The Ascertainable Standards that Define the Boundaries of the SEC's Rulemaking Authority

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On the heels of the U.S. Supreme Court's decision in West Virginia v. Environmental Protection Agency, the "major questions" doctrine quickly came to be perceived as a significant impediment to the finalization of the Securities and Exchange Commission's proposed rule on climate-related disclosures.

This Article presents a new argument against finalization, an argument that does not require the application of the major questions doctrine. This argument finds its authority in the policy objectives and the one policy constraint found in the statutes that underlie the proposed rule. These policy standards, referred to as ascertainable standards in the Article, not only provide guidance to the SEC in its rulemaking, including the promulgating of rules on climate-related disclosures, but also identify the boundaries of authority that the SEC must not cross.

The SEC has exceeded its delegated authority in promulgating its proposed rule on climate-related disclosures by not adhering to the ascertainable standards found in the 33 and 34 Acts: "for the protection of investors," promoting "efficiency, competition, and capital formation," and "materiality." These ascertainable standards are identified through the application of the "intelligible principle" test of the nondelegation doctrine and apply to all SEC rulemaking promulgated under these Acts, not just the proposed climate-related disclosures. Moreover, it would not be surprising to find that if a review of all SEC rules and interpretations were to occur, many of them would be found to violate the boundaries of the SEC's discretionary authority.

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I. INTRODUCTION

What are the legal limitations of the Securities and Exchange Commission's ("SEC") rulemaking authority in the area of climate-related disclosures? This is the critical issue that needs to be addressed when evaluating the SEC's proposed rule, *The Enhancement and Standardization of Climate-Related Disclosures for Investors* ("Proposed Rule").[1]

On the heels of the U.S. Supreme Court's decision in *West Virginia v. Environmental Protection Agency*,[2] the "major questions" doctrine (a legal doctrine which limits an agency's power to act on issues of "economic and political significance" without clear authorization from Congress)[3] quickly came to be perceived as a significant impediment to the finalization of the Proposed Rule.[4] In addition, other arguments against finalization have been made, including those based on the First Amendment[5] and the federal government's unauthorized interference in the internal affairs of a corporation.[6]

This Article presents a new argument against finalization. This argument finds its authority in the "ascertainable stand-

1 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, 249).

2 West Virginia v. EPA, 142 S. Ct. 2587 (2022). *See also* Biden v. Nebraska, 143 S. Ct. 2355 (2023). In *Biden*, the Supreme Court denied the Biden Administration's attempt to implement a $400 billion student loan forgiveness program without Congressional approval. By doing so it affirmed its commitment to the major questions doctrine.

3 Cass Sunstein provides an excellent summary of this doctrine. *See* Cass R. Sunstein, *There Are Two "Major Questions" Doctrines*, 73 ADMIN. L. REV. 475, 475 (2021).

4 *See* Christina Thomas, Andrew Olmem & Katelyn Merick, *Supreme Court Decision Casts Doubt on SEC's Climate Proposal and Other Regulatory Initiatives*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 12, 2022), https://perma.cc/5PYR-DVRH.

5 *See* Sean J. Griffith, *What's "Controversial" About ESG? A Theory of Compelled Commercial Speech Under the First Amendment*, 101 NEB. L. REV. 876 (2023). According to Griffith in the context of the Proposed Rule:

> Rules compelling commercial speech receive deferential judicial review, provided they are purely factual and uncontroversial . . . . Applied to securities regulation, the compelled commercial speech paradigm requires the SEC to justify disclosure mandates as a form of investor protection . . . . Disclosure mandates that are uncontroversially motivated to protect investors are eligible for deferential judicial review. Disclosure mandates failing this test must survive a form of heightened scrutiny . . . . The SEC's recently proposed climate disclosure rules fail to satisfy these requirements. Instead, the proposed climate rules create controversy by imposing a political viewpoint, by advancing an interest group agenda at the expense of investors generally, and by redefining concepts at the core of securities regulation. Having created controversy, the proposed rules are ineligible for deferential judicial review. Instead, a form of heightened scrutiny applies, under which they will likely be invalidated.

Id. at 876–77.

6 In regard to the corporate governance disclosures found in the Proposed Rule, Sharfman and Copland argue that interfering in the internal affairs of a corporation presents another major roadblock. *See* Bernard S. Sharfman & James R. Copland, Comment Letter on Proposed Rule for the Enhancement and Standardization of Climate-Related Disclosures for Investors (June 16, 2022), at 17–18, https://perma.cc/XD7T-5CVM. The corporate governance disclosures found in the Proposed Rule are discussed in Part V of this Article.

ards" that are found in the text of the statutes that underlie the Proposed Rule. Ascertainable standards are both policy objectives that the Board must use in its decision-making and a reviewing court will use when determining if the Board has acted in an "arbitrary and capricious" manner or has crossed the boundaries of its statutory authority under the Administrative Procedure Act ("APA").[7] The focus of this Article is on using ascertainable standards to determine when the SEC has exceeded its statutory authority.

In the statutes that underlie the Proposed Rules, the Securities Act of 1933 ("33 Act")[8] and the Securities Exchange Act of 1934[9] ("34 Act"; together the "Acts"), there are three ascertainable policy standards that Congress has placed in the Acts to guide the SEC's rulemaking discretion. These standards are (1) "for the protection of investors" or "protection of investors" ("investor protection"),[10] (2) promoting "efficiency, competition, and capital formation,"[11] and (3) materiality.[12]

This ascertainable standards approach was the approach taken by Justice William Rehnquist in his concurring opinion in *Industrial Union Dept., AFL-CIO v. American Petroleum Institute*.[13] It is also consistent with Professor Kevin Stack's "purposivist theory of agency statutory interpretation."[14] According to Stack, an agency "has a duty to (1) develop an understanding of the purposes or principles of the statute, (2) evaluate alternatives for action in relation to those purposes or principles, (3) act in ways, other things equal, that best furthers those purposes or principles, and (4) adopt only interpretations permitted by the statute's text."[15] Thus, Stack's theory requires agencies to carry out their regulatory powers that are granted under statutes "in accordance with the principles or purposes the statutes establish."[16]

Moreover, this approach is consistent with the major questions doctrine. Justice Amy Coney Barrett, in her concurring

7 *See* 5 U.S.C. § 706.

8 Securities Act of 1933, 15 U.S.C. §§ 77a–77aa.

9 Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78qq.

10 *See, e.g.*, 15 U.S.C. § 78f.

11 *See, e.g.*, 15 U.S.C. § 77b.

12 *See* Part III.B.

13 Industrial Union Dept., AFL-CIO v. American Petroleum Institute, 448 U.S. 607, 685-686 (1980).

14 Kevin M. Stack, *Purposivism in the Executive Branch: How Agencies Interpret Statutes*, 109 NW. U. L. REV. 871, 871 (2015).

15 *Id.* at 876.

16 *Id.*

opinion in *Biden v. Nebraska*,[17] explains how the major questions doctrine is to be used: "I understand it to emphasize the importance of context when a court interprets a delegation to an administrative agency. Seen in this light, the major questions doctrine is a tool for discerning—not departing from—the text's most natural interpretation."[18] I believe this is also how the ascertainable standards approach should be understood.

Interestingly, the identification of ascertainable standards, found in all statutes with a regulatory component ("regulatory statute"), begins with the nondelegation doctrine and its "intelligible principle" test.[19] The nondelegation doctrine was created by the U.S. Supreme Court to help enforce our Constitutional separation of powers.[20] As such, it requires Congress to refrain from abdicating or transferring its legislative functions (Article I, Section 1 of the U.S. Constitution) to another branch of government (e.g., broad grants of discretionary authority to an administrative agency) *unless* Congress "shall lay down by legislative act an *intelligible principle* to which the person or body authorized to [exercise the delegated authority] is directed to conform . . . ."[21] According to Stack, "the doctrine marks a formal distinction between regulatory and nonregulatory statutes: regulatory statutes must include intelligible principles whereas nonregulatory statutes need not. In that formal sense, the doctrine makes regulatory statutes constitutionally distinctive."[22]

Needless to say, the triad of ascertainable standards allows the Acts to meet the very liberal requirements of the nondelegation doctrine's intelligible principle test[23] as well the more rigor-

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17 No. 22-506 (U.S. June 30, 2023).

18 *Id.* In *Biden*, the Supreme Court denied the Biden Administration's attempt to implement a $400 billion student loan forgiveness program without Congressional approval. By doing so it affirmed its commitment to the major questions doctrine.

19 *Id.* at 875 ("But even when regulatory statutes lack specificity, constitutional law provides a distinctive backstop: A constitutionally valid delegation of lawmaking power to an administrative agency must include an "intelligible principle" to guide the agency's action.") (footnote omitted) (citing J. W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409 (1928)). According to Stack, the requirement of an intelligible principle is what distinguishes a regulatory from a nonregulatory statute. *Id.* at 894.

20 Mistretta v. United States, 488 U.S. 361, 371 (1989) ("The nondelegation doctrine is rooted in the principle of separation of powers that underlies our tripartite system of Government."); *See also* Peter J. Wallison, *An Empty Attack on the Nondelegation Doctrine*, THE FEDERALIST SOC'Y (April 22, 2021), https://perma.cc/4SKS-L8SB.

21 *Mistretta*, 488 U.S. at 372 (1989) (alteration in original) (emphasis added) (quoting *J. W. Hampton, Jr.*, 276 U.S. at 409). This "intelligible principle" test was first articulated by former Chief Justice William Howard Taft in J. W. Hampton, Jr., & Co. v. United States.

22 Stack, *supra* note 14, at 894.

23 According to the Supreme Court in *Gundy v. United States*:

ous test, at least in terms of policy judgments, that Justice Neil Gorsuch proposed in his dissent in *Gundy v. United States*.[24] But for the purposes of this Article, passing these tests is not the most important role to be played by these ascertainable standards. The focus here is on how these standards are to guide the SEC in its decision-making, including rule-making, and to be used by the courts when they review SEC decisions.[25]

The identification and understanding of these ascertainable standards are then used to fill in the blanks of what Congress meant when it repeatedly inserted the vague term of "in the public interest" into the Acts. This term has been misunderstood as being an ascertainable standard in its own right, providing the broadest possible agency discretion. This is not correct; it is not a stand-alone ascertainable standard. As stated by the U.S. Supreme Court in *NAACP v. FPC*: "[t]his Court's cases have *consistently* held that the use of the words 'public interest' in a regulatory statute is not a broad license to promote the general public welfare. Rather, the words take meaning from the purposes of the regulatory legislation."[26] Therefore, "in the public interest" only becomes understandable when it is animated with the three ascertainable standards that are clearly specified in the Acts. These standards sharply restrict what is meant by the

> [N]ondelegation inquiry always begins (and often almost ends) with statutory interpretation. The constitutional question is whether Congress has supplied an intelligible principle to guide the delegee's use of discretion. So the answer requires construing the challenged statute to figure out what task it delegates and what instructions it provides . . . . Only after a court has determined a challenged statute's meaning can it decide whether the law sufficiently guides executive discretion to accord with Article I [of the U.S. Constitution].

Gundy v. United States, 139 S. Ct. 2116, 2123 (2019).

[24] According to Justice Gorsuch:

> To determine whether a statute provides an intelligible principle we must ask: Does the statute assign to the executive only the responsibility to make factual findings? Does it set forth the facts that the executive must consider and the criteria against which to measure them? And most importantly, did Congress, and not the Executive Branch, make the policy judgments? Only then can we fairly say that a statute contains the kind of intelligible principle the Constitution demands.

Id. at 2141 (Gorsuch, J., dissenting).

[25] Am. Power & Light Co. v. SEC, 329 U.S. 90, 105 (1946) ("Necessity therefore fixes a point beyond which it is unreasonable and impracticable to compel Congress to prescribe detailed rules; it then becomes constitutionally sufficient if Congress clearly delineates the general policy, the public agency which is to apply it, and *the boundaries of this delegated authority*.") (emphasis added).

[26] NAACP v. Fed. Power Comm'n, 425 U.S. 662, 669 (1976) (emphasis added).

term in the Acts and how broadly the SEC can act in its rule-making.

When these ascertainable standards are applied to the Proposed Rule, a court is more likely to find that the SEC has significantly exceeded its statutory authority. Until the SEC corrects these mistakes, the Proposed Rule is at risk of being set aside in whole or in part. Moreover, it would not be surprising to find that if an ascertainable standard review of all SEC rules and interpretations were to occur, many of them would be found to violate the boundaries of authority created by the identified standards. For example, the SEC takes the position that it has broad authority to compel public companies to include shareholder proposals on social issues in their proxy statements.[27] By taking this position, the SEC is showing a blatant disregard for the three ascertainable standards that permeate the Acts and the boundaries of authority that they create.

Part II of this Article explains how the "intelligible principle" test is to be used as an analytical tool in identifying the boundaries of the SEC's delegated authority. Part III introduces the triad of ascertainable standards that exist in the Acts. Part IV looks closer at "investor protection" as an ascertainable standard. Parts V and VI do the same for "efficiency, competition, and capital formation" and "materiality," respectively. Part VII uses the ascertainable standards to define "in the public interest." This Part argues that the term can be thought of as a maximization problem where the objective being maximized is "investor protection." Moreover, promoting "efficiency, competition, and capital formation" is a "hard" constraint, and materiality is a "soft" constraint in this optimization approach. Part VIII discusses "in the public interest" and the ascertainable standards in the context of *Chevron* deference. Part IX concludes this Article with a discussion of what the SEC can do in the way of

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27 Bernard [S.] Sharfman, *Shareholder Proposals on Social Issues Are 'Not in the Public Interest'*, REALCLEARMARKETS (June 7, 2023), https://perma.cc/UVB5-QJ6Y. According to Sharfman:

> So, why does the SEC think it has the authority to compel the insertion of shareholder proposals on social issues, not only when they are not significant to a company's business, but also when there is not even a "nexus" between the social issue and the company? The only explanation is that the Commission is interpreting the statutory terms, "in the public interest" and "for the protection of investors" (investor protection), to mean that it has almost unlimited discretionary authority to compel shareholder proposals.

Id.

climate-related disclosures within the boundaries of authority created by the three ascertainable standards.

II. A FRAMEWORK FOR IDENTIFYING THE LIMITS OF SEC AUTHORITY IN RULEMAKING

The authority for court review of administrative rules, including the Proposed Rule, is provided by Section 706 of the Administrative Procedure Act ("APA"): "[t]o the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action."[28] Typically, a plaintiff seeking to set aside a SEC rule would argue that the finalizing of the rule was an "arbitrary and capricious" act under Section 706(2)(A) of the APA:

> The reviewing court shall— . . .
> 2) hold unlawful and *set aside* agency action, findings, and conclusions found to be—. . .
>
> > (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;[29]

However, the focus of this Article is not on an arbitrary and capricious act, but rather on where the SEC has exceeded its statutory authority. This means that Section 706(2)(C) of the APA, not 706(2)(A), is the appropriate authority:

> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; . . . .[30]

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28 5 U.S.C. § 706.

29 5 U.S.C. § 706(2)(A) (emphasis added).

30 5 U.S.C. § 706(2)(C). *See also* Citizens Comm. for Hudson Valley v. Volpe, 425 F.2d 97, 101 (2d Cir. 1970) ("Section 706(2) (C) permits the reviewing court to set aside agency action found to exceed the agency's statutory authority."); WildEarth Guardians v. United States Fish & Wildlife Serv., 784 F.3d 677, 683 (10th Cir. 2015) ("The APA directs courts to set aside agency actions that are taken 'in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.' 5 U.S.C. § 706(2)(C). Because of this provision, 'an essential function of our review under the APA is determining whether an agency acted within the scope of its authority.'") (quoting Copar Pumice Co. v. Tidwell, 603 F.3d 780, 801 (10th Cir. 2010)); Pharm. Rsch. & Mfrs. Am. v. FTC, 790 F.3d 198, 204 (D.C. Cir. 2015) ("PhRMA claims that the FTC action violates Section 706(2)(C), which states that a court may 'hold unlawful and set aside agency action, findings, and conclusions found to be . . . in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.' 5 U.S.C. § 706(2)(C).") (omission in original). A plaintiff seeking to set aside an agency rule based on the "major questions" doctrine would do so under 706(2)(C).

A. Applying the "Intelligible Principle" Test

Given this power of review, a court can use the "intelligible principle" test to identify when an agency has exceeded its rulemaking authority under the authorizing legislation. The justification for using the test in this way was provided by Justice Rehnquist in his concurring opinion in *Industrial Union Dept., AFL-CIO v. American Petroleum Institute*:

> As formulated and enforced by this Court, the nondelegation doctrine serves three important functions. First, and most abstractly, it ensures to the extent consistent with orderly governmental administration that important choices of social policy are made by Congress, the branch of our Government most responsive to the popular will. See *Arizona v. California,* 373 U.S. 546, 626, 83 S.Ct. 1468, 1511, 10 L.Ed.2d 542 (1963) (Harlan, J., dissenting in part); *United States v. Robel,* 389 U.S. 258, 276, 88 S.Ct. 419, 430, 19 L.Ed.2d 508 (1967) (BRENNAN, J., concurring in result). Second, the doctrine guarantees that, to the extent Congress finds it necessary to delegate authority, it provides the recipient of that authority with an "intelligible principle" to guide the exercise of the delegated discretion. See *J. W. Hampton & Co.* v. *United States,* 276 U.S., at 409, 48 S.Ct., at 352; 72 L.Ed. 624 (1928); *Panama Refining Co.* v. *Ryan,* 293 U.S., at 430, 55 S.Ct., at 252. Third, and derivative of the second, the doctrine ensures that courts charged with reviewing the exercise of delegated legislative discretion will be able to test that exercise against ascertainable standards. See *Arizona v. California, supra,* 373 U.S., at 626, 83 S.Ct., at 1511 (Harlan, J., dissenting in part); *American Power & Light Co.* v. *SEC, supra,* at 106, 67 S.Ct., at 142.[31]

The first function of the nondelegation doctrine is essentially one of feedback, promoting political responsibility by encouraging Congress to clearly identify important choices of social policy in its legislation and discouraging the unmoored abdication or transfer of its legislative functions to other branches of government.[32] This is consistent with what Chief Justice Taft said in *J. W. Hampton, Jr., & Co. v. United States*: "[i]n determining

[31] Indus. Union Dep't, AFL-CIO v. Am. Petroleum Inst., 448 U.S. 607, 685–86 (1980) (Rehnquist, J., concurring).

[32] BOGDAN IANCU, LEGISLATIVE DELEGATION: THE EROSION OF NORMATIVE LIMITS IN MODERN CONSTITUTIONALISM 223 (2012).

what [one branch of government] may do in seeking assistance from another branch, the extent and character of that assistance must be fixed according to common sense and the inherent necessities of the government coordination."[33]

The second function is to identify policy objectives (also referred to as ascertainable standards in this Article) that the agency can use in guiding its use of its delegated authority. These policy objectives also provide the agency with boundaries of discretion that it must not cross when using such authority. The third function refers to the "ascertainable standards" found in the underlying statutes that can be used by the courts when reviewing an administrative rule for compliance with the boundaries of an agency's delegated authority.[34] As stated by Justice Harlan in his dissent in *Arizona v. California*:

> The principle that authority granted by the legislature must be limited by adequate standards serves two primary functions vital to preserving the separation of powers required by the Constitution. First, it insures that the fundamental policy decisions in our society will be made not by an appointed official but by the body immediately responsible to the people. Second, it prevents judicial review from becoming merely an exercise at large by providing the courts with some measure against which to judge the official action that has been challenged.[35]

The foundation for Justice Rehnquist's understanding can be found in *American Power & Light Co. v. SEC*:

> The judicial approval accorded these "broad" standards for administrative action is a reflection of the necessities of modern legislation dealing with complex economic and social problems. See Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 398, 60 S.Ct. 907, 914, 84 L.Ed. 1263. The legislative process would frequently bog down if Congress were constitutionally required to appraise beforehand the myriad situations to which it wishes a particular policy to be applied and to formulate specific rules for each situation. Necessity therefore fixes a point beyond which it is unreasonable and impracticable to compel Congress to prescribe detailed rules; *it then becomes constitutionally sufficient if*

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33 J. W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 406 (1928).

34 *Indus. Union Dep't*, 448 U.S. at 686.

35 Arizona v. California, 373 U.S. 546, 626 (1963) (Harlan, J., dissenting in part) (footnote omitted).

> *Congress clearly delineates the general policy, the public agency which is to apply it, and the boundaries of this delegated authority*. Private rights are protected by access to the courts to test the application of the policy in the light of these legislative declarations.[36]

B. Non-Ascertainable Standards

In applying the intelligible principle, it is important to note that non-ascertainable standards can be used to meet the requirements of the nondelegation doctrine. Non-ascertainable standards include the inclusion in regulatory statutes of vague and unhelpful policy objectives as "just and reasonable,"[37] "public interest,"[38] and "public convenience, interest, or necessity."[39] Such standards do not provide an agency with policy guidance, encouraging it to establish its own, and make it extremely difficult for a reviewing court to determine the boundaries of an agency's delegated authority under a piece of legislation.

Why this approach has been tolerated by the Court is explained by Justice Scalia in his dissent in *Mistretta v. United States*:

> Since Congress is no less endowed with common sense than we are, and better equipped to inform itself of the "necessities" of government; and since the factors bearing upon those necessities are both multifarious and (in the nonpartisan sense) highly political—including, for example, whether the Nation is at war, see *Yakus v. United States*, 321 U.S. 414 , 64 S.Ct. 660, 88 L.Ed. 834 (1944), or whether for other reasons "emergency is instinct in the situation," *Amalgamated Meat Cutters and Butcher Workmen of North America v. Connally*, 337 F.Supp. 737, 752 (DC 1971) (three-judge court)—it is small wonder that we have almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law.[40]

The results of this approach were summarized by the Court in *Whitman v. American Trucking Associations, Inc.*:

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36 Am. Power & Light Co. v. SEC, 329 U.S. 90, 105 (1946) (emphasis added).
37 Tagg Bros. & Moorhead v. United States, 280 U.S. 420, 431, 440 (1930).
38 N.Y.C. Cent. Sec. Corp. v. United States, 287 U.S. 12, 24 (1932).
39 Fed. Radio Comm'n v. Nelson Bros. Bond & Mortg. Co., 289 U.S. 266, 279 (1933).
40 Mistretta v. United States, 488 U.S. 361, 416 (1989) (Scalia, J., dissenting).

> In the history of the Court we have found the requisite "intelligible principle" lacking in only two statutes, one of which provided literally no guidance for the exercise of discretion, and the other of which conferred authority to regulate the entire economy on the basis of no more precise a standard than stimulating the economy by assuring "fair competition." See *Panama Refining Co. v. Ryan*, 293 U.S. 388, 55 S.Ct. 241, 79 L.Ed. 446 (1935); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 55 S.Ct. 837, 79 L.Ed. 1570 (1935). We have, on the other hand, upheld the validity of § 11(b)(2) of the Public Utility Holding Company Act of 1935, 49 Stat. 821, which gave the Securities and Exchange Commission authority to modify the structure of holding company systems so as to ensure that they are not "unduly or unnecessarily complicate[d]" and do not "unfairly or inequitably distribute voting power among security holders." *American Power & Light Co. v. SEC*, 329 U.S. 90, 104, 67 S.Ct. 133, 91 L.Ed. 103 (1946). We have approved the wartime conferral of agency power to fix the prices of commodities at a level that "'will be generally fair and equitable and will effectuate the [in some respects conflicting] purposes of th[e] Act.'" *Yakus v. United States*, 321 U.S. 414, 420, 423–426, 64 S.Ct. 660, 88 L.Ed. 834 (1944). And we have found an "intelligible principle" in various statutes authorizing regulation in the "public interest." See, *e.g., National Broadcasting Co. v. United States*, 319 U.S. 190, 225–226, 63 S.Ct. 997, 87 L.Ed. 1344 (1943) (Federal Communications Commission's power to regulate airwaves); *New York Central Securities Corp. v. United States*, 287 U.S. 12, 24–25, 53 S.Ct. 45, 77 L.Ed. 138 (1932) (Interstate Commerce Commission's power to approve railroad consolidations).[41]

C. "In the Public Interest" and the Acts

One of those non-ascertainable standards, "in the public interest," plays a prominent role in the Acts. In the 33 Act, there are twenty-five mentions of "in the public interest." In the 34 Act, there are one hundred and seventy-four mentions. The emptiness of this policy objective without an examination of the purposes of the underlying statute cannot be overstated. As Jus-

[41] Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 474 (2001) (alteration in original).

tice Scalia has said in his dissenting opinion in *Mistretta v. United States*: "[w]hat legislated standard, one must wonder, can possibly be too vague to survive judicial scrutiny, when we have repeatedly upheld, in various contexts, a 'public interest' standard?"[42] As noted by Paul Larkin, it is "a requirement that would seem to apply without Congress even saying it."[43] More importantly for purposes of this Article, "in the public interest" does nothing to help achieve Justice Rehnquist's second and third functions of the nondelegation doctrine. As stated by Sean Sullivan, "[i]t is difficult to envision judicial review of agency rulemaking for consistency with a 'public interest' standard as the kind of check on power that [James] Madison was contemplating."[44] In sum, it is an empty shell of a policy objective, a non-ascertainable standard when standing alone that does not provide an agency with guidance in its mission or a reviewing court the boundaries of delegated authority that it can use in its review.

Some have tried to argue that even though the public interest standard has no substance of its own, it provides an agency with broad discretion in deciding what it means. This understanding is in error. As stated by the U.S. Supreme Court in *NAACP v. FPC*: "This Court's cases have *consistently* held that the use of the words 'public interest' in a regulatory statute is not a broad license to promote the general public welfare. Rather, the words take meaning from the purposes of the regulatory legislation."[45]

This does not mean that the "public interest" standard has no meaning, only that it has a *derivative meaning*. The "public interest" standard becomes understandable if it is properly understood in the context of the purposes of the underlying regulatory statute. The Court in *NAACP v. FPC* used the following example to make this point:

> For example, in the case of the Interstate Commerce Commission, which is responsible for enforcing an Act "designed . . . better to assure adequacy in transportation ser-

[42] *Mistretta*, 488 U.S. at 416.

[43] Paul J. Larkin, *Revitalizing the Nondelegation Doctrine*, 23 FEDERALIST SOC'Y REV. 238, 243 (2022) ("Some delegations merely provide that an agency must act 'in the public interest,' a requirement that would seem to apply without Congress even saying it.").

[44] Sean P. Sullivan, *Powers, But How Much Power? Game Theory and the Nondelegation Principle*, 104 VA. L. REV. 1229, 1247 (2018).

[45] NAACP v. Fed. Power Comm'n, 425 U.S. 662, 669 (1976) (emphasis added).

> vice," "the term 'public interest' . . . is not a concept without ascertainable criteria, but has direct relation to adequacy of transportation service, to its essential conditions of economy and efficiency, and to appropriate provision and best use of transportation facilities. . . ." *New York Central Securities Corp. v. United States*, 287 U.S. 12, 24–25, 53 S.Ct. 45, 47–48, 77 L.Ed. 138, 145–146. See also *New Haven Inclusion Cases*, 399 U.S. 392, 432, 90 S.Ct. 2054, 2078, 26 L.Ed.2d 691, 720; *National Broadcasting Co. v. United States*, 319 U.S. 190, 216, 63 S.Ct. 997, 1009, 87 L.Ed. 1344, 1362; *Federal Radio Comm'n v. Nelson Bros. Co.*, 289 U.S. 266, 285, 53 S.Ct. 627, 636, 77 L.Ed. 1166, 1178.[46]

In essence, the "public interest" standard only becomes meaningful when its empty shell is filled with ascertainable standards.

III. The Acts' Ascertainable Standards

As argued in this Part, the triad of ascertainable standards found in the Acts is made up of two policy objectives and one policy constraint. Investor protection and promoting "efficiency, competition, and capital formation" are the policy objectives with the former, as discussed in Section A of this Part, being the primary objective. Investor protection is also a relatively vague term. However, at the very least, this term restricts the authority of the Acts to a world bounded by the investment in securities and, as argued in Part IV, only pertains to being informed of investment risk. The policy constraint is "materiality." This constraint applies primarily to the types of disclosures that issuers of securities must make under the Acts. Materiality can be thought of as a "soft" constraint, a condition that is required unless a non-material disclosure is necessary to facilitate the two policy objectives. These are the ascertainable standards that animate our understanding of "in the public interest" as used in the Acts, filling up the term's empty shell. All three ascertainable standards must be used by the SEC when promulgating its disclosure rules or else the SEC risks a reviewing court determining that the agency has gone beyond the bounds of its delegated authority.

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[46] *Id.* (omission in original).

A. The Policy Objectives

Through the incorporation of Section 106 of the National Securities Markets Improvement Act of 1996 ("NSMIA") into the Acts, the policy objectives of SEC rulemaking, "for the protection of investors" and promoting "efficiency, competition, and capital formation," were explicitly identified:[47]

> Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[48]

This is the language found in the 33 Act. The language incorporated in the 34 Act is slightly different with the inclusion of the words "or in the review of a rule of a self-regulatory organization."[49] This extra language is the result of the 34 Act provid-

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47 *See* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3424–25, § 106:

> SEC. 106. PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION.
>
> (a) SECURITIES ACT OF 1933.—Section 2 of the Securities Act of 1933 (15 U.S.C. 77b) is amended—
>
> (1) by inserting "(a) DEFINITIONS.—" after "SEC. 2."; and
>
> (2) by adding at the end the following new subsection:
>
> "(b) CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION.—Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.".
>
> (b) SECURITIES EXCHANGE ACT of 1934.—Section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c) is amended by adding at the end the following new subsection:
>
> "(f) CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION.—Whenever pursuant to this title the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.".

48 Securities Act of 1933 § 2(b), 15 U.S.C. § 77b(b).

49 In the 34 Act, the following language is provided:

> Whenever pursuant to this chapter the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protec-

ing the SEC with additional rulemaking authority over self-regulatory organizations. Similar language was incorporated into the Investment Company Act of 1940.[50]

These two policy objectives are ascertainable standards that make the term, "in the public interest," understandable, consistent with what was described in *NAACP v. FPC*.[51] While "for the protection of investors" has been a prominent part of the Acts since the beginning, the 1996 modification added a second explicit objective, promoting "efficiency, competition, and capital formation." These ascertainable standards fulfill Justice Rehnquist's second function of the nondelegation doctrine[52] by providing policy guidance to the SEC. They also fulfill Justice Rehnquist's third function by providing a reviewing court with identifiable boundaries of authority which the SEC cannot exceed in its rulemaking.[53]

Professor Jill Fisch has argued that the 1996 language "merely directs the SEC to consider specific factors; Congress did not tell the SEC how to balance these factors against each other, specify a dominant factor, or mandate a net positive outcome."[54] I disagree. While the 1996 new language requires the SEC to focus on these two policy objectives, *the main policy focus must always be investor protection*. This is the policy objective that *most* animates "in the public interest." For example, when one looks at the text of the Acts, "whenever the term 'in the public interest' appears in the Acts, the term 'for the protection of investors' is almost always sure to follow."[55] The close proximity of these terms cannot be a coincidence.[56] Moreover, the legislative focus on investor protection was made explicit in the House Report accompanying the House version of NSMIA:

> tion of investors, whether the action will promote efficiency, competition, and capital formation.

Securities Exchange Act of 1934 § 23(a)(2), 15 U.S.C. § 78c(f).

50 *See* National Securities Markets Improvement Act of 1996 § 106(c).

51 NAACP v. Fed. Power Comm'n, 425 U.S. 662, 669 (1976).

52 Indus. Union Dep't, AFL-CIO v. Am. Petroleum Inst., 448 U.S. 607, 685–86 (1980) (Rehnquist, J., concurring).

53 *Id.*

54 Jill E. Fisch, *The Long Road Back: Business Roundtable and the Future of SEC Rulemaking*, 36 SEATTLE U. L. REV. 695, 714 (2013) citing the analysis of James D. Cox & Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 TEX. L. REV. 1811, 1818–20 (2012).

55 Bernard S. Sharfman, *Non-Material Mandatory Climate Change Disclosures*, OHIO ST. BUS. L.J. ONLINE 1, 3 (2021).

56 *Id.*

> The new section [Section 106] makes clear that matters relating to efficiency, competition, and capital formation are only part of the public interest determination, which also includes, among other things, consideration of the protection of investors. For 62 years, the *foremost mission* of the Commission has been investor protection, and this section does not alter the Commission's mission. In considering efficiency, competition, and capital formation, the Commission shall analyze the potential costs and benefits of any rulemaking initiative, including, whenever practicable, specific analysis of such costs and benefits. The Committee expects that the Commission will engage in rigorous analysis pursuant to this section.[57]

and,

> The legislation [NSMIA] . . . seeks to promote efficiency, competition, and capital formation in the capital markets *without compromising investor protection* by . . . requiring the consideration of efficiency, competition, and capital formation whenever the Securities and Exchange Commission (Commission) makes a public interest determination in its rulemaking; . . . .[58]

Just one month prior to the publication of the House Report, the same point was made in a speech by then SEC Chair, Arthur Levitt. According to Levitt, "the primacy of investor interests was present at the creation" of the SEC.[59] Moreover, he stated that "[t]he *foremost mission* of the SEC for 62 years has been *investor protection*, and no matter how well-intentioned any additional role may be, it will inevitably distract attention from our primary focus. That's a price we can ill afford."[60]

In sum, a rigorous analysis must be done regarding the policy objective of "efficiency, competition, and capital formation," a requirement that the D.C. Circuit Court of Appeals strongly endorsed in its 2011 decision in *Business Roundtable v. SEC*.[61] Ad-

57 *Id.* H.R. REP. NO. 104–622, at 39 (1996).

58 H.R. REP. NO. 104-622, at 16 (emphasis added).

59 Arthur Levitt, Chairman, SEC, Remarks by Chairman Arthur Levitt (May 17, 1996) (transcript available at https://perma.cc/AQ94-FEPF).

60 *Id.* (emphasis added).

61 Bus. Roundtable v. SEC, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011). In vacating the SEC's universal proxy access rule, Rule 14-11, under the authority provided by Section 706(2)(a) of the APA, the D.C. Circuit found that the SEC failed in its statutory obligation to do the required analysis and consideration: "Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to

ditionally, this policy objective must be seriously considered by the SEC when promulgating a rule. Moreover, the promotion of "efficiency, competition, and capital formation" would be a fine rulemaking outcome. However, this objective must remain secondary to the objective of investor protection. It can never trump the prime objective of investor protection. This is still the "foremost mission" of the SEC[62] and its expected enhancement *must* always be the expected outcome of SEC rulemaking.

The outstanding question is how to handle the other objective of promoting "efficiency, competition, and capital formation"? This question will be addressed in Part V.

B. The Policy Constraint: Materiality

Materiality, as an ascertainable standard, is distinct from the two policy objectives identified in Section 106 of NSMIA. For one, it is not mentioned in that statutory provision as a policy objective. However, there are multiple references to materiality in the Acts. In the 33 Act, there are currently forty-two references, and in the 34 Act, there are currently one hundred references. For example, under Section 8(b) of the 33 Act, "[i]f it appears to the Commission that a registration statement is on its face incomplete or inaccurate in any *material* respect, the Commission may . . . issue an order prior to the effective date of registration refusing to permit such statement to become effective until it has been amended in accordance with such order."[63]

Moreover, according to the SEC in its 1972 annual report: "A *basic purpose* of the Federal securities laws is to provide dis-

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quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters." *Id.*

62 H.R. REP. NO. 104-622, at 39.

63 15 U.S.C. § 77h(b). References to materiality come in many forms. In the 33 Act, references include "be true and complete in all material respects," "how the rights of the securities being offered may be materially limited," "liability for material misstatements and omissions," "incomplete or inaccurate in any material respect," "untrue statement or omission of a material fact," "could cause actual results to differ materially," "not subject to material dispute," "material contract," "material conflict of interest," and "material to the inquiry." In the 34 Act, references include "false or misleading with respect to any material fact," "material term," "material anticompetitive burden," "disputed issues of material fact," "direct and material effect on the determination of financial statement amounts," "material to the financial statements," "material effect on the financial statements of the issuer," "material written communications," "material noncompliance of the issuer," "material patent right," "material change," "materially reduce market liquidity," "material loss," "in any material respect," "material, nonpublic information," "material impact," "if any information or document provided therein becomes materially inaccurate," and "material contracts." 15 U.S.C. §§ 77a–77aa.

closure of material financial and other information on companies seeking to raise capital through the public offering of their securities, as well as companies whose securities are already publicly held. This aims at enabling investors to evaluate the securities of these companies on an informed and realistic basis."[64] As observed by Professor Ruth Jebe, it is fair to say that materiality "constitutes the primary framing mechanism for financial reporting."[65]

Thus, materiality as an ascertainable standard creates a strong presumption that the SEC can only require material disclosures in its rulemaking outside of those statutory non-material disclosures that Congress has incorporated into the Acts.[66] Yet, there is no explicit statutory language in the Acts that forbids the SEC from promulgating rules requiring non-material disclosures such as non-material climate-related disclosures. This conflict or tension in statutory interpretation is resolved if we understand materiality as a "soft" constraint—a condition that is required in rulemaking unless a non-material disclosure is necessary to facilitate the policy objectives of the Acts—investor protection and the promotion of "efficiency, competition, and capital formation." This argument will be discussed further in Part VI.

C. The Puzzling Issue of Conjunctive versus Disjunctive

As an interesting side note, the focus on the policy objectives of the Acts resolves the issue of whether there is any significance to the puzzling and inconsistent way the Acts alternate between the conjunctive ("and") and the disjunctive ("or") when the terms "in the public interest" and "for the protection of investors" are used. This alternating approach has been found in the Acts since their enactments back in 1933 and 1934, respec-

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64 38 SEC ANN. REP. 23 (1972).

65 Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 56 AM. BUS. L.J. 645, 656 (2019).

66 For example, the conflict minerals disclosure requirements that are now part of Section 13(p) of the 34 Act. 15 U.S.C. § 78m(p). This represents the incorporation of Section 1502, the Conflict Minerals Provision, of the Dodd-Frank Wall Street Reform and Consumer Protection Act. According to the SEC, "the Conflict Minerals Provision's only limiting factor is that the conflict minerals must be 'necessary to the functionality or production' of an issuer's products. The provision has no materiality thresholds for disclosure based on the amount of conflict minerals an issuer uses in its production processes." *See* Conflict Minerals, 75 Fed. Reg. 80963 (Dec. 23, 2010) (to be codified at 17 C.F.R. pts. 229, 249) (footnote omitted). For a discussion of why these disclosures are not material, see David M. Lynn, *The Dodd-Frank Act's Specialized Corporate Disclosure: Using the Securities Laws to Address Public Policy Issues*, 6 J. BUS. & TECH. L. 327 (2011).

tively. As discussed, "in the public interest" is an empty shell such that it cannot stand on its own as a policy objective. Prior to insertion of the language that requires the SEC to consider the promotion of "efficiency, competition, and capital formation," investor protection was the only policy objective that was provided to animate the term "in the public interest." Materiality also animates the term, but it is in the form of a policy constraint on SEC actions and not as a policy objective. Therefore, whether the Acts use "and" or "or" to connect the two terms, investor protection, while an ascertainable standard in its own right, is also being used to give meaning to "in the public interest," allowing the term to contain a policy objective. In sum, there is no significance to this alternating approach to the use of "and" or "or" in this context. Any type of statutory interpretation construing some other meaning in the alternating between the conjunctive and disjunctive would simply "frustrate evident legislative intent."[67]

IV. A CLOSER LOOK AT INVESTOR PROTECTION

How much authority the SEC has to regulate based on the policy objective of investor protection is a function of how the terms "protection of investors" and "for the protection of investors," as found in the Acts, are to be defined. For example, if the definition is broad and vague, such as "protecting investors who invest in securities that are sold in the United States," this would appear to give the SEC almost unfettered authority to create disclosure rules and take legal actions for any reason it could come up with. In this Part, it is argued that Congress intended investor protection to have a much narrower meaning, with the result being that the SEC must adhere to significant boundaries in its discretionary authority. This would apply to promulgating rules that include climate-related disclosures such as in the Proposed Rule or any other rule such as compelling

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[67] The Congressional Research Service provides a good summary of on how the "and" and "or" issue is evaluated by the courts:

> Ordinarily, as in everyday English, use of the conjunctive "and" in a list means that all of the listed requirements must be satisfied, while use of the disjunctive "or" means that only one of the listed requirements need be satisfied. Courts do not apply these meanings "inexorably," however; if a "strict grammatical construction" will frustrate evident legislative intent, a court may read "and" as "or," or "or" as "and." Moreover, statutory context can render the distinction secondary.

CONG. RSCH. SERV., STATUTORY INTERPRETATION: GENERAL PRINCIPLES AND RECENT TRENDS 9–10 (2014) (footnotes omitted), https://perma.cc/ZNF5-LF3Y.

shareholder proposals on social issues into the proxy statements of public companies.[68]

A. Investor Protection

In the 33 Act, there are twenty-seven mentions of "protection of investors" and seventeen mentions of "for the protection of investors." The latter overlap with the former. In the 34 Act, there are two hundred and twelve mentions of "protection of investors" and one hundred and fifty-four mentions of "for the protection of investors." Again, the latter overlap with the former. As already discussed, this is one of two policy objectives identified in Section 106 of the NSMIA, and, as argued above, the "foremost mission" of the SEC. Unfortunately, the Acts do not provide a definition of investor protection to guide the SEC in its rulemaking. Neither does the SEC provide such definitions in the Proposed Rule. This is a significant oversight on the part of both Congress, in creating the Acts, and the SEC, in promulgating the Proposed Rule. Without such a definition and explanation of how it is to be applied, the Proposed Rule must be assumed to be unmoored from the Acts.

i. A Workable Definition

Based on my earlier writing, *Non-Material Mandatory Climate Change Disclosures*,[69] this Section provides the needed definition. To begin, the Acts were children of the 1929 stock market collapse and meant to correct the wrongs that paved the way for the Great Depression:

> The stock market crash of 1929 exposed a catalogue of corporate practices employed to deceive and discriminate against the small investor. These practices were largely instrumental in bringing on *mass financial ruin*. For years corporations had floated large quantities of unsound stocks without telling investors about the true state of their assets and earning power, or the identity of their promotors, managers, and chief stockholders. Corporate insiders, capitalizing on secret information about impending corporate action, had themselves extracted huge profits from ordinary investors by selling their own stock to the public in advance of

[68] Sharfman, *Shareholder Proposals on Social Issues Are 'Not in the Public Interest'*, *supra* note 27.

[69] Sharfman, *Non-Material Mandatory Climate Change Disclosures*, *supra* note 55, at 4–6.

> expected price declines. Organizers of holding and investment companies, by obtaining unfair contracts or excessive payments from their operating subsidiaries, had siphoned off vast sums of subsidiary profits. In reorganizations, security conversions, and dividend declarations, the interests of small investors were often sacrificed to those of large stockholders.[70]

Accordingly, in the words of Professor Michael Guttentag, the Acts are focused on protecting "investors from fraud, an unlevel informational playing field, the extraction of private benefits from the firm by firm insiders, and investors' propensity to make unwise investment decisions . . . ."[71] However, investor protection does not extend to protecting investors from investing in securities that have a level of risk that may result in financial losses.[72] As stated by President Franklin Roosevelt in his kick-off message to Congress that resulted in the Acts:

> In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.
>
> Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.
>
> There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.
>
> This proposal adds to the ancient rule of caveat emptor, the further doctrine "let the seller also beware." It puts the burden of telling the whole truth on the seller. It should give

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70 *The Meaning of "Control" in the Protection of Investors*, 60 YALE L.J. 311, 311 (1951) (emphasis added) (footnotes omitted).

71 Michael D. Guttentag, *On Requiring Public Companies to Disclose Political Spending*, 2014 COLUM. BUS. L. REV. 593, 619 n.92 (2014) (citing Michael D. Guttentag, *Protection from What? Investor Protection and the Jobs Act*, 13 UC DAVIS BUS. L.J. 207, 222–33 (2013)).

72 Guttentag, *Protection from What?*, *supra* note 71, at 232–33.

> impetus to honest dealing in securities and thereby bring back public confidence.[73]

Moreover, there is no hint that "expressive investor protection" is included in the definition of investor protection. This is a term coined by Professor Michael Guttentag that refers to disclosures that investors would use to protect themselves from investing in securities issued by firms with attributes that investors simply find objectionable such as the selling of firearms, tobacco, or throwing carbon and other harmful emissions into the atmosphere.[74] As discussed above, there is a historical basis for the Acts to provide the SEC with the authority to require disclosures regarding the material risks of investing in a specific public company, but there is no such historical basis for requiring disclosures regarding expressive investor protection.[75] If Congress intended to include expressive investor protection in the Acts, then why didn't it take the opportunity to do so when it inserted the policy objective of promoting "efficiency, competition, and capital formation" in 1996? Thus, being informed of the financial risks of buying, selling, and holding of individual securities ("firm specific investment risk") is how investor protection is defined under the Acts.

ii. Prior SEC Guidance on Climate-Related Disclosures

We see this understanding of investor protection in the two interpretive releases that preceded the Proposed Rule. In 1971, the SEC "issued an interpretive release stating that registrants should consider disclosing . . . the financial impact of compliance with environmental laws, based on the materiality of the information."[76] In 2010, the SEC issued another interpretive release ("2010 Guidance") that was consistent with this understanding. That release, still current, recommends reporting companies provide disclosures on climate change risk factors "that make an investment in the registrant speculative or risky" or "are reasonably likely to have a material effect on a public company's fi-

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73 Franklin D. Roosevelt, President of the U.S., Message to Congress on Federal Supervision of Investment Securities (Mar. 29, 1933) (transcript available at https://perma.cc/55ZS-DTJ3).

74 Guttentag, *On Requiring Public Companies to Disclose Political Spending*, *supra* note 71, at 616–17, 622–23.

75 *Id.* at 619.

76 SEC, Commission Guidance Regarding Disclosure Related to Climate Change, 10 (Feb. 2, 2010), https://perma.cc/QD4G-8KN9, citing Disclosures Pertaining to Matters Involving the Environment and Civil Rights, 36 Fed. Reg. 13989 (July 19, 1971).

nancial condition or operating performance."[77] According to the 2010 Guidance, the following topics and how they affect the reporting company may require disclosure: the impact of climate-change legislation and regulation; international accords on climate change, such as the Paris Accord; indirect consequences of climate-change regulation, such as a reduction of demand for goods that create high levels of greenhouse gas emissions; and the physical impacts of climate change, such as severe weather, on the company's operations.[78]

iii. The Proposed Rule and Investor Protection

The Proposed Rule departs from the SEC's prior guidance on climate change disclosures, where the sole focus was on informing investors of firm specific investment risk, to one where "expressive investor protection" is allowed. In excruciating detail, taking up several hundred pages of the Proposed Rule, the SEC lays out its requirements for the reporting of Scope 1, 2, and 3 emissions.[79] Such disclosures, while not providing material information on a particular company's investment risk, would allow investors to reject investment in the securities of a company that produces carbon emissions that go beyond a certain level.[80] While these disclosures would help investment advisors structure Environmental, Social, and Governance ("ESG") funds that investors may want to invest in,[81] such expressive investor protection is not currently provided for in the Acts and, therefore, requiring such climate change disclosures would be beyond the SEC's delegated authority.

The requirement of disclosing Scope 3 emissions is perhaps most egregious in regard to being irrelevant in providing material information that would help investors become informed of a reporting company's investment risk. Scope 3 emissions are defined as:

77 *Id.* at 15.

78 *Id.* at 15, 17.

79 According to the Proposed Rule, Scope 1 emissions are defined as "direct GHG [greenhouse gas] emissions that occur from sources owned or controlled by the company. These might include emissions from company-owned or controlled machinery or vehicles, or methane emissions from petroleum operations." *See* 87 Fed. Reg. 21334, *supra* note 1, at 21344. Scope 2 emissions are defined as "those emissions primarily resulting from the generation of electricity purchased and consumed by the company. Because these emissions derive from the activities of another party (the power provider), they are considered indirect emissions." *Id.* Scope 3 emissions are defined in the text. *Id* at 21344–45.

80 87 Fed. Reg. 21334, *supra* note 1.

81 *Id.* at 21425.

> [A]ll other indirect emissions not accounted for in Scope 2 emissions. These emissions are a consequence of the company's activities but are generated from sources that are neither owned nor controlled by the company. These might include emissions associated with the production and transportation of goods a registrant purchases from third parties, employee commuting or business travel, and the processing or use of the registrant's products by third parties.[82]

Here, the carbon emissions of "upstream and downstream contractors," including non-public companies, are swept up into the calculation of a reporting company's carbon emissions disclosures.[83] As observed by Commissioner Peirce, "[s]cope 3 data is really about what other people do," not the reporting company.[84] This has the result of pressuring companies that should be outside the SEC's reach to provide Scope 3 data without regard to the cost of producing that data. Most importantly, nothing could be further from helping to inform investors of a specific reporting company's investment risk. All it does is create "noisy" (meaningless) data.

As noted in a comment letter James Copland and I wrote to the SEC discussing Scope 3 emissions, but applicable to the reporting of all Scope emissions, investors in securities "may be interested in having this information for reasons other than ascertaining the financial [investment] risk of the security to be bought or sold; but the latter, not the former, is the actual nexus required by Congress in its grant of authority to the Commission."[85] For the SEC to have such authority, Congress must amend the Acts.[86]

V. A CLOSER LOOK AT EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

In the text of the 33 Act, there are only two mentions of promoting "efficiency, competition, and capital formation."[87] In

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82 *Id.* at 21344–45.

83 Bernard S. Sharfman & James R. Copland, *The SEC Can't Transform Itself Into a Climate-Change Enforcer,* THE WALL ST. J. (Sept. 14, 2022), https://perma.cc/HJJ6-WCWF.

84 Hester M. Peirce, Commissioner, SEC, We are Not the Securities and Environment Commission – At Least Not Yet (Mar. 21, 2022) (transcript available at https://perma.cc/4XLN-5JQ4).

85 Sharfman & Copland, *supra* note 6, at 7–8.

86 *Id.*

87 15 U.S.C. § 77b(b).

the 34 Act there are three mentions.[88] Yet, as a policy objective of the Acts, Congress has explicitly placed it, as a result of Section 106 of NSMIA,[89] alongside investor protection, the primary objective of the Acts, as another objective. This creates an issue: how do we maximize two objectives at the same time? According to Harvard's Michael Jensen, "[i]t is logically impossible to maximize in more than one dimension at the same time unless the dimensions are what are known as 'monotonic transformations' of one another."[90] This observation presents an obvious ambiguity in the statutory language.

A. Resolving the Ambiguity

As already discussed, investor protection remains the primary objective of the Acts. The question then becomes how to specify this objective in a way that is consistent with the wishes of Congress. Given its prominence in Section 106,[91] a conservative approach would be that SEC rulemaking, including the mandating of climate-related disclosures, cannot be less than neutral in the enhancement of efficiency, competition, and capital formation. As a result, SEC rulemaking can never have an *expected* negative impact on efficiency, competition, and capital formation. If so, then we can view the promotion of "efficiency, competition, and capital formation" as a form of a "hard" constraint—a constraint that must always be satisfied.

B. The Proposed Rule's Negative Impact on Corporate Governance

Unfortunately, the Proposed Rule does not take this approach. The required disclosures found in Section D of Part III of the Proposed Rule[92] will have an expected negative impact on the corporate governance of reporting companies. As a result, the expected impact on efficiency, competition, and capital formation will also be negative. The following discussion on their impact is based on a comment letter that James Copland and I

88 5 U.S.C. §§ 78c(f), 78o(n)(2).

89 *See* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3424–25, § 106.

90 Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPLIED CORP. FIN. 8, 10–11 (2001).

91 *See id.*

92 87 Fed. Reg. 21334, *supra* note 1, at 93–98.

wrote to the SEC.[93] These disclosures target both the board of directors and senior management.

i. Disclosures Required of the Board

Reporting companies are to provide "a description of the *processes* and *frequency* by which the board or board committee discusses climate-related risks," including "*how* the board is informed about climate-related risks . . . *how* frequently the board considers such risks" and "*whether and how* the board or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight."[94] The latter is meant to help "an investor to understand *whether and how* the board or board committee considers climate-related risks when reviewing and guiding business strategy and major plans of action, when setting and monitoring implementation of risk management policies and performance objectives, when reviewing and approving annual budgets, and when overseeing major expenditures, acquisitions, and divestitures."[95] In addition, "the proposed rule would require disclosure about *whether and how* the board sets climate-related targets or goals and *how* it oversees progress against those targets or goals, including the establishment of any interim targets or goals."[96]

ii. Disclosures Required of Senior Management

In regard to senior management, "a registrant would be required to disclose, as applicable, whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, to identify such positions or committees and disclose the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise."[97] Moreover, it would also "require disclosure about the *processes* by which the responsible managers or management committees are informed about and monitor climate-related risks."[98] Finally, the Proposed Rule would require "disclosure about *whether* the responsible positions or

93 Sharfman & Copland, *supra* note 6, at 13–17.
94 87 Fed. Reg. 21334, *supra* note 1, at 95 (emphasis added).
95 *Id.* (emphasis added).
96 *Id.* (emphasis added).
97 *Id.* at 96.
98 *Id.* (emphasis added).

committees report to the board or board committee on climate-related risks and *how* frequently this occurs."[99]

iii. The Impact

These disclosures, especially as they pertain to the *whether* and *how* of board and management decision-making, including those critical decisions that pertain to "business strategy and major plans of action, when setting and monitoring implementation of risk management policies and performance objectives, when reviewing and approving annual budgets, and when overseeing major expenditures, acquisitions, and divestitures,"[100] make the board and management extremely vulnerable to second-guessing and public criticism by shareholders.[101] The expected result would be to cool the ability of the board, the most informed locus of authority in a corporation, to make value-maximizing decisions, and senior management, the "locus of authority . . . separate from but under the control of the board, [that] not only runs the company on a day-to-day basis but also provides the board with recommendations on what investment projects and strategies the company should proceed with and then implements them with Board approval,"[102] to do their jobs guided by their own understanding of what is in the best interests of the company.[103]

iv. Summary

Section D disclosures will have a negative impact on reporting companies. It should not be a surprise that these types of disclosures are not made voluntarily. For the board, it will make it harder for its members to make decisions that are most efficient for purposes of value-maximization. For senior management, it will make it harder for them to provide recommendations to the board and do their day-to-day activities with optimal efficiency in mind. It will also make reporting companies less competitive with private and foreign companies that are not required to make such disclosures. However, it is unclear how these disclosures will impact capital formation. Nevertheless, given the expected negative outcomes on efficiency and competi-

99 *Id.* at 97 (emphasis added).

100 *Id.* at 95.

101 Sharfman & Copland, *supra* note 6, at 13–17.

102 Bernard S. Sharfman, *Activist Hedge Funds in a World of Board Independence: Creators or Destroyers of Long-Term Value?*, 2015 COLUM. BUS. L. REV. 813, 838 (2015).

103 *Id.* at 842–43.

tion, it is strongly urged that the SEC reconsider its Section D disclosures. If not, the SEC risks having these disclosures set aside by a reviewing court.

VI. A CLOSER LOOK AT MATERIALITY

As already discussed in Part III.B, materiality creates a strong presumption that the SEC can only require material disclosures in its rulemaking outside of those statutory non-material disclosures that Congress has incorporated into the Acts. Such a finding provides enhanced justification for the SEC when requiring disclosures under its regulatory authority. However, the Acts do not define "materiality," requiring the SEC to come up with its own definition.

A. The Definition of Materiality

From at least 1937 until 1982, the SEC used an "average prudent investor" standard.[104] Judge Friendly stated that standard in *SEC v. Geon Industries, Inc.*:

> Rule 12b-2 under the 1934 Act, like Rule 405 under the 1933 Act, instructs that use of the term 'material' to 'qualify a requirement for the furnishing of information *as to any subject*, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered.'[105]

In *TSC v. Northway*, the Supreme Court provided its own definition of materiality. It opened its discussion of materiality by noting the following:

> The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor. Variations in the formulation of a general test of materiality occur in the articulation of just how significant a fact must be or, put another way, how certain it must be that the fact would affect a reasonable investor's judgment.[106]

[104] Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23916, 23925 (Apr. 22, 2016) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249).

[105] SEC v. Geon Indus., Inc., 531 F.2d 39, 48 (2d Cir. 1976) (emphasis added).

[106] TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976).

The Court then provided the following definition of materiality in the context of the SEC's proxy rules:

> What the [general] standard [of materiality] does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.[107]

In *Basic Inc. v. Levinson*, the Court extended that definition to a Rule 10b-5 action involving a merger. There, the Court stated that "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information."[108]

In acknowledging that the federal courts were following the Supreme Court's definition as found in *TSC v. Northway*, the SEC soon followed suit in the context of its own actions:

> As noted above, the *Northway* standard was developed in the context of Rule 14a-9, an anti-fraud provision under the proxy rules; however, the standard has been applied by courts in other anti-fraud contexts as well as most other areas of the federal securities laws where the question of materiality has arisen. Based on the trend to apply the *Northway* standard in every type of federal securities law violation, it seems clear that the test of materiality developed by the Supreme Court in *Northway* would be applied *for any purpose* under the Securities Act and the Exchange Act and that the definition of materiality under those acts should reflect this standard.[109]

For example, the SEC has revised Rule 405 (promulgated under the 33 Act) to read: "The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable inves-

107 *Id.* at 449.

108 Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988).

109 Proposed Revision of Regulation C, Registration and Regulation 12B, Registration and Reporting, 46 Fed. Reg. 41971, 41977–78 (Aug. 18, 1981) (to be codified at 17 C.F.R. pts 201, 230, 240) (emphasis added) (footnotes omitted). This proposal was adopted by the SEC in the following year. *See* 46 Fed. Reg. 11380, 11393–94 (March 16, 1982).

tor would attach importance in determining whether to purchase the security registered."[110] Rule 12b-2 (promulgated under the 34 Act), uses the same definition.[111]

Professors Jill Fisch, George Georgiev, Donna Nagy, and Cynthia Williams argued in a comment letter to the SEC that the materiality standards found in *TSC v. Northway* and *Basic v. Levinson* are not relevant to SEC rulemaking, including those involving climate-related disclosures:

> A crucial first step in understanding these cases is that they deal with whether or not an issuer, at some specified point in the past, had a legal duty to disclose particular information, under a particular set of circumstances and in light of the applicable regulatory framework. In other words, the Supreme Court's materiality test applies to an ex post liability determination by a court or another adjudicatory body, not to an ex ante policy choice by a regulator. In stark contrast, when it engages in disclosure rulemaking, the Commission is making ex ante policy choices. *Unsurprisingly, then, neither TSC Industries, nor Basic, nor any other Supreme Court case touches on or limits the types of information the Commission is empowered to require when it promulgates disclosure rules*.[112]

Yet, as discussed above, since the earliest days of the SEC, the Commission has felt the need to focus on and define the term "materiality," and how it must act as a constraint on its disclosure rulemaking, including its 2010 Guidance.[113] For example, the 2010 Guidance focused on disclosing material risk factors "that make an investment in the registrant speculative or risky" or "are reasonably likely to have a material effect on [a public company's or registrant's] financial condition or operating performance."[114] As the Proposed Rule noted, "[t]he 2010 Guidance emphasized that if climate-related factors have a material impact on a firm's financial condition, disclosure may be required under current Item 101 (Description of Business), Item

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110 17 C.F.R. § 230.405 (2022).

111 17 C.F.R. § 240.12b-2 (2022).

112 Jill E. Fisch, George S. Georgiev, Donna M. Nagy & Cynthia A. Williams, Comment Letter on Proposed Rule for The Enhancement and Standardization of Climate-Related Disclosures for Investors (S7-10-22) (June 6, 2022), at 14 (footnotes omitted) (emphasis added), https://perma.cc/LX5G-MQ6H.

113 Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 76.

114 *Id.* at 15–17 (footnote omitted).

103 (Legal Proceedings), Item 105 (Risk Factors), or Item 303 (MD&A) of Regulation S-K."[115] As noted by Fisch and Georgiev, "many existing disclosure requirements expressly incorporate a materiality test."[116] No doubt the materiality framework of the Acts was the impetus for this approach.

B. The "Reasonable Investor"

The Supreme Court's definition of materiality and its general acceptability by the federal courts and the SEC "for all purposes" also requires an exploration of what it means to be a "reasonable investor." As the Court stated in *TSC v. Northway*:

> The determination [of materiality] requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact.[117]

The result, according to Professor Amanda Rose, is that "[t]he 'reasonable investor' is at best a shadowy figure, described only generically in judicial opinions and—in doctrine if not in practice—someone for the fact-finder to identify case-by-case."[118] Therefore, in the context of identifying how materiality limits the disclosure authority of the SEC, I agree with Professor Rose that "the identity of the reasonable investor is a policy choice that should be made by the SEC in rulemaking or by Congress in legislation, so that companies understand how to think about their disclosure obligations . . . ."[119] So far, neither Congress nor the SEC has sought to tackle this issue.[120]

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115 87 Fed. Reg. 21334, *supra* note 1, at 296.

116 Fisch et al., *supra* note 112, at 14. They provide the following ruled qualified by materiality: "Examples of rules qualified by materiality include Item 103 of Regulation S-K (requiring disclosure of "material pending legal proceedings") and Item 303 of Regulation S-K (requiring disclosure of matters that have had a "material impact" on reported operations or are reasonably likely to have such an impact on future operations)." *Id.* at n.62. They also provide examples of rules that they do not believe are qualified by materiality: "Examples of rules not qualified by materiality include, among others, Item 401 of Regulation S-K (requiring disclosure of specified information about directors, executive officers, promoters, and control persons) and Item 402(c)(1) of Regulation S-K (requiring disclosure of the salary, bonus, stock awards, stock option awards, and other specified elements of executive compensation without subjecting the elements or the amounts involved to a materiality test)". *Id.*

117 TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450 (1976).

118 Amanda Rose, *The "Reasonable Investor" of Federal Securities Law: Insights from Tort Law's "Reasonable Person" & Suggested Reforms*, 43 J. CORP. L. 77, 79 (2017).

119 *Id.* at 80.

120 *Id.* at 79.

However, not is all lost in trying to identify the reasonable investor. I believe former SEC Commissioner Elad Roisman had it right when he said that "it seems clear that a 'reasonable investor' is someone whose interest is in a financial return on an investment."[121] This means that determining materiality of disclosures must be tied "to a company's financial value."[122] This understanding of the reasonable investor is supported by Sean Griffith's argument that investor protection should be understood as the protection of a class of investors who are interested in financial returns:

> Because all investors invest with an expectation of a financial return, the interest that investors, as a class, share is the financial return of the investment. Investors, like all people, may have other interests besides financial return. People might care about clean water, breathable air, and puppies. But, given a large enough group, there will be others who are indifferent, opposed, or even if they share the same general preferences, have an ordinal ranking of preferences that renders them opposed to action on a specific issue. In markets, the law of large numbers will operate to cancel out offsetting preferences, leaving the one interest that all investors share—that is, their interest in a financial return.
>
> While it is true that some people may use their investments to achieve non-financial objectives, this does not change the fact that the expectation of a financial return is the one interest investors share as a class.[123]

Therefore, in order for disclosures to be material, they must relate to the financial returns of the investment.[124] This is what a reasonable investor would require.

C. Materiality and the Proposed Rule's Greenhouse Gas Emissions ("GHG") Emissions Disclosures

Consistent with this Article's understanding of materiality and its role as a policy constraint, the SEC incorporated the 2010 Guidance into the Proposed Rule. But then, it went off the

[121] Elad L. Roisman, Commissioner, SEC, Can the SEC Make ESG Rules that are Sustainable? (June 22, 2021) (transcript available at https://perma.cc/54PG-45CY).

[122] *Id.*

[123] Griffith, *supra* note 5, at 921 (footnotes omitted).

[124] *See id.* at 884 ("The 'reasonable investor' aspect of materiality demands that information be on topic—that is, relevant to investment analysis").

rails. It did not require a materiality standard for a reporting company's required disclosures of Scope 1 and Scope 2 emissions. Moreover, even though the Proposed Rule allegedly incorporates a "materiality standard" in its required disclosures of Scope 3 emissions, this is not correct. Commissioner Pierce has strongly criticized this "materiality standard," saying in essence it is a "fiction."[125] Pierce describes this fiction as follows:

> The materiality limitation is not especially helpful because the Commission suggests that such emissions generally are material and admonishes companies that materiality doubts should "'be resolved in favor of those the statute is designed to protect,' namely investors." That admonition does not work as the Supreme Court intended it when "investors" are redefined to mean "stakeholders," for whom the cost of collecting and disclosing information is irrelevant. The release offers without explicitly endorsing a possible quantitative metric (40% of a company's total GHG emissions) at which Scope 3 emissions might well be material, but then layers on a hazy qualitative test: "where Scope 3 represents a significant risk, is subject to significant regulatory focus, or 'if there is a substantial likelihood that a reasonable [investor] would consider it important.'" The Commission also reminds companies that "[e]ven if the probability of an adverse consequence is relatively low, if the magnitude of loss or liability is high, then the information in question may still be material." Further deterring omission of Scope 3 data, the release says, "it may be useful [for investors of companies that do omit Scope 3 emissions for lack of materiality] to understand the basis for that determination." Likewise, if a company "determines that certain categories of Scope 3 emissions are material, [it] should consider disclosing why other categories are not material." In sum, the Commission seems to presume materiality for Scope 3 emissions.[126]

Moreover, Scope 3 emissions data does not appear relevant to providing reasonable investors with information on a company's financial returns. As a result, it is hard to see how these climate-related disclosures can be considered material.

The Proposed Rule's disregard for materiality in regard to Scope emissions, an approach that was not explained or justified

[125] Peirce, *supra* note 84.

[126] *Id.* (alterations in original) (footnotes omitted).

in the Proposed Rule, was foreshadowed in a speech by Commissioner Allison Lee in May 2021.[127] In that speech, Lee argued that the SEC has broad authority to require climate-related disclosures even if they are not material:

> Indeed our statutory rulemaking authority under Section 7 of the Securities Act of 1933 gives the SEC full rulemaking authority to require disclosures in the public interest and for the protection of investors. That statutory authority is not qualified by "materiality." Similarly, the provisions for periodic reporting in Sections 12, 13 and 15 of the Securities Exchange Act of 1934 are not qualified by "materiality."[128]

This break from a materiality standard is problematic. Materiality as a constrain on mandatory disclosures serves at the behest of investor protection and, secondarily, for the promotion of efficiency, competition, and capital formation. As Professor J.W. Verret observed, "how can disclosure that the SEC is unable to demonstrate as material ever further the purposes of investor protection or capital formation?"[129] Moreover, he further observes that "[i]f a rule does not provide material benefit to shareholders, and has significant costs associated with it, it would seem unlikely the SEC could determine that the rule furthered the goals of investor protection, efficiency, competition and capital formation."[130]

D. Material v. Non-Material Disclosures

Does every disclosure that the SEC requires in its rulemaking have to be material? As former SEC Commissioner Allison Lee observed, when statutory authority is not qualified by materiality, the technical answer is no.[131] As already discussed, this observation is consistent with this Article's argument that materiality is a "soft" constraint on the SEC's disclosure authority. But this does not mean the SEC has authority to mandate non-material disclosures without boundaries. When the SEC requires non-material disclosures, the disclosures cannot be un-

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127 Allison Herren Lee, Commissioner, SEC, Living in a Material World: Myths and Misconceptions about "Materiality" (May 24, 2021) (footnote omitted), https://perma.cc/7292-ZEZ7.

128 *Id.* (footnote omitted).

129 J.W. Verret, *The Securities Exchange Act Is a Material Girl, Living in a Material World: A Response to Bebchuk and Jackson's 'Shining Light on Corporate Political Spending'*, 3 HARV. BUS. L. REV. 453, 457 (2013).

130 *Id.* at 457–58.

131 *See* Lee, *supra* note 127.

moored from the Acts. There must be some nexus between the rulemaking authority provided to the SEC in the Acts and the rules it promulgates. If not, then the Acts are in conflict with the nondelegation doctrine. Fortunately, a nexus is provided by the Acts' other two ascertainable standards. Therefore, without an operative section requiring non-material disclosures, such as Scope 1, 2, and 3 emissions, the SEC can only require them if they facilitate the two policy objectives found in the Acts—investor protection and promoting efficiency, competition, and capital formation.

VII. IN THE PUBLIC INTEREST

It is critically important for Congress, the representatives of the people, to correctly define the term "in the public interest" in the context of a regulatory statute. If not, then we leave it to the discretion of agency administrators whose definition may result in the abuse of governmental power. According to Professor Jodi Short:

> "Public interest" standards in statutory delegations to agencies represent the greatest hopes and the darkest fears of the U.S. administrative state. On the one hand, the public interest standard provides a vessel for agencies to infuse policymaking with the moral and ethical commitments of the community. On the other hand, regulation in the public interest opens the door to the arbitrary exercise of tyrannical state power.[132]

Moreover, without a good definition of "in the public interest," we have no idea what aspect of the "common good"[133] Congress is trying to target in the regulatory statute, leaving the administering agency with little guidance on how it should proceed. According to Professor Lee Strang, "[l]aw's overarching purpose is to better secure the common good, while its specific purpose will vary depending on the particular goal the legislator has in mind for a particular statute. Law is an instrument or

[132] Jodi L. Short, *In Search of the Public Interest*, 40 YALE J. ON REGUL. 759, 762 (2023).

[133] According to Aristotle, "[T]hose constitutions [overall structure of government] that aim at the common advantage are—in accord with what is unconditionally just—correct, whereas those that aim only at the advantage of the rulers are erroneous ones, and deviations from the correct constitutions. For they are like the rule of a master, whereas a city is a community of free people." *See* ARISTOTLE, POLITICS bk. III 61 (C. D. C. Reeves trans., Hackett Publ'g Co., 2017) (c. 384 B.C.E) (footnote omitted).

tool of the legislator to effect a change in society to better order society toward the common good."[134]

Fortunately, the statutory language of the Acts allows us to understand how "in the public interest" is to be defined for purposes of evaluating the SEC's rulemaking authority. As already discussed, the repeated references to the term "in the public interest" does not mean that Congress has provided the SEC with the maximum discretion to act. Instead, it has no real meaning until after the ascertainable standards of the Acts are identified and understood. The triad of ascertainable standards fill up the empty shell that is "in the public interest," providing the common good objectives of the Acts.

In the context of the Acts, "in the public interest" can be thought of as a maximization problem with two constraints. What is being maximized when the SEC takes an action, such as promulgating climate-related disclosures, is "investor protection." This is the primary mission of the Acts. Based on the historical context of the Acts, investor protection is defined as informing investors of firm specific investment risk. The first constraint of this maximization problem is actually the secondary objective, the promotion of efficiency, competition, and capital formation. To specify this objective as a constraint, a SEC action can never have an expected negative effect on the promotion of efficiency, competition, and capital formation. However, the expected impact can be neutral and most definitely positive. This makes the objective a "hard" constraint in the maximization problem—a constraint that must always be satisfied. The second constraint is materiality. As already mentioned, not every required disclosure needs to be material. In that sense, materiality is a "soft" constraint on the SEC's rulemaking authority. Nonetheless, non-material disclosures can only be required if it can be shown that they advance investor protection, as defined in the Article, and have at least a neutral impact on the promotion of efficiency, competition, and capital formation.

VIII. REASONABLENESS AND CHEVRON DEFERENCE

Two major accomplishments of this Article have been providing definitions for two key and highly ambiguous terms that permeate the Acts: "in the public interest" and "for the protection of investors." If the SEC were to adopt these definitions,

134 Lee J. Strang, *The Role of the Common Good in Legal and Constitutional Interpretation*, 3 U. ST. THOMAS L.J. 48, 57 (2005).

which this Article has argued to be what Congress intended, then there would be no problem for a reviewing Court to provide the SEC with deference in the use of these definitions for purposes of rulemaking. This follows from *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, where the Supreme Court stated the following:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute. "The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." *Morton v. Ruiz*, 415 U.S. 199, 231 (1974). If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. Sometimes the legislative delegation to an agency on a particular question is implicit rather than explicit. In such a case, a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.[135]

This is referred to as *Chevron* deference.

Yet, as discussed in *NAACP v. FPC*, it is hard to see how a reviewing court could provide *Chevron* deference to the SEC's use of the terms "in the public interest" and "for the protection of investors" when it refuses to provide definitions that "take

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[135] Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842–44 (1984) (footnotes omitted) (parallel citations omitted).

meaning from the purposes of the regulatory legislation."[136] Again, citing to Commissioner Lee's speech setting the stage for the Proposed Rule, she argued that the terms "in the public interest" and "for the protection of investors" allowed the SEC to ignore the policy constraint of materiality in any proposed rule on climate-related disclosures.[137] This argument was made without bothering to define what those terms meant to the SEC.[138] Unfortunately, this abdication approach was also taken in the Proposed Rule. The only explanation is that the SEC is interpreting "in the public interest" and "for the protection of investors" to mean that it has almost unlimited discretion to implement whatever required disclosures it wants, including having such discretion in the area of climate-related disclosures. This is an *unreasonable* interpretation of the terms, being unmoored from the Acts, and not worthy of *Chevron* deference.[139]

IX. WHAT CAN THE SEC DO?

According to Professor Stack, "having identified the statute's purposes or principles, the agency has an obligation to do something with them."[140] The identification of these purposes or principles (ascertainable standards) that appear in the Acts is what this Article has provided the SEC. Therefore, in the process of creating and finalizing its rules, including its rules on climate-related disclosures, it "has an obligation to do something with them."[141]

In addition, the SEC must make a good faith effort to abide by these ascertainable standards and not go off in a direction which a majority of Commissioners may personally feel is superior. Unfortunately, as discussed in this Article, the divergence

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136 NAACP v. Fed. Power Comm'n, 425 U.S. 662, 669 (1976).

137 *See* Lee, *supra* note 127.

138 *See id.*

139 Chevron deference is now undergoing review by the U.S. Supreme Court. *See Loper Bright Enterprises v. Raimondo*, SCOTUSBLOG (last visited Oct. 13, 2023), https://perma.cc/S32G-3324 (the issue in *Loper* is "Whether the court should overrule *Chevron v. Natural Resources Defense Council*, or at least clarify that statutory silence concerning controversial powers expressly but narrowly granted elsewhere in the statute does not constitute an ambiguity requiring deference to the agency." If Chevron is overruled or narrowed in *Loper*, it is likely that the SEC will be compelled to provide definitions of "in the public interest" and "for the protection of investors" that will be provided little or no deference by a reviewing court. As a result, the best definition in the eyes of the reviewing court will win).

140 Stack, *supra* note 14, at 895.

141 Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 76.

from these standards, a divergence that represents a denial of "the principle of legislative supremacy," is clearly found in the Proposed Rule. According to Professor Evan Criddle in his discussion of Professor Stack's purposive approach to rulemaking:

> To the extent that the Constitution requires Congress to embed intelligible principles in regulatory statutes, both textualists and purposivists should be able to accept that *the principle of legislative supremacy* requires agencies to respect these principles as authoritative guidance when addressing statutory ambiguities, silences, contradictions, and other puzzles. For this reason alone, the idea that agencies may turn to "the incumbent administration's views of wise policy" rather than seeking in good faith to apply a statute's intelligible principle is antithetical to bedrock constitutional principles.[142]

Moreover, this constitutional approach must be taken despite the recognition that agency administrators, including SEC commissioners, may feel the need to diverge from this approach because of political pressure:

> Political oversight is a basic feature of agency life. Virtually all agencies remain in some dialogue with the White House on the implementation of policy, and likewise face the recurrent prospect of being called to account for their decisions before congressional committees. At this high level of abstraction, an agency implements its statute in a context in which the agency as a whole is viewed as appropriately influenced by the views of current politicians.[143]

What should also be apparent from this Article is that, no matter which administration is in power, the more one can identify ascertainable standards with substantive meaning, the more restraints Congress is placing on an agency's discretionary authority to act. In that regard, the ascertainable standards of the Acts create significant boundaries for SEC rulemaking: investor protection being defined as informing investors of firm specific investment risk; making sure disclosures will actually enhance efficiency, competition, and capital formation and not lead to their reduction; and the constraint of materiality requiring the

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[142] Evan J. Criddle, *The Constitution of Agency Statutory Interpretation*, 69 VAND. L. REV. EN BANC 325, 336–37 (2016) (emphasis added).

[143] Kevin M. Stack, *Agency Statutory Interpretation and Policymaking Form*, 2009 MICH. ST. L. REV. 225, 228 (2009) (footnotes omitted).

SEC to be very cautious in its approach to promulgating climate-related disclosures. Thus, the remaining question to be asked is, given these boundaries, what can the SEC do in the way of climate-related disclosures for investors?

The required approach is already found in the 2010 Guidance where the focus is on disclosing material risk factors "that make an investment in the registrant speculative or risky" or "are reasonably likely to have a material effect on [a public company's or registrant's] financial condition or operating performance."[144] These material effects would need to be reported in Item 101 (Description of Business), Item 103 (Legal Proceedings), Item 105 (Risk Factors), or Item 303 (MD&A) of Regulation S-K.[145]

Since 2010, investors have become more aware of the risks that climate change has had and may have on our economy, and clearly an update of that guidance with more examples of firm specific investment risk that a reporting company needs to disclose would be useful. For example, investors are becoming better informed of low probability, high impact climate change events that may materially harm a reporting company,[146] or the impact on a company from multiple freak winter storms that take down an entire state's power grid for days.[147] Moreover, even if the risk of these events have already been disclosed, further disclosure may be required if the probability and/or impact of such events have increased over the years.

However, this update does not necessarily need to take the form of a proposed rule. It can simply be provided as an interpretive release—a rule or statement "issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers."[148] No notice or comment period is required given that all the SEC is doing is updating its 2010 Guidance.

In sum, the SEC is significantly constrained in what it can do in the way of requiring climate-related disclosures. A climate-

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144 Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 76, at 15–17 (footnote omitted).

145 *See id.* at 13–20.

146 Bernard S. Sharfman, *Non-Material Mandatory Climate Change Disclosures*, *supra* note 55, at 6; *see also*, Neil Hodge, *How to Address Low-Probability, High-Impact Risks*, RISK MANAGEMENT (Feb. 1, 2021), https://perma.cc/5YFE-EY5M.

147 *2021 Texas power crisis*, WIKIPEDIA (Oct. 23, 2021, 7:27 AM), https://perma.cc/46V2-Q3CV.

148 *Agency Guidance Through Interpretive Rules,* ADMIN. CONF. OF THE UNITED STATES (Aug. 8, 2019), https://perma.cc/5QCC-PCMG .

related disclosure framework that can work within these constraints is already found in its 2010 Guidance. For the SEC to do more, Congress must amend the Acts.