mandatory disclosures on ESG factors (including climate-related ones) of the kind Commissioner Lee describes would violate the First Amendment. Commissioner Peirce and academics note that ESG factors are not a readily definable group of policies and encompass many

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[13] Elad L. Roisman, Commissioner, Sec. & Exchange Comm'n, *Keynote Speech at the Society for Corporate Governance National Conference* (July 7, 2020) available at https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020.
[14] Business Roundtable, *supra* note 7, at 10.
[15] *Id.*
[16] *Id.* at 11.
[17] *E.g.*, MSCI ESG Ratings Corporate Search Tool (https://www.msci.com/our-solutions/esg-investing/esg-ratings/esg-ratings-corporate-search-tool); S&P Global (https://www.spglobal.com/esg/scores/); Sustainalytics (https://www.sustainalytics.com/esg-ratings/).
[18] *Id.* at 434–34.

broad topics.[19] ESG factors often "hew to [] what a select group of stakeholders believe to be good or moral behavior."[20] Compelling disclosures around a uniform set of principles violates the First Amendment. *West Virginia State Bd. of Educ. v. Barnette*, 319 U.S. 624, 642 (1943) ("If there is any fixed star in our constitutional constellation, it is that no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion or force citizens to confess by word or act their faith therein."). Strict scrutiny applies to such content-based regulations. *Reed v. Town of Gilbert*, 576 U.S. 155, 159 (2015). And Justice Breyer has observed that "the regulatory spheres in which the Securities and Exchange Commission or the Federal Trade Commission operate are defined by content." *Barr v. Am. Ass'n of Pol. Consultants, Inc*, 140 S. Ct. 2335, 2360 (2020). Bending to the will of activist investors and money managers to compel climate-related disclosures, especially ones that favor "green" companies or punish "brown" ones, will lead to failure.

Once, a non-partisan SEC recognized that compelling environmental and social disclosures over and above the materiality requirement would not assist the reasonable investor in making the decision to invest—and it was right. Hewing to the neutral materiality standard is the best way to protect all investors and promote efficient markets. The Commission has no business regulating capital markets by favoring one set of climate values and investors over another.

Sincerely,

Eric S. Schmitt

Eric. S. Schmitt
Missouri Attorney General

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[19]Hester M. Peirce, *SEC Commissioner Airs Her Beef With Stakeholders*, The CLS Blue Sky Blog (July 26, 2018) available at https://perma.cc/PV6N-R9LT.
[20] *Id.*