

# The First Amendment Implications of a Mandatory Environmental, Social, and Governance Disclosure Regime

by Rebecca Susko

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It is undeniable that globalization has increased the extent to which corporate entities are connected to the daily lives of people from every corner of the world. Yet coupled to the growing reach of corporations is a growing demand that the behavior of private business reflect public aims.<sup>1</sup> The tethering of corporate action to social policy is not new. Indeed, corporate law has been blended with social policy through the securities disclosure regime for decades.<sup>2</sup> However, what is new is a rapidly growing interest across business, government, and civil society in using disclosure regimes to transform corporate behavior. In fact, the refocusing of corporate purposes toward the achievement of environmentally and socially responsible outcomes has been characterized by some as a “mega-trend.”<sup>3</sup>

In many ways, this trend has been embraced by the corporate world through the adoption of voluntary reporting on environmental, social, and governance (ESG) indicators. Indeed, efforts to develop voluntary transnational reporting standards have proliferated in recent years.<sup>4</sup> However, some scholars have argued that industry-led efforts to adopt voluntary disclosure standards are simply

a means for companies to create a non-enforceable regime precisely to “resist the legalization of their social duties.”<sup>5</sup> Thus, the establishment of voluntary standards may serve to undermine the development of a stronger form of regulation: sovereign domestic law.<sup>6</sup>

Nevertheless, since 2000, 22 countries and the European Union (EU) have enacted legislation that requires public companies to report on environmental and social indicators.<sup>7</sup> Conspicuously missing from this list of countries is the United States. While the United States has certain environmental and social disclosure requirements in industry-specific contexts,<sup>8</sup> there is currently no mandatory general ESG reporting framework.<sup>9</sup> The lack of a mandatory ESG reporting regime is problematic because the available empirical evidence suggests that the effectiveness of ESG disclosure regimes only manifests when the regime is mandatory, specific, and targeted to an identifiable group of users.<sup>10</sup>

Despite calls from some for a mandatory ESG disclosure regime in the United States, there has been hesitation from the business community toward adopting manda-

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1. See Cynthia Williams, *Corporate Social Responsibility and Corporate Governance*, in OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe ed., Oxford Univ. Press 2018) (manuscript at 37-38), available at [https://digitalcommons.osgoode.yorku.ca/cgi/viewcontent.cgi?article=2783&context=scholarly\\_works](https://digitalcommons.osgoode.yorku.ca/cgi/viewcontent.cgi?article=2783&context=scholarly_works).
2. See Cynthia Williams, *The Securities and Exchange Commission and Corporate Social Responsibility*, 112 HARV. L. REV. 1199, 1203 (1999).
3. Jerry K.C. Koh & Victoria Leong, *The Rise of the Sustainability Reporting Megatrend: A Corporate Governance Perspective*, 18 BUS. L. INT’L 233, 234 (2017).
4. See Cynthia Williams, *The Global Reporting Initiative, Transnational Corporate Accountability, and Global Regulatory Counter-Currents*, 1 U.C. IRVINE J. INT’L TRANSNAT’L & COMP. L. 67, 69 (2016).

5. Ronen Shamir, *Between Self-Regulation and the Alien Tort Claims Act: On the Contested Concept of Corporate Social Responsibility*, 38 LAW & SOC’Y REV. 635, 636 (2004).
6. See Williams, *supra* note 4, at 70.
7. *Id.* at 73 (citing INITIATIVE FOR RESPONSIBLE INVESTMENT, CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE EFFORTS BY NATIONAL GOVERNMENTS AND STOCK EXCHANGES (2015), [http://iri.hks.harvard.edu/files/iri/files/corporate\\_social\\_responsibility\\_disclosure\\_3-27-15.pdf](http://iri.hks.harvard.edu/files/iri/files/corporate_social_responsibility_disclosure_3-27-15.pdf)). These countries include Argentina, China, Denmark, Ecuador, the EU, Finland, France, Germany, Greece, Hungary, India, Indonesia, Ireland, Italy, Japan, Malaysia, the Netherlands, Norway, South Africa, Spain, Sweden, Taiwan, and the United Kingdom.
8. One example of such industry-specific disclosure requirements is the conflict mineral disclosures required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
9. Williams, *supra* note 1 (manuscript at 16).
10. See Williams, *supra* note 4, at 82.

tory environmental and social disclosure requirements. This fear is due to the potential threats of liability that a mandatory disclosure regime presents. Given the legal risks associated with a mandatory disclosure regime, it is likely that any attempt by the U.S. Securities and Exchange Commission (SEC) to mandate nonfinancial disclosures in the United States would be vigorously challenged by the business community.

One safeguard shielding corporations from a potential mandatory disclosure regime is the free speech protections afforded by the First Amendment. Although First Amendment protections have generally been curtailed in the context of commercial speech, recent challenges to mandatory disclosures have revealed conflicting treatment of compelled commercial disclosures among the lower courts. This uncertain judicial treatment of compelled commercial disclosures is likely a factor disincentivizing the SEC from creating the type of ESG disclosure regime that would be most effective: a mandatory disclosure regime.

Thus, despite the market trending toward increased ESG disclosure, the lower courts have created a level of untenable ambiguity about precisely the matters that would otherwise appropriately be included in regulations mandating such disclosure. It is therefore critical that compelled commercial disclosure jurisprudence is clarified to enable the SEC to take more meaningful and considered action toward establishing mandatory ESG reporting requirements that will better effectuate the goals of nonfinancial disclosure. In the absence of doctrinal clarity, the United States will continue to lag behind the ESG disclosure mega-trend.

It is against this background that this Comment analyzes the First Amendment implications if the SEC were to implement a mandatory ESG disclosure regime. The Comment proceeds in five parts. Part I explores the rising interest in the use of ESG disclosures as a mechanism to spur private business to address public concerns. Part II tracks the evolution of First Amendment protections for commercial speech, and highlights the growing doctrinal confusion that has emerged as courts attempt to apply commercial speech jurisprudence to compelled disclosures. In addition, Part II argues that the recent precedent that developed from judicial review of the conflict mineral disclosure requirement of the Dodd-Frank Act<sup>11</sup> has resulted in a novel and heightened level of scrutiny for compelled commercial disclosures. Next, Part III assesses whether two existing disclosure frameworks, if adopted as mandatory by the SEC, would pass constitutional scrutiny under this new, heightened level of review. Drawing from the conclusions of Part III, Part IV proposes a rejection of heightened scrutiny in the context of compelled disclosures in favor of a return to prior precedent, which best comports with First Amendment jurisprudence and the policies undergirding the commercial speech doctrine. Part V concludes.

