SOCIAL ISSUES IN THE SPOTLIGHT: THE INCREASING NEED TO IMPROVE PUBLICLY-HELD COMPANIES' CSR AND ESG DISCLOSURES

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ABSTRACT

There is ever-increasing investor interest in corporate social responsibility (CSR) generally, and environmental social governance (ESG) in particular. Investors' desires have triggered increased corporate ESG disclosures to indicate companies' commitment to socially responsible behavior. As pressure for ESG-related disclosures continues to rise, there is increasing pressure on the SEC to support and mandate enhanced ESG disclosures.

Notwithstanding many calls for mandatory ESG disclosures, the SEC has not implemented such a requirement. Instead, ESG disclosures are voluntary. Voluntary ESG disclosures are common, but to a large extent are marred by a lack of standardization in ESG data methodology. The increasing investor interest in ESG has led publicly held companies to take various approaches in framing their ESG disclosures. Many observers have asked the SEC to take a more active role with respect to ESG disclosures. Some observers call for mandatory ESG disclosures. To date, the SEC's approach has been limited to providing guidance for companies electing to make ESG disclosures. This article analyzes the various ways in which the SEC could mandate or encourage better ESG disclosures. The article concludes that regardless of whether the SEC imposes mandatory disclosures or continues its voluntary approach, the SEC should adopt a safe harbor rule. A safe harbor rule would encourage ESG disclosures while at the same time limit, but not eliminate, the risk of liability for defective ESG-related disclosures.

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I. INTRODUCTION

Over the last 90 years, scholars and policy makers have debated the extent to which corporations should be engaging in socially responsible behavior as part of their mission.[1] Over the past several decades, corporate

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1. *See, e.g.,* Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931) (arguing that corporate managers should be required to take into account the interests of all shareholders); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932) ("[P]ublic opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as a profit-making function, that this view has already had some effect upon legal theory, and that it is likely to have a greatly increased effect upon the latter in the near future."); Milton Friedman, *The*

social responsibility (CSR) has had renewed vitality and increasing investor interest. The emergence of environmental social governance (ESG) provided a renewed focus on CSR by embracing the use of metrics[2] to measure a company's commitment to socially responsible behavior.[3] ESG also specifically identifies three aspects of CSR–environmentalism or sustainability, social responsibility generally, and a corporate governance system that fosters CSR.[4]

The current wave of social protests and increased emphasis on social justice are likely to spur even more interest in ESG and make reforms more pressing. For example, the growth in social awareness increases consumer boycotts,[5] which in turn will encourage companies to focus more on their social responsibilities and good corporate governance, including elimination of toxic corporate culture and enhancement of diversity, inclusion, and equity.[6] Recent years have also witnessed increased concern over

Social Responsibility of Business is to Increase Profits, THE NEW YORK TIMES MAGAZINE, Sept. 13, 1970 (stating a corporation has one social responsibility – to maximize wealth for its shareholders).

2. As they are commonly understood, "[m]etrics are measures of quantitative assessment commonly used for assessing, comparing, and tracking performance or production. Generally, a group of metrics will typically be used to build a dashboard that management or analysts review on a regular basis to maintain performance assessments, opinions, and business strategies." *Metrics Definition*, INVESTOPEDIA, https://www.investopedia.com/terms/m/metrics.asp [https://perma.cc/JKK2-29NW].

3. *See, e.g.,* Abhishek Vishnoi, *Five Trends MSCI Sees in the Growth in Sustainable Investing*, BLOOMBERG GREEN (Jan. 15, 2020), https://www.bloomberg.com/news/articles/2020-01-16/here-are-five-trends-msci-sees-leading-growth-in-esg-investing [https://perma.cc/S962-WGSQ] (discussing growth in ESG investing); Shane Blanton & Anna West, *2019 ESG Survey,* CALLAN INSTITUTE, https://www.callan.com/wp-content/uploads/2019/09/2019-ESG-Survey.pdf [https://perma.cc/CK4J-HBAE] (visited Feb. 23, 2020); Billy Nauman, *ESG Money Market Funds Grow 15% in First Half*, FINANCIAL TIMES (July 14, 2019), https://www.ft.com/content/2c7b8438-a5a6-11e9-984c-fac8325aaa04 [https://perma.cc/A8E3-B67E].

4. In another article, I explore the evolution of CSR over the past century and how the law has reacted. *See* Thomas Lee Hazen, *Corporate and Securities Law Impact on Social Responsibility and Corporate Purpose*, 62 B.C.L. REV. 851 (2021) (examining the impact of corporate and securities law on CSR). This article addresses the ways in which CSR and ESG-related securities law reforms should be implemented.

5. For representative consumer boycotts, *see, e.g., Boycotts*, N.Y. TIMES, https://www.nytimes.com/topic/subject/boycotts [https://perma.cc/SYJ9-GUKD] (last visited Aug. 1, 2020); *Boycotts List,* ETHICAL CONSUMER, https://www.ethicalconsumer.org/ethicalcampaigns/boycotts [https://perma.cc/WKW7-HUJG] (last visited Aug. 1, 2020).

6. *See, e.g.,* White & Case Client Memo (Aug. 7, 2020), *ESG Takes Center Stage Amid Economic Crisis and Social Unrest*, https://www.jdsupra.com/legalnews/esg-takes-center-stage-amid-economic-10813/ [https://perma.cc/CJN2-7FY6] ("It is not only the environment that is directing investor behavior and shaping corporate strategies and values. The unequal impact of COVID 19 on the 'have nots' in society has been widely recognized. This has been compounded by the Black Lives Matter (BLM) movement and protests,

problematic corporate culture in terms of sexual harassment, discrimination, and other problems. These developments have increased investor emphasis on ESG and corporate culture.

There is a good deal of scholarly literature documenting the increasing investor interest in CSR and ESG over the years.[7] The push for more ESG awareness by public companies was recently highlighted in an open letter from BlackRock, a major investment manager, telling corporations to focus on both sustainability and improved shareholder communication of companies' efforts on that issue.[8] BlackRock has considerable company among institutional investors who are also pressuring corporate America for more meaningful commitment to ESG.[9] Not everyone agrees that this is a good trend,[10] but it is undeniable that the trend is gaining increased traction.

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which started at the end of May in the United States but quickly spread to Europe and have shone a spotlight on persistent racial injustice and social inequality more broadly."). *See also, e.g.,* Allison Herren Lee, *SEC Commissioner Lee Discusses Regulation S-K and ESG Disclosures*, CLS BLUE SKY BLOG (Aug. 27, 2020), https://clsbluesky.law.columbia.edu/2020/08/27/sec-commissioner-lee-discusses-regulation-s-k-and-esg-disclosures/ [https://perma.cc/6UJR-99K8] (bemoaning the absence of required discussion of climate risk and diversity).

7. *See, e.g.,* Edouard Dubois & Ali Saribas, *Making Corporate Purpose Tangible–A Survey of Investors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 19, 2020), https://corpgov.law.harvard.edu/2020/06/19/making-corporate-purpose-tangible-a-survey-of-investors/ [https://perma.cc/N8T2-CW7H] (discussing survey showing investor interest in ESG and metrics).

8. *A Fundamental Reshaping of Finance,* BLACKROCK https://www.blackrock.com/uk/individual/larry-fink-ceo-letter [https://perma.cc/TQM3-4NL3]. *See, e.g.,* David A. Katz & Laura McIntosh, *Sustainability in the Spotlight*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Jan. 27, 2020), https://corpgov.law.harvard.edu/2020/01/27/sustainability-in-the-spotlight/ [https://perma.cc/N5Q4-B8WH] (discussing the Blackrock letter to CEOs).

9.

> BlackRock is among many managers, including pioneering public employee pension funds such as CalPERS and NYCERS, which started many years ago to focus on companies' social values as part of the fund's investment strategy. In addition to the many ESG oriented pension plans, it is estimated that there are 300 mutual funds and exchange traded funds that continue to attract increased investor interest. In yet another significant development, Moody's Investor Service expects that ESG will be of increased importance in evaluating a company's credit risks.

Hazen *supra* note 4 at 858–59. *Cf.* Max. M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381 (2020) (demonstrating that trustees of trusts and pension funds can make ESG investments consistent with their fiduciary duties).

10. For example, the National Center for Public Policy Research wrote an open letter to BlackRock's CEO, urging the need for economic recovery during the COVID-19 crisis as a reason for focusing on shareholder primacy and profitability. NATIONAL CENTER FOR PUBLIC POLICY RESEACH (Apr. 15, 2020), *Open Letter from the National Center on Public*

Another recent victory for activist shareholders occurred when Chevron's shareholders voted in favor of a shareholder proposal asking management to report on its lobbying efforts regarding climate change and the Paris Agreement on climate change.[11]

The Securities and Exchange Commission (SEC) is the federal regulatory agency charged with implementing and overseeing the federal securities laws. Scholarly literature calling for increased SEC commitment to CSR and its relevance to investors is not new.[12] Similarly, there has been an ongoing debate as to whether the purpose of corporations should be limited solely to profit maximization.[13] This article does not engage in the debate over who the law should recognize as the true corporate stakeholders,[14] nor does it engage in the debate over the wisdom of increased

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Policy to Lawrence Fink, Chief Executive Officer BlackRock, Inc., https://nationalcenter.org/ncppr/2020/04/15/open-letter-to-blackrock-ceo-larry-fink/ [https://perma.cc/9PDA-RAPR] ("This economic crisis makes it more important than ever that companies like BlackRock focus on helping our nation's economy recover. BlackRock and others must not add additional hurdles to recovery by supporting unnecessary and harmful environmental, social, and governance (ESG) shareholder proposals."). BlackRock responded that COVID-19 does not negate the desirability of sustainable investing. *See* BlackRock (May 2020), *Sustainable Investing: Resilience Amid Uncertainty*, https://www.blackrock.com/corporate/literature/investor-education/sustainable-investing-resilience.pdf [https://perma.cc/LW92-W6UV]. *See also, e.g., Stakeholder Principles in the COVID Era*, WORLD ECONOMIC FORUM (Apr. 2020), http://www3.weforum.org/docs/WEF_Stakeholder_Principles_COVID_Era.pdf [https://perma.cc/Y7BH-2Z4X] (stressing the importance of commitment to sustainability while focusing on stakeholders' COVID-19 concerns).

11. *See* David Wethe & Kevin Crowley, *Chevron Investors Rebuff Board in Climate Lobbying Vote*, BLOOMBERG LAW (May 27, 2020, https://www.bloomberg.com/news/articles/2020-05-27/chevron-investors-back-proposal-for-climate-lobbying-report [https://perma.cc/278B-UWZS]). The Paris agreement can be found at https://ec.europa.eu/clima/policies/international/negotiations/paris_en [https://perma.cc/EN8N-BMBD].

