COMMITTEE ON CAPITAL MARKETS REGULATION

An Analysis of the Constitutionality of State ESG Laws

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Introduction

State legislation addressing the consideration of environmental, social, and governance ("ESG") principles by asset managers and other financial institutions has expanded rapidly over the past five years. Between 2021 and 2023, more than 300 articles of legislation relating to ESG investing were introduced in state legislatures.[1] As of September 2024, 36 states have enacted one or more such laws.[2] These laws generally fall into two categories: (1) those that prohibit the consideration of ESG factors ("anti-ESG"), and (2) those that expressly permit or require the consideration of ESG factors ("pro-ESG").[3] In addition, the attorneys general of 39 states have taken stances on whether the consideration of ESG factors by asset managers is consistent with existing fiduciary laws.[4]

In this report, the Committee on Capital Markets Regulation ("Committee") will review the proliferation of state ESG requirements and consider the issues that state ESG requirements raise for US capital markets. Specifically, state ESG mandates threaten market efficiency by complicating the regulatory landscape, increasing compliance costs, and making it difficult for financial institutions to operate on a national scale. This report will also evaluate the legality of state ESG requirements with a focus on whether state ESG requirements violate the Constitution under a variety of legal theories, including the Dormant Commerce Clause, the Supremacy Clause, and the First Amendment. As more state ESG laws have been enacted, legal challenges have sprung up in federal courts on each of these theories and this report will review those cases.

Part I overviews the principal types of pro- and anti-ESG laws that states have enacted as well as the stances of state governments on the consideration of ESG factors by fiduciaries under existing laws. Part II identifies the substantial costs to US investors and capital markets that can result from inconsistent state ESG standards. Part II also reviews the evidence showing that past efforts at harmonizing conflicting financial regulatory standards have increased the efficiency of capital markets in the US and in other jurisdictions. Part III then shows how state ESG standards, both pro- and anti-, raise significant questions of legality under the Constitution and reviews relevant case law. The Committee supports the harmonization of divergent state regulatory regimes to enhance the efficiency of US capital markets.

[1] Tina Casey, *Anti-ESG Fever Shows Signs of Bending, Not Breaking (Yet)*, TRIPLE PUNDIT (May 1, 2024), https://www.triplepundit.com/story/2024/anti-esg-rural-communities/800791.

[2] *ESG Battlegrounds: How the States Are Shaping the Regulatory Landscape in the U.S.*, SIMPSON THACHER 1 (Sept. 2024), https://www.stblaw.com/docs/default-source/publications/esg_updatedbattlegroundsalert.pdf.

[3] *Id.*

[4] *Id*. at 20, 30.

I. Overview of Conflicting State ESG Laws

States that have enacted new laws or interpreted existing laws to address the consideration of ESG factors by asset managers and other financial institutions fall into two main opposing categories: (1) those that restrict or prohibit the consideration of ESG factors ("anti-ESG"), and (2) those that permit, encourage, or require the consideration of ESG factors ("pro-ESG"). As **Table 1** shows, states have applied anti- and pro-ESG standards to various types of financial institutions and in multiple contexts.

Table 1

Affected entity/activity	Anti-ESG	Pro-ESG
Managers of government assets and public pension funds	Prohibiting consideration of ESG factors in investment or proxy voting decisions: Florida (HB 3); Arkansas (HB 1253); Idaho (SB 1405); Kansas (HB 2100); Kentucky (HB 236); Montana (HB 228); New Hampshire (HB 457); North Carolina (HB 750); North Dakota (HB 1429); South Carolina (HB 3690); Tennessee (HB 955); Utah (SB 96); West Virginia (HB 2862)	Requiring consideration of ESG factors in investment or proxy voting decisions: California (SB 185); Colorado (SB 23-016); Illinois PA 101-473); Maine (HP 65/LD 99); Maryland (HB 740)
Private asset managers and proxy advisers	State attorney general asserts that consideration of ESG factors by private asset managers and proxy advisers violates fiduciary duties: AL; AK; AR; GA; ID; IN; IA; KS; KY; LA; MS; MO; MT; NE; NH; OH; SC; TX; UT; VA; WV	State attorney general asserts that consideration of ESG factors by private asset managers and proxy advisers is consistent with fiduciary duties: AZ; CA; CO; CT; DC; DE; IL; ME; MD; MA; MN; NJ; NY; OR; PA; VT; WA; WI
Depository institutions	Prohibiting banks and other depository institutions holding state funds from boycotting ESG-disfavored industries (e.g., fossil fuels): Florida (HB 3, HB 989); Idaho (HB190)	Requiring depository institutions to disclose policies with regard to ESG-disfavored industries and requiring state government to consider those policies when contracting for services: Connecticut (State Treasurer Responsible Gun Policy)

Affected entity/activity	**Anti-ESG**	**Pro-ESG**
Insurers	Prohibiting insurers from making coverage or premium decisions based on ESG criteria: North Dakota (HB 1429); Tennessee (HB 2100); Texas (SB 833)	Requiring insurers to participate in climate risk disclosure survey: Colorado (SB 23-016)
Investor/Customer Disclosures	Requiring broker-dealers and investment advisers to disclose to customers any consideration of any ESG factors: Missouri (15 CSR 30-51.170, 172); Wyoming (002-4 WCR § 4-7, 002-5 WCR § 5-7, 002-10 WCR § 10-15)	Requiring companies doing business in state to make specified ESG disclosures: California (SB 253, SB 261)
All financial institutions	Prohibiting financial institutions from denying services based on ESG factors: Florida (HB 3, HB 989); Tennessee (HB 2100); Utah (HB 449); Wyoming (HB 0236) Restricting government entities from contracting with or investing in companies boycotting ESG-disfavored industries (e.g., fossil fuels): Kentucky (SB 205), Oklahoma (HB 2034), Texas (SB 13, SB 19), West Virginia (SB 262)	

II. Conflicting State ESG Laws Threaten the Efficiency of US Capital Markets

Inconsistent state ESG laws threaten to fracture US capital markets by making it more costly or impracticable for asset managers, banks, and other financial institutions to operate on a national scale. This growing trend is garnering considerable attention from the media and regulators. Indeed, in a July 2024 speech, acting Comptroller of the Currency Michael Hsu remarked that "culture wars, identity politics, and weaponization of finance are pushing toward greater and greater fragmentation of the US financial system," and averred that his office would act as "a bulwark against this" with respect to nationally chartered banks.[5] Below we describe these potential costs in greater detail and highlight examples of how past efforts to harmonize divergent state financial regulatory regimes have produced benefits for US capital markets.

a. The Costs of Conflicting State ESG Standards

We provide four examples of how the proliferation of inconsistent state ESG laws will result in costs for US financial institutions, capital markets participants, and the US financial system as a whole.

First, financial firms' direct operating costs may be increased. For example, if various states require consideration of certain ESG factors while other states prohibit the consideration of ESG factors when investing, whether with respect to state pension funds specifically or more generally, a financial institution operating in both states may need to either segregate its operations or offer separate products for multiple states, increasing costs.

Second, financial firms may need to stop doing business in one or more states, harming these firms, and reducing efficiency in the markets. For instance, a smaller firm which cannot absorb the costs of creating multiple product lines may be driven to abandon operations in certain states merely due to the burden of complying with both sets of laws. But taken to the extreme, laws with extraterritorial reach could effectively require financial institutions to exit certain state markets. For example, in 2023 Florida passed House Bill 3, mandating that depository institutions holding public Florida funds may not consider ESG factors, including a person's "affiliations" or "business sector," in *any* product offerings.[6] Thus, Florida would prohibit these firms from doing business in other states where consideration of ESG factors is required.[7] As a result, businesses will shrink, firms will lose revenue, and costs will increase as firms can no longer fully capture the advantages of operating at scale. Moreover, as firms shutter business in some states, the markets will become more concentrated and less efficient.

Third, state ESG laws may be inconsistent with federal laws, further driving financial firms out of certain state markets and potentially hindering national efforts to safeguard the US financial

[5] Michael Hsu, Acting Comptroller of the Currency, Off. of the Comptroller of the Currency, Remarks Before the Exchequer Club: Size, Complexity, and Polarization in Banking 13-14 (July 17, 2024).

[6] H.R. 3, 2023 Leg., Reg. Sess. (Fla. 2023), *available at* https://laws.flrules.org/2023/28.

[7] *See States Require "Fair Access" to Financial Services*, SULLIVAN & CROMWELL LLP 7 (May 1, 2024), https://www.sullcrom.com/SullivanCromwell/_Assets/PDFs/Memos/States-Require-Fair-Access-Financial-Services.pdf (stating that Florida House Bill 3 "do[es] not define 'customer' or 'consumer' or otherwise include any explicit geographic limitations of the fair access requirements.").

system. For instance, the Department of the Treasury has expressed concern that limitations like the ones in House Bill 3 "severely restrict[] the factors banks may consider when assessing risks… [which] create[s] uncertainty and may inhibit effective anti-money laundering and countering the financing of terrorism… and sanctions compliance programs, undermining efforts to promote national security."[8]

Fourth, retail investors may face increased prices and reduced product quality. As the operating costs of the financial firms serving consumers increase in the examples above, some of these costs will be passed on to consumers, making financial services more expensive. Further, as firms leave certain markets and competition decreases, the choices available to consumers and the quality of the financial services available to them will be reduced.

b. *The Benefits of Harmonization*

In several past instances, federal legislation aimed at harmonizing divergent state standards has counteracted regulatory segmentation and produced substantial benefits for US markets. Similar efforts in other jurisdictions have produced similar results. Below, we highlight four examples where the United States or the European Union have harmonized laws across all their member states, opening up regional markets and improving efficiency.

i. *National Securities Markets Improvement Act of 1996*

Until the 1990s a broad range of securities offerings were required to be registered both at the federal level with the Securities and Exchange Commission ("SEC") and with state securities regulators in each state in which the products were offered or sold ("blue sky laws"). Further, investment advisers were also subject to separate regulation by the SEC and by each state in which they operated.[9] Thus, US financial markets were fragmented by blue sky laws in a way directly analogous to the operation of state ESG laws.

To address these issues, Congress passed the National Securities Markets Improvement Act of 1996 ("NSMIA"), which preempted state law to exempt more categories of securities from state registration, and to make the SEC the sole regulator of large investment advisers. NSMIA was passed to "promote efficiency and capital formation in the financial markets"[10] as well as to "reduce the burden to investment advisers of the overlapping and duplicative regulation existing prior to the enactment of NSMIA."[11] When he signed it into law, President Clinton projected that NSMIA would save "hundreds of millions of dollars."[12]

[8] Letter from Brian E. Nelson, Under Sec'y for Terrorism & Fin. Intel., U.S. Dep't of the Treasury, to The Hon. Josh Gottheimer, Representative, U.S. House of Representatives 1 (July 18, 2024).

[9] *Series 63 § 3.3.1*, ACHIEVABLE, https://app.achievable.me/study/finra-series-63/learn/registration-investment-advisers-state-registered-vs-federal-covered (last visited June 25, 2024).

[10] National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, 3416 (1996) (codified in scattered sections of the U.S. Code).

[11] Regulation Analyst Certification, 68 Fed. Reg. 9,482, 9,484 n.22 (Feb. 27, 2003) (codified at 17 C.F.R. pt. 242).

[12] Press Release, White House, Statement by the President 1 (Oct. 11, 1996), 1996 WL 584922.

Empirical literature highlights the benefits that have resulted from NSMIA's harmonization of state securities regulation.[13] A 2020 empirical study finds that "NSMIA has made it easier for startups to raise private capital from out-of-state investors by exempting private firms from complying with the blue sky laws of every new state where they issue securities."[14] The study concludes that "[t]he deregulation of securities laws—in particular [NSMIA]—has increased the supply of private capital to late-stage private startups, which are now able to grow to a size that few private firms used to reach."[15]

ii. Employee Retirement Income Security Act of 1974

In the 1960s, federal regulation of employee benefit plans was sparse, and state regulators began to fill in the gaps.[16] Recognizing the need to harmonize the law, US Congress passed the Employee Retirement Income Security Act of 1974 ("ERISA") "to protect interstate commerce and the interests of participants in employee benefit plans" by establishing certain uniform rules relating to plan administration,[17] and by explicitly preempting any state laws which "relate to" any ERISA plan.[18] ERISA has allowed multistate employers to offer the same package of benefits to employees nationwide, thereby reducing costs and increasing operational efficiency. Conversely, commenters note that "[e]roding ERISA preemption will adversely impact labor markets, disadvantage employees based on where they live or work, cause employers to cut back on benefit coverage, and raise the cost of health insurance and retirement plans."[19]

iii. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994

While there had long been restrictions on interstate banking and branching, in the 1980s states began to take it upon themselves to allow interstate banking subject to certain conditions.[20] A patchwork of state regulation arose, and in response US Congress passed the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act"). The Riegle-Neal Act removed federal barriers[21] and established nationwide branching and interstate bank acquisition laws.[22] Subsequent studies find that the Riegle-Neal Act led to a proliferation of branch banks[23] and to "an increase in service quality, competition in the lending market, and profit efficiency."[24]

[13] Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs*, 33 REV. FIN. STUD. 5463, 5468 (2020).
[14] *Id.* at 5464.
[15] *Id.* at 5463.
[16] Katie Mahoney & Chantel Sheaks, *What Is ERISA and Why Is Federal Preemption Vital?*, U.S. CHAMBER COM. (Aug. 31, 2023), https://www.uschamber.com/health-care/what-is-erisa-and-why-is-federal-preemption-vital.
[17] 29 U.S.C. § 1001(b).
[18] 29 U.S.C. § 1144(a).
[19] *Protecting ERISA Preemption*, ERIC https://www.eric.org/protecting-erisa-preemption/ (last visited May 28, 2024).
[20] *Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994*, FED. RSRV. HIST., https://www.federalreservehistory.org/essays/riegle-neal-act-of-1994 (last visited May 30, 2024).
[21] Christian A. Johnson & Dr. Tara Rice, *Assessing a Decade of Interstate Bank Branching*, 65 WASH. & LEE L. REV. 73, 75 (2008).
[22] *Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994*, *supra* note 20.
[23] Johnson & Rice, *supra* note 21, at 76.
[24] Astrid A. Dick, *Nationwide Branching and Its Impact on Market Structure, Quality, and Bank Performance*, 79 J. BUS. 567. 569 (2006).

iv. *European Union: The Markets in Financial Instruments Directive of 2004*

Before the Markets in Financial Instruments Directive of 2004 ("MiFID I"), the 1993 Investment Services Directive only "provided a limited degree of harmonization in the provision of investment services" and in cross-border market access in the European Union.[25]

In 2004, the EU passed MiFID I as a part of its effort to create a unified internal market.[26] MiFID I aligned requirements across individual EU jurisdictions for the offering of investment services, and allowed investment firms to access regulated markets and operate freely throughout the EU according to a harmonized set of standards via a single registration process.[27] MiFID I also harmonized investor protection standards and mandated consistent standards for the disclosure of pre- and post-trade price information for equities trades.[28]

Empirical evidence shows that MiFID I's harmonization of standards has been effective in improving the efficiency of EU capital markets. For example, a 2020 study found that MiFID I increased both stock price efficiency and market liquidity.[29]

[25] *The Markets in Financial Instruments Directive and the Single European Market in Investment Services*, CLEARY GOTTLIEB 1-2 (Jan. 20, 2006), https://www.clearygottlieb.com/-/media/organize-archive/cgsh/files/publication-pdfs/update--the-markets-in-financial-instruments-directive-and-the-single-european-market-in-investment-services.pdf.

[26] *See Aims and Values*, EUR. UNION, https://european-union.europa.eu/principles-countries-history/principles-and-values/aims-and-values_en (last visited June 25, 2024).

[27] *See, e.g.*, *Markets in Financial Instruments (MiFID) and Investment Services*, EUR-LEX (Oct. 11, 2016), https://eur-lex.europa.eu/legal-content/EN/LSU/?uri=celex:32004L0039; Parliament and Council Directive 2004/39/EC, 2004 O.J. (L 145) 1.

[28] *See, e.g.*, *Markets in Financial Instruments (MiFID) and Investment Services*, *supra* note 27; *The Markets in Financial Instruments Directive and the Single European Market in Investment Services*, *supra* note 25, at 4.

[29] Daniel Aghanya et al., *Market in Financial Instruments Directive (MiFID), Stock Price Informativeness and Liquidity*, 113 J. BANKING & FIN. 105730 (2020).

III. An Analysis of the Constitutionality of State ESG Laws

The state ESG requirements reviewed above present several significant legal questions under the US Constitution. First, they potentially violate the Dormant Commerce Clause by discriminating against out-of-state market participants. Second, they potentially violate the Supremacy Clause by conflicting with superseding federal laws. Third, they potentially violate the First Amendment by restricting or compelling speech, indeed political speech. We discuss each of these issues as well as the current state of related litigation in greater detail below.

a. The Dormant Commerce Clause

The Dormant Commerce Clause is a constitutional law doctrine that prohibits state economic regulations that discriminate against out-of-state parties or that impermissibly burden interstate commerce.[30] The doctrine protects free trade among states and prevents segmentation of the national marketplace.[31] Below, we review the Dormant Commerce Clause doctrine in greater detail and apply it to various examples of state ESG laws.

i. Dormant Commerce Clause Doctrine

The Supreme Court's Dormant Commerce Clause analysis consists of two main prongs. First, if a state economic regulation discriminates against interstate commerce or out of state economic actors on its face, it will very likely be struck down.[32] Second, even if a law is not facially discriminatory, the law may still violate the Dormant Commerce Clause if it creates an "undue burden" on interstate commerce, as determined by applying a balancing test described in *Pike v. Bruce Church, Inc*. (1970) (the "*Pike* test").

1. Facial Discrimination

A law is facially discriminatory where there are "explicit distinctions between in-state and out-of-state economic actors or between in-state and interstate commerce."[33] For example, in *Healy v. Beer Institute* (1989), a Connecticut law which resulted in the need for *interstate* but not intrastate brewers and shippers of beer to set a ceiling on the prices they could charge to in-state wholesalers was found facially discriminatory and thus in violation of the Dormant Commerce Clause.[34] Facially discriminatory laws are strictly scrutinized by the Court – a rigorous standard described as "a virtually per se rule of invalidity."[35]

[30] U.S. CONST. art. I, § 8, cl. 3; Granholm v. Heald, 544 U.S. 460, 476 (2005); Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970); *see also* Michael S. Knoll & Ruth Mason, *Bibb Balancing: Regulatory Mismatches Under the Dormant Commerce Clause*, 91 GEO. WASH. L. REV. 1, 12 & n. 48 (2023).

[31] Knoll & Mason, *supra* note 30, at 11-12.

[32] *Granholm*, 544 U.S. at 476; *see also* Knoll & Mason, *supra* note 30, at 12 & n. 48; *The Dormant Commerce Clause and Moral Complicity in a National Marketplace*, 137 HARV. L. REV. 980, 983 (2024).

[33] Knoll & Mason, *supra* note 30, at 12.

[34] Healy v. Beer Inst., 491 U.S. 324, 340-41 (1989); *see also* Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 372-73 (2023).

[35] *Granholm*, 544 U.S. at 476; *see also, e.g.*, Knoll & Mason, *supra* note 30, at 12 & n. 48.

2. *Pike* Undue Burden Test

If a law is not facially discriminatory, the Court applies the *Pike* test. Under the test, which the Court described in *Pike v. Bruce Church, Inc*., a plaintiff first needs to plausibly allege that a state law places a "substantial burden" on interstate commerce. If so, the Court will weigh the benefits against the burdens. A law will be struck down if the burdens are "clearly excessive" compared to the benefits.[36] Further, "[i]f a legitimate local purpose is found… the extent of the burden that will be tolerated will… depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activity."[37] Thus, the law must also be tailored to fit its purpose.

In *Pike*, an Arizona regulation required all cantaloupes grown in-state to be packaged in-state as well.[38] The law was not facially discriminatory, because it did not by its terms draw a distinction between in- and out-of-state economic actors – it only applied to in-state producers.[39] Instead, the Court explained that the constitutionality of facially neutral laws would be judged against the balancing test.[40] The Arizona law in *Pike* failed the test, because the state's interest in identifying the petitioner's high-quality cantaloupes as being grown in Arizona did not outweigh the burden on interstate businesses of being required to build an in-state packing facility.[41]

However, the *Pike* test is currently falling out of favor; the Court has not invalidated a facially neutral law for "a generation."[42]

a. Heightened *Pike* Scrutiny for Latent Discriminatory Purpose

In the Court's most recent Dormant Commerce Clause opinion, *National Pork Producers Council v. Ross* (2023)*,* the Court stressed that anti-discrimination is at the heart of the Dormant Commerce Clause.[43] This is true not only when a law is facially discriminatory but also when there is "latent discrimination" – *i.e.*, when "a law's practical effects… disclose the presence of a discriminatory purpose."[44] Indeed, the Court observed that, "[t]he 'practical effect[s]' of the [*Pike* Arizona] order… revealed a discriminatory purpose—an effort to insulate in-state processing and packaging businesses from out-of-state competition."[45] Discrimination will be found where laws "deprive businesses and consumers in other States of 'whatever competitive advantages they may possess.'"[46] Further, states cannot enact laws motivated by "economic protectionism – that is,

[36] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (citation omitted).
[37] *Id.*
[38] *Id.* at 138-39.
[39] Knoll & Mason, *supra* note 30, at 22 n.86.
[40] *Pike*, 397 U.S. at 142.
[41] *Id.* at 145.
[42] Knoll & Mason, *supra* note 30, at 6 (citation omitted).
[43] Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 369 (2023).
[44] *Id.* at 377.
[45] *Id.* at 378 (quoting *Pike*, 397 U.S. at 140, 145)).
[46] Healy v. Beer Inst., 491 U.S. 324, 339 (1989) (citation omitted).

regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors."[47]

In *National Pork*, petitioners challenged a California law which banned the sale of pork derived from pigs that have been "confined in a cruel manner."[48] Petitioners conceded that the law was not facially discriminatory, and the Court therefore applied the *Pike* undue burden test. Further, petitioners did not claim that the California law's effects revealed *latent* discrimination, thus the Court stated that their "claim falls well outside *Pike*'s heartland."[49] The Court thus applied the *Pike* test with more skepticism,[50] and held that the law did not violate the Dormant Commerce Clause. It is not clear how the Court would have analyzed the law if petitioners had instead claimed its effects revealed a discriminatory purpose.[51]

The outcome of *National Pork* was nuanced. Justices Gorsuch, Thomas, Sotomayor, and Kagan found that the law did not create a substantial burden and thus did not violate the Dormant Commerce Clause. Further, Justice Barrett found that the law did create a substantial burden on interstate commerce, but (along with Justices Gorsuch and Thomas) expressed the view that as the law did not have an economic purpose, the *Pike* test was not even capable of being applied.[52] Thus, a majority of the Justice found that the law could not be struck down on Dormant Commerce Clause grounds – four because there was no substantial burden, and one because, despite the presence of a substantial burden, the *Pike* test did not apply. The remaining four Justices dissented in part, as they would have found that the law did plausibly create a substantial burden. We further describe the Court's "substantial burden" analysis below.

b. Court Split on Substantial Burden

As noted above, the *National Pork* Court split on when to find a "substantial burden" under the *Pike* test. Four Justices – Gorsuch, Thomas, Sotomayor, and Kagan – did not find a substantial burden because out-of-state businesses had a choice over whether to comply with the state law, segregate operations for that state's market, or exit the market.[53] In their view, laws "threaten[ing] only to shift market share from one set of out-of-state firms to another" or which "merely allege harm to some producers' favored 'methods of operation'" do not present a substantial burden.[54]

[47] *Nat'l Pork*, 598 U.S. at 369 (internal quotation and citations omitted); *see also*, *e.g.*, *Supreme Court Limits Challenges to State Laws and Regulatory Authority Under Dormant Commerce Clause Doctrine*, WINSTON & STRAWN LLP (June 5, 2023), https://www.winston.com/en/insights-news/supreme-court-limits-challenges-to-state-laws-and-regulatory-authority-under-dormant-commerce-clause-doctrine.

[48] CAL. HEALTH & SAFETY CODE § 25990(b)(2) (West 2023).

[49] *Nat'l Pork*, 598 U.S. at 380.

[50] *Id.*

[51] *See, e.g.,* Joseph Dages et al., *Kind of a Pig Deal: US Supreme Court's Decision in Nat'l Pork Producers v. Ross May Pave Way for More ESG-Driven State Legislation and Policymaking*, STEPTOE (May 15, 2023), https://www.steptoe.com/en/news-publications/kind-of-a-pig-deal-us-supreme-courts-decision-in-natl-pork-producers-v-ross-may-pave-way-for-more-esg-driven-state-legislation-and-policymaking.html.

[52] *Nat'l Pork*, 598 U.S. at 380-83, 393-94.

[53] *Id.* at 384.

[54] *Id.* at 384-87 (citation omitted).

These Justices found it irrelevant that the firms impacted were primarily or even exclusively out-of-state.[55]

Four other Justices – Roberts, Alito, Kavanaugh, and Jackson – stressed that the "substantial burden" analysis should look beyond the costs of complying with a law and consider "other derivative harms," including operational delays where time is of the essence or increased danger.[56] They also took the existence of "sweeping extraterritorial effects" of the law into account.[57] Petitioners claimed that the pork market is interconnected, that different cuts of pork are sold in different states, and that producers and suppliers would require assurances that the pork was raised in compliance with the California law.[58] As a result, the law had the broad extraterritorial effect of "effectively requiring compliance by farmers who do not even wish to ship their product into California."[59] Taking this into account, the latter group of Justices found that the California law plausibly placed a substantial burden on interstate commerce, and would have remanded the case to the lower court to consider the claim under *Pike*. Finally, Justice Barrett also thought the law created a substantial burden, separately reasoning that the "costs are pervasive, burdensome, and will be felt primarily (but not exclusively) outside California."[60] However, as described above, Justice Barrett found that the *Pike* test could not be applied, and therefore joined in affirming the lower court's judgment to dismiss the case for failure to state a claim.

3. Market Participant Exception

One important exception to the Dormant Commerce Clause is the "market participant" rule. Under this doctrine, where a state is acting as a market participant rather than a market regulator, the Dormant Commerce Clause does not apply.[61] However, the "market participant" rule does not apply if a law has a "downstream" regulatory effect on another market.[62] As the Court has explained, "[t]he limit of the market-participant doctrine must be that it allows a State to impose burdens on commerce *within* the market in which it is a participant… The State may not impose conditions, whether by statute, regulation, or contract, that have a substantial regulatory effect outside of that particular market."[63] For example, in *South-Central Timber Development, Inc. v. Wunnicke* (1984), a plurality of the Supreme Court opined that Alaska could not compel the purchasers of state-owned timber to subsequently process the timber in-state, because although Alaska was participating in the timber market as a seller, it was not participating in the timber *processing* market.[64] The law had a downstream effect on a different market, and thus did not qualify for the market participant exception.[65]

[55] *Id.* at 384.
[56] *Id.* at 397-98.
[57] *Id.* at 400.
[58] Nat'l Pork Producers Council v. Ross, 6 F.4th 1021, 1028 (9th Cir. 2021).
[59] Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 400 (2023).
[60] *Id.* at 394.
[61] *The Market Participant Doctrine and Forced Arbitration*, 137 HARV. L. REV. 1359, 1364 (2024).
[62] *See* South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 99 (1984) (plurality opinion).
[63] *Id.* at 97 (emphasis added).
[64] *Id.* at 98-99.
[65] *Id.*

ii. Application of the Dormant Commerce Clause to State ESG Laws

The uncoordinated and conflicting pro- and anti-ESG standards that states have enacted subject out-of-state asset managers and other financial institutions to costly and potentially impossible compliance burdens relative to in-state competitors. Some of these laws may violate the Dormant Commerce Clause. Below, we give examples of state ESG laws where (i) the state is acting as a market participant, (ii) the state is regulating in-state economic activity, and (iii) the state is regulating out-of-state economic activity. We discuss how laws in each category might be analyzed under a Dormant Commerce Clause challenge.

1. State Acting as Market Participant – No Violation

State laws where the state is acting as a market participant do not violate the Dormant Commerce Clause. State regulation of public pension investments provides a prominent example of the market participation exception. Certain states have required that managers of public pension plans consider ESG factors in investment and proxy voting decisions. Conversely, several states have required the opposite. For instance, Kentucky House Bill 236, passed in 2023, prohibits consideration of "non-pecuniary interests" (including ESG) in making investment decisions for state retirement assets.[66] As explained above, where a state acts as a market participant, with no regulatory effect outside that market, the Dormant Commerce Clause is not violated.[67] Where a state law is limited to controlling investment and proxy voting decisions over in-state public pension funds only, the state is acting as a market participant – procuring investment services in its own right – and the law is confined to the public pension market in which the state is participating. Thus, this type of law is beyond the reach of the Dormant Commerce Clause.[68]

2. Regulation of In-State Economic Activity – Potential Violation

State laws which regulate the conduct of business within its borders have the potential to violate the Dormant Commerce Clause. Investor and customer disclosure laws for companies doing business in-state provide an example.

Several state laws have required that investment advisers and broker-dealers make disclosures to customers when ESG factors are incorporated into investment decisions, while other laws have required that companies provide ESG disclosures as a condition of conducting business in the state. For instance, California Senate Bills 253 and 261 require public and private companies that do business in the state to make climate-related disclosures, including greenhouse gas emissions and climate-related financial risk reports, subject to annual revenue thresholds of $1 billion and $500 million, respectively.[69] These laws may run afoul of the Dormant Commerce Clause.

[66] H.R. 236, 2023 Gen. Assemb., Reg. Sess. (Ky. 2023).

[67] *South-Central Timber*, 467 U.S. at 93, 97.

[68] *See, e.g.,* Robin Happel, *"Woke" Capitalism and Its Dissidents: Legal Strategies to Counter Anti-ESG Laws,* PACE U. ELISABETH HAUB SCH. L.: PACE ENV'T L. REV. BLOG (Dec. 1, 2023), https://pelr.blogs.pace.edu/2023/12/01/woke-capitalism-and-its-dissidents-legal-strategies-to-counter-anti-esg-laws/.

[69] *See, e.g.*, Kenneth P. Herzinger et al., *California Passes New ESG Disclosure Laws Ahead of SEC, Triggering Increased Regulatory and Litigation Risk for Companies Doing Business in California*, PAUL HASTINGS (Nov. 28,

a. Market Participant Exception Does Not Apply

The market participant exception does not apply to these laws as they regulate services provided to private consumers in the state. Further, the laws we reviewed are not facially discriminatory, as they apply to all financial services providers and companies that do business in the state, whether or not incorporated in the state. For instance, the California laws do not by their terms draw a distinction between in- and out-of-state economic actors – they apply only to companies doing business in the state.

b. *Pike* Analysis – Substantial Burden Potentially Exists

As the laws are not facially discriminatory, courts would apply the *Pike* undue burden test. Plaintiffs would first need to show that a law places a substantial burden on interstate commerce. For example, the California ESG laws arguably substantially burden interstate commerce. These laws go beyond federal disclosure laws, including the SEC's recently promulgated rules regarding climate disclosures by public companies (which are currently stayed pending legal review).[70] Four of the Justices on the current Court find the presence of "sweeping extraterritorial effects" to be an important factor in identifying a substantial burden.[71] A 2024 court challenge to the California laws – *Chamber of Commerce of the U.S. v. Randolph* – points to the fact that in effect, out-of-state companies doing very little business in California may be subject to the laws' burdens, while exclusively in-state companies below the revenue thresholds will be exempt.[72] So, for example, all in-state companies with $499 million in revenue will be exempt, even if the entirety of their revenue comes from California. Meanwhile, companies nation-wide with over $500 million in revenue with just $1 million in revenue from California will be subject to Senate Bill 261. Further, the Justices in *National Pork* who focused on extraterritorial effects found it relevant that producers who did not even wish to sell their pork in California would need to comply with the California law. Likewise here, even companies "in the supply chain that have *no intention* of doing business in California[] [will be subject] to significant political and economic pressure to conform their conduct to the policy preferences of… California."[73] The laws sweep in activities that have no relation to California, such that if a company with more than $500 million in revenue makes a single sale in California, it needs to disclose its *worldwide* emissions and climate risks.[74] As a result, the laws require disclosures concerning (and thus impose costs with regard to) out-of-state activities.[75] The evidence of these extraterritorial effects may thus be enough to sway these four Justices. Further, if an economic analysis shows that the costs will be felt "primarily" outside California, Justice Barrett may also be convinced, as this was an important factor to her.

2023), https://www.paulhastings.com/insights/client-alerts/california-passes-new-esg-disclosure-laws-ahead-of-sec-triggering-increased.

[70] *See, e.g.*, *California SB 253 and SB 261: What Businesses Need to Know*, PERSEFONI: THE PERSEFONI BLOG (Sept. 11, 2024), https://www.persefoni.com/blog/california-sb253-sb261.

[71] Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 400 (2023).

[72] Amended Complaint for Declaratory & Injunctive Relief at 28, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801-KS (C.D. Cal. Feb. 22, 2024).

[73] *Id.* (emphasis added).

[74] *Id.*

[75] *Id.*

i. Conflicting In-State ESG Laws May Increase the Burden on Interstate Commerce

Further, certain ESG laws regulating in-state commerce may create compliance burdens beyond those found in *National Pork* if they directly *conflict* with ESG laws in other states, an issue which was not addressed in that case.[76] For example, North Dakota passed a law in 2023 specifying the circumstances under which insurance companies may consider ESG factors in providing insurance policies in the state.[77] If one state were to prohibit insurance companies from considering ESG factors, while another required it, companies doing business in both states would need to adopt different practices in each state. Legal scholars have observed that in cases involving "mismatched" state regulation, the Supreme Court measures the costs and benefits of a challenged law against the law in other states.[78] In *Bibb v. Navajo Freight Lines* (1959), the Court considered a Dormant Commerce Clause challenge to an Illinois requirement that trucks use curved mudflaps.[79] Because other states required that trucks use straight mudflaps, the Court "took those other states' regulations as the benchmark in measuring the burden imposed by Illinois's different rule," and attributed to Illinois the costs to interstate truckers of complying with Illinois's rule.[80] Ultimately, the Court found that the state's interest in regulating for safety reasons did not outweigh the "need for national uniformity."[81] It is thus possible that Court precedent could be used to argue that interstate burdens are amplified when state laws directly conflict.[82] In these conflict cases, the statute being challenged is the one which would potentially be declared invalid.[83] Practically speaking, stricter statutes will be challenged more often than laxer ones, leading to a de-regulatory effect when the stricter laws are struck down.[84]

ii. In-State ESG Laws Are Unlikely to Have a Discriminatory or Protectionist Purpose

As *National Pork* suggests, a law will be scrutinized more closely if it purposely discriminates against out-of-state commerce based on its practical effects, or if it is motivated by economic protectionism. Indeed, the plaintiffs in *Randolph* – the pending case challenging California's ESG disclosure laws – suggest the laws at issue are protectionist because they "benefit in-state economic interests by burdening out-of-state competitors."[85] This is demonstrated in *Randolph* through the

[76] *See, e.g.,* Joseph Dages et al., *supra* note 51.

[77] H.R. 1429, 68th Legis. Assemb., Reg. Sess. (N.D. 2023).

[78] Knoll & Mason, *supra* note 30, at 8, 29.

[79] 359 U.S. 520, 521-23 (1959); *see also* Knoll & Mason, *supra* note 30, at 39-40.

[80] Knoll & Mason, *supra* note 30, at 40.

[81] *Id.* (quoting *Bibb*, 359 U.S. at 527).

[82] *Id.* at 8 ("[I]n mismatch cases, the Court uses external benchmarks consisting of *other states' laws* to measure both the burden on interstate commerce and the challenged state's regulatory interest…. [S]uch a posture can place a heavy burden on innovating states.").

[83] *Id.* at 60.

[84] *Id.* at 61.

[85] Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 369 (2023) (internal quotation and citations omitted); Amended Complaint for Declaratory & Injunctive Relief at 28, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801-KS (C.D. Cal. Feb. 22, 2024) (explaining that "the laws 'offend the Commerce Clause' by 'build[ing] up . . . domestic commerce' through burdens upon the industry of other States'" (citing *Nat'l Pork*, 598 U.S. at 369) (international quotations omitted)).

disproportionate impact those laws will have on out-of-state businesses, and would also further exist where conflicting laws in other states place additional compliance burdens on out-of-state competitors vis-à-vis in-state businesses. However, defendant states will argue their ESG laws are motivated by environmental or social policy goals, rather than economic protectionism. It is therefore questionable whether courts will be swayed to find a discriminatory or protectionist purpose.

c. *Pike* Analysis – Balancing Benefits Against a Substantial Burden

If a substantial burden is established, even if not discriminatory, plaintiffs would need to show the burdens outweigh the benefits, or that the law is not appropriately tailored to invalidate a state law under the Dormant Commerce Clause. The plaintiffs in *Randolph* argue both.[86] They argue that the California ESG disclosure laws will have broad extraterritorial effects, impacting companies which do not even wish to do business in California, and reporting will require "significant time and money, up to millions of dollars per company."[87] Meanwhile the plaintiffs claim the benefits are "slim to non-existent," as the laws cannot meaningfully impact climate change nor does the state show that the disclosures are material to investors.[88] And, plaintiffs argue the laws are overbroad because they may compel a company with negligible business in California to disclose information about worldwide operations taking place outside California.[89]

d. Conclusion

On balance, in the wake of *National Pork*, a challenge against a state ESG law which regulates in-state economic activity is unlikely to succeed.[90] The Court has not used *Pike* to invalidate a law since the 1980s,[91] and would be less likely to do so in a case where the law is not motivated by an intent to discriminate against interstate commerce or economic actors. It remains to be seen, however, whether a case presenting a state law in direct conflict with the law in other states could change the Court's calculus.

3. Regulation of Out-of-State Economic Activity – Potential Violation

State laws that directly regulate the conduct of business outside their own borders have the greatest potential to violate the Dormant Commerce Clause.

To illustrate the argument, take Florida House Bill 3, which requires that depository institutions holding public Florida funds must certify that they do not deny services to *any* person (even out-

[86] Amended Complaint for Declaratory & Injunctive Relief, *supra* note 72, at 27-29.
[87] *Id.* at 28.
[88] *Id.*
[89] *Id.*
[90] *See, e.g.*, Abby Husselbee & Sara Dewey, *Litigation Updates on California's New Climate Disclosure Laws*, ENV'T & ENERGY L. PROGRAM HARV. L. SCH. (Feb. 16, 2024), https://eelp.law.harvard.edu/litigation-updates-on-californias-new-climate-disclosure-laws/.
[91] Knoll & Mason, *supra* note 30, at 6.

of-state) based on ESG factors.[92] We note at the outset that the analysis of an analogous pro-ESG law – *i.e.*, a law requiring depository institutions holding public funds to certify that they take ESG factors into account in rendering services to every customer (even out-of-state) – would follow the same logic, and has the potential to violate the Dormant Commerce Clause to the same extent as the Florida law examined here.

a. Market Participant Exception Does Not Apply

At first impression, under House Bill 3, Florida appears to be acting as the recipient of the depository services in its own capacity. If so, the law would qualify for the "market participant" exception, meaning it would not violate the Dormant Commerce Clause. However, the law may not qualify for this exception because it "impose[s] conditions… that have a substantial regulatory effect outside of that particular market."[93] Florida is participating in the in-state public depository market. But the Florida law regulates depository institutions beyond this market, because the institutions may need to change their practices nationwide, and for non-government clients, in order to comply with the Florida law. Hence, the law may raise a Dormant Commerce Clause issue.

b. *Pike* Analysis – Substantial Burden Potentially Exists

The Florida law does not discriminate against out-of-state actors on its face, and as such would need to be analyzed under *Pike*. The law arguably substantially burdens interstate commerce. As discussed above, four current Justices find "sweeping extraterritorial effects" to be relevant to the substantial burden analysis, and also stress that "derivative harms" (such as operational delays where time is of the essence) should be taken into account. The Florida law creates such "sweeping extraterritorial effects" due to its major impact on services rendered entirely outside the state, requiring depository institutions to conform their operations nationwide to the Florida rules. Moreover, altering product offerings nationwide will inevitably result in operational delays in an industry where prompt action (*e.g.*, to extend a loan to a business or person in need of immediate funds) is often crucial. Thus, these four Justices may be convinced that a substantial burden exists. Justice Barrett may also find a substantial burden exists if the costs will be "primarily" felt outside Florida.

i. Conflicting Out-of-State ESG Laws May Increase the Burden on Interstate Commerce

The Florida law could also create burdens beyond those contemplated in National Pork. For instance, the law could create an impossible compliance burden, forcing some private actors out of the market. If a depository institution is required under a second state's law (whether its home state or a third state) to consider ESG factors in rendering services to any person, then the

[92] H.R. 3, 2023 Leg., Reg. Sess. §§ 14-15 (Fla. 2023); *see also States Require "Fair Access" to Financial Services*, *supra* note 7, at 7 (stating that Florida House Bill 3 "do[es] not define 'customer' or 'consumer' or otherwise include any explicit geographic limitations of the fair access requirements.").

[93] South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 97 (1984); *see also Back O&G or We'll Blacklist You Say Red States*, THE CLIMATE CAPITALIST (Dec. 13, 2022), https://theclimatecapitalist.com/articles/back-o-g-or-well-blacklist-you-say-red-states.

institution would not be able to simultaneously do business in both Florida and that second state. In *National Pork*, some Justices did not find a substantial burden where a company might *choose* not to operate in a state due to the costs of complying with state law. However, contradictory ESG laws have the potential to *force* actors out of the market – a burden beyond that in *National Pork*. And, as explained above, when considering a case involving conflicting legal regimes, the Court may attribute the full costs of complying with a law to the state being challenged.[94] The burdens of the Florida law also go further than those in *National Pork* because they are not related to commerce taking place inside the state. In *National Pork*, producers in theory could alter their practices only as to the pork which would be sold into the California market. In contrast, the Florida law burdens the entirety of a company's operations, with no opportunity to segregate product lines for different markets.

ii. Out-of-State ESG Laws Potentially Have a Discriminatory or Protectionist Purpose

The Florida law also arguably reveals a discriminatory purpose by way of its effects. The law prohibits public depository institutions from denying services to a person based on "any rating, [or] scoring… based on factors including… the person's failure to meet or commit to meet… [e]nvironmental standards… [or] [s]ocial governance standards."[95] Thus, a bank would not be able to take a potential customer's ESG score into account when deciding whether to deny a loan, to any customer, anywhere. This protects Florida's in-state banking market by leveling the playing field – out-of-state banking markets are deprived of "whatever competitive advantages they [might have] possess[ed]" by taking ESG scores into account in making loan decisions outside of Florida.[96] Although in- and out-of-state depository institutions doing business with Florida are now on equal footing in the way they must consider loan applications, the law has placed restrictions on out-of-state commerce. The law thus "benefit[s] in-state economic interests by burdening out-of-state competitors,"[97] in potential violation of the Dormant Commerce Clause. However, Florida (and other states defending laws in this category) will argue environmental and social policy goals are what motivate the law, not economic protectionism.

c. *Pike* Analysis – Balancing Benefits Against a Substantial Burden

To complete the *Pike* analysis, the burdens of the Florida law may outweigh the benefits. A state's interest in applying its ESG policy preferences to out-of-state actors arguably does not outweigh the substantial burden on interstate commerce outlined above. Further, the law is not properly tailored – the legitimate local interest the state has in promoting its morals legislation could be just as well served with a lesser impact on interstate commerce by limiting the law to bank services provided in-state.[98]

[94] *Supra* III.a.ii.2.b.i.

[95] Fla. H.R. 3 § 14.

[96] Healy v. Beer Inst., 491 U.S. 324, 339 (1989) (internal quotations and citation omitted).

[97] Nat'l Pork Producers Council v. Ross, 598 U.S. 356, 369 (2023) (internal quotation and citations omitted).

[98] *See* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

d. Conclusion

Given that ESG laws like the Florida law which directly regulate out-of-state economic activity create substantial burdens beyond what was found in *National Pork*, these out-of-state ESG laws are the most likely to violate the Dormant Commerce Clause.

b. The Supremacy Clause

The Constitution's Supremacy Clause provides that federal laws take precedence over state and local laws.[99] A state law is invalid if it conflicts with a federal law that either expressly or impliedly preempts the state law. State ESG laws potentially violate the Supremacy Clause by conflicting with superseding federal statutes regulating asset managers, national banks and other financial institutions. Below we highlight four specific examples: (1) National Securities Markets Improvement Act of 1996 (NSMIA), (2) Employee Retirement Income Security Act of 1974 (ERISA), (3) the National Banking Acts of 1863 and 1864 (later known as the "National Bank Act"), and (4) the Clean Air Act each of which preempts state law to some extent. There could be other issues of federal law that preclude state regulation. For example, principles of federalism could prevent a state from attempting to regulate interstate emissions, which is arguably the intended effect of certain state ESG laws. However, we do not explore those topics here.

We note that while the market participant doctrine creates an exception for state proprietary action in the context of the Dormant Commerce Clause, the Supreme Court has never applied it in the context of preemption under the federal statutes discussed here.[100] A discussion of whether the doctrine could be extended to these statutes is beyond the scope of this paper. Thus, we assess preemption under NSMIA, ERISA, the National Bank Act, and the Clean Air Act without taking the possibility of the market participant exception into account.

i. Preemption under NSMIA

NSMIA is a federal statute passed in 1996 intended to "promote efficiency and capital formation in the financial markets"[101] as well as to "reduce the burden to investment advisers of… overlapping and duplicative regulation" by establishing a uniform set of regulatory requirements for securities markets and investment advisers.[102] NSMIA exempts many financial products and firms from substantive state securities law regulations. Among these are exchange-listed securities, and securities issued by federally registered investment companies, including mutual funds.[103] NSMIA expressly provides that a state may not "directly or indirectly prohibit, limit, or impose conditions, based on the merits of such offering or issuer, upon the offer or sale" of any such

[99] U.S. CONST. art. VI, cl. 2; *see also Preemption*, LEGAL INFO. INST. (Mar. 2024), https://www.law.cornell.edu/wex/preemption.

[100] *The Market Participant Doctrine and Forced Arbitration*, *supra* note 61, at 1360.

[101] National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, 3416 (1996) (codified in scattered sections of the U.S. Code).

[102] Regulation Analyst Certification, 68 Fed. Reg. 9,482, 9,484 n.22 (Feb. 27, 2003) (codified at 17 C.F.R. pt. 242).

[103] 15 U.S.C. § 77r(b)(1)&(2).

security.[104] NSMIA also allocates exclusive regulatory oversight of larger investment advisers to the SEC,[105] and prohibits states from making certain rules applicable to broker-dealers, including regarding financial responsibility, making and keeping records, and reporting requirements.[106]

Today, exchange listed securities and federally registered funds are ubiquitous. It is easy to see how many forms of state ESG laws may run afoul of NSMIA's requirement that a state may not prohibit or impose conditions on the sale of these types of investments based on their merits.[107] For example, a pro-ESG "boycott" law that prohibits state entities from investing in an ESG-disfavored industry such as fossil fuels would indirectly prohibit the sale to state entities of both the exchange listed securities of companies in that industry and mutual funds investing in that industry, based on a determination by the state that such securities do not merit investment.[108] State entities could not legally purchase those securities, and hence their sale to state entities would be prohibited.

State ESG laws may also be preempted by NSMIA's provisions covering financial services professionals. Any state law attempting to substantively regulate SEC-registered investment advisers, or requiring certain additional undertakings by broker-dealers, may be invalid. For example, two recent Missouri anti-ESG laws – one covering broker-dealers and their agents, the other covering investment advisers and their agents – required those intermediaries to obtain written consent from clients before incorporating social or nonfinancial objectives into their advice.[109] The laws were challenged in federal court in *SIFMA v. Ashcroft*. In August 2024 the court invalidated the laws, including on the grounds that: as the Missouri investment adviser law creates new obligations applicable to SEC-regulated investment advisers and their agents, it is preempted; and as NSMIA prohibits states from requiring broker-dealers to make and keep additional records, the Missouri broker-dealer law is preempted.[110]

ii. Preemption under ERISA

ERISA, passed in 1974, establishes a uniform set of rules and regulations for the administration of retirement plans. ERISA includes "the broadest federal preemption clause ever utilized in national

[104] *Id.* § 77r(a)(3).

[105] However, states may still take enforcement action against fraud, require notice filings, and collect fees. Exemption for Investment Advisers Operating in Multiple States, 63 Fed. Reg. 39708, 39709 n.10 (July 24, 1998) (codified at 17 C.F.R. pts. 275 & 279); *see also* Complaint for Declaratory & Injunctive Relief at 15, SIFMA v. Ashcroft, No. 2:23-cv-4154 (W.D. Mo. Aug. 10, 2023).

[106] 15 U.S.C. § 78o(i)(1).

[107] 15 U.S.C. § 77r(a)(3); *see also* Complaint for Declaratory & Injunctive Relief, *supra* note 105, at 35-36.

[108] *See, e.g.*, Order on Motion to Dismiss at 15, SIFMA v. Ashcroft, No. 23-cv-04154-SRB (W.D. Mo. Jan. 5, 2024) (finding that plaintiffs adequately alleged a Missouri regulation imposed a merit-based condition where investment advisers were required to obtain consent before recommending covered securities incorporating ESG objectives because the regulation "impose[d] an extra hurdle… based on the substantive characteristics of those securities." (internal quotation and citation omitted)).

[109] MO. CODE REGS. tit. 15, §§ 30-51.170(3)&172(3) (2024); *see also* Johnathan Richman, *Missouri Court Denies Dismissal of SIFMA Challenge to Missouri's Anti-ESG Rules for Financial Advisers*, PROSKAUER: CORP. DEF. & DISPS. BLOG (Jan. 8, 2024), https://www.proskauer.com/blog/missouri-court-denies-dismissal-of-sifma-challenge-to-missouris-anti-esg-rules-for-financial-advisers.

[110] Order on Motion for Summary Judgment at 8-11, SIFMA v. Ashcroft, No. 23-cv-04154-SRB (W.D. Mo. Aug. 14, 2024).

legislation,"[111] superseding any state laws, rules, or other state action which "relate to any employee benefit plan" covered by ERISA.[112] The Supreme Court has stated that "[a] law 'relates to' an [ERISA plan]… if it has a connection with or reference to such a plan."[113] The Court has suggested this could occur where a state law "bind[s] plan administrators to any particular choice… [or] preclude[s] uniform administrative practice."[114] Further, a law may still "relate to" an ERISA plan, "even if the law is not specifically designed to affect such plans, or the effect is only indirect."[115]

The Department of Labor – one of the federal regulators of ERISA – recently passed a new rule clarifying that consideration of ESG factors may be compatible with an ERISA plan administrator's fiduciary duties, provided they relate to risk-return analysis.[116] Further, if two alternatives are equally financially appropriate, a fiduciary may consider ESG factors in selecting an investment.[117]

ESG state laws and regulations prohibiting or requiring the investment of state pension funds based on ESG factors may be preempted where those state pensions also rely on ERISA fiduciary standards.[118] For example, under Florida statute, the managers of the state retirement system must "comply with the fiduciary standards set forth in [ERISA]."[119] Because the Florida statute expressly "references" ERISA, other aspects of Florida law that run contrary to ERISA fiduciary standards may be susceptible to ERISA preemption.[120] In 2022, despite the state law mandating compliance with ERISA fiduciary standards, the state entity which manages the retirement system passed guidelines requiring that "an investment decision must be based only on pecuniary factors . . . [which] do not include the consideration of the furtherance of social, political, or ideological interests."[121] As the consideration of ESG factors is potentially consistent with ERISA fiduciary

[111] Scott J. Stitt et al., *ERISA Preemption*, *in* BLOOMBERG LAW, EXECUTIVE & DIRECTOR COMPENSATION REFERENCE GUIDE 3 (2020), *available at* https://www.tuckerellis.com/webfiles/ERISA_Preemption_Stitt_Snyder_Sanders.pdf.

[112] 29 U.S.C. § 1144(a).

[113] Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 97 (1983).

[114] New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 659-60 (1995); *see also* Stitt et al., *supra* note 111, at 6.

[115] Ingersoll-Rand Co. v. McClendon, 498 U.S. 133, 139 (1990).

[116] *See, e.g.*, *DOL's New Rule on ERISA Investment Duties and Its Relationship to ESG*, COVINGTON (Dec. 29, 2022), https://www.cov.com/en/news-and-insights/insights/2022/12/dols-new-rule-on-erisa-investment-duties-and-its-relationship-to-esg.

[117] *See, e.g.*, Cynthia Hanawait & Dyan Garcia, *DOL Rule Clarifies that ESG Analysis is Consistent with Fiduciary Duty. Will it Preempt State Anti-ESG Laws?*, COLUMBIA L. SCH.: CLIMATE L. BLOG (Nov. 23, 2022), https://blogs.law.columbia.edu/climatechange/2022/11/23/dol-rule-clarifies-that-esg-analysis-is-consistent-with-fiduciary-duty-will-it-preempt-state-anti-esg-laws/.

[118] *Id.*

[119] FLA. STAT. § 121.4501(15)(a) (2023); *see also* Hanawait & Garcia, *supra* note 117.

[120] Hanawait & Garcia, *supra* note 117.

[121] STATE BD. OF ADMIN. OF FLA., A RESOLUTION DIRECTING AN UPDATE TO THE INVESTMENT POLICY STATEMENT AND PROXY VOTING POLICIES FOR THE FLORIDA RETIREMENT SYSTEM DEFINED BENEFIT PENSION PLAN § 1(a) (Aug. 23, 2022); Hanawait & Garcia, *supra* note 117.

standards, the guidelines potentially conflict with ERISA, and may therefore face challenges on the basis of preemption.[122]

Further, to the extent ESG laws purport to regulate investment advisers and broker-dealers who give advice in relation to ERISA pension plans, they may also be superseded by ERISA.[123] Indeed, the court in *SIFMA v. Ashcroft* found that the Missouri rules requiring broker-dealers and investment advisers to disclose, obtain consent, and keep records relating to investments with ESG objectives were preempted by ERISA.[124] The court found that the rules had a "connection" with ERISA plans as they "interfere[d] with ERISA by restricting what investments may be recommended or selected, and by mandating disclosure and recordkeeping requirements not required by ERISA."[125]

iii. Preemption under the National Bank Act

The National Banking Acts of 1863 and 1864 (later known as the "National Bank Act") created a uniform federal bank chartering system under the supervision of a newly created federal agency and a national currency.[126] Nationally chartered banks are primarily regulated under federal law,[127] and the National Bank Act grants these banks certain powers, including "receiving deposits," "loaning money on personal security," and "all such incidental powers as shall be necessary to carry on the business of banking."[128] While national banks may also be subject to state or local law, under Supreme Court precedent laid out in *Barnett Bank of Marion County, N.A. v. Nelson* (1996), state law is preempted where it "prevents or significantly interferes with the exercise by the national bank of its powers."[129] In *Barnett Bank*, while the National Bank Act allowed federally chartered banks to sell insurance in small communities, a Florida law barred many banks from selling insurance in the state (including in those small communities).[130] The Court held that the Florida law was preempted, because it significantly interfered with the ability to exercise a permissible nationally granted power.[131] It did not matter that a national bank could comply with both laws by simply choosing not to sell insurance in Florida.[132] The Court reasoned that "[the] history [of national bank legislation] is one of interpreting grants of both enumerated and incidental

[122] Hanawait & Garcia, *supra* note 117.

[123] *See, e.g.*, Complaint for Declaratory & Injunctive Relief at 36, SIFMA v. Ashcroft, No. 2:23-cv-4154 (W.D. Mo. Aug. 10, 2023) (arguing that to the extent the Missouri laws relate to ERISA plan assets, they are preempted).

[124] Order on Motion for Summary Judgment at 12-14, SIFMA v. Ashcroft, No. 23-cv-04154-SRB (W.D. Mo. Aug. 14, 2024).

[125] *Id.* at 13.

[126] *National Banking Acts of 1963 and 1964*, FED. RSRV. HIST. (July 31, 2022), https://www.federalreservehistory.org/essays/national-banking-acts; *Founding of the OCC & the National Banking System*, OFF. COMPTROLLER CURRENCY, https://www.occ.treas.gov/about/who-we-are/history/founding-occ-national-bank-system/index-founding-occ-national-banking-system.html (last visited Aug. 20, 2024).

[127] *See, e.g.*, Cantero v. Bank of Am., N.A., 602 U.S. 205, 210 (2024).

[128] 12 U.S.C. § 24.

[129] *Cantero*, 602 U.S. at 209 (citations omitted); Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 33 (1996).

[130] *Barnett Bank*, 517 U.S. at 27-29.

[131] *Id.* at 33-35.

[132] *Id.* at 31.

'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law."[133]

State laws that have been struck down on the basis of preemption include laws that have prevented national banks from exercising the powers granted to them, or which have interfered with a bank's "flexibility"[134] or "efficiency"[135] in doing so.[136] On the other hand, state laws which have been upheld include laws that regulate a national bank's "'daily course of business' such as generally applicable state contract, property, and debt-collection laws" and which "'in no manner hinder[]' the national bank's banking operations."[137] Further, as discussed above, the market participant exemption has never been used by the Supreme Court to uphold a state law in the context of National Bank Act preemption.

As acting Comptroller of the Currency Michael Hsu remarked in a July 2024 speech, banking law is becoming increasingly fragmented at the state level, a trend which his office vowed to fight.[138] Making good on this promise, in October 2024 the OCC filed an amicus brief in a case against an Illinois law prohibiting certain swipe fees, arguing that the law is preempted by the National Bank Act.[139] The OCC's brief explained the law would "create extraordinary uncertainty and impose debilitating operational challenges."[140] Posing similar risks, a number of state and local ESG rules purport to control the conduct of national banks and therefore may raise National Bank Act preemption issues.[141] Two examples are discussed below. While the OCC has signaled its strong stance on federal preemption, it remains to be seen whether it will weigh in on these and other state and local ESG laws.[142]

In 2023 the New York City Banking Commission announced it had revised the certificates banks (including national banks) must submit under a New York City rule to be designated to hold public city funds.[143] Specifically, with respect to their anti-discrimination policies, depository institutions are required to "set forth the detailed plan and the specific steps affirmatively taken by such bank"

[133] *Id.* at 32.
[134] *Cantero*, 602 U.S. at 217 (quoting Fid. Fed. Sav. & Loan Ass'n v. De la Cuesta, 458 U. S. 141, 142 (1982)).
[135] *Id.* at 218 (quoting First Nat'l Bank of San Jose v. California, 262 U.S. 366, 369 (1923)).
[136] *Id.* at 214-19.
[137] *Id.* at 219 (quoting First Nat'l v. Kentucky, 76 U.S. 353, 362-63 (1869)).
[138] Michael Hsu, Remarks Before the Exchequer Club: Size, Complexity, and Polarization in Banking, *supra* note 5, at 13-14.
[139] *Banks Cheer as Hsu Comes Out Strong on Preemption*, CAPITOL ACCOUNT (Oct. 3, 2024), https://www.capitolaccountdc.com/p/banks-cheer-as-hsu-comes-out-strong.
[140] *Id.*
[141] *See, e.g.*, Randy Benjenk & Emily Hooker, *The Continued Evolution of the Anti-ESG Landscape for Financial Institutions*, COVINGTON 6 (Mar. 2024), https://www.cov.com/-/media/files/corporate/publications/2024/03/the-continued-evolution-of-the-anti-esg-landscape-for-financial-institutions-predictions-for-2024-and-beyond.pdf; *States Require "Fair Access" to Financial Services*, *supra* note 7, at 8; Keith Kollmeyer et al., *New ESG Requirements for Banks that Hold Public Funds May Raise Challenging Compliance Issues*, MINTZ (June 29, 2023), https://www.mintz.com/insights-center/viewpoints/2023-06-29-new-esg-requirements-banks-hold-public-funds-may-raise.
[142] *See Banks Cheer as Hsu Comes Out Strong on Preemption*, *supra* note 139.
[143] *NYC Banking Commission Announces Measures to Ensure City's Designated Banks More Accountable to Public*, CITY OF N.Y. (Feb. 10, 2023), https://www.nyc.gov/office-of-the-mayor/news/104-23/nyc-banking-commission-measures-ensure-city-s-designated-banks-more-accountable-to [hereinafter *NYC Designated Banks*]

to combat discrimination.[144] In May 2023, the Banking Commission voted to stop depositing city funds with Capital One, N.A., a national bank, stating that it had "refused to submit required policies," leading to the "conclu[sion] that they are not taking meaningful actions to combat discrimination in their operations and are not responsible stewards of public dollars."[145] The New York City rule potentially violates the *Barnett Bank* test. By refusing to hold funds at national banks unless they adhere to the city's anti-discrimination procedures, New York City may be "significantly interfering" with these banks' ability to exercise the federally granted power to receive deposits, as the rule impairs the banks' "flexibility" and "efficiency" in doing so. And, in cases where a bank is deemed not to comply with the rule, it is prevented from receiving deposits from the city altogether.

Another example is West Virginia Senate Bill 262, which requires the state treasurer to maintain a list of "financial institutions," including national banks, which "boycott" fossil fuel companies.[146] TD Bank, N.A., a nationally chartered bank, was recently added to the list.[147] Once a financial institution is listed, the treasurer may refuse to enter into a banking contract with it, prohibit it from bidding for a banking contract, or require it to agree to cease energy boycotting activity for the duration of a banking contract.[148] "Banking contracts" cover the "banking goods or services" an institution provides to the state[149] and therefore broadly sweep in all banking activities, including those for which national banks were given powers to conduct by the National Bank Act. This law also potentially violates *Barnett Bank*. If the state bars a national bank from bidding, or refuses to contract with it, that clearly prevents the bank from exercising its powers. Even if the state chooses to require the bank to agree to halt "boycotting" as a condition to the contract, that action "significantly interferes" with the bank's ability to provide banking services, because it impedes the "efficiency" of the bank's nationally authorized operations. And, as with the NYC rule, the West Virginia law is not like a generally applicable state law regulating daily activity.

iv. Preemption under the Clean Air Act

The Clean Air Act ("CAA"), first enacted in 1955, requires the Environmental Protection Agency ("EPA") to set health-based air quality standards and emissions standards and controls for sources of air pollution, among other provisions.[150] The CAA contains a "savings clause," allowing the

[144] N.Y.C. RULES tit. 22, chp. 1, § 1-03(c)(2)(ii); *NYC Designated Banks*, *supra* note 143.

[145] *New York City Banking Commission Votes to Approve 26 Depository Banks for Two Years, Limits New Deposits at Capital One and KeyBank*, N.Y.C. COMPTROLLER (May 25, 2023), https://comptroller.nyc.gov/newsroom/new-york-city-banking-commission-votes-to-approve-26-depository-banks-for-two-years-limits-new-deposits-at-capital-one-and-keybank/; Letter from Mary C. Jackman, Assistant Comm'r & Treasurer, N.Y.C. Banking Comm'n, to Hon. Adrienne Adams, Speaker, N.Y.C. Council (Apr. 10, 2023), *available at* https://www.nyc.gov/assets/finance/downloads/pdf/treasury/banking_commission/2023-bank-designation-list-city-council-letter.pdf.

[146] S. 262, 2022 Leg., Reg. Sess. (W. Va. 2022).

[147] W. VA. TREASURER, RESTRICTED FINANCIAL INSTITUTE LIST (Apr. 8, 2024), *available at* https://www.wvtreasury.com/portals/wvtreasury/content/legal/memorandum/Restricted-Financial-Institutions-List-2024.pdf

[148] *Id.*

[149] W. Va. CODE §12-1C-1(a)(1) (2024).

[150] *See, e.g.*, RICHARD K. LATTANZIO, CONG. RSCH. SERV., CLEAN AIR ACT: A SUMMARY OF THE ACT AND ITS MAJOR REQUIREMENTS (Sept. 13, 2022).

states to set more stringent air pollution standards than required under the CAA.[151] The Supreme Court has not considered the proper scope of the CAA's savings clause. However, federal circuit courts "have consistently construed… the Clean Air Act's saving clause… [as] preempt[ing] state law to the extent it purports to regulate air pollution originating out of state."[152]

State ESG laws attempting to regulate air pollution may face preemption challenges under the CAA. For instance, California Senate Bills 253 and 261 require companies over certain revenue thresholds that do business in the state to make climate-related disclosures about their worldwide operations, including greenhouse gas emissions and climate-related financial risk reports.[153] A lawsuit pending in federal district court argues that both laws are preempted by the CAA.[154] Plaintiffs contend the laws are "aimed at stigmatizing companies for the purpose of pressuring them to lower their emissions nation- and even world-wide."[155] They argue, among other points, that the CAA is a "comprehensive statutory system [which] precludes supplemental state regulation of alleged harms arising from interstate greenhouse-gas emissions,"[156] and that the CAA's savings clause does not shield the laws because they are not limited to in-state emissions.[157]

c. The First Amendment

The First Amendment of the Constitution prohibits the federal government and the states from taking any action "abridging the freedom of speech"[158] of private persons.[159] Freedom of speech includes both the right to choose what to say, as well as the right to choose not to speak.[160] In addition, conduct which is "sufficiently imbued with elements of communication"[161] – known as "expressive conduct" – is also considered speech. This area of law is complex and has evolved as the Supreme Court has considered the application of the First Amendment to new contexts. Given the substantial body of Supreme Court precedent, "much of free speech analysis is directed at

[151] Kyle A. Piasecki, *Surviving Preemption in a World of Comprehensive Regulations*, 49 U. MICH. J. L. REFORM CAVEAT 32, 35 (2015); 42 U.S.C. § 7416.

[152] Plaintiffs' Opposition to Defendants' Partial Motion to Dismiss at 17, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801 (C.D. Cal. May 1, 2024).

[153] *See, e.g.*, Herzinger et al., *supra* note 69; Amended Complaint for Declaratory & Injunctive Relief at 23-24, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801-KS (C.D. Cal. Feb. 22, 2024).

[154] Plaintiffs' Opposition to Defendants' Partial Motion to Dismiss, *supra* note 152, at 15-18.

[155] Amended Complaint for Declaratory & Injunctive Relief, *supra* note 72, at 24, 4.

[156] Plaintiffs' Opposition to Defendants' Partial Motion to Dismiss, *supra* note 152, at 16.

[157] *Id.* at 17.

[158] U.S. CONST. amend. I; Telescope Media Grp. v. Lucero, 936 F.3d 740, 750 (8th Cir. 2019) (explaining the Fourteenth Amendment applies the First Amendment to the states); *see also* Eugene Volokh, *First Amendment*, BRITANNICA (June 22, 2024), https://www.britannica.com/topic/First-Amendment.

[159] VICTORIA L. KILLION, CONG. RSCH. SERV., FREEDOM OF SPEECH: AN OVERVIEW 1-2 (Sept. 13, 2024) (citing Walker v. Tex. Div., Sonds of Confederate Veterans, Inc. 576 U.S. 200, 207 (2015)); Private speakers can include both corporations and individuals. Citizens United v. Fed. Election Comm'n, 558 U.S. 310, 342 (2010) ("[P]olitical speech does not lose First Amendment protection 'simply because its source is a corporation.'") (citation omitted).

[160] *Lucero*, 936 F.3d at 752; *see also* Complaint for Declaratory and Injunctive Relief at 37, SIFMA v. Ashcroft, No. 2:23-cv-4154 (W.D. Mo. Aug. 10, 2023).

[161] Texas v. Johnson, 491 U.S. 397, 404 (1989) (internal quotations and citation omitted); KILLION, *supra* note 159, at 2.

determining the appropriate legal standards [or "level of scrutiny"] to apply to [a] challenged law or government action."[162]

Challengers to state ESG laws are utilizing First Amendment arguments in a number of pending and recently decided federal court cases. Academics are also publishing their views on additional types of ESG laws which may violate the First Amendment, paving the way for future litigation. Below, we discuss the arguments for how the First Amendment could be applied to invalidate a range of state ESG laws.

i. Boycotts

ESG laws that prevent companies from "boycotting" certain industries could be unconstitutional if they are interpreted as restricting non-commercial speech, in violation of *NAACP v. Claiborne*.[163] That 1982 case concerned a boycott by African Americans in Mississippi of white merchants for the purpose of demanding racial equality.[164] Several merchants sued to recover lost profits. However, the Court held that "[t]he nonviolent elements of petitioners' [boycott] activities are entitled to the protection of the First Amendment."[165] Subsequently, "[c]ourts have recognized boycotts as having First Amendment protection if their goal is to influence political and social change rather than to obtain economic gain."[166]

In August 2024 a business group filed a lawsuit challenging Texas's "anti-boycott" Senate Bill 13 ("SB 13"), which requires the state comptroller to maintain a list of financial companies that "boycott" the fossil fuel energy sector.[167] Under SB 13, state governmental entities must divest from and may not acquire new investments in listed financial companies, and governmental entities may not enter certain contracts unless the counterparty verifies in writing that it does not boycott energy companies.[168] The lawsuit argues that companies that choose to limit their commercial relations based on fossil fuel considerations ("boycotters" under SB 13) are expressing a viewpoint, both through speech and expressive conduct, "on a matter of public concern."[169] Because the Texas law discriminates against speech based on viewpoint, it should be subject to "strict scrutiny" review.[170] "Strict scrutiny" is used by the courts to review "content-based" restrictions regulating the substance of non-commercial speech, including on topics which "relat[e] to any matter of political, social, or other concern to the community."[171] Such laws are

[162] KILLION, *supra* note 159, at Summary.

[163] *See, e.g.*, *Are Anti ESG Laws Anti 1st Amendment?*, THE CLIMATE CAPITALIST (May 2, 2023), https://theclimatecapitalist.com/articles/are-anti-esg-laws-anti-1st-amendment; Happel, *supra* note 68.

[164] NAACP v. Claiborne, 458 U.S. 886, 889 (1982).

[165] *Id.* at 915.

[166] Dara E. Purvis, *Boycotts*, FREE SPEECH CTR. AT MIDDLE TENN. STATE UNIV. (July 5, 2024), https://firstamendment.mtsu.edu/article/boycotts/.

[167] S. 13, 87th Leg., Reg. Sess. (Tex. 2021).

[168] *Id.*

[169] Complaint for Declaratory & Injunctive Relief at 4, 32, 34, Am. Sustainable Bus. Council v. Hegar, NO. 1-24-CV-1010 (W.D. Tex. Aug. 29, 2024).

[170] *Id.* at 32, 34.

[171] Connick v. Myers, 461 U.S. 138, 146 (1983); *see also, e.g.,* VICTORIA L. KILLION, CONG. RSCH. SERV., THE FIRST AMENDMENT: CATEGORIES OF SPEECH (Mar. 28, 2024).

presumptively unconstitutional[172] and rarely survive strict scrutiny review.[173] Under strict scrutiny, "the government [must] prove[] that [the law is] narrowly tailored to serve [a] compelling state interest[]."[174]The Supreme Court has stated that viewpoint discrimination – "the specific motivating ideology or the opinion or perspective of the speaker" – is "an egregious form of content discrimination."[175]

The plaintiff argues that SB13 cannot survive strict scrutiny review.[176] Specifically, prohibiting state investment or contracting with "companies that the state perceives to engage in anti-fossil fuel speech or expression" is not even a legitimate state interest, much less a compelling one.[177] And while Texas's stated intent was to "stop[] a 'movement' that is 'denying capital to [Texas's] responsible, hard-working energy businesses,'"[178] the law may not be tailored to achieve this because the law has allegedly contributed to a loss of approximately $668 million in economic activity and over 3,000 fewer jobs.[179] Moreover, plaintiff contends the law impermissibly compels companies to alter their speech to align with Texas's view on fossil fuels in order to obtain government benefits,[180] another possible basis for invalidation.[181]

ii. Compelled Subsidization of Speech

An alternative theory of why state ESG divestiture laws raise issues under the First Amendment focuses on compelled subsidization of speech. For example, in 2015 California passed a pro-ESG law prohibiting the California Public Employee's Retirement System ("CalPERS") from investing in thermal coal companies (the "CalPERs law").[182] The law arguably restricts investment decisions for the purposes of communicating a stance on ESG issues, and hence the law could be considered speech.[183] Specifically, ideologically motivated investment decisions may arguably be considered expressive conduct amounting to speech.[184] In *Citizens United v. Federal Election Commission* (2010), the Supreme Court held that government prohibitions on a corporation's use of general treasury funds to support a candidate's campaign in certain federal elections, whether through direct contributions or through media campaigns, violated the First Amendment.[185] From this,

[172] Reed v. Town of Gilbert, 576 U.S. 155, 163 (2015).
[173] KILLION, *supra* note 159, at 4-5.
[174] *Reed*, 576 U.S. at 163.
[175] Rosenberger v. Rector & Visitors of Univ. of Va., 515 U.S. 819, 829 (1995).
[176] Complaint for Declaratory & Injunctive Relief at 32, 34, Am. Sustainable Bus. Council v. Hegar, NO. 1-24-CV-1010 (W.D. Tex. Aug. 29, 2024).
[177] *Id.*
[178] *Id.* at 2 (citation omitted).
[179] *Id.*
[180] *Id.* at 4, 33, 35.
[181] *See* KILLION, *supra* note 159, at 1.
[182] S. 185, 2025 Leg., Reg. Sess. (Cal. 2015).
[183] *See* Michael W. McConnell, *Reconsidering Citizens United as a Press Clause Case*, 123 YALE L. J. 412, 421 (2013); *see also* Mark R. Kubish, *ESG, Public Pensions, and Compelled Speech*, 11 TEX. A&M L. REV. 71, 96 (2023).
[184] *See, e.g.*, Kubish, *supra* note 183, at 96-97.
[185] 558 U.S. 310, 320-21, 365 (2010).

commentators have concluded that “governmental restrictions on the use of resources *for the purpose of communicating a message* are properly understood as restrictions on speech.”[186]

Moreover, state employees are required to contribute to CalPERS.[187] Compelled payments to an entity making controversial statements may be considered compelled speech. In *Janus v. AFSCME* (2018), the Supreme Court held that a state could not require non-union members to pay fees to a public union where that union was the sole representative of both members and non-members in collective bargaining situations, including on “policy matters.”[188] The Court reasoned that compelled fees would, “violate[] the free speech rights of nonmembers by compelling them to subsidize private speech on matters of substantial public concern.”[189] Thus, under the Court’s reasoning in *Janus*, such employees are arguably being *compelled* to make private speech on the controversial topic of climate change.[190] The law would therefore be reviewed under the exacting scrutiny standard for compelled subsidies set out in *Janus*, meaning it must “‘serve a compelling state interest that cannot be achieved through means significantly less restrictive of associational freedoms.’”[191] The rigor with which a court reviews a law under exacting scrutiny sits just below that of strict scrutiny.[192] Recent scholarship argues the CalPERs law would fail exacting scrutiny because there are other means for California to achieve climate-related goals that are significantly less restrictive of First Amendment rights.[193] Therefore, the CalPERs law arguably violates the First Amendment.

iii. Compelled Disclosure

Both pro-ESG and anti-ESG disclosure laws have been litigated in federal court based on the First Amendment’s protection against compelled disclosure. Plaintiffs in *Chamber of Commerce of the U.S. v. Randolph* argue that California’s pro-ESG Senate Bills 253 and 261, compelling businesses to make climate-related disclosures, violate the First Amendment.[194] They first posit that strict scrutiny should apply, arguing that the disclosures amount to compelled non-commercial speech on the “‘controversial subject[]’ of ‘climate change.’”[195] The Supreme Court generally applies some form of intermediate scrutiny to “commercial speech,” which is “expression related solely to the economic interests of the speaker and its audience,”[196] or that "does no more than propose a

[186] McConnell, *supra* note 183, at 421.

[187] *See* Kubish, *supra* note 183, at 91.

[188] 585 U.S. 878, 884-86 (2018).

[189] *Id.* at 885-86; *see also* Kubish, *supra* note 183, at 73.

[190] *See* Kubish, *supra* note 183, at 86-87, 96, 104-108 (arguing that CalPERS’s speech is private speech, not government speech); *see also Janus*, 585 U.S. at 913-14 (identifying climate change as a “controversial subject[]” and a “sensitive political topic[]”).

[191] *Janus*, 585 U.S. at 894 (quoting Knox v. Service Employees*,* 567 U.S. 298, 310 (2012)).

[192] *See, e.g.*, David L. Hudson Jr., *Exacting Scrutiny*, FREE SPEECH CTR. AT MIDDLE TENN. STATE UNIV. (July 2, 2024), https://firstamendment.mtsu.edu/article/exacting-scrutiny/.

[193] Kubish, *supra* note 183, at 95.

[194] Amended Complaint for Declaratory & Injunctive Relief at 18-22, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801-KS (C.D. Cal. Feb. 22, 2024).

[195] *Id.* at 18, 20 (quoting *Janus*, 585 U.S. at 913).

[196] Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of N.Y., 447 U.S. 557, 561 (1980); KILLION, *supra* note 171.

commercial transaction."[197] Under the standard intermediate scrutiny test, provided the speech is neither misleading nor concerning unlawful activity, the Court asks "whether the regulation directly advances the [substantial] governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest."[198] Plaintiffs in *Randolph* argue that the speech is non-commercial and hence intermediate scrutiny does not apply because the goal of reducing emissions is not "related solely to economic interests,"[199] and the speech is "required regardless of whether it is connected to proposing a commercial transaction."[200] Instead, strict scrutiny applies, and the laws are presumptively unconstitutional.[201]

The state argues that an even more lenient form of intermediate scrutiny called "*Zauderer* review" should apply. This level of review is reserved for compelled commercial disclosures of "purely factual and uncontroversial information."[202] In *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio* (1985), the Supreme Court considered an Ohio rule that required that attorneys advertising their services to clients on a contingency-basis also needed to explain that if the case failed the client could still be liable for non-legal costs.[203] The Court upheld the Ohio rule as compelling only "purely factual and uncontroversial information about the terms under which his services will be available."[204] In this context, the Court will consider whether a law is "reasonably related to the State's interest in preventing deception of consumers."[205] Plaintiffs argue *Zauderer* is not the correct standard because the laws do not regulate commercial speech and do not compel "purely factual and uncontroversial information."[206] The required disclosures are not purely factual, because, for instance, they require companies to *predict* climate-related risks, and *subjectively estimate* emissions.[207] And the Supreme Court itself has identified climate change as a "sensitive political topic[]."[208] Plaintiffs go on to argue that the laws could not survive any level of scrutiny, because the state has no legitimate interest in providing this information to consumers, and the laws are overly broad, sweeping in "[*a*]*ny* company meeting the revenue threshold that does business in the State… regardless of any plausible connection between the business and climate change and any advertisement, investor, consumer, or employee."[209]

[197] Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 776 (1976); KILLION, *supra* note 159, at 6-7.
[198] *Cent. Hudson*, 447 U.S. at 566; *see also* KILLION, *supra* note 159, at 7.
[199] Reply Memorandum of Points & Authorities in Support of Plaintiff's Motion for Summary Judgment on Claim I at 3, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801-ODW-PVC (C.D. Cal. Aug. 19, 2024) (internal quotations and citation omitted).
[200] Amended Complaint for Declaratory & Injunctive Relief at 20, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801-KS (C.D. Cal. Feb. 22, 2024).
[201] *Id.* at 18-20.
[202] Order on Motion to Dismiss at 19, SIFMA v. Ashcroft, No. 23-cv-04154-SRB (W.D. Mo. Jan. 5, 2024) (quoting Zauderer v. Off. of Disciplinary Counsel of the Sup. Ct. of Ohio, 471 U.S. 626, 651 (1985)).
[203] *Zauderer*, 471 U.S. at 650.
[204] *Id.* at 651.
[205] *Id.*; *see also* KILLION, *supra* note 159, at 9.
[206] Reply Memorandum of Points & Authorities in Support of Plaintiff's Motion for Summary Judgment on Claim I at 2-7, Chamber of Com. of the U.S. v. Randolph, NO. 2:24-cv-00801-ODW-PVC (C.D. Cal. Aug. 19, 2024).
[207] *Id.* at 4-5.
[208] *Id.* at 7 (quoting Janus v. Am. Fed'n of State, Cnty., & Mun. Emps., Council 31, 585 U.S. 878, 913-14 (2018)).
[209] *Id.* at 8-10.

Meanwhile, in *SIFMA v. Ashcroft* (2024), a federal district court considered two Missouri rules requiring broker-dealers and investment advisers to disclose to and obtain consent from customers before investing in or recommending products incorporating ESG-objectives. The court determined that the Missouri laws concerned compelled commercial speech. The court then found that more lenient "*Zauderer* review" did not apply, as the speech was neither purely factual nor uncontroversial.[210] The laws required customers to "acknowledge… that incorporating a social objective or other non-financial [objective]… *will result* in investments… that are *not* solely focused on maximizing a financial return."[211] The court found that such a consent was not purely factual and in fact was misleading by pointing to the Department of Labor's reasoning in its ERISA ESG rulemaking, observing that a "non-financial objective[] *may* present purely financial considerations."[212] Further, the compelled speech was not uncontroversial, because they implicated controversial "political priorities" on ESG investing.[213]

The *SIFMA v. Ashcroft* court instead applied heightened intermediate scrutiny, holding that the laws failed the test because they were not appropriately tailored – that is, the rules were "more extensive than is necessary to further the government's interest."[214] If the government's interest was to prevent fraud, "the [r]ules could have been more narrowly and carefully worded to avoid being inaccurate and/or misleading."[215] On the other hand, if the government's interest was in promoting its stance on the ESG policy debate, the government could have achieved this through "'a less coercive method of publicizing their views on 'social' investing… [such as] a 'public-information campaign' to advance their desired message 'without burdening a speaker with unwanted speech.'"[216] Thus, the court ruled that the laws violated the First Amendment.

[210] Order on Motion for Summary Judgment at 16-17, SIFMA v. Ashcroft, No. 23-cv-04154-SRB (W.D. Mo. Aug. 14, 2024).
[211] *Id.* (quoting the regulations at issue).
[212] *Id.* at 17 (emphasis added) (internal quotations and citation omitted).
[213] *Id.*
[214] *Id.* at 18 (internal quotations and citation omitted).
[215] *Id.*
[216] *Id.* (citations omitted).

Conclusion

State ESG laws are proliferating rapidly and in diverse contexts and sectors of the capital markets, including asset management, insurance, banking, and investor disclosure. These laws threaten to segment US capital markets, undoing past efforts at harmonization and reducing the efficiency of US markets. In addition, they present significant legal issues under the US Constitution, including under the Dormant Commerce Clause, Supremacy Clause, and the First Amendment. This in turn suggests lawsuits against state ESG laws will continue to proliferate, further complicating compliance concerns for financial professionals and institutions that hinder the efficiency of the US capital markets. The Committee supports the harmonization of divergent state regulatory regimes to enhance the efficiency of US capital markets.

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