Potential Legal Challenges to the SEC's Climate Disclosure Rule

March 14, 2024

On March 6, 2024, the Securities and Exchange Commission ("SEC") adopted final rules to require registrants to disclose certain climate-related information in registration statements and annual reports (the "Rule"). In the last week, seven suits challenging the Rule have been filed. These include three suits now consolidated in the Fifth Circuit, brought respectively by state attorneys general, two energy companies, and oil industry groups. In addition, state attorneys general filed in the Eighth and Eleventh Circuits, the Ohio Bureau of Workers' Compensation with two state attorneys general in the Sixth Circuit, and the Sierra Club in the D.C. Circuit.

This Debevoise In Depth reviews various potential bases for legally challenging the Rule, including under the Administrative Procedures Act, Major Questions Doctrine, First Amendment, and nondelegation doctrine. We do not address here all potential objections, such as the Sierra Club's recent claim regarding the Rule's inadequacy.

Notwithstanding the existing and expected challenges to the Rule, we recommend that all public companies consider the Rule's application to their organizations and begin taking the steps necessary to comply. This is especially important for large accelerated filers, which will need to implement additional accounting controls under the new Article 14 of Regulation S-X for their fiscal year beginning in 2025.

Bases for Legal Challenge

Parties opposing the Rule have 60 days from the Rule's publication in the Federal Register to petition for judicial review in federal courts. Although such petitions need not enumerate the bases for challenge, we anticipate litigants will raise one or more of the following.

Administrative Procedures Act

Under the Administrative Procedures Act ("APA"), among other bases, courts must set aside agency action found to be (1) arbitrary and capricious, (2) in excess of an agency's

statutory authority, or (3) promulgated without observance of the procedure required by law. Opponents of the Rule therefore may challenge it on any or all of these bases. For example, the petition filed by the state attorneys general in the Eleventh Circuit raises all three APA grounds.

First, opponents may argue that the Rule is arbitrary and capricious because the SEC failed sufficiently to take public comments into account, justify the Rule's purported benefits, or conduct an adequate cost-benefit analysis. A recent Fifth Circuit decision, *Chamber of Commerce v. SEC*, could provide a blueprint for such a challenge. In that case, the court held that the SEC acted arbitrarily and capriciously as it "failed to respond to petitioners' comments and failed to conduct a proper cost-benefit analysis" in finalizing the share repurchase disclosure rule. Potential litigants are undoubtedly assessing the adequacy of the Commission's response to the more than 24,000 comment letters the SEC noted it had received, as well as the metrics used for the Commission's cost-benefit analysis.

Second, opponents may argue that the Rule's detailed and extensive climate-related disclosure requirements exceed the SEC's statutory rulemaking authority. According to its authorizing statutes, the SEC may promulgate rules or regulations requiring disclosure on certain enumerated topics, and of information that it believes is "necessary or appropriate in the public interest or for the protection of investors." Notably, Congress itself statutorily expanded the subject matter of mandatory disclosures to include topics such as executive compensation, corporate governance, and conflict minerals. Opponents therefore may argue that the SEC cannot impose climate-related disclosure requirements without a similar statutory directive from Congress. In addition, opponents may point to Congress's mandate for the EPA's Greenhouse Gas Reporting Program to challenge the SEC's authority on climate-related disclosures. The SEC, by contrast, has sought to justify the Rule by underscoring its responsibility to harmonize and standardize the market's wide range of voluntary and mandatory climate-risk reporting in accordance with the SEC's statutory mandate of protecting investors.

Third, as previewed by Commissioners Hester Pierce and Mark Uyeda during the meeting announcing the Rule, opponents may challenge the Rule under the APA by asserting it substantially changed relative to the proposed rule and thus did not allow the public adequate notice and opportunity to comment. Among the most significant changes from the proposed rule, the Rule omits mandatory Scope 3 emissions disclosure, significantly pares back required financial statement disclosure, and subjects many of the Rule's elements to a "materiality" qualifier.

According to the Supreme Court, in order to adhere to the APA's fair notice requirements, the final rule must be a "logical outgrowth" of the proposed rule. Circuit courts have interpreted this standard differently. According to the Fifth Circuit, "the

logical-outgrowth test requires that the proposed rule fairly apprises interested persons of the subjects and issues the agency is considering. . . . [T]he Proposed and Final Rule must be alike in kind so that commentators could have reasonably anticipated the Final Rule." Likewise, the Eleventh Circuit has reasoned that a "rule is deemed a logical outgrowth if interested parties should have anticipated that the change was possible, and thus reasonably should have filed their comments on the subject during the notice-and-comment period." Foreseeability is a touchstone when determining whether a Final Rule must be reopened for notice and comment.

Major Questions Doctrine & Chevron Deference

Another expected avenue for challenge is the major questions doctrine ("MQD"), a judicially created doctrine according to which courts should be "skeptical" of agency efforts to regulate matters of "vast economic and political significance." According to the MQD, if such a major question is involved, courts should require that the agency point to "clear congressional authorization" of the proposed regulation.

Both the Supreme Court and the Fifth Circuit have embraced the MQD on a wide range of subjects, with the Supreme Court recently applying the doctrine to invalidate environmental regulations in *West Virginia v. EPA*. In that case, the Court overturned regulations that imposed emissions caps on coal-fired power plants on the basis that such an industry-wide change violated the MQD. According to the majority in the *West Virginia* decision, there is "little reason to think Congress assigned such decisions" to the EPA via the Clean Air Act.

Relatedly, opponents of the Rule may argue that the SEC's imposition of mandatory climate-related disclosures constitutes a major question and that Congress has not clearly authorized the SEC to act in this area. Indeed, if the new rule is found to constitute a major question, it could be difficult for the SEC to argue that Congress has spoken clearly to confer to the SEC the authority to promulgate regulations requiring reporting of climate-related information, especially given the allocation of environmental administrative authority to the EPA. In its defense, the SEC may emphasize the materiality of these disclosures to the financial health of registrants, highlight its history of requiring disclosure of environmental information dating back to the 1970s, and point to disclosure of climate-related financial risk mandated by the Commission since 2010.

Notably, in applying the MQD, the Supreme Court consistently has bypassed the two-step analysis known as "*Chevron* deference" for determining whether deference should be accorded to federal administrative agency actions interpreting a statute. Conservative members of the Court have long evinced a commitment to decreasing the powers of administrative agencies and even overturning *Chevron* entirely, and two cases argued

this term, but not yet decided, offer opportunities to do so. If *Chevron* deference is narrowed or overturned, courts would have increased power to vacate the Rule.

First Amendment Challenges

Opponents also may assert that the new disclosure requirements constitute unconstitutional compelled speech. Mandatory disclosures of factual and uncontroversial information are a form of commercial speech and typically constitutional as long as reasonably related to a government interest.

However, critics of the Rule may argue that climate-related disclosures are subjective and potentially disparaging. Such speech is subjected to higher scrutiny by the courts, requiring the government to show a substantial interest which is directly and materially advanced by a narrowly tailored rule. The Rule's opponents also may argue that public demand for increased information on the climate performance of companies is not a substantial government interest, uncertainty remains about the disclosures necessary to advance this demand for increased information, and less restrictive means are available. This argument is arguably buoyed by the D.C. Circuit's 2014 decision in *National Association of Manufacturers et al. v. SEC*, in which the court held that the SEC's conflict minerals rule violated the First Amendment because the government's interest was speculative in that the SEC could not prove the measure it adopted would alleviate the harms to a material degree.

Additional Avenues: Nondelegation Doctrine & Congressional Review Act

In addition to the above, there are other possible avenues for legal challenge of the Rule, including the two discussed briefly below.

*First, l*egal challenges may be brought under a rarely invoked separation-of-powers principle known as the nondelegation doctrine. The Supreme Court repeatedly has held that Congress may authorize an agency to regulate as long as it provides an "intelligible principle" on which to base the regulations. Although the Supreme Court has not used the nondelegation doctrine to strike down a statute since the New Deal, opponents may cite this as an additional basis to challenge what many see as regulatory overreach.

Second, the Congressional Review Act ("CRA") allows both houses of Congress to nullify rules finalized by the Executive Branch and sent to Congress within the previous 60 "legislative days" via a joint resolution signed by the President. Once a rule has been disapproved under the CRA, the agency may not issue a new rule in "substantially the same form" without subsequent statutory authorization. Given the March approval date, it is unlikely that the Rule will be subject to CRA action.

Timeline

Under the Rule, the deadline for compliance varies by the type of registrant and type of disclosure. No companies will be required to finalize their disclosures until 2026, and, even then, it would only be large accelerated filers making only some of the disclosures.

Judicial review and the November presidential election could interfere with that timeline or even prevent the Rule from ever taking effect. Upon receipt of a petition for review, a court can issue a preliminary injunction almost immediately based on a finding such as that irreparable injury is likely absent an injunction. Given the compliance timeline, it may be challenging for opponents to establish irreparable harm, but a litigant may be able to meet the irreparable harm standard if demonstrating significant costs that must be incurred long before the deadline.

Once a court hears a challenge on the merits, it can stay the Rule's effectiveness. Such a stay is typically intended to give the SEC the opportunity to correct a rule. If the SEC fails to correct the rule by the stay's expiration, the court may vacate the rule.

In the legal challenge to the SEC's share repurchase disclosure rule in *Chamber of Commerce v. SEC*, the entire process, from rule publishing to vacating, took roughly seven-and-a-half months. Applied to this Rule, that would be late October 2024. The Rule therefore theoretically could be vacated even before the November 2024 presidential election and before any registrants would be required to begin tracking data required to be reported under the Rule.

Finally, in the event of a leadership change in the White House, a Republican-led SEC may decline to defend the Rule in ongoing litigation or could seek to repeal the Rule entirely.

Given the litigation risk described above, and the potential narrowing of Chevron deference, the future and ultimate scope of the Rule remain uncertain.

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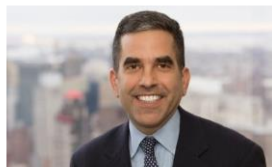
For more about the Rule, see our Debevoise In Depth: SEC Issues Long-Awaited Climate-Disclosure Rule and, for updates regarding the ongoing legal challenges, our Debevoise ESG Resource Center. Please do not hesitate to contact us with any questions.



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