12. *See, e.g.,* Douglas M. Branson, *Progress in the Art of Social Accounting and Other Arguments for Disclosure on Corporate Social Responsibility*, 29 VAND. L. REV. 539 (1976) (suggesting that corporations conduct social audits to investigate the extent of their social responsibility); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999) (suggesting that SEC disclosure could increase corporate social transparency and have a positive effect on corporate social responsibility). *See also, e.g.,* RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION (1976) (recommending laws requiring corporations to be socially responsible).

13. *See* the authorities cited *supra* in note 1.

14. *Compare, e.g.,* Lucian A. Bebchuck & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORN. L. REV. 91 (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544978 [https://perma.cc/T6W9-6MFD] (claiming that stakeholderism adversely impacts shareholders, stakeholders, and society generally); *with, e.g.,* LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 29 (2012) ("The notion that corporate law requires directors . . . to maximize shareholder wealth simply isn't true.").

ESG focus. Instead, recognizing the reality that CSR and ESG are here to stay, the article addresses the ways in which the SEC can improve CSR and ESG disclosures.

The article begins with a description of the current landscape of CSR and ESG disclosures.[15] This is followed by a brief overview of the securities laws' disclosure obligations.[16] Next, the article explains materiality, a concept that is the lynchpin of the securities laws' disclosure requirements.[17] The analysis of materiality is followed by exploration of the potential ways the SEC could enhance CSR and ESG disclosures,[18] including the advisability of mandating disclosure[19] or taking additional steps to encourage voluntary disclosure.[20]

II. CSR AND ESG

CSR was the term first used by advocates of increased corporate social responsibility to provide a shorthand description of their movement.[21] CSR reflects the general principle that companies should be mindful of the public good and not simply be motivated by profit maximization.[22] ESG developed as a subcategory of CSR and uses a metrics-driven format to measure a company's commitment to social responsibilities.[23]

ESG's basic premise is that metrics-driven data provides investors with more meaningful information about a company's commitment to the environment and other socially relevant concerns. The term ESG has another important impact on general CSR concepts. ESG identifies the three distinct elements of CSR. The "E" focuses on a company's environmental impact or

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15. *See infra* text accompanying notes 35-45.
16. *See infra* text accompanying notes 46-66.
17. *See infra* text accompanying notes 67-105.
18. *See infra* text accompanying notes 106-150.
19. *See infra* text accompanying notes 151-216.
20. *See infra* text accompanying notes 217-250.
21. *See, e.g.,* Mauricio Andres Latapi Agudelo, Lara Jóhannsdóttir & Brynhildur Davidstóttir, *A Literature Review of the History and Evolution of Corporate Social Responsibility*, 4 J. CORP. SOCIAL RESP. 1 (2019) (describing the history and development of CSR); Eric C. Chaffee, *The Origins of Corporate Social Responsibility,* 85 U. CIN. L. REV. 347 (2017) (discussing CSR's origins).
22. *See, e.g.,* John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1 (2005) (studying how corporations and activists perceive the corporate social responsibility movement).
23. George Kell, *The Remarkable Rise of ESG*, FORBES (July 11, 2018), https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/#575351571695 [https://perma.cc/ME24-EL6Q] (describing the evolution of ESG).

sustainability policies. The "S" addresses other socially important issues including, for example, diversity and inclusion, paying reasonable living wages to employees, fighting against discrimination, and public health issues. The "G," addresses the approach the company takes in corporate governance, including, for example, use of independent directors, improved monitoring of corporate operations, responsible hiring and promotion practices, and the company's approach to inclusion and diversity.

ESG has not replaced CSR as either a moniker or a concept, but rather, it is a subcategory of CSR. The broader concept of CSR remains relevant since it includes a generalized descriptive analysis independent of the use of metrics. It follows that disclosure considerations apply not only to the ESG metrics-driven discussions that investors crave, but also to more generalized descriptions of a company's commitment to social values. CSR disclosures would include, for example, a company's approach to balancing the pursuit of social values with its profit-driven mission. Accordingly, this explores various aspects of corporate social responsibility and also identifies disclosure issues relating to metrics-driven ESG.

The securities laws already have some disclosure requirements relating to the individual aspects of ESG – environmental issues, social concerns, and corporate governance. These existing disclosures focus on discrete situations rather than addressing ESG generally. For example, with respect to its shareholder proposal rule,[24] the SEC has recognized that investors have a legitimate interest in a company's environmental impact.[25] With respect to social issues generally, the SEC has recognized that investors have a legitimate interest in the company's approach to social issues such as animal

24. 17 C.F.R. § 240.14a-8(i)(8).

25. *See, e.g.,* Amazon.com, Inc., 2019 SEC No-Action Letter, 2019 LEXIS 267 (Apr. 3, 2019) (stating management could not rely on Rule 14a-8(i)(5) to exclude a shareholder proposal requesting that the company issue an annual report on the environmental and social impacts of food waste generated from the company's operations given the significant impact that food waste has on societal risk from climate change and hunger); Chevron Corp., 2019 SEC No-Action Letter, 2019 LEXIS 155 (Mar. 15, 2019) (stating management could not rely on Rule 14a-8(i)(7) to exclude a proposal requesting that the board issue an annual report to shareholders on plastic pollution); Arch Coal, Inc., 2013 SEC No-Action Letter, 2013 LEXIS 223 (Jan. 31, 2013) (stating management could not rely on Rule 14a-8(i)(5) to exclude a shareholder proposal requesting a report on the conditions resulting from the company's mountaintop removal operations that could lead to environmental and public health harms and on feasible, effective measures to mitigate those harms; the staff noted that the proposal did not agree that the proposal was not "otherwise significantly related" to the company's business); Dean Foods Co., SEC No-Action Letter, 2005 WL 723855 (Mar. 25, 2005) (stating management could not exclude a shareholder proposal requesting that Dean disclose its social, environmental and economic performance by issuing annual sustainability reports).

cruelty,[26] diversity and inclusion,[27] public health concerns,[28] and other similar areas of concern. These shareholder proposal examples are not reflective of a mandatory disclosure requirement, but rather arise in the context of a company's response to shareholder initiatives with respect to management's proxy statement.

With respect to the governance aspect of ESG, the SEC already has some specific disclosure mandates. For example, the SEC requires disclosure of a publicly held company's internal controls to monitor the company's operations,[29] as well as disclosures regarding the company's audit committee.[30] In addition, some environmental disclosures are required if they relate directly to the company's bottom line. One such example is the need to address potential material Superfund[31] and other potential environmental liabilities.[32] The foregoing examples of the SEC's response

26. *See, e.g.,* Lovenheim v. Iroquois Brands, Ltd., 618 F. Supp. 554 (D.D.C. 1985) (granting preliminary injunction against exclusion of shareholder proposal that the directors form a committee to consider termination of distribution of pate de foie gras until a more humane production method is developed).

27. *See, e.g.,* The Coca–Cola Co., SEC No-Action Letter, 2003 WL 122319 (Jan. 7, 2003) (stating management could not rely on either 14a–8(i)(3) nor 14a–8(i)(7) to exclude a shareholder proposal requesting that the board of directors amend the company's "corporate, diversity, and equal employment policies to exclude reference to sexual orientation" and "cease support of homosexual lifestyle and other deviant lifestyle behaviors opposed by the majority of people.").

28. *See, e.g.,* The Coca Cola Co., SEC No-Action Letter, 2019 LEXIS 58 (Feb. 21, 2019) (stating management could not rely on Rule 14a-8(i)(7) or Rule 14a-8(i)(10) to exclude a shareholder proposal requesting that the board issue a report on sugar and public health, with support from a group of independent and nationally recognized scientists and scholars providing critical feedback on the Company's sugar products marketed to consumers, especially those Coke products targeted to children and young consumers. The Proposal also specifies that the report should include an assessment of risks to the Company's finances and reputation associated with changing scientific understanding of the role of sugar in disease causation).

29. 15 U.S.C. § 78m(b)(2). *See, e.g., In re* Robert S. Harrison, Exchange Act Release No. 34–22466 (Sept. 26, 1985) (holding an issuer must institute internal accounting controls to monitor the activities of its chief financial officer and prepare financial statements); *see also In re* Tonka Corp., Exchange Act Release No. 34–22448 (Sept. 24, 1985) (explaining that Tonka "failed to devise and maintain a system of internal accounting controls with respect to corporate investments sufficient to provide reasonable assurances that transactions were executed in accordance with management's general or specific authorizations . . . ").

30. *See, e.g.,* Regulation S-K item 407, 17 C.F.R. § 229.407 (disclosures relating to a company's audit committee).

31. Corporations with environmental hazards on their real property may be subject to liability for the costs of cleanup. *See* Env't Prot. Agency *What is Superfund?*, https://www.epa.gov/superfund/what-superfund [https://perma.cc/YK82-8U87].

32. *See, e.g.,* SEC Interpretation: Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures (May 18,

to some specific environmental social and governance issues do not extend to more generalized disclosures regarding the company's approach to these issues generally. ESG-related disclosures are promoted as a way to fill this gap.

It is notable that the existing mandatory disclosures mentioned above relate primarily to the company's operations and performance in terms of profitability. For example, the internal controls and audit committee requirements are geared toward corporate performance. These disclosure requirements are not framed in terms of the broader question of social responsibility.[33] The only departure from linking disclosures to profitability and performance does not arise in the context of mandatory disclosure, but rather in the SEC's responses to shareholder proposals for inclusion in management's proxy statement. Recognizing and encouraging enhanced ESG disclosures would expand that focus.

This article urges the SEC to supplement these existing disclosure requirements by mandating, or at least encouraging, more holistic ESG and CSR disclosures. Many large companies already engage in voluntary ESG disclosures.[34] After discussing ESG and the securities laws' disclosure philosophy, the discussion that follows explores the various ways that this could be accomplished and standardized under the securities laws.

1989), https://www.sec.gov/rules/interp/33-6835.htm [https://perma.cc/9JZS-89V5] (discussing need to consider environmental liabilities in MD&A disclosures); *see also* James G. Archer, Thomas M. McMahon & Maureen M. Crough, *SEC Reporting of Environmental Liabilities*, 20 ENV'T. L. REP. 10105 (1990) (discussing, among other things, a company's need to disclose environmental liabilities).

33. These disclosures are consistent with the now outdated view of Milton Friedman that the only social responsibility of a corporation is to make money for its shareholders. *c.f.* Friedman *supra* note 1.