11. Pub. L. No. 111-203, §929-Z, 124 Stat. 1376, 1871 (2010).

## I. The Rise of ESG Disclosure

Since the enactment of the Securities Act of 1933 and the Exchange Act of 1934,<sup>12</sup> the SEC has been empowered to regulate business entities by requiring public disclosure of information when securities are issued and through periodic disclosure thereafter.<sup>13</sup> The purpose of such disclosures is to reduce the information gap between company managers and investors to promote fair and efficient capital markets.<sup>14</sup> Although SEC disclosures are typically filtered through the lens of materiality, under §14(a) of the Exchange Act, the SEC may require disclosures “as necessary or appropriate in the public interest or for the protection of investors.”<sup>15</sup> Therefore, the SEC has the power to compel disclosure both for the protection of investors and for the protection of the public interest.<sup>16</sup>

The initial enactment of the Securities Act and the Exchange Act resulted in two separate reporting regimes.<sup>17</sup> In order to eliminate duplicative reporting requirements, the SEC promulgated Regulation S-K that integrated the reporting requirements into a single regulatory regime.<sup>18</sup> Regulation S-K has been expanded and reorganized since the mid-1960s and now is the single, integrated repository for nonfinancial disclosure requirements.<sup>19</sup> Regulation S-K requires disclosure of both qualitative and quantitative information, with an increasing emphasis on the use of narrative disclosure that incorporates forward-looking information.<sup>20</sup>

Beginning in the 1960s, there was a movement to incorporate more robust social disclosures in the SEC’s regulatory regime, stemming from the anti-war and environmental movements that took hold during this time.<sup>21</sup> These efforts focused on incorporating a wider range of social, environmental, and ethical components into the materiality standard. Initial efforts were rejected by the SEC, which found that social and environmental disclosures were not the primary concern of investors.<sup>22</sup> As such, the SEC continued to rely on economic and financial indicators to inform its understanding of the materiality standard.

Beginning in the 1990s, there was a dramatic rise of multinational corporations and a rapid rate of globalization that led to increasing interest and concern over the activities of such corporations. Many of the efforts centered primarily around protesting corporate action perceived to be unethical.<sup>23</sup> Another strand of discourse emerging at that time was a push toward greater corporate accountabil-

12. 15 U.S.C. §§77a et seq.; 15 U.S.C. §§78a et seq.

13. See Williams, *supra* note 2.

14. Business and Financial Disclosure Required by Regulation S-K, SEC Release No. 33-10064, 81 Fed. Reg. 23916 (Apr. 13, 2016) [hereinafter SEC Concept Release].

15. Exchange Act §14(a), 15 U.S.C. §78n.

16. See Williams, *supra* note 2.

17. See SEC Concept Release, *supra* note 14.

18. See *id.*

19. See *id.*

20. See Williams, *supra* note 2.

21. See *id.*

22. See *id.*

23. See Koh & Leong, *supra* note 3.

ity through transparency of financial information and of social issues more broadly.<sup>24</sup> The first attempt at a coordinated effort to promote corporate transparency was taken up in 1997 by the nongovernmental organization Coalition for Environmentally Responsible Economies (CERES). CERES developed the Global Reporting Initiative (GRI) (described in Section I.B.), a nonprofit organization that created a voluntary disclosure framework that corporations can use as a mechanism for reporting on ESG issues.<sup>25</sup>

Since 1997, other initiatives have developed reporting metrics, standards, and guidelines to help companies more effectively disclose ESG information.<sup>26</sup> The rising interest in ESG reporting among investors, regulators, consumers, and other stakeholders has been described as a “mega-trend.”<sup>27</sup> Indeed, the Governance and Accountability Institute reports that as of 2017, 85% of S&P 500 companies report on sustainability indicators, up from less than 20% in 2011.<sup>28</sup>

Currently, there is a wide variety of disclosure regimes, both mandatory and voluntary. Countries from virtually every region of the world now engage in some type of reporting.<sup>29</sup> Two such reporting regimes, the mandatory EU Directive on Non-Financial Disclosures and the voluntary GRI, are discussed below.

### A. The EU Directive on Non-Financial Disclosures

In 2014, the Council of the EU adopted Directive 2014/95/EU, a directive that establishes required disclosures of non-financial and diversity information that applies to certain large businesses.<sup>30</sup> This Directive was part of an initiative started in 2011 to improve disclosure of social and environmental information among businesses operating in EU Member States.<sup>31</sup> It required Member States to transpose its policies into domestic law by December 2016, such that the disclosure provisions would be effective for the 2017 financial year.<sup>32</sup> The Directive, which establishes a mandatory reporting regime, requires large public interest entities<sup>33</sup> with more than 500 employees to include in the management report a nonfinancial statement that includes:

information to the extent necessary for an understanding of the undertaking’s development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:

- (a) a brief description of the undertaking’s business model;
- (b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;
- (c) the outcome of those policies;
- (d) the principal risks related to those matters linked to the undertaking’s operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;
- (e) non-financial key performance indicators relevant to the particular business.<sup>34</sup>

In addition to establishing certain mandatory disclosure requirements, the harmonization across the EU created by the Directive is also expected to make it easier for corporations to operate in multiple Member States. Additionally, stakeholders will have an increased ability to compare non-financial disclosures across sectors and businesses.<sup>35</sup>

### B. The GRI

The GRI, a private nonprofit, is a transnational body that aims to empower civil society to seek greater corporate accountability through the use of sustainability reporting.<sup>36</sup> The GRI’s primary goal is to make sustainability reporting standard practice for corporations—akin to the status of financial reporting—enabling corporations to measure, understand, and communicate their performance, set goals to manage change effectively, and offer ESG disclosures that are comparable across entities.<sup>37</sup>

To accomplish this goal, GRI has developed a set of voluntary reporting standards that are both quantifiable and flexible. The reporting framework is modeled after the Generally Accepted Accounting Principles and is designed to not only simplify but also unify reporting criteria of ESG issues that are often abstract and complex.<sup>38</sup> The GRI

24. See C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 134 (2002).

25. See Koh & Leong, *supra* note 3.

26. Examples of such initiatives include the Dow Jones Sustainability Indices, the Sustainability Accounting Standards Board, and the Organisation for Economic Co-operation and Development Guidelines for Multinational Enterprises.

27. See Koh & Leong, *supra* note 3.

28. See GOVERNANCE & ACCOUNTABILITY INSTITUTE, FLASH REPORT: 85% OF S&P 500 INDEX COMPANIES PUBLISH SUSTAINABILITY REPORTS IN 2017 (2018), <https://www.ga-institute.com/press-releases/article/flash-report-85-of-sp-500-indexR-companies-publish-sustainability-reports-in-2017.html>.

29. See Barnali Choudhury, *Social Disclosure*, 13 BERKELEY BUS. L.J. 183, 195 (2016).

30. See European Commission, *Non-Financial Reporting*, [https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting\\_en](https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en) (last visited Sept. 3, 2018).

31. See Council Directive 2014/95/EU, pmb1., 2014 O.J. (L 330).

32. See *id.* art. 4.

33. Such entities include approximately 6,000 large companies and groups across the EU, including listed companies, banks, insurance companies,

and other companies designated by national authorities as public interest entities. See European Commission, *supra* note 30.

34. Council Directive 2014/95/EU, art. 1, 2014 O.J. (L 158).

35. See Koh & Leong, *supra* note 3.

36. See Galit A. Sarfaty, *Regulating Through Numbers: A Case Study of Corporate Sustainability Reporting*, 53 VA. J. INT’L L. 575, 592 (2013).

37. See Chloe Ghoogassian, *Evading the Transparency Tragedy: The Legal Enforcement of Corporate Sustainability Reporting*, 11 HASTINGS BUS. L.J. 361, 367 (2015).

38. Paulette L. Stenzel, *Connecting the Dots: Synergies Among Grassroots Tools for Authentic Sustainable Development*, 25 FORDHAM ENVTL. L. REV. 393, 400 (2014).

framework allows companies to decide what standards to report on, reflecting the indicators considered most important for the business and stakeholders.<sup>39</sup> Overall, the purpose of the framework is to promote transparency and accountability to empower economically, socially, and environmentally sound decisionmaking.<sup>40</sup> Currently, the GRI is the most widely utilized sustainability reporting standard. Of the world's largest 250 corporations, 92% report on their sustainability performance and 74% of those use the GRI standards to do so.<sup>41</sup>

The current iteration of the GRI standards includes universal standards that every entity can utilize and topic-specific standards that an entity can choose to include based on the issues considered most critical to stakeholders.<sup>42</sup> The universal standards include GRI 102: General Disclosures, which requests information about a company's profile, strategy, ethics and integrity, governance, stakeholder engagement practices, and reporting process, and GRI 103: Management Approach, which allows a company to provide a narrative explanation about the ways the entity manages material topics.

Topic-specific standards cover a wide range of economic, environmental, and social issues including GRI 204: Procurement Practices, GRI 302: Energy, and GRI 411: Rights of Indigenous Peoples.<sup>43</sup> GRI also produces sector-specific guidelines to help entities in specific industries focus their reports on the particular topics that are material to that sector.<sup>44</sup> Sectors for which guidance is available include financial services, food processing, non-governmental organizations, mining and metals, airport operators, construction and real estate, oil and gas, media, event organizers, and electric utilities.<sup>45</sup>

## II. First Amendment Challenges to Mandatory Disclosure Requirements

Despite increasing reliance on the use of corporate disclosure to promote social and environmental policies—which has been hailed by certain investors and the general public—corporations have been pushing back against this movement. Indeed, many corporations view the use of securities disclosures as a co-option of a primarily private tool to promote public goals.<sup>46</sup> There is also skepticism that onerous disclosure requirements may actually harm shareholder interests as the cost of compliance increases and the market becomes saturated with information of question-

able value.<sup>47</sup> Not surprisingly, therefore, corporations have sought to challenge the use of mandatory ESG disclosure requirements. One avenue of attack taken by corporations is to challenge disclosure requirements as violative of the First Amendment's free speech protections. Specifically, challenges have focused around the compelled nature of such disclosures in the context of commercial speech.

### A. First Amendment Protection of Commercial Speech: Intermediate Scrutiny

Under the First Amendment, the U.S. Supreme Court has not extended the same level of protection for all types of speech. Distinctions between types of speech are based, in part, on the content of the speech as well as the context in which the speech is made.<sup>48</sup> Unlike other forms of speech such as political speech, commercial speech receives a lower level of protection.<sup>49</sup> The limitations and level of protection for commercial speech were first established in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*.<sup>50</sup> There, the Court recognized that while commercial speech should be afforded protection for the benefit of providing information to the marketplace, some limits on commercial speech were justified to ensure consumers could engage in informed decisionmaking.<sup>51</sup> Specifically, content-neutral "time, place, and manner" restrictions were held to be appropriate where there is a significant government interest and where there are alternative channels of communicating the information.<sup>52</sup> Additionally, the Court found regulations prohibiting false or misleading information were also permissible in the context of commercial speech.<sup>53</sup>

The protections afforded to commercial speech were further refined by the Court in *Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*. There, the Supreme Court announced a four-part test to analyze whether a restriction on commercial speech is constitutionally valid under the First Amendment.<sup>54</sup> First, for commercial speech to be afforded First Amendment protection, it must be related to a lawful activity and not be misleading.<sup>55</sup> Next, a court must assess whether the restriction imposed on the commercial speech is based on a substantial government interest.<sup>56</sup> If the first two prongs are met, a court then asks whether the restriction directly advances the substantial govern-

39. See Sarfaty, *supra* note 36.

40. Ghoogassian, *supra* note 37, at 367-69.

41. GRI, *GRI and Sustainability Reporting*, <https://www.globalreporting.org/information/sustainability-reporting/Pages/gri-standards.aspx> (last visited Sept. 3, 2018).

42. GRI, *GRI Standards Download Center*, <https://www.globalreporting.org/standards/gri-standards-download-center/> (last visited Sept. 3, 2018).

43. *Id.*

44. GRI, *Sector Guidance*, <https://www.globalreporting.org/information/sector-guidance/Pages/default.aspx> (last visited Sept. 3, 2018).

45. GRI, *G4 Sector Disclosures*, <https://www.globalreporting.org/information/sector-guidance/sectorguidanceG4/Pages/default.aspx> (last visited Sept. 3, 2018).

46. See Choudhury, *supra* note 29.

47. See *id.*

48. See *id.*

49. *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 557, 561 (1980). The Supreme Court has characterized commercial speech as an "expression related to solely the economic interest of the speaker and its audience." *Id.*

50. 425 U.S. 748 (1976).

51. See *id.* at 771; Andrew C. Budzinski, *A Disclosure-Focused Approach to Compelled Commercial Speech*, 112 MICH. L. REV. 1305, 1311 (2014).

52. *Virginia State Bd. of Pharmacy*, 425 U.S. at 771.

53. See *id.* at 771-72.

54. *Central Hudson*, 447 U.S. at 566.

55. *Id.*

56. *Id.*

ment interest asserted.<sup>57</sup> Finally, it must be determined whether the restriction is not more extensive than necessary to meet the asserted interest.<sup>58</sup>

Although this four-part test is arguably akin to a strict scrutiny analysis, the Supreme Court has recognized a distinction between the way that the four-part test in *Central Hudson* is applied and the way that strict scrutiny applies.<sup>59</sup> As such, restraints on commercial speech under *Central Hudson* are assessed under what has become known as an intermediate level of scrutiny.<sup>60</sup>

## B. First Amendment Protection of Compelled Commercial Speech: Rational Basis Review

Shortly after the Supreme Court announced the *Central Hudson* test and intermediate protection for commercial speech, it became clear that there was a jurisprudential gap with respect to compelled commercial speech. The issue of compelled speech was not raised in *Central Hudson* because the commercial speech in question was purely voluntary. Thus, after *Central Hudson*, it was not clear whether intermediate scrutiny should also apply where commercial speech is not voluntary, but rather compelled. This issue came squarely before the Court in *Zauderer v. Office of Disciplinary Counsel*.<sup>61</sup>

In *Zauderer*, the Court considered an Ohio statute that required all attorney advertising that mentions contingency fees to disclose whether the fees are computed before or after deduction of costs and expenses.<sup>62</sup> There, the Court noted that it had long recognized that “disclosure requirements trench much more narrowly on an advertiser’s interests than do flat prohibitions on speech.”<sup>63</sup> Nevertheless, disclosure requirements can still implicate an advertiser’s First Amendment rights. Thus, the Court held that “an advertiser’s rights are adequately protected as long as disclosure requirements are reasonably related to the State’s interest in preventing deception of consumers.”<sup>64</sup>

In *Zauderer*, the Supreme Court thus announced that unlike voluntary commercial speech, compelled speech through disclosure requirements should be assessed under a lower level of scrutiny: rational basis review. Importantly, however, the Court left open the question of whether disclosure requirements would be analyzed under rational basis review only where the state interest is to prevent deception of consumers.<sup>65</sup>

## C. First Amendment Protection of Compelled Commercial Speech Unrelated to Preventing Consumer Deception: Intermediate Scrutiny or Rational Basis Review?

In the absence of clear guidance on the issue of what standard of review to apply to disclosure requirements unrelated to preventing misleading speech, it was unclear whether all disclosure requirements would be subject to rational basis review, particularly in those instances where there is a tenuous connection between the required disclosure and preventing consumer deception.

### I. The Case for Intermediate Scrutiny: NAM I and NAM II

This precise conflict was brought before the District Court for the District of Columbia in 2013 when the National Association of Manufacturers (NAM) challenged an SEC regulation promulgated under the Dodd-Frank Act.<sup>66</sup> Pursuant to §1502 of the Dodd-Frank Act, the SEC was required to adopt a regulation requiring certain securities issuers to disclose whether their products use conflict minerals and to specify whether such minerals originate in the Democratic Republic of the Congo (DRC) or an adjoining country.<sup>67</sup> Defending its regulation, the SEC contended that *Zauderer*’s rational basis review was the appropriate standard.<sup>68</sup>

In their challenge, NAM argued for the application of strict scrutiny or at least intermediate scrutiny under *Central Hudson*’s framework. NAM’s argument hinged on the fact that the disclosure required the issuer to engage in burdensome and stigmatizing speech.<sup>69</sup> Specifically, an issuer was required to state in its annual report either that conflict minerals are not necessary to the functionality of its products or, if such an assertion could not be made, the issuer must describe its products as “not DRC conflict free.”<sup>70</sup> Thus, the disclosure effectively required an issuer to “confess blood on its hands.”<sup>71</sup> NAM argued that this was in violation of the First Amendment, which has been recognized as protecting not only a speaker’s right to speak, but also a speaker’s right to refrain from speaking.<sup>72</sup> Given that rational basis review is considered an exception and not the rule in First Amendment commercial speech jurisprudence, NAM advocated for intermediate scrutiny in this context.

57. *Id.*

58. *Id.*

59. *See* Lorillard Tobacco Co. v. Reilly, 533 U.S. 525, 554 (2001).

60. *See* City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 434 (1993).

61. 471 U.S. 626 (1985).

62. *See id.* at 632.

63. *Id.* at 651.

64. *Id.*

65. *See* Celia R. Taylor, *The Unsettled State of Compelled Corporate Disclosure Regulation After the Conflict Mineral Rule Cases*, 21 LEWIS & CLARK L. REV. 427, 437 (2017).

66. *See* National Ass’n of Mfrs. v. Securities & Exch. Comm’n (NAM I), 956 F. Supp. 2d 43, 47 (D.D.C. 2013).

67. *See id.*; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §1502, 124 Stat. 1376 (2010) (codified at 15 U.S.C. §78m).

68. *See* NAM I, 956 F. Supp. 2d at 77.

69. *See id.* at 73.

70. Taylor, *supra* note 65, at 431-32.

71. National Ass’n of Mfrs. v. Securities & Exch. Comm’n (NAM II), 748 F.3d 359, 373 (D.C. Cir. 2014).

72. *See* Wooley v. Maynard, 430 U.S. 705, 714 (1977) (“The right to speak and the right to refrain from speaking are complementary components of the broader concept of ‘individual freedom of mind.’”).

The district court in *National Ass'n of Manufacturers v. Securities & Exchange Commission (NAM I)* concluded that it must apply intermediate scrutiny under *Central Hudson* because the regulation fell outside of the *Zauderer* framework given that the disclosure was not aimed at preventing misleading or deceptive speech.<sup>73</sup> Thus, the district court limited the application of rational basis review only to those disclosures whose purpose is intended to avert consumer deception. In applying intermediate scrutiny, the district court found that the SEC's rule passed constitutional muster.

On appeal, the D.C. Circuit Court reversed, finding the rule unconstitutional on the grounds that the disclosure requirement was not narrowly tailored to meet the government's interest.<sup>74</sup> Nevertheless, the D.C. Circuit affirmed the district court's holding that intermediate scrutiny is the appropriate standard to apply where the regulation of speech concerns consumer deception.<sup>75</sup> Specifically with regard to the federal government's ability to regulate the securities industry, the court refused to read its prior case, *Securities & Exchange Commission v. Wall Street Publishing*, broadly.<sup>76</sup>

In *Wall Street Publishing* the D.C. Circuit applied "limited First Amendment scrutiny"—as opposed to *Central Hudson's* intermediate scrutiny—in holding that the SEC could seek an injunction requiring *Stock Market Magazine* to disclose the consideration it received in exchange for publishing articles that promoted particular firms' securities.<sup>77</sup> The court in *Wall Street Publishing* stated that in the context of areas of extensive federal regulation like securities, the judiciary need not inquire into the substantial government interest underlying the regulatory objective.<sup>78</sup> Indeed, the court noted that speech relating to the purchase or sale of securities forms a distinct category of speech altogether different than commercial speech.<sup>79</sup>

Despite the recognition in *Wall Street Publishing* that speech related to securities is distinct from other forms of commercial speech, the D.C. Circuit in *National Ass'n of Manufacturers v. Securities & Exchange Commission (NAM II)* limited the application of *Wall Street Publishing* to instances where disclosures are specifically about regulating misleading speech.<sup>80</sup> The *NAM II* court stated that "[t]o read *Wall Street Publishing* broadly would allow Congress to easily regulate otherwise protected speech using the guise of securities laws."<sup>81</sup> Thus, in *NAM II*, the D.C. Circuit established that SEC disclosure requirements are not afforded any special treatment under the First Amendment beyond established commercial speech jurisprudence. As such, securities disclosures are subject to

the *Central Hudson* framework, as are other forms of commercial speech, when the government interest is not related to regulating misleading speech or protecting consumers from deceptions.

## 2. The Case for Rational Basis Review: AMI

Interestingly, a few months after the *NAM II* decision, the D.C. Circuit, sitting en banc, explicitly overruled *NAM II* in *American Meat Institute v. U.S. Department of Agriculture (AMI)*.<sup>82</sup> There, the D.C. Circuit held that *Zauderer's* rational basis review is not limited to cases where the government's interest is in protecting consumers from deception. Rather, the court in *AMI* held that *Zauderer* should apply broadly where a disclosure requires purely factual, uncontroversial information.<sup>83</sup>

In an even more unusual turn of events, when the D.C. Circuit agreed to rehear the *NAM II* case in light of the ruling in *AMI*, the court arguably ignored both the explicit overruling of the *NAM II* decision and the substantive analysis of the *AMI* decision. Instead, the *National Ass'n of Manufacturers v. Securities & Exchange Commission (NAM III)* court determined that the types of disclosures that the SEC rule required were not, in fact, commercial speech because the disclosures were not connected to advertising or product labeling at the point of sale.<sup>84</sup> As noted in the *NAM III* dissent:

In their [the majority's] view, the permissive review normally afforded to commercial disclosure mandates under *Zauderer* extends only to a sub-category of commercial speech: advertisements and product labels. No other court has ever identified such a limit under *Zauderer* (or for any other purpose under commercial-speech law). The majority's newly minted constriction of *Zauderer* to those particular forms of commercial speech contradicts that decision's core rationale . . . The majority's approach . . . would impose a *more* searching First Amendment standard on a disclosure that imposes a *less* burdensome requirement on the speaker. The anomaly in that result . . . has little to do with *AMI's* application of *Zauderer* to contexts beyond prevention of consumer deception.<sup>85</sup>

By switching the question from "what standard of review applies to compelled commercial speech that is not related to preventing deception?" to "are compelled SEC disclosures commercial speech at all?" the *NAM III* court appeared to entirely ignore the central holding of *AMI* in an effort to simply reaffirm its prior decision in *NAM II*.

73. See *NAM I*, 956 F. Supp. 2d at 77.

74. See *NAM II*, 748 F.3d at 373.

75. See *id.* at 370-73.

76. 851 F.2d 365, 366 (D.C. Cir. 1988).

77. *Id.* at 373-74.

78. See *id.* at 373.

79. See *id.*

80. See *NAM II*, 748 F.3d at 372.

81. *Id.*

82. See *American Meat Inst. v. U.S. Dep't of Agric. (AMI)*, 760 F.3d 18, 22, 44 ELR 20173 (D.C. Cir. 2014).

83. See *id.*

84. See *National Ass'n of Mfrs. v. Securities & Exch. Comm'n (NAM III)*, 800 F.3d 518, 522-24 (D.C. Cir. 2015).

85. See *id.* at 535 (Srinivasan, C.J., dissenting) (internal citations omitted).

### 3. Something More Than Intermediate Scrutiny: *NAM III*

Given the strange tack that the court took in *NAM III*, the majority also offered an alternative ground for its decision: even if the compelled disclosure is commercial speech, it is still unconstitutional under *AMI*. However, far from applying the rational basis review called for in *AMI*, the *NAM III* court, in effect, established a level of scrutiny that is even higher than the intermediate scrutiny of *Central Hudson*. This is so with respect to (a) the evidence that must be available in support of the mandatory disclosure regime, (b) the interpretation of “controversial,” and (c) the novel prohibition on disclosure of stigmatizing information.

#### a. Heightened Evidentiary Burden

First, in *NAM III*, the court establishes a heightened requirement that any compelled disclosure must be supported by substantial evidence that the disclosure will, in fact, achieve its stated goal to a material degree. Under rational basis review as applied in *AMI*, the first step is to both identify the governmental interest and assess the effectiveness of the disclosure requirement in achieving this interest.<sup>86</sup> Certainly, in applying *Central Hudson*'s intermediate scrutiny the Supreme Court has noted that the party seeking to uphold a restriction on commercial speech must justify that burden, which is “not satisfied by mere speculation or conjecture; rather, a governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree.”<sup>87</sup> However, under rational basis review, the party seeking to compel commercial speech need not provide the same exacting evidence, particularly where it is self-evident that the harm the compelled speech seeks to address will occur in the absence of the required disclosure.<sup>88</sup> In *AMI*, the D.C. Circuit expressly distinguished the amount of evidence necessary under rational basis review.<sup>89</sup> In *AMI*, the court found that, as compared to *Central Hudson*'s intermediate scrutiny, under *Zauderer*'s rational basis review, “such evidentiary parsing is hardly necessary when the government uses a disclosure mandate to achieve a goal of informing consumers about a particular product trait, assuming of course that the reason for informing consumers qualifies as an adequate interest.”<sup>90</sup> Thus, it is clear that at minimum the court in *NAM III* misapplies the evidentiary burden required by the party seeking to compel commercial speech under rational basis review.

However, the *NAM III* court goes even beyond what is required by the *Central Hudson* framework of intermediate scrutiny. In applying *Central Hudson*, the Supreme Court

in *Edenfield v. Fane* hinted that studies and even anecdotal evidence that validate the government's interest would be sufficient to meet the evidentiary burden.<sup>91</sup> But in *NAM III*, the D.C. Circuit suggests that there must be specific evidence not only of the harm to be eliminated, but also specific evidence that the required disclosure actually does alleviate the harm.<sup>92</sup> While the *AMI* court suggests that there need only be evidence that the disclosure will alleviate the harm to a material degree, the *NAM III* court was unsatisfied by anything less than quantifiable proof that the disclosure regime is actually producing benefits.

The *NAM III* court also appeared to weigh the collateral costs of the required disclosure regime when assessing the benefits, as opposed to only considering the level to which the disclosure eliminates the stated harm.<sup>93</sup> The court therefore requires not just an informed acceptance that a mandatory disclosure regime will make progress toward eliminating the stated harm, but concrete and quantifiable proof that a mandatory disclosure *does*, in fact, alleviate harm without generating any material collateral costs.<sup>94</sup> This newly fashioned standard is well-illustrated in the *NAM III* court's assessment of the conflict minerals disclosure requirement:

That is not to say that we know for certain that the conflict minerals rule will not help—other sources contend the rule will do so. But it is to say that whether §1502 will work is not proven to the degree required under the First Amendment to compel speech.<sup>95</sup>

Such a standard sets up a Catch-22 where a mandatory disclosure regime cannot pass First Amendment scrutiny without evidence of its actual success, but such a regime can never generate the evidence that is required until it passes First Amendment scrutiny. Thus, the way in which the *NAM III* court applies rational basis review has effectively raised the evidentiary standard even beyond intermediate scrutiny, establishing what may be an impossibly high standard to meet.

#### b. Overly Broad Understanding of “Controversial” Information

The court in *NAM III* also establishes an untenable interpretation of the meaning of “controversial” information. Under *Zauderer*, rational basis review applies when the required disclosure is of “purely factual and uncontroversial information.”<sup>96</sup> The D.C. Circuit in *AMI* reaffirmed this position.<sup>97</sup> Although in *NAM III* the D.C. Circuit generally declined to follow the *AMI* decision, the court did

86. *See id.* at 524-25.

87. *Edenfield v. Fane*, 507 U.S. 761, 770-71 (1993).

88. *See Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 652-53 (1985).

89. *Keep AMI*, 760 F.3d 18, 26, 44 ELR 20173 (D.C. Cir. 2014).

90. *Id.*

91. *See Edenfield*, 507 U.S. at 771.

92. *See NAM III*, 800 F.3d 518, 525-26 (D.C. Cir. 2015).

93. *See id.*

94. *See id.*

95. *Id.* at 527.

96. *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 651 (1985).

97. *See AMI*, 760 F.3d 18, 27, 44 ELR 20173 (D.C. Cir. 2014).

claim to follow *AMI* on this particular point, stating that it was “bound to follow that [*AMI*’s] holding.”<sup>98</sup>

Nevertheless, since announcing the language of *Zauderer*, the Supreme Court has not provided a clear definition of the term “uncontroversial.” In the absence of clear guidance, the lower courts have struggled to provide meaning to the term. In *AMI*, the D.C. Circuit adopted the position that controversial commercial speech is speech that “communicates a message that is controversial for some reason other than [a] dispute about simple factual accuracy.”<sup>99</sup> The U.S. Court of Appeals for the Ninth Circuit has rejected this view, finding that uncontroversial compelled commercial speech “refers to the factual accuracy of the compelled disclosure, not to its subjective impact on the audience.”<sup>100</sup> For example, in *American Beverage Ass’n v. San Francisco*, the Ninth Circuit recently found a disclosure concerning the alleged health risks of sugary beverages to be “controversial” under the *Zauderer* framework.<sup>101</sup> There, the Ninth Circuit found that a warning required to be placed on sugary beverages stating “[d]rinking beverages with added sugar(s) contributes to obesity, diabetes, and tooth decay,” was “controversial” because it was directly contrary to statements by the Food and Drug Administration.<sup>102</sup> Such a statement was reasonably factually disputable because it is actually *overconsumption* of sugary beverages that leads to poor health outcomes.<sup>103</sup> Thus, the Ninth Circuit confined the analysis of “controversial” commercial speech to whether the compelled speech is reasonably factually in dispute.

In *NAM III*, the court arguably took yet another approach in attempting to clarify the standard developed in *AMI*. Rather than simply defining “controversial” speech as speech that relates to issues in dispute, the D.C. Circuit in *NAM III* goes even further to suggest that “controversial” speech is speech that is akin to ideological speech.<sup>104</sup> Indeed, in questioning the fundamental nature of facts themselves, the *NAM III* court suggests that any opinion can be couched as a fact and many propositions taken as fact may not be true.<sup>105</sup> In holding that compelled disclosure of this type of normative or opinion-based information is constitutionally infirm under the First Amendment, the *NAM III* court created a heightened standard where nearly any mandatory disclosure relating to ESG metrics could be struck down as compelling ideologically or morally driven speech. Therefore, under *NAM III*, there are arguably very few subjects of speech that could survive as “uncontroversial.”

### c. Novel Prohibition on Stigmatizing Disclosures

Finally, in *NAM III*, the court reads a novel prohibition on stigmatizing information into the *Zauderer* framework. In relying on prior precedent, which holds that an important aspect of the principle of free speech is the freedom to choose what not to say, the court in *NAM III* states “[b]y compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment.”<sup>106</sup> This suggests that any mandatory disclosure that requires a securities issuer to describe information that casts it in a negative light necessarily infringes on First Amendment protections.

It is unclear how such an extreme position can be reconciled with existing disclosure requirements, many of which require securities issuers to report information that is arguably stigmatizing (e.g., legal proceedings). Moreover, commercial speakers have historically been afforded far less protection, and thus far less autonomy, to choose the content of their message.<sup>107</sup> Therefore, the *NAM III* court has in effect conflated prior precedent regarding commercial speech with prior precedent regarding freedom to choose what to leave unsaid. In elevating commercial speech in this way, the court in *NAM III* has established a novel prohibition on disclosures of commercial speech that compel stigmatizing information.

## III. Can a Mandatory ESG Disclosure Regime Survive After *NAM III*?

In light of the arguably heightened standard that the D.C. Circuit established in *NAM III*, efforts to expand the existing ESG disclosure regime in the United States may face new obstacles. Nonetheless, the global mega-trend forcing increased ESG reporting, coupled with the EU’s bold step of mandating certain types of disclosures, means that the United States may soon become a laggard in this space. While the United States could follow in the EU’s footsteps and implement a mandatory ESG disclosure regime, care would need to be taken by the SEC to craft such mandatory disclosure requirements in order to survive First Amendment scrutiny. Although it is impossible to predict precisely how the SEC might craft additional mandatory disclosure requirements, a comparison of how existing regimes fare after *NAM III* provides useful insight into the challenges a mandatory ESG disclosure regime would face.

The following sections apply the *NAM III* framework using the EU Directive and standards from the GRI as case studies. The analysis that follows assumes that any SEC disclosure regime would be considered commercial speech despite not being directly connected to advertising or product labeling at the point of sale. This is the position

98. *NAM III*, 800 F.3d at 528.

99. *AMI*, 760 F.3d at 27.

100. *CTIA-The Wireless Ass’n v. City of Berkeley*, 854 F.3d 1105, 1117 (9th Cir. 2017).

101. *See American Beverage Ass’n v. San Francisco*, 871 F.3d 884, 895 (9th Cir. 2017).

102. *Id.*

103. *See id.*

104. *See NAM III*, 800 F.3d 518, 530 (D.C. Cir. 2015).

105. *See id.* at 528.

106. *Id.* at 530.

107. *See Jennifer M. Keighley, Can You Handle the Truth? Compelled Commercial Speech and the First Amendment*, 15 U. PA. J. CONST. L. 539, 554 (2012).

of the majority of courts that have grappled with disclosure requirements.<sup>108</sup>

### A. *Mandatory Disclosures Modeled After the EU Directive*

Were the SEC to adopt a mandatory ESG disclosure regime similar to the regime adopted by the EU in its Directive on Non-Financial Disclosures, there would be many hurdles to overcome in order to pass constitutional muster under *NAM III*. This is so despite the relatively open-ended language of the Directive. Nevertheless, it is likely that mandatory disclosures that relate to *process* are more likely to survive scrutiny, as compared to disclosures that relate to the *outcomes* of those processes.

#### I. Reasonable Relationship to a Substantial State Interest

Under rational basis review, as would be applied to compelled commercial speech, a mandatory disclosure regime modeled after the EU Directive could survive constitutional scrutiny only if the required disclosure is reasonably related to a substantial state interest.<sup>109</sup> The EU Directive requires disclosure related to environmental matters, social and employee matters, respect for human rights, anti-corruption, and bribery matters.<sup>110</sup> As such, were the SEC to adopt a similar requirement, the agency would be required to identify specific interests related to each of these matters. Based on prior precedent, it is likely that the SEC could establish a substantial governmental interest with respect to some but not all of the disclosure requirements mandated under the EU Directive.

There is a substantial state interest with respect to matters related to the environment and human health. It is well-established that protecting human health and the environment constitutes a substantial state interest.<sup>111</sup> Therefore, it is likely that the SEC could articulate a substantial interest for mandating disclosures related to certain environment and employee matters, such as employee health and safety.

It is also likely that there is a substantial state interest with respect to anti-corruption and bribery matters. In certain instances, the Supreme Court has recognized that a governmental interest in preventing corruption, the appearance of corruption, and bribery may be considered

a substantial—even a compelling—state interest.<sup>112</sup> Thus, it is also likely that the SEC could identify a substantial governmental interest in mandating disclosure of anti-corruption and bribery matters.

Mandated disclosures related to social matters and respecting human rights present a bigger challenge. While some matters related to both categories certainly fall within a substantial government interest—protecting human health<sup>113</sup> or eliminating discrimination against women<sup>114</sup>—other aspects of social and human rights matters may not fall within a recognized substantial government interest. For example, it is not clear whether a court would recognize a substantial governmental interest in requiring corporations to report on processes for receiving and addressing complaints. Likewise, it is unclear whether there can be a substantial government interest in protecting the human rights of non-U.S. citizens. Because social and human rights matters sweep so broadly, it may be difficult for the SEC to fully articulate a substantial government interest that covers all social and human rights matters that require disclosure under the EU Directive.

However, in addition to articulating a substantial government interest, under *NAM III*, a compelled disclosure now must also be supported by evidence that the disclosure will, in fact, achieve its stated goal to a material degree.<sup>115</sup> Thus, the SEC would need substantial and concrete evidence to suggest that disclosing information related to environmental matters, social and employee matters, respect for human rights, anti-corruption, and bribery matters will materially achieve improvements in these areas.

Whether such evidence exists is still an open question.<sup>116</sup> Indeed, many reporting initiatives have been labeled as merely box-checking exercises, suggesting a tenuous connection between disclosure and actual performance outcomes.<sup>117</sup> Thus, it is unlikely that the SEC could provide sufficiently concrete evidence under *NAM III* for many of the reporting categories mandated by the EU Directive.

#### 2. “Controversial” Information

Even were the SEC able to articulate a significant interest based on sufficient evidence, many of the required disclosure categories under the EU Directive would likely fail under *NAM III* because they can be viewed as ideologically driven. Compelled disclosure of noncontroversial information is subject to rational basis review and is far more likely to be upheld under First Amendment principles. But the court in *NAM III* has defined noncontroversial information so narrowly that many disclosures required by the EU

108. See, e.g., *Riley v. MoneyMutual, LLC*, No. CV 16-4001 (DWF/LIB), 2017 WL 3822727, at \*5 (D. Minn. Aug. 30, 2017) (finding Minnesota’s requirement that lenders of short-term loans make certain disclosures to the Minnesota Commissioner of Commerce was commercial speech subject to rational basis review); *Pharmaceutical Care Mgmt. Ass’n v. Rowe*, 429 F.3d 294, 309-10 (1st Cir. 2005) (finding Maine’s requirement that pharmacy benefits managers disclose certain information to covered entities was commercial speech subject to rational basis review).

109. See *AMI*, 760 F.3d 18, 22, 44 ELR 20173 (D.C. Cir. 2014).

110. See Council Directive 2014/95/EU, art. 1, 2014 O.J. (L 330).

111. See *CTIA-The Wireless Ass’n v. City of Berkeley*, 854 F.3d 1105, 1118 (9th Cir. 2017) (citing *Posadas de P.R. Assocs. v. Tourism Co. of P.R.*, 478 U.S. 328, 341 (1986)).

112. See *Citizens United v. Federal Election Comm’n*, 558 U.S. 310, 356 (2010) (citing *Buckley v. Valeo*, 424 U.S. 1, 25 (1976)).

113. See *CTIA-The Wireless Ass’n*, 854 F.3d at 1118 (citing *Posadas de P.R. Assocs. v. Tourism Co. of P.R.*, 478 U.S. 328, 341 (1986)).

114. See *Board of Dirs. of Rotary Int’l v. Rotary Club of Duarte*, 481 U.S. 537, 549 (1987) (finding the elimination of discrimination against women to be a compelling governmental interest).

115. See *NAM III*, 800 F.3d 518, 525-26 (D.C. Cir. 2015).

116. See, e.g., *Stenzel*, *supra* note 36, at 401.

117. See *Sarfaty*, *supra* note 34, at 606-09.

Directive would likely fail to survive constitutional review. *NAM III* effectively determined that controversial information is any information that can be viewed as ideological or normative.<sup>118</sup>

This characterization of controversial information likely captures many of the disclosure topics under the EU Directive, like environmental and human rights impacts. For example, despite the general recognition that human activities are the primary cause of climate change, the existence of even the smallest number of climate change deniers converts climate change into an ideological issue, thereby making greenhouse gas emissions reporting controversial. As such, even data- and fact-driven reporting can be couched in normative terms depending on what the data might be used to signify.

The EU Directive also requires reporting on the processes pursued to address environmental matters, social and employee matters, respect for human rights, anti-corruption, and bribery matters. One example is the process of due diligence. Disclosure of internal processes is more likely to pass as noncontroversial under *NAM III*, as it requires only a description of whether such processes are in place and what those processes entail. In describing internal processes, the focus is less on results and more on the operational workings, making it easier to find such disclosures noncontroversial.

As an illustration, consider the difference between reporting the estimated existence and prevalence of water-polluting activities in the supply chain, compared to simply reporting that audits are conducted to examine the issue of water pollution in the supply chain. The former disclosure raises a host of normative issues such as what water pollution levels are safe. By contrast, the latter disclosure is more value-neutral and does not require a company to stigmatize itself. Therefore, those aspects of the EU Directive that require reporting of *processes* as opposed to *outcomes* are more likely to survive constitutional scrutiny under *NAM III*.

## B. Mandatory Disclosures Modeled After the GRI

Were the SEC to adopt a mandatory ESG disclosure regime modeled after the GRI standards, there would be many of the same hurdles discussed in the context of adopting a system similar to the EU Directive as described in Section IV.A. However, unlike a system modeled after the EU Directive, the GRI standards that are specific, narrow, and more tightly correlated to business outcomes have a greater likelihood of surviving scrutiny under *NAM III*.

### I. Reasonable Relationship to a Substantial State Interest

As described above, under *NAM III*, a mandatory disclosure regime modeled after the GRI would be found consti-

tutionally valid only if the required disclosure is reasonably related to a substantial state interest and supported by substantial evidence that the disclosure will achieve its stated goal to a material degree. Unlike the EU Directive with general subject areas, many of the GRI topical standards are highly specific and granular. For example, GRI 302-4: Reduction of Energy Consumption requires the reporting organization to report the “[a]mount of reductions in energy consumption achieved as a direct result of conservation and efficiency initiatives, in joules,” along with the type of energy included in the reduction and the basis for calculating the reduction.<sup>119</sup>

Due to the way that the disclosure is framed, the SEC could more easily define the substantial state interest in terms of providing information to consumers and investors to prevent deception. This is so because a disclosure like GRI 302-4 is more easily connected to business outcomes such as reduced operating costs resulting from reduced energy consumption.<sup>120</sup> As such, when justifying the mandatory disclosure, the SEC could avoid the pitfalls of defining the governmental interest based on environmental or social objectives and instead ground the governmental interest in terms more traditionally used in the context of commercial speech. As a result, the SEC need only present evidence that disclosing such information to consumers or investors does in fact raise consumer awareness and reduce deception. This makes it far more likely that a disclosure like GRI 302-4 could survive constitutional scrutiny under *NAM III*.

Not all GRI standards are as specific and granular as GRI 302-4, however. GRI reporting standards that are less definite tend to have a more tenuous connection to simply preventing consumer deception. Take as an example GRI 411-1: Incidents of Violations Involving Rights of Indigenous Peoples. This reporting standard requires organizations to report the “[t]otal number of identified incidents of violations involving the rights of indigenous peoples during the reporting period.”<sup>121</sup> The direct connection to business outcomes with respect to rights of indigenous peoples is much less clear, likely eliminating the possibility that the SEC could define the governmental interest in terms of preventing consumer and investor deception. As such, GRI 411-1 would face similar obstacles as the required disclosures based on the EU Directive.

## 2. “Controversial” Information

As with a disclosure scheme modeled after the EU Directive, mandatory disclosures modeled after the GRI suffer the same problems under the overly broad definition of “controversial” established in *NAM III*. This is well-illustrated by GRI 411-1, which requires reporting the number of incidents where the rights of indigenous peoples were

119. GRI, CONSOLIDATED SET OF GRI SUSTAINABILITY REPORTING STANDARDS 168 (2016).

120. See Choudhury, *supra* note 29, at 213.

121. GRI, *supra* note 119, at 343.

118. See *NAM III*, 800 F.3d at 530.

violated. The GRI provides some guidance on this standard, stating that in the context of this disclosure an “incident” is a “legal action or complaint registered with the reporting organization or competent authorities through a formal process, or an instance of non-compliance identified by the organization through established procedures.”<sup>122</sup>

However, neither the standard nor the guidance indicates precisely what qualifies as the “rights” of indigenous peoples. While international instruments like the Universal Declaration of Human Rights<sup>123</sup> could presumably be a guide, it is far from clear how expansively companies would interpret such rights. The range of interpretations suggests that the information has an ideological or normative underpinning, making the GRI 411-1 disclosure controversial under *NAM III* and unlikely to pass constitutional muster.

Indeed, even a GRI standard like GRI 302-4 (described above) could be found to be controversial. Although this disclosure is factual in nature, it nevertheless requires reporting specifically on the *reduction* of energy. This alone could be suggestive of a particular moral or normative stance, namely that decreasing energy use is good while not decreasing energy use is bad.

A similar sort of logic was employed by the Ninth Circuit in *CTIA-The Wireless Ass'n v. City & County of San Francisco*.<sup>124</sup> There, the Ninth Circuit found that San Francisco's requirement that retailers disclose to consumers how to reduce exposure to radiofrequency energy emissions from cell phones could be “interpreted by consumers as expressing San Francisco's opinion that using cell phones is dangerous.”<sup>125</sup> As such, even the more fact-driven and granular GRI standards would be at risk of failing under *NAM III* if there is a plausible way to consider the disclosure expressive of a particular ideological or normative, and thus controversial, viewpoint.

#### IV. Beyond *NAM III*

While the discussion in Part III attempts to highlight the elements of existing disclosure frameworks that would survive constitutional scrutiny under *NAM III*, the only truly apparent conclusion that emerges is that the compelled commercial speech jurisprudence is at best in conflict with itself and at worst antithetical to the principles underlying the lesser protection afforded to commercial speech under the First Amendment.<sup>126</sup> As is clear from the opaque and, at times, discordant application of *Zauderer*, there has emerged neither a consistent understanding of when rational basis review should be applied nor what constitutes “purely factual and uncontroversial information.” Given the unsettled status of the law, par-

ticularly in the context of securities disclosures, it would be prudent for the Supreme Court to enter the fray and clarify the commercial speech and compelled commercial speech doctrines.

First, it should be firmly established that SEC disclosure statements constitute commercial speech for the purposes of First Amendment analysis. The *NAM III* court suggested that disclosures do not constitute commercial speech unless they are connected to advertising or product labeling at the point of sale. This understanding of commercial speech is far more narrow than under the widely accepted meaning of commercial speech expounded in *Central Hudson*, which described commercial speech as an “expression related to solely the economic interest of the speaker and its audience.”<sup>127</sup> The very nature of SEC disclosure statements is to reduce informational asymmetries to allow investors to more accurately value securities and prevent market failures.<sup>128</sup> It is hard to imagine expressions more related to the economic interests of both the speaker and the audience.

Moreover, the fundamental purpose of securities disclosure statements suggests that in the context of compelled SEC disclosures, rational basis review under *Zauderer* should apply as opposed to intermediate scrutiny under *Central Hudson*. The basic policy underlying the more narrow First Amendment protections afforded to commercial speakers in the context of compelled speech is that the costs of requiring specific speech (as compared to banning speech) are outweighed by the benefits of protecting consumers. On balance, *Zauderer* therefore permits greater curtailment of First Amendment rights in favor of protecting consumers from misleading or deceptive information when dealing with compelled commercial speech.

In the securities context, investors are arguably analogous to consumers, and disclosures ensure that investors are provided accurate information relevant to their decisions as consumers in the securities market. Securities disclosures reflect the same balancing of interests that underlie the doctrine of compelled commercial speech and, thus, *Zauderer's* rational basis review should apply. Although it may be argued that rational basis review would permit the SEC too much leeway, enabling it to compel disclosures for a host of social or ethical reasons, SEC disclosures have always been moored to the concept of materiality. Information is material if there is “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.”<sup>129</sup> Thus, materiality is a lens through which the SEC must consider its disclosure requirements. By operation, this appropriately limits the SEC's reach but it does not necessarily preclude social or ethical disclosures so long as such information is considered material to investors.

122. *Id.*

123. Universal Declaration of Human Rights, G.A. Res. 217A (III), U.N. GAOR, 3d Sess., at 71, U.N. Doc. A/810 (1948).

124. See *CTIA-The Wireless Ass'n v. City & County of San Francisco*, 494 F. App'x 752 (9th Cir. 2012).

125. *Id.* at 753.

126. See *Repackaging Zauderer*, 130 HARV. L. REV. 972, 986 (2017).

127. *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 557, 561 (1980).

128. See Choudhury, *supra* note 29, at 187.

129. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

Finally, in establishing that *Zauderer*'s rational basis review should apply to compelled commercial disclosures, specific elements of *NAM III* must be expressly rejected as misapplications of the *Zauderer* analysis. This is particularly true in light of the confusion among the lower courts and the illogical results that follow from the *NAM III* court's reasoning. For example, under a broadly worded framework like the EU Directive, disclosures that are less outcome-oriented and more focused on describing processes appear more likely to survive scrutiny under *NAM III*. In contrast, under the more granular framework of the GRI, narrowly defined and quantifiable outcomes appear more likely to pass constitutional muster. These conflicting conclusions illustrate how the reasoning of *NAM III* is doctrinally untenable.

Rejecting *NAM III* requires specifically ridding compelled commercial speech jurisprudence of the heightened evidentiary standard that *NAM III* established. Under *NAM III*, mandated disclosures must be supported by concrete and quantifiable proof that the disclosure will, in fact, alleviate the harm identified as a substantial governmental interest. This is antithetical to the way in which rational basis review is applied. Rational basis review simply requires that a court be able to articulate *any* rational relationship to the legitimate government interest. As a deferential standard, the evidentiary burden should not be high.

Additionally, further clarity is needed on the meaning of "noncontroversial" information. At least within the context of SEC disclosures, required information will necessarily be filtered through the lens of materiality. As such, it is unnecessary to utilize the narrow meaning of "noncontroversial" adopted in *NAM III*. Instead of attempting to distinguish information that is ideological or normative from information that is not, a far more useful understand-

ing of "noncontroversial" refers to the factual accuracy of the information and not to its subjective impact on the audience.<sup>130</sup> This distinction between controversial and noncontroversial information better comports with the policies underlying compelled commercial speech jurisprudence, which places high value on protecting consumers from deceptive or misleading information.

## V. Conclusion

With the growing interest in employing ESG disclosure to regulate the behavior of private corporations, there is likely to be an increasing need for judicial involvement. If mandatory disclosure regimes are to functionally contribute to the evolution of corporate behavior, there will need to be increased certainty with respect to the ways in which commercial speech and compelled commercial speech will be treated under the First Amendment. Currently, it remains uncertain how courts will treat compelled commercial disclosures and how the SEC could successfully craft mandatory disclosures that protect the rights of commercial speakers while also protecting other corporate stakeholders.

Attempting to analyze two existing disclosure frameworks under recent precedent illustrates the current disarray among the lower courts regarding the application of the commercial speech doctrine. In order to rectify this untenable situation, a rejection of the *NAM III* standard is required in favor of the more appropriately balanced rational basis review of *Zauderer*. A return to *Zauderer* will provide the needed certainty, not only to the business community, but also to the SEC. With doctrinal clarity restored, U.S. regulators can catch up to their EU counterparts and continue to support the growing trend toward corporate social responsibility.

130. See *CTIA-The Wireless Ass'n v. City of Berkeley*, 854 F.3d 1105, 1117 (9th Cir. 2017).