34. *See, e.g.,* Jon Lukomnik, *State of Integrated and Sustainability Reporting 2018*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 3, 2018), https://corpgov.law.harvard.edu/2018/12/03/state-of-integrated-and-sustainability-reporting-2018/ [https://perma.cc/FM8K-4ZDD] ("Sustainability reporting for large public companies around the world has become the norm. Si2's research this year (2018) found that 78 percent of the S&P 500 issued a sustainability report for the most recent reporting period, most with environmental and social performance metrics. The rate of sustainability reporting for the world's largest companies is even higher, with some figures noting as high as 93 percent. This is a starkly different picture from the 1980s, when a handful of companies in vulnerable sectors—extractives and chemicals, which had to respond to public backlash against environmental mishaps—were the only ones to publish environmental reports with limited performance metrics. It was not until the 1990s that sustainability reports as we know them today started gaining traction, after the concept of "triple bottom line"—environmental, social and economic—corporate performance was introduced and became popular.") (footnote omitted) (summarizing Sol Kwon, *State of Sustainability and Integrated Reporting 2018*, https://www.weinberg.udel.edu/IIRCiResearchDocuments/2018/11/2018-SP-500-Integrated-Reporting-FINAL-November-2018-1.pdf [https://perma.cc/JJ8Z-H6KZ].

III. THE CURRENT STATE OF ESG DISCLOSURES AND THE LACK OF STANDARDIZATION

The absence of mandatory ESG disclosures has resulted in a voluntary regime. Increased pressure from socially responsible institutional investors has spurred many companies to make ESG-related and other social responsibility disclosures.[35] Voluntary ESG disclosures are quite common today, but there is a lack of standardization across the board.[36] There are ESG data providers that prepare and disseminate ESG data and company ratings to investors and investment analysts.[37] For example, as of 2016, there were more than one hundred organizations that provided ESG data.[38] There

35. *See, e.g.,* Paul Rissman & Diana Kearney, *Rise of the Shadow ESG Regulators: Investment Advisers, Sustainability Accounting, and Their Effects on Corporate Social Responsibility*, 49 ENV'T. L. REP. NEWS & ANALYSIS 10155, 10155 (2019) (suggesting that institutional investors' ever-increasing focus on social responsibility will "push CSR to the forefront of corporate consciousness, [and] is the finalization of a set of material disclosure standards for sustainability topics"). *See also, e.g.,* Virginia Harper Ho, *Risk Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647 (2016) (discussing the potential positive impact of institutional investors' monitoring companies' ESG metrics).

36. *See, e.g.,* U.S. GOV'T ACCOUNTABILITY OFF., GAO-20-530 Report to Honorable Mark Warner U.S. Senate, Public Companies Disclosures of Environmental, Social, and Governance Factors and Options to Enhance Them (2020), https://www.gao.gov/assets/710/707949.pdf [https://perma.cc/L62Y-6ZYR] (noting the lack of standardization as a significant problem); Press Release, Sen. Mark Warner, Warner on New GAO Report Highlighting Importance of Requiring Corporate Disclosure of Environmental, Social, and Governance Issues (July 6, 2020), https://www.warner.senate.gov/public/index.cfm/2020/7/warner-on-new-gao-report-highlighting-importance-of-requiring-corporate-disclosure-of-environmental-social-and-governance-issues [https://perma.cc/73RM-TGPR] ("The GAO report makes the need for comparable disclosure clear: even basic metrics like carbon dioxide emissions can be reported differently from company to company. It is time that the SEC grapple directly with the metrics that GRI and SASB have developed – which researchers have consistently found to be material to company performance – and issue guidance on quantifiable and comparable disclosures."); Florian Berg, Julian F. Koelbel & Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings* (May 18, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533 [https://perma.cc/MNN5-RBVK] (discussing the key variations that result in problematic lack of standardization). In a positive development, the Sustainability Accounting Standards Board and the Global Reporting Initiative announced a joint initiative to provide a greater degree of standardization in their ESG reporting methodologies. *See* Michael Cohn, *SASB Teams with GRI on Sustainability Reporting*, ACCOUNTING TODAY (July 13, 2020), https://www.accountingtoday.com/news/sasb-teams-with-gri-on-sustainability-reporting [https://perma.cc/RXA7-AJTU] (announcing the joint initiative).

37. *See generally State of ESG Data and Metrics*, 8 J. ENV. INVESTING no. 1 (2017) (evaluating ESG data).

38. *See, e.g., Who are the ESG Rating Agencies?*, SUSTAINABLE PERSPECTIVE FOR THE MAINSTREAM INVESTOR, SUSTAINABLE INSIGHT CAPITAL MANAGEMENT (Feb. 2016), https://w

are a large number of independent firms that use their own format and methodology for ESG data. A consequence of varying formats and methodologies is a lack of standardization. Similarly, publicly held companies have taken various approaches in framing their ESG disclosures,[39] which adds to the lack of standardization. Thus, there is no uniformity in the way that companies and third-party providers present ESG-related information. The absence of standardization in ESG metrics has been said to result in confusing inconsistencies in ESG data.[40] Even ESG advocates recognize and bemoan the lack of industry-wide standards and the need to create more consistency.[41]

It is worth noting that not everyone is a fan of across-the-board standardization. For example, SEC Chair Clayton expressed his view that different industries and companies have their own context that can make across-the-board standardization inappropriate.[42] It is certainly possible that

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ww.sicm.com/docs/who-rates.pdf [https://perma.cc/TX7H-6YGZ] (describing ESG data providers). It was estimated that "the six leading providers of ESG data cover in excess of 2,000 securities." *Id.* at 2.

39. Advisory subcommittee report *infra* note 118 at 5–6 (some footnotes omitted).

40. Sakis Kotsantonis & George Serafeim, *Four Things No One Will Tell You About ESG Data*, 31 J. APPLIED CORP. FIN 50 (2019) (discussing inconsistency in ESG data). *See also, e.g., ESG's Unsustainable Irony: A Lack of Transparency*, INVESTMENT NEWS (Feb. 18, 2020), https://www.investmentnews.com/esgs-unsustainable-irony-a-lack-of-transparency-188374 [https://perma.cc/4N7K-TAW2] (calling for consistency in ESG data); *see also* Huw Van Steenis, *Defective Data is a Big Problem for Sustainable Investing,* FINANCIAL TIMES (Jan. 21, 2019), https://www.ft.com/content/c742edfa-30be-328e-8bd2-a7f8870171e4 [https://perma.cc/G63L-L9EL] (identifying the need for better ESG data).

41. *See, e.g., ESG Investing is Growing, but Lack of Standards is Hampering Investor Adoption Rate*, RESPONSIBLE-INVESTORS (May 24, 2019), https://responsible-investors.com/2019/05/24/esg-investing-is-growing/ [https://perma.cc/AW5K-PES4] (bemoaning the lack of standardization); *see also* Brad Foster & David Tabit, *As Demand for ESG Investing Grows so Too Does the Need for High-Quality Data*, PENSIONS & INVESTMENTS (Apr. 19, 2019) https://www.pionline.com/article/20190419/ONLINE/190419817/commentary-as-demand-for-esg-investing-grows-so-too-does-the-need-for-high-quality-data [https://perma.cc/96FP-VJW6] (recognizing the need for better ESG data). *See also, e.g.,* Jill M. D'Aquilla, *The Current State of Sustainability Reporting—A Work in Progress*, CPA J., (July 2018) https://www.cpajournal.com/2018/07/30/the-current-state-of-sustainability-reporting/ [https://perma.cc/AT4E-XFJ5] (indicating 60% of companies believe their sustainability related disclosures help investors make comparisons between companies, but 92% of investors do not agree).

42. Jay Clayton, Remarks to the Economic Club of New York (Nov. 19, 2020) https://www.sec.gov/news/speech/clayton-economic-club-ny-2020-11-19 [https://perma.cc/KQ6P-YGMN] ("It has often been noted that this process can be more efficient if disclosure is standardized or uniform. However, standardization can be difficult across industries, and in particular, with respect to forward-looking information, it can be vexing as it requires uniform assumptions about the future. Personally, I am of the view that any standardization should be approached on a sector-by-sector basis, starting with the sectors that are already using metrics to track and assess climate-related risks.").

as the ESG data industry evolves, even without regulatory impetus, there will be some self-imposed standardization that will make it easier for investors to digest and evaluate the information.[43] However, as discussed throughout this article, the SEC should help jumpstart this process in order to accelerate ESG standardization.

As recently explained by an SEC investor advisory subcommittee, publicly held companies have taken varied approaches to ESG-related disclosures:

> Some publish lengthy stand-alone reports; others include ESG-related information in their annual reports or SEC '34 Act filings; some provide information according to third party standards such as [Global Reporting Initiative] GRI, the Sustainability Accounting Standards Board (SASB), the Task Force on Climate-Related Financial Disclosures (TCFD), etc. Others do not report directly but, as noted above, reply to third party surveys requested by ESG data providers, which in turn provide ESG information or scoring systems to investors. Some Issuers engage in a combination of all of these and other methods. The point is that, despite a great deal of information being in the mix, there is a lack of consistent, comparable, material information in the marketplace and everyone is frustrated – Issuers, investors, and regulators.[44]

This absence of standardization was a major impetus for the advisory subcommittee's recommendation that the SEC mandate ESG disclosures and adopt rules to help promote more meaningful ESG disclosures.[45]

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43. *See, e.g.,* State Street Global Advisors, *The ESG Data Challenge* (Mar. 2019), https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf [https://perma.cc/BA77-W2VJ].

44. Advisory subcommittee report *infra* note 118 at 5 (footnotes referencing https://www.globalreporting.org/, https://www.sasb.org/, and https://www.fsb-tcfd.org/ omitted). *See also, e.g.,* Recommendations of the SEC Advisory Committee Relating to ESG Disclosures (May 21, 2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/esg-disclosure.pdf [https://perma.cc/KRP4-5G46]. *See also, e.g.,* Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 46 AM. BUS. L.J. 645 (2020) (promoting SASB's approach to sustainability as compared to the SEC's "hand-off" approach).

45. *See, e.g.,* Blaine Townsend, *The Case for Standardized Audited ESG Reporting*, ACCOUNTING TODAY (May 15, 2019), https://www.accountingtoday.com/opinion/the-case-for-standardized-audited-esg-reporting [https://perma.cc/2386-5WLR] (calling for ESG regulation and standardization) and the discussion *infra* in the text accompanying notes 118-137.

IV. OVERVIEW OF THE SECURITIES LAWS' DISCLOSURE REQUIREMENTS

The basic premise of the federal securities laws is to focus on disclosure, not on directly impacting corporate conduct, rights, and obligations, which is the province of state corporate law. Also, unlike the state securities laws that predated federal law, which still exist today, the federal securities laws focus on disclosure and do not impose a merit analysis on securities. The securities laws thus embrace Louis Brandeis' observation that sunlight is the best disinfectant.[46] The underlying premise of federal securities law was to eliminate the "let that buyer beware" from securities transactions[47] and to provide transparency and full disclosure to allow investors to make informed investment decisions. The required disclosures are thus created to provide information that is deemed essential to investors with adequate information upon which they can base their investment decisions.[48] Although the securities laws are focused on disclosure rather than corporate conduct, disclosure necessarily has a salutary impact on corporate conduct, lest corporations be forced to make disclosures that prove unpopular with investors.

The increased focus on CSR, ESG, and sustainability raises questions as to whether the securities laws should respond at all, and if so, how the

46. LOUIS DEMBITZ BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914) ("Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman"). Professor Alasdair Roberts traces this sentiment to an earlier analysis in James Brice, The American Commonwealth (1888):

> Public opinion is a sort of atmosphere, fresh, keen, and full of sunlight, like that of the American cities, and this sunlight kills many of those noxious germs which are hatched where politicians congregate. That which, varying a once famous phrase, we may call the genius of universal publicity, has some disagreeable results, but the wholesome ones are greater and more numerous. Selfishness, injustice, cruelty, tricks, and jobs of all sorts shun the light; to expose them is to defeat them. No serious evils, no rankling sore in the body politic, can remain long concealed, and when disclosed, it is half destroyed.

Alasdair Roberts, *Where Brandeis got "sunlight is the best disinfectant"*, (Mar. 1, 2015) https://aroberts.us/2015/03/01/where-brandeis-got-sunlight-is-the-best-disinfectant/ [https://perma.cc/TA6B-XLH8].

47. The securities laws have been described as a shift from the paradigm of *caveat emptor* to one of *caveat vendor*: "[t]his proposal adds to the ancient rule of caveat emptor the further doctrine, 'let the seller also beware.' It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence." Message to Congress from President Franklin Roosevelt (March 29, 1933), as quoted in H.R. REP. 73–85 (1933).

48. *See* the discussion of materiality *infra* text accompanying notes 67-105.

response should look. With respect to ESG specifically, SEC Chair Clayton observed:

> Disclosure is at the heart of our country's and the SEC's approach to both capital formation and secondary liquidity. As stewards of this powerful, far reaching, dynamic and ever evolving system, a key responsibility of the SEC is to ensure that the mix of information companies provide to investors facilitates well-informed decision making. The concepts of materiality, comparability, flexibility, efficiency and responsibility (i.e., liability) are the linchpins of our approach. This group knows these concepts well, knows that they are interrelated, and knows that, when we consider changes to our approach to disclosure, these concepts should be front of mind. Turning to "ESG", a broad term, we are increasingly seeing disclosure of ESG information by issuers in the marketplace and requests for ESG information by investors. I am also aware of efforts by third parties to develop disclosure frameworks relating to ESG topics as well as calls by some market participants for issuers to follow third-party disclosure frameworks relating to ESG topics.[49]

Before analyzing the specifics of ESG disclosures, the discussion that follows provides a brief overview of the securities laws' disclosure requirements and the periodic disclosure system.

The first federal securities law, the Securities Act of 1933,[50] focuses on public offerings of securities. Among other things, the 1933 Act requires that companies that offer securities to the public must do so pursuant to a registration statement that provides investors with full disclosure of material facts regarding the company and the securities being offered.[51] The 1933 Act does not apply to transactions or securities beyond the public offering context. Once a public offering is over, the 1933 Act ceases to apply.

The Securities Exchange Act of 1934[52] imposes periodic reporting requirements on publicly held companies once they become public. Section 12(a) requires SEC registration of companies with securities listed on a

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49. Chairman Jay Clayton, Meeting of the Investor Advisory Committee (Dec. 13, 2018), https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-meeting-121318 [https://perma.cc/9W4A-XS5T].

50. Act of May 27, 1933, c. 38, Title I, §1, 48 Stat. 74, codified in 15 U.S.C. §§ 77a *et seq*.

51. *See generally* 1, 2 THOMAS LEE HAZEN TREATISE ON THE LAW OF SECURITIES REGULATION chs. 2–3, 9 (West Academic Publishing, 7th ed. 2016).

52. Act of June 6, 1934, c. 404, Title I, § 1, 48 Stat. 881, codified in 15 U.S.C. §§ 78a *et seq*.

national securities exchange.[53] Section 12, in turn, imposes periodic reporting requirements. With respect to the over-the counter markets, publicly held companies not listed on a national exchange, section 12(g) requires registration of companies with more than $10 million in assets and 2,000 shareholders of record or imposes a lower shareholder threshold for companies with 500 record shareholders who are not accredited investors.[54] Companies registered under the Securities Exchange Act's periodic reporting requirements are not the only ones required to file periodic reports. The 1934 Act's periodic reporting requirements are triggered for companies which, even if they are not registered under section 12, issue securities under a registration statement required by the Securities Act of 1933.[55]

The basic reports for publicly held companies that must be filed with the SEC are: (a) quarterly reports on Form 10-Q,[56] (b) an annual report on Form 10-K,[57] and (c) an interim report on Form 8-K[58] for any month in which certain specified events occur. Additional disclosures are required for registered companies when the management solicits proxies or consents for shareholder votes.[59] The details of the line-item disclosures required in these reports are found in SEC Regulation S-K[60] and in Regulation S-X for financial information.[61] The Securities Exchange Act's periodic reporting

53. 15 U.S.C. § 78l(a)(2).

54. 15 U.S.C. § 78l(g)(1). Unaccredited investors include financial institutions, many investment funds, officers and directors of the company, and individuals with a net worth of at least $1,000,000, excluding the value of one's primary residence, or have income of at least $200,000 each year for the last two years (or $300,000 combined income if married) and have the expectation to make the same amount going forward. *E.g.,* Securities Act § 2(a)(15), 15 U.S.C. § 77(a)(15); SEC Rules 215, 501(a), 17 C.F.R. 230.215, 501(a).

In addition to the periodic reporting requirements, section 12 registration subjects the company to the other obligations, including the 1934 Act's requirements, proxy regulation (15 U.S.C. § 78n(a) and applicable SEC rules), tender offer (15 U.S.C. §§ 78m(d),(e), 78n(d), (e), (f) and applicable SEC rules), as well as reporting of insider transactions in the company shares (15 U.S.C. § 78p and applicable SEC rules).

55. Section 15(d) of the 1934 Act, 15 U.S.C. § 78o(d), provides that companies that have issued securities under a 1933 Act registration statement with more than 300 record holders of such securities are subject to 1934 Act periodic reporting requirements.

56. 17 C.F.R. § 249.308a, https://www.sec.gov/files/form10-q.pdf [https://perma.cc/Y9UD-DCLK].

57. 17 C.F.R. § 249.310, https://www.sec.gov/files/form10-k.pdf [https://perma.cc/X4MF-QDQH] (stating that the annual report is to be filed instead of the fourth quarter quarterly report).

58. 17 C.F.R. § 249.308, https://www.sec.gov/files/form8-k.pdf [https://perma.cc/6Y92-5MD8].

59. Schedule 14A, 17 C.F.R. § 240.14a-101 (proxy statement disclosures); annual report to shareholders, 17 C.F.R. § 240.14a-3(b) (annual report to shareholders).

60. 17 C.F.R. part 239.

61. 17 C.F.R. part 210.

requirements contain various items where ESG-related disclosures could be included.[62]

Thus, there are various current reporting requirements that potentially implicate ESG-related disclosures. For example, discussion of employment issues and environmental impact can arise in an SEC filing as part of a company's description of its business.[63] These disclosure items could involve employment practices that raise social responsibility, environmental impact, and sustainability issues. Furthermore, companies are asked to evaluate risk factors in their disclosures.[64] Management discussion and analysis disclosures also can involve ESG disclosures.[65] These are among some of the existing disclosure requirements that could involve discussion of ESG-related topics.[66]

The discussion that follows focuses on the securities laws' materiality requirement. This is followed by various disclosures that could implicate ESG-related disclosures.

V. MATERIALITY – THE LYNCHPIN OF DISCLOSURE

A. Overview of Materiality and its Applicability to ESG

The materiality requirement is derived from common law fraud and is the lynchpin of the securities laws' disclosure requirements. In a common law action for fraud or deceit, a successful plaintiff must prove there was a material misstatement or omission of fact.[67] The common law materiality

62. Additional disclosures could be required for public offerings under the registration requirements of the Securities Act of 1933. *See* 15 U.S.C. §§ 77e, 77f, 77j; 1933 Act Forms S-1 and S-3, 17 C.F.R. §§ 239.11, 239.13, https://www.sec.gov/files/forms-1.pdf [https://perma.cc/PBQ3-656S], https://www.sec.gov/files/forms-3.pdf [https://perma.cc/6NZU-74F].

63. Regulation S-K item 101 addresses disclosures relating to a company's business. 17 C.F.R. § 239.101.

64. *See, e.g.,* Regulation S-K item 503(c), 17 C.F.R. § 239.503(c). *See also, e.g.,* Virginia Harper Ho, *The Business Case for Monitoring Nonfinancial Risk*, 4 J. CORP. L. 647 (2016) (advocating that more attention be paid to ESG risks).

65. Regulation S-K item 303, 17 C.F.R. § 239.303. *See, e.g.,* Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations, Release Nos. 33-10751; 34-88094 (Jan. 30, 2020) (discussing metrics generally) and the discussion *infra* in the text accompanying notes 157-163

66. *See, e.g.,* Virginia Harper Ho, *Disclosure Overload? Lessons for Risk Disclosure & ESG Reporting Reform from the Regulation S-K Concept Release*, 65 VILL. L. REV. 67 (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452457 [https://perma.cc/B9J9-3Y2R] (challenging objections to ESG disclosure reform).

67. *See, e.g.*, Muller-Paisner v. TIAA, 289 Fed. Appx. 461 (2d Cir. 2008) (dismissing securities and common law fraud claims for failure to allege a material misstatement but upholding claims based on breach of fiduciary duty).

requirement is incorporated into the securities laws by statute,[68] case law,[69] and by SEC rule.[70] In other words, "[f]or the securities lawyer 'materiality' is the name of the game."[71] Materiality depends on whether the plaintiff can establish "a substantial likelihood that a reasonable shareholder would consider [the misstatement or omission] important."[72] The test of materiality is thus focused on the question of whether a reasonable investor would have considered the matter significant.[73] It is not necessary to conclude that the investor *would* have acted differently.[74] As such, materiality can include a wide variety of factors a reasonable investor would consider significant.

Materiality is not established merely because a shareholder might have found the information to be of interest.[75] Whether something is material is based on an objective analysis based on the reasonable investor. The fact that someone subjectively views a statement as significant is not sufficient to establish materiality.[76] In order for a statement to be materially misleading, there must be a significant element of inaccuracy or obfuscation. Whether a fact is material depends not upon the literal truth of statements, but upon the ability of reasonable investors to become accurately informed

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68. *E.g.,* Securities Act of 1933 § 17(a)(2), 15 U.S.C. § 77q(a)(2) (prohibiting material misstatements and omissions in connection with the offer or sale of securities); Securities Exchange Act § 18(a), 15 U.S.C. § 78r(a) (imposing liability for material misstatements and omissions in filings with the SEC).

69. Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011) (requiring materiality for a Rule 10b-5 action); Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (requiring materiality for a Rule 10b-5 action); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976) (applying the materiality standard in the context of the federal proxy rules).

70. *E.g.,* Securities Exchange Act Rule 3b-6(d), 17 C.F.R. § 240.3b-6(d) (defining materiality); Securities Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (prohibiting material misstatements and omissions in connection with purchases and sales of securities).

71. RICHARD W. JENNINGS & HAROLD MARSH, JR., SECURITIES REGULATION: CASES AND MATERIALS 1023 (5th ed. 1982).

72. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); *Accord* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011); Basic Inc. v. Levinson, 485 U.S. 224 (1988).

73. *See, e.g.,* United States v. Peterson, 101 F.3d 375 (5th Cir. 1996) (explaining it was material for general partner to fail to disclose that it was repurchasing interest of limited partner who was suing general partner for breach of fiduciary duty).

74. *See, e.g.,* Folger Adam Co. v. PMI Industries, Inc., 938 F.2d 1529 (2d Cir. 1991), *cert. denied,* 502 U.S. 983 (1991) (explaining that it could not be said as a matter of law that omitted income projections were not material).

75. *See, e.g.,* Milton v. Van Dorn Co., 961 F.2d 965, 969 (1st Cir. 1992) ("[T]he mere fact that an investor might find information interesting or desirable is not sufficient to satisfy the materiality requirement.").

76. *See* United States v. Litvak, 889 F.3d 56, 59 (2d Cir. 2018) (explaining that evidence of the counterparty's representative's "idiosyncratic and erroneous belief" of the statement's significance was prejudicial and not relevant to the objective test for materiality).

by the statement based on the total mix of publicly available information.[77] This is sometimes referred to as the mosaic misrepresentation thesis.[78]

Determination of materiality is highly factual and therefore can be unpredictable.[79] The Supreme Court has repeatedly held that the concept of materiality cannot be distilled into a bright-line test.[80] Due to the fact that the factual determinations can be highly nuanced, materiality determinations are rarely appropriate for summary judgment or judgment on the pleadings.[81] In fact, it has repeatedly been held that the concept of materiality cannot be distilled into a bright-line test.[82] Thus, the determination is to be made on a fact specific case-by-case basis as to whether the statements in question were of the type that a reasonable investor would consider significant in making an investment decision. As one SEC Commissioner observed, materiality does not provide a very good benchmark for determining what sustainability-related issues may be material as applied to standards of disclosure.[83]

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77. McMahan & Co. v. Wherehouse Entertainment, Inc., 900 F.2d 576, 579 (2d Cir. 1990), *cert. denied*, 501 U.S. 1249 (1991) ("Some statements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors.").

78. *See, e.g.,* Allan Horwich, *The Mosaic Theory of Materiality—Does the Illusion Have a Future*?, 43 SEC. REG. L.J. 129 (2015) (discussing materiality in the context of insider trading and the mosaic theory).

79. *See* 3 HAZEN *supra* note 51 §§ 12:60-12:77 (discussing materiality in detail).

80. Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011) (rejecting defendant's contention that the absence of statistical significance necessarily rendered immaterial a study on the adverse consequences of a drug); Basic Inc. v. Levinson, 485 U.S. 224 (1988) (rejecting a bright line price and structure as a threshold for materiality of merger negotiations).

81. *E.g.,* City of Monroe Employees Retirement System v. Bridgestone Corp., 399 F.3d 651 (6th Cir. 2005) (discussing the highly factual nature of materiality); Folger Adam Co. v. PMI Industries, Inc., 938 F.2d 1529 (2d Cir. 1991), *cert. denied*, 502 U.S. 983 (1991) (explaining that it could not be said as a matter of law that omitted income projections were not material); SEC v. Conrad, 354 F. Supp. 3d 1330 (N.D. Ga. 2019) (discussing factual issues as to whether some statements were materially misleading; others were materially misleading); Securities and Exchange Commission v. Johnston, 310 F. Supp. 3d 265 (D. Mass. 2018) (discussing how fact issues regarding materiality precluded summary judgment). *See also, e.g.,* Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, 568 U.S. 455 (2013) (explaining how, if sufficiently alleged, materiality need not be determined at the time of class certification but should await summary judgment or trial on the merits).

82. Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011) (rejecting defendant's contention that the absence of statistical significance necessarily rendered immaterial a study on the adverse consequences of a drug); Basic Inc. v. Levinson, 485 U.S. 224 (1988) (rejecting a bright line price and structure as a threshold for materiality of merger negotiations).

83. Statement of Commissioner Allison Herren Lee, "Modernizing" Regulation S-K: Ignoring the Elephant in the Room (Jan. 30, 2020), https://www.sec.gov/news/public-statement/lee-mda-2020-01-30 [https://perma.cc/U9UZ-826J] ("It is also clear that the broad, principles-based "materiality" standard has not produced sufficient disclosure to ensure that investors are getting the information they need—that is, disclosures that are consistent,

In applying the materiality requirement, courts have invoked a number of doctrines that can exacerbate the challenges in determining whether particular information or statements are objectively material. This is especially true with respect to so-called "soft information," which includes predictions, opinions, and the like.[84] Two questions frequently arise with regard to the issues surrounding soft information. The first question addresses the extent to which there is an affirmative obligation to make a prediction or other disclosures of soft information. The second question is whether an incorrect opinion, projection, or prediction is actionable.[85] These same questions arise with respect to the substance of ESG disclosures.

When applying a materiality yardstick to opinions, the courts have recognized that puffery or sales talk does not rise to the level of materiality required to be actionable in court.[86] Statements that are merely aspirational rather than factual representations are not material.[87] The same is true for statements that are too vague to be considered material.[88] Thus, generalized statements about a company's commitment to social responsibility and good corporate governance are easily susceptible to not being material.[89]

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reliable, and comparable.").

84. *See* 3 HAZEN *supra* note 51 § 12:69 (discussing soft information generally).

85. *See* 3 HAZEN *supra* note 51 § 12:69 at 718.

86. *See, e.g.,* Carvelli v. Ocwen Financial Corp., 934 F.3d 1307 (11th Cir. 2019) (holding that statements regarding progress it was making toward state regulatory compliance were puffery; statements expressing only belief and expectations were opinions and thus not material); Robbins v. Moore Medical Corp., 894 F. Supp. 661 (S.D.N.Y. 1995) (holding that brief laudatory statements were merely statements of general enthusiasm and were not materially misleading); Marion Merrell Dow, Inc., 1994 WL 396187 (W.D. Mo. 1994) (holding that projection that company was looking forward to growth in earnings per share were "vague, soft, puffing statements" that could not have been reasonably relied upon as a guarantee). *Cf.* Aisha Saad & Diane Strauss, *The New "Reasonable Investor" and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Regulation*, 17 BERK. BUS. L.J. at 397 (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3590809 [https://perma.cc/S82D-FCVA] (arguing in favor of a reliance-based approach to materiality for voluntary ESG disclosures that would narrow the availability of a puffery defense).

87. *See, e.g.,* Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co., 845 F.3d 1268 (9th Cir. 2017).

88. *See, e.g.,* Searls v. Glasser, 64 F.3d 1061 (7th Cir. 1995) (holding that statement that company was recession-resistant was too vague to be material); Galati v. Commerce Bancorp, Inc., 2005 WL 3797764 at *5 (D.N.J. Nov. 7, 2005), *affirmed* 220 Fed. Appx. 97 (3d Cir. 2007) (claims of illegal conduct were too speculative to be material).

89. *See, e.g.*, Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co., 845 F.3d 1268 (9th Cir. 2017) (holding that officer's alleged sexual misconduct and alleged violation of ethics code were not material; the court noted that the company's statements promoting the company's code of ethics "were transparently aspirational" and "did not reasonably suggest that there would be no violations of [the code] by the CEO or anyone

However, to the extent that CSR discussion in SEC filings goes beyond mere generalizations and aspirations, materiality thresholds may be implicated.[90] Similarly, linking sustainability to profitability can render the otherwise aspirational statements material.[91]

The extension of CSR generally to ESG metrics may move the needle towards or past materiality[92] to the extent that the disclosures appear to be more factual than aspirational. The more detail in the CSR or ESG discussion, the more likely it is that a reasonable investor would perceive the statements as factual representations rather than aspirational generalizations. Even without specific factual representations, a detailed discussion of CSR and ESG factors could be viewed as implying the existence of underlying conduct consistent with the metrics. To the extent that there is underlying conduct that is inconsistent with the stated principles, investors may have a better chance of establishing material omissions with respect to that conduct.

There is considerable support for the proposition that ESG disclosures can be material under the current regime of voluntary disclosure. There is also support in the investment community to encourage the SEC to explicitly recognize the materiality of ESG issues.[93] For example, the SEC has

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else"); Ulbricht v. Ternium S.A., 2020 WL 5517313 at * 9 (E.D.N.Y. 2020) (holding code of conduct prohibition against bribery was aspirational and did not imply that company's officers did not engage in bribery); In re Braskem S.A. Securities Litigation, 246 F. Supp. 3d 731, 754–56 (S.D.N.Y. 2017) (holding code of ethics was aspirational and did not imply that it was complied with). *See also, e.g.,* James v. Exxon Mobil Corp., *65 Misc.3d 1233(A)* (N.Y. Sup. Ct. 2020) (table, text on Westlaw) (holding company providing conceptual information about managing climate change risks did not make material misstatements).

90. *See, e.g., In re* Vale S.A. Securities Litigation, 2020 WL 2610979 (E.D.N.Y. 2020) (noting that while general aspirations of sustainability were aspirational, the materiality threshold was satisfied by company's specific recommendations regarding steps being taken).

91. *See, e.g., id.* (quoting *In re* BHP Billiton Ltd. Sec. Litig., 276 F. Supp. 3d 65, 79 (S.D.N.Y. 2017)) ("While certain statements, viewed in isolation, may be mere puffery, when the statements are made repeatedly in an effort to reassure the investing public about matters particularly important to the company and investors, those statements may become material to investors.").

92. *See* the discussion of qualitative versus quantitative disclosures *infra* in the text accompanying notes 97-105.

93. *See, e.g.,* Petition for SEC Rulemaking Regarding Climate Change Disclosures (June 10, 2020), https://www.sec.gov/rules/petitions/2020/petn4-763.pdf [https://perma.cc/MDN9-5QMH] (calling for to requiring companies to identify the specific locations of their significant assets, so that investors, analysts and financial markets can do a better job assessing the physical risks companies face related to climate change); Petition for SEC Rulemaking Regarding ESG Disclosures (Oct. 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf [https://perma.cc/DS48-A3TX] (suggesting ESG disclosures are material); Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 56 AM. BUS. L.J. 645 (2019) (criticizing the SEC's failure to act on sustainability and arguing in favor of Sustainability Accounting Standards Board (SASB) standards as a basis for

observed that "a disclosure is considered material if it reflects the significant economic, environmental, and social impacts of the organization of the stakeholders, and the capacity of the stakeholders to influence the economic, environmental and social impacts or activities of the organization."[94] The SEC's analysis of materiality in the ESG context reinforces the amorphous fact-based determination of what is material and what is not. Thus, the existing SEC guidance fails to provide specifically referenced instructions on how to make materiality determinations.

Even without the needed standardization, at least with the benefit of hindsight, there have been situations in which ESG disclosures would have been material. For example, as one accounting observer commented:

> Governance risk is financially material (see: corporate fraud). Social risk is financially material (see: #MeToo movement). Environmental risk is financially material (see: Valdez oil spill). We can't afford another 50 years for ESG reporting to become standardized and on par with financial reporting and auditing. Hopefully, the pain that catalyzes that eventual shift won't leave a lasting scar.[95]

Even members of the corporate community recognize that ESG disclosures can be material in the context of the current voluntary disclosure system.[96] As discussed below, materiality determinations may be aided by classifications of qualitative and quantitative materiality.

B. Qualitative and Quantitative Materiality

The evolution of the CSR movement to include ESG has materiality-based implications. General discussions of CSR are qualitative in nature. On the other hand, ESG is premised on use of metrics. The use of metrics

determining materiality of ESG issues); Hannah V. Vizcarra, *The Reasonable Investor and Climate Related Information: Changing Expectations for Financial Disclosures,* 50 ENV. L. REP. 10106 (2020) (supporting the materiality of climate change disclosures).

94. SEC Memorandum Circular No. 4, Sustainability Reporting Guidelines for Publicly Held Companies, at 16 (2019), http://www.sec.gov.ph/wp-content/uploads/2019/02/2019MCNo4.pdf [https://perma.cc/8SZX-YYPC].

95. Blaine Townsend, *The Case for Standardized Audited ESG Reporting,* ACCOUNTING TODAY (May 15, 2019), https://www.accountingtoday.com/opinion/the-case-for-standardized-audited-esg-reporting [https://perma.cc/94VH-KMNV].

96. *See, e.g.,* David Katz & Laura McIntosh, *Corporate Governance Update: EESG and the Covid-19 Crisis,* HARV. L.F. ON CORP. GOV. AND FIN. REG. (May 31, 2020), https://corpgov.law.harvard.edu/2020/05/31/corporate-governance-update-eesg-and-the-covid-19-crisis/ [https://perma.cc/UND4-MNZ6] ("[I]t is now clear that certain EESG issues potentially have a material impact on short-term financial returns as well as long-term enterprise value.").

provides more of a quantitative feel to the disclosures. Since metrics-based discussion is reasonably perceived to be more quantitative, it can be viewed as more likely to appear to be factual rather than having the generalized aspirational tone that can be attached to qualitative CSR discussion. However, as noted above, there are instances in which qualitative disclosures will be material.

The SEC and the courts have embraced qualitative materiality for many years.[97] For example, with respect to governance issues, the SEC has stated that management integrity is "always a material factor."[98] There are other instances in which small quantitative misstatements can still be material if

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97. *See, e.g.,* SEC v. Joseph Schlitz Brewing Co., 452 F. Supp. 824 (E.D.Wis.1978) (holding that nondisclosure of kickback scheme was material regardless of de minimis quantitative significance because inter alia, it reflected on the lack of management integrity); *In re* Petrobras Securities Litigation, 116 F.3d 368, 380 (S.D.N.Y. 2015) (quoting Strougo v. Barclays PLC, 105 F. Supp. 3d 330, 349 (S.D.N.Y. Apr. 24, 2015)) ("The errors in Petrobras' financial statements were directly related to its concealment of the unlawful bribery scheme, revelation of which would 'call into question the integrity of the company as a whole.'"); In the Matter of Franchard Corp., 423 S.E.C. 163 (1964) (holding CEO's cash withdrawals should be judged not by the quantitative amount but rather the extent to which they reflect negatively on management integrity which rendered the disclosures materially misleading). *See also, e.g.,* Weisberg v. Coastal States Gas Corp., 609 F.2d 650, 655 (2d Cir. 1979) ("[F]actual information concerning the honesty of directors in their dealings with the corporation . . . . would be material to shareholders."); *In re* Grupo Televisa Securities Litigation, 368 F. Supp. 3d 711 (S.D.N.Y. 2019) (holding that sufficiently pleading materiality of failure to disclose company's participation in bribery scheme; also sufficiently pleading company's statements about its code of ethics were materially misleading); *In re* Unisys Corp. Securities Litigation, 2000 WL 136795 (E.D. Pa. 2000) (holding that misstatements relating to less than 1% of income could be material) (relying on *In re* Westinghouse Securities Litigation, 90 F.3d 696, 714–715 (3d Cir. 1996)); United States v. Hatfield, 724 F. Supp. 2d 321, 328 (E.D.N.Y. 2010) ("It is well-settled that information impugning management's integrity is material to shareholders."); Berman v. Gerber Products Co., 454 F. Supp. 1310, 1321–23 (W.D. Mich. 1978) (holding that in making a tender offer facts relating to integrity of ender offeror's management are material). *But cf.* Roeder v. Alpha Industries, Inc., 814 F.2d 22, 27 (1st Cir. 1987) (holding that there was no duty to disclose bribe since plaintiff could not point to any statement that was materially misleading without the disclosure); DoubleLine Capital LP v. Odebrecht Fin., Ltd., 323 F. Supp. 3d 393, 441–42 (S.D.N.Y. 2018) (holding that in the absence of an express statement, a corporation has no affirmative duty to disclose "uncharged, unadjudicated wrongdoing;" similarly, the company corporation need not disclose illegal internal policies, or violations of the corporation's internal codes of conduct and legal policies. A duty to disclose uncharged criminal conduct may arise when failure to disclose such conduct would make other statements materially misleading); Menaldi v. Och-Ziff Capital Mgmt. Grp. LLC, 164 F. Supp. 3d 568, 581–82 (S.D.N.Y. 2016) (holding there was no duty to disclose uncharged wrongdoing but upholding complaint for other misrepresentations).

98. In the Matter of Franchard Corp., 423 S.E.C. 163, 172 (1964). *See, e.g.,* Tom C.W. Lin, *Executive Private Misconduct,* 88 GEO. WASH. L. REV. 327, 361–70 (2020) (lamenting the gaps in disclosure requirements regarding executive misconduct).

qualitatively material.[99]

Concerns about qualitative materiality can be especially prominent when dealing with financial disclosures. For example, the SEC in its Staff Accounting Bulletin (SAB) 99, takes the position that even relatively small accounting discrepancies can be material.[100] The SEC additionally requires both qualitative and quantitative disclosures relating to market risk.[101] While helpful in many instances,[102] qualitative disclosures have been criticized as too murky to support a meaningful materiality analysis.[103] For example, a former SEC Commissioner commented that "[any]one who has tried to apply SAB No. 99 is left with little certainty."[104] These concerns about a qualitative approach to financial disclosures are merely reflective of the amorphous nature of materiality determinations as discussed above. The materiality

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99. *See, e.g.,* Gebhardt v. ConAgra Foods, Inc., 335 F.3d 824 (8th Cir. 2003) (finding that materiality is qualitative not solely quantitative and thus the percentage of revenue was not dispositive of materiality; instead, the court looks to the total mix of information).

100. *See* Staff Accounting Bulletin No. 99—Materiality, Release No. SAB 99, 64 Fed. Reg. 451250–01 (Aug. 12, 1999), which, among other things, sets forth non-exclusive examples of qualitative factors that might cause a small quantitative misstatement to be considered material. Those factors include: whether the misstatement masks a change in earnings or other corporate trends, whether the misstatement hides a failure to meet analysts' consensus expectations for the business, and whether the misstatement changes a loss into income or changes income into a loss.

101. Regulation S-K item 305, 17 C.F.R. § 229.305 (stating that qualitative and quantitative disclosures about market risk are required to the extent they are material).

102. *See, e.g.,* ECA, Local 134 IBEW Joint Pension Tr. of Chicago v. JP Morgan Chase Co*.,* 553 F.3d 187, 205 (2d Cir. 2009) (noting that qualitative factors are intended to allow for a finding of materiality if the quantitative size of the misstatement is small, but the effect of the misstatement is large), relying on Ganino v. Citizens Utilities Co., 228 F.3d 154, 162 (2d Cir. 2000) ("[W]e have consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation."); Litwin v. Blackstone Group, L.P., 634 F.3d 706, 717 (2d Cir. 2011) ("[A] court must consider both quantitative and qualitative factors in assessing an item's materiality and that consideration should be undertaken in an integrative manner."); S.E.C. v. Patel, 2008 WL 781914, at *10–11 (D.N.H. Mar. 24, 2008) (recognizing qualitative in addition to a quantitative approach to materiality but finding no material misstatements or omissions).

103. *See, e.g.,* Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 BUS. LAW. 317, 329 (2007) ("The courts are left with little guidance as to how to weigh quantitative indicia of materiality, while unable to escape the importance of doing so."); Glenn F. Miller, Comment*, Staff Accounting Bulletin No. 99: Another Ill–Advised Foray Into the Murky World of Qualitative Materiality*, 95 NW. U.L. REV. 361 (2000). *But see*, *e.g.,* Caroline A. Antonacci, *SAB 99: Combating Earnings Management with a Qualitative Standard of Materiality*, 35 SUFFOLK U. L. REV. 75 (2001) (noting that SAB No. 99 combats earnings management).

104. Paul S. Atkins, SEC Commissioner, Remarks to the "SEC Speaks in 2008" Program of the Practicing Law Institute (Feb. 8, 2008), available at https://www.sec.gov/news/speech/2008/spch020808psa.htm [https://perma.cc/5FW8-LMWS].

conundrum reinforces the difficulty of effectively clarifying guidelines for an effective ESG disclosure regime relying solely on existing law. The current regime fosters undesirable uncertainty in outcomes depending solely on determining materiality. Rather than merely applying existing materiality concepts, it would be preferable for the SEC to provide specifically tailored line-item disclosure requirements, a safe harbor rule, more helpful SEC disclosure guidance, or a combination of some or all of those.

The distinction between qualitative and quantitative materiality has two implications for ESG disclosures. In the first instance, the use of metrics may support the impression that the statements are factual rather than merely aspirational, which could increase the likelihood of categorizing the statements as material. Secondly, even to the extent that the use of metrics is quantitative, insignificant deviations can still be material, since as pointed out above, even small financial impact can be material under a qualitative analysis.

As noted above, qualitative and quantitative distinctions can impact materiality determinations. The foregoing discussion reveals that in evaluating materiality as it applies to CSR and ESG more generally, the focus must include both qualitative and quantitative factors.

The discussion above highlights the unpredictable nature of materiality determinations. Securities lawyers and companies need to strive for precision and certainty in drafting disclosure items generally. The amorphous nature of materiality means that it is not sufficiently precise to simply rely on an across-the-board requirement that CSR and ESG disclosures must be made when they are material.[105] This requirement is nothing more than a truism and does not provide helpful guidance for evaluating disclosures. Thus, an SEC policy that does no more than point to materiality as the sole determinant of when companies should make CSR and ESG disclosures is problematic. Materiality as the sole determinant would be likely to cause confusion and significantly further the current inconsistent state of these disclosures. The discussion that follows explores the various approaches the SEC could take to improve the current state of CSR and ESG disclosures.

VI. OVERVIEW OF POTENTIAL APPROACHES TO ENCOURAGING OR REQUIRING CSR AND ESG DISCLOSURES

The SEC has a checkered history in terms of receptiveness to

105. As discussed in the next section, an SEC advisory committee included this in its recommendations. *See infra* notes 118-137 and accompanying text.

incorporating social responsibility into the SEC disclosure system.[106] In recent years, the SEC has become increasingly interested in CSR and ESG disclosures in particular. For example, the current regulation consists of voluntary disclosures with some SEC guidance on how companies should frame their ESG disclosures.[107] The SEC's recognition of CSR and ESG's significance is not limited to disclosures a company may voluntarily decide to make. For example, the ability of shareholders to require management to include shareholder proposals in management's proxy statements[108] often reflects shareholder interest in CSR and ESG.[109] In recent years, the SEC staff has become increasingly more receptive to shareholder proposals relating to sustainability,[110] climate change,[111] and ESG.[112]

Even if a clear determination can be made that certain CSR or ESG issues are material, there is no affirmative duty to disclose absent an SEC

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106. *See* Hazen *supra* note 4, at 855–903 (discussing various SEC encounters with social responsibility issues).

107. *See, e.g.,* Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations, Release Nos. 33-10751; 34-88094 (Jan. 30, 2020) (including guidance for discussing sustainability and metrics in MD&A disclosures); SEC Memorandum Circular No. 4, Sustainability Reporting Guidelines for Publicly Held Companies (2019), http://www.sec.gov.ph/wp-content/uploads/2019/02/2019MCNo4.pdf [https://perma.cc/A6BQ-EY9G] (including guidance on materiality and suggestions for referencing ESG metrics).

108. SEC Rule 14a-8, 17 C.F.R. § 240.14-8 addresses the circumstances under which management must include a shareholder-initiated proposal in the proxy statement used by management to solicit proxies.

109. *See generally* 3 HAZEN *supra* note 51 §§ 10:43-10:47, 10:55.

110. *See, e.g.,* Host Hotels & Resorts, Inc., SEC No-Action Letter 2018 LEXIS 117 (Feb. 28, 2018) (stating that management could not rely on Rule 14a-8(i)(3) or 14a-8(i)(6) to exclude a proposal requesting that the company issue an annual sustainability report with due diligence about operations at the company's properties, including the impact on investors of hotel operators environmental, human rights, and labor practices).

111. *See, e.g.,* Gibson, Dunn & Crutcher LLP, SEC No-Action Letter 2019 LEXIS 260 (Apr. 3, 2019) (noting that management could not rely on Rule 14a-8(5) or 14a-8(7) to exclude a proposal requesting that the Company to issue an annual report on the environmental and social impacts of food waste generated from the Company's operations given the significant impact that food waste has on societal risk from climate change and hunger); Ross Stores, Inc., SEC No-Action Letter 2019 LEXIS 192 (Mar. 29, 2019) (stating that management could not rely on Rule 14a-8(i)(7) to exclude a proposal which requested that the board prepare a climate change report to shareholders).

112. Rite Aid Corp., SEC No-Action Letter 2018 LEXIS 253 (Apr. 23, 2018) (stating that management could not rely on Rule 14a-8(i)(7) or 14a-8(i) (10) to exclude a proposal which requested that the company prepare a sustainability report describing the company's ESG risks and opportunities, including customer and worker safety, privacy and security, and environmental management). As noted earlier, there was recent success when Chevron's shareholders voted in favor of a climate change proposal. *See* David Wethe & Kevin Crowley, *supra* note 11.

form or Schedule that imposes a line item disclosure obligation. For example, Rule 10b-5(b) prohibits omission of material facts only when the omitted facts are "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[113] The Supreme Court has made it clear that the securities laws do not require disclosure simply because a fact is material.[114] Thus, there is no duty of disclosure based on materiality alone. In other words, absent a line item disclosure requirement or impermissible insider trading,[115] "silence is golden."[116] Accordingly, a trigger (such as a voluntary ESG discussion or an existing line-item disclosure requirement) is necessary for a rule to the effect that it is materially misleading to omit CSR or ESG information. The discussion that follows explores the various approaches the SEC could take to improve CSR and ESG disclosures.

VI. VOLUNTARY OR MANDATORY DISCLOSURE?

Whether to make ESG disclosures is a strategic decision that each company can make. As noted above, the SEC does not currently mandate CSR or ESG disclosures. Although there have been some efforts in Congress to increase ESG disclosure,[117] there is no indication to date that they have any traction. This article focuses on potential SEC initiatives. Of course, a willing Congress could take the initiative as well.

An SEC investor advisory subcommittee recently issued a series of

113. 17 C.F.R. § 240.10b-5(b) (2011).

114. Basic, Inc. v. Levinson, 485 U.S. 224, 239 n. 17 and accompanying text (1988).

115. Rule 10b-5 insider trading violations are based on the so-called disclose or abstain from trading rule. *See, e.g.,* United States v. O'Hagan, 521 U.S. 642 *passim* (1997) (applying the disclose or abstain rule).

116. As stated by Delaware Chancellor Leo Strine:

> [t]he maxim silence is golden is not simply a goad to good manners at the local movie theater, it is good advice in many realms of life. For example, those are truly words of wisdom when you are not under a duty to speak and someone asks you a question that potentially touches upon information that you would rather not divulge.

Corp. Prop. Assoc. 14 Inc. v. CHR Holding Corp., No. 3231-VCS, 2008 WL 963048 at *1 (Del. Ch. Ct. 2008). *See also, e.g.,* Roeder v. Alpha Indus., Inc., 814 F.2d 22, 27 (1st Cir. 1987) (holding there was no duty to disclose bribe since plaintiff could not point to insider trading or any statement that was materially misleading without the disclosure).

117. Shareholder Protection Act of 2019, S. 1630, 116th Cong. (2019-2020) (requiring public companies to make public disclosure of political contributions); ESG Disclosure Simplification Act of 2019, H.R. 4329, 116th Cong. (2019-2020) (requiring more robust ESG disclosures).

recommendations regarding standardizing ESG-related disclosures.[118] The recommendations include mandating ESG disclosures by publicly held companies. The subcommittee recommends principles-based, rather than rules-based disclosure requirements. The report by the subcommittee identified the lack of standardization that currently exists with respect to ESG disclosures.[119] This lack of standardization creates investor confusion.[120] The report included five observations and recommendations. First, investors need reliable ESG disclosures to enable informed investment and voting decisions.[121] Second, publicly held companies should provide material ESG disclosures.[122] Third, SEC-mandated standardized ESG disclosures would level the playing field between large, medium, and smaller public companies.[123] Fourth, the report posits that standardized ESG disclosures would encourage the flow of capital into the U.S. markets.[124] Fifth, the report urges that the U.S. "take the lead" with respect to material ESG disclosures.[125] More specifically, the recommendations included mandating ESG disclosures by publicly held companies by invoking principles-based, rather than rule-based, disclosure requirements. The report of the subcommittee identified the lack of standardization that currently exists with respect to ESG disclosures[126] and acknowledged that its absence creates investor confusion.[127]

Some off-shore regulators have imposed mandatory ESG disclosures.[128]

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118. Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (May 14, 2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf [https://perma.cc/8AES-T8WS] [hereinafter "Advisory subcommittee report"].

119. Advisory subcommittee report *supra* note 118 at 4.

120. Advisory subcommittee report *supra* note 118 at 4.

121. Advisory subcommittee report *supra* note 118 at 7.

122. Advisory subcommittee report *supra* note 118 at 8.

123. Advisory subcommittee report *supra* note 118 at 8.

124. Advisory subcommittee report *supra* note 118at 9.

125. Advisory subcommittee report *supra* note 118 at 9,

126. Advisory subcommittee report *supra* note 118 at 4.

127. Advisory subcommittee report *supra* note 118 at 4.

128. For example, there is a 2014 European Union (EU) Directive on the Disclosure of Non-Financial and Diversity Information requiring certain companies to provide specific sustainability disclosures. Directive 2014/95, of the European Parliament and of the Council of Oct. 22, 2014, art. 1, 2014 O.J. (L 330/1) 1, 5 (EU). As explained by Professor Fisch:

> The Directive requires non-financial reporting by 1) large companies, 2) "public-interest" entities, and 3) companies with more than 500 employees per year, on average. CSR EUR. & GRI, Member State Implementation of Directive 2014/95/EU, at 8 (2017), https://www.accountancyeurope.eu/wp-content/uploads/1711-NFRpublication-GRI-CSR-Europe.pdf [https://perma.cc/7BMD-C3CG]

In 2020, the European Union adopted mandatory ESG disclosures.[129] This means the U.S. has to play considerable catch-up to become the leader that the advisory subcommittee report recommends.[130] The report contains some guidance as to what steps should be taken to enhance ESG disclosures in the U.S. One recommendation is the adoption of a mandatory ESG disclosure regime. In recommending mandatory ESG disclosures, the report wisely recommends a principles-based approach:

> [T]he SEC should take the lead on this issue by establishing a principles-based framework that will provide the Issuer-specific material, decision-useful, information that investors (both

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> (explaining these criteria).
>
> Because the Directive is implemented at the country level, different countries have adopted varying criteria with respect to its application. For example, the Danish regulation redefines "large company" to include, inter alia, companies with an average of 250 employees. Innovative Implementation of EU Directive on Non-Financial Reporting, GRI (Feb. 7, 2018), https://www.globalreporting.org/information/news-and-press-center/Pages/EU-Directive-on-Non-Financial-Reporting.aspx [https://perma.cc/QQ72-U539]. In contrast, the Greek legislation imposes a duty to report on companies of all sizes. *Id.*

Fisch *infra* note 139 at 928 n. 22. *See also, e.g.,* Anna Maleva-Otto & Joshua Wright, *New ESG Disclosure Obligations,* HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Mar. 24, 2020), https://corpgov.law.harvard.edu/2020/03/24/new-esg-disclosure-obligations/ [https://perma.cc/6J9U-Y7WN] (discussing EU regulation on Sustainability-Related Disclosures - Regulation (EU) 2019/2088); Barbara Novick, Deborah Winshel, Michelle Edkins, Kevin G. Chavers, Zachary Olesiuk & John McKinley, *Exploring ESG: A Practitioner's Perspective,* BLACKROCK (2016), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-exploring-esg-a-practitioners-perspective-june-2016.pdf [https://perma.cc/4SE2-X9NQ] (comparing various countries responses to ESG disclosures).

129. *See, e.g.,* David M. Silk, David A. Katz & Sebastian V. Niles, *U.K. and EU Regulators Move Ahead on ESG Disclosures and Benchmarks,* HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Apr. 26, 2020) (describing the new EU ESG disclosure regime); *EU Parliament Adopts Sustainability Taxonomy Regulation to Fight Greenwashing,* NAT. L. REV. (July 12, 2020), https://www.natlawreview.com/article/eu-parliament-adopts-sustainability-taxonomy-regulation-to-fight-greenwashing [https://perma.cc/94PS-VCXE] ("The Regulation establishes six environmental objectives as the basis of the taxonomy. They are (i) climate change mitigation, (ii) climate change adaptation, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circular economy, including waste prevention and increasing the uptake of secondary raw materials, (v) pollution prevention and control and (vi) protection and restoration of biodiversity and ecosystems.").

130. *See, e.g.,* Preston Brewer, *analysis: Tracking the SEC's Evolving Approach to ESG Disclosures,* BLOOMBERG LAW (Nov. 4, 2019), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-tracking-secs-evolving-approach-to-esg-disclosures [https://perma.cc/PA32-PDB7] ("Europe is ahead of the U.S. in responsible investing. And it's far ahead of the U.S. in mandating disclosure of ESG risks and opportunities by financial market participants and financial advisers. The EU's ESG disclosure regime works to harmonize disclosures across both sectors and financial market operators. It does this by requiring ESG risks and opportunities be disclosed in a consistent, standardized way that enables comparison.").

> institutional and retail) require to make investment and voting decisions. This disclosure should be based upon the same information that companies use to make their own business decisions. If the SEC does not take the lead, it is highly likely that other jurisdictions will impose standards in the next few years that US Issuers will be bound to follow, either directly or indirectly, due to the global nature of the flow of investment into the US markets.[131]

At least one other SEC official agrees with the principles-based approach, observing that "the very breadth of these issues illustrates the importance of a flexible disclosure regime designed to elicit material, decision-useful information on a company-specific basis."[132] As discussed more fully below,[133] a principles-based approach to required disclosures would be preferable to a rules-based mandate. Of course, with a principles-based approach, there is always the potential that overly general principles would perpetuate some of the uncertainty that exists under the current voluntary disclosure regime.

The subcommittee's report was not unanimous, with four members of the subcommittee voting against the recommendations.[134] One dissenter observed: "I don't think many people would benefit from what would probably be a massive amount of boiler plate legalese or a master manual with lots of boxes to be checked."[135] Similarly, at least two SEC Commissioners questioned the wisdom of enhancing ESG disclosures.[136]

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131. Advisory subcommittee report *supra* note 118 at 9.

132. William Hinman, Applying a Principles-Based Approach to Disclosing Complex, Uncertain, and Evolving Risks (Mar. 15, 2019), https://www.sec.gov/news/speech/hinman-applying-principles-based-approach-disclosure-031519 [https://perma.cc/VPQ5-MRET].

133. *See infra* text accompanying notes 138-156.

134. Support for the committee report was split 14 to 4. *See* Jacob Rund, *SEC Urged by Advisory Panel to Tackle ESG Disclosures,* BLOOMBERG LAW (May 21, 2020), https://news.bloomberglaw.com/esg/sec-urged-by-advisory-panel-to-tackle-esg-disclosures [https://perma.cc/LBS5-2BGN].

135. *Id.*

136. Elad L. Roisman, *Keynote Speech at the Society for Corporate Governance National Conference* (July 7, 2020), https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020 [https://perma.cc/X2DX-YTUH] (suggesting a principles-based materiality approach is preferable to mandating ESG disclosures); Hester Peirce, *Commissioner Peirce Speaks to SEC Advisory Committee,* CLS BLUE SKY BLOG (May 26, 2020), https://clsbluesky.law.columbia.edu/2020/05/26/commissioner-peirce-speaks-to-sec-investor-advisory-committee/ [https://perma.cc/7AN3-7ZCG] ("If this committee is able to focus our attention on discrete pieces of information for which disclosure mandates are necessary, perhaps a substantive discussion could follow. A more general call to develop a new ESG reporting regime—without a clear explanation of why the past fifty years of discussion on the topic has not crystallized into a universally applicable set of material ESG

Notwithstanding these criticisms, the principle of encouraging and standardizing ESG disclosures is consistent with what investors want. The U.S. Government Accountability Office (GAO) subsequently issued a report reviewing and analyzing the strong sentiments from many sectors. The GAO report called for the improved ESG disclosures and some of the recommendations that the SEC establish a standardized framework for ESG disclosures.[137]

This article suggests that the SEC should go much further than it has to date in taking steps to encourage and improve, if not mandate, ESG disclosures. Alternatively, the SEC could stop short of imposing a mandate that companies make specified ESG disclosures. For example, the SEC could provide improved guidance for voluntary ESG disclosures that would, in turn, encourage some degree of standardization. More specific guidelines in terms of SEC guidance on ESG disclosures could go a long way towards providing investors with better and more meaningful ESG disclosures. At the very least, the SEC should adopt a safe harbor rule to encourage disclosures while limiting the potential for liability resulting from those disclosures.

VII. EVALUATING THE ALTERNATIVES – SHOULD CSR AND ESG DISCLOSURES BE REQUIRED OR SIMPLY ENCOURAGED?

As noted earlier, an SEC advisory subcommittee recommends mandating material ESG disclosures and the creation of a principles-based approach in order to provide guidelines which will help bring about more standardization of ESG disclosures.[138] There has been significant scholarly support for the imposition of mandatory ESG disclosures.[139] In 2016, the SEC solicited comments on whether to require ESG disclosures[140] but to date

items, but now is the magic moment—may not be as helpful. Otherwise, let's keep using our tried and true disclosure framework, which is rooted in materiality and is flexible enough to accommodate a wide range of issuers, each with its unique and ever-evolving set of risks."); *see also, e.g.,* Hester Peirce, *Scarlet Letters: Remarks Before the American Enterprise Institute* (June18, 2019), https://www.sec.gov/news/speech/speech-peirce-061819 [https://perma.cc/AVF2-S4EG] (questioning the value of ESG).

137. GAO Report to Honorable Mark Warner U.S. Senate, Public Companies Disclosures of Environmental, Social, and Governance Factors and Options to Enhance Them (July 2, 2020), https://www.gao.gov/assets/710/707949.pdf [https://perma.cc/L3MZ-3DRH].

138. Advisory subcommittee report *supra* note 118

139. *See generally* Jill E. Fisch, *Making Sustainability Disclosures Sustainable,* 107 GEO. L.J. 923 (2019) (proposing that the SEC adopt principles-based sustainability disclosures).

140. *See, e.g.,* Business and Financial Disclosure Required by Regulation S-K: Concept Release, 81 Fed. Reg. 23916, 23919 (SEC Apr. 22, 2016) (referencing objections to enhanced ESG disclosure).

has not moved in that direction.

Another alternative suggested by some is to focus on ESG funds and their disclosure obligations rather than focusing on the publicly held companies that they invest in.[141] Specifically, one SEC Commissioner would like to see increased disclosure by ESG funds explaining how ESG factors are evaluated and weighed in making investment decisions.[142] This would provide investors in funds with more detailed descriptions of the funds' investment policies. Such enhanced disclosure by the funds becomes even more meaningful if the SEC improves the ESG disclosures made by the companies the ESG funds are considering as investments. Mutual funds are registered under the Investment Company Act of 1940.[143] Among its many requirements, the Investment Company Act requires a mutual fund "to identify its principal investment strategies, including the types of securities in which it invests principally."[144] Thus, for example, ESG focused funds are required to explain their investment strategies in explaining who the fund

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141. Roisman *supra* note 136.

142. Roisman *supra* note 136. Also, the Department of Labor recently adopted a rule to go even further with respect to ERISA (Employee Retirement Income Security Act) regulated pension plans by requiring plan managers to focus on financial performance rather than ESG considerations. Employee Benefits Security Administration, 85 Fed. Reg. 72846-01 (Dept. of Labor Nov. 13, 2020). ERISA plans managers are required to evaluate "investments and investment courses of action based solely on pecuniary factors that have a material effect on the return and risk of an investment based on appropriate investment horizons and the plan's articulated funding and investment objectives . . . ." Employee Benefits Security Administration, 85 Fed. Reg. 39113 (proposed Jun. 30, 2020) (to be codified at 29 U.S.C. ch. 18 § 1001). ERISA regulates many employer-sponsored retirement plans. The Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at scattered sections of 26 U.S.C and 29 U.S.C. §§ 1001–1461). *Compare* U.S. GOV'T ACCOUNTABILITY OFF., GAO-19-1239, REPORT TO CONGRESSIONAL REQUESTERS: Retirement Plan Investing (May 2020); Ted Knutson, *GAO Urges Removal of Roadblocks to ESG Investing in Retirement Plans,* FORBES (May 22, 2018), https://www.forbes.com/sites/tedknutson/2018/05/22/esg-investing-roadblocks-by-retirement-plans-should-be-removed-urges-congressional-report/#4578f8ac517a [https://perma.cc/UDT9-QHXV] (calling on the Department of Labor to go in the other direction and ease barriers to pension plan ESG investing). BlackRock maintains that its focus on sustainability is investment-motivated. *See* Sandra Boss, BlackRock, Inc., *Our Approach to Sustainability*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 20, 2020), https://corpgov.law.harvard.edu/2020/07/20/our-approach-to-sustainability/#more-131469 [https://perma.cc/Y7U3-BHNT] ("This past January, BlackRock wrote to clients about how we are making sustainability central to the way we invest, manage risk, and execute our stewardship responsibilities. This commitment is based on our conviction that climate risk is investment risk and that sustainability-integrated portfolios, and climate-integrated portfolios in particular, can produce better long-term, risk-adjusted returns.").

143. Act of Aug. 22, 1940, 54 Stat. 789, (codified as 15 U.S.C.A. §§ 80a–1 - 80a–52).

144. Investment Company Institute, SEC Staff No-Action Letter, 2001 WL 1530143 (Dec. 4, 2001).

focuses on – ESG or sustainability – in selecting investments.[145] Further, there is literature supporting ESG investments as consistent with fund managers' fiduciary duties.[146] Although increased disclosure by funds is worthy of consideration, detailed discussion of the mutual fund disclosure requirements is beyond the scope of this article.

Support for enhanced ESG disclosures is not universal and more generalized opposition to mandatory disclosure as a general matter is not new[147] and continues today.[148] Thus, mandatory ESG reporting by publicly held companies has its detractors and critics.[149] For example, it has been suggested that voluntary disclosures are sufficient in light of shareholder

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145. *See, e.g.,* Managed Portfolio Series, SEC Staff Comment letter, 2020 WL 2866862 (May 05, 2020) (discussing sufficiency of fund's disclosures relating to its ESG investing strategies); Allianz Funds Multi-Strategy Trust, SEC Staff Comment Letter, 2018 WL 1731582 (Apr. 3, 2018) (discussing use of "sustainability" in fund's name). SEC Rule 35d-1, 17 C.F.R. 270.35d-1, governs fund names and the extent to which a fund's name may implicate a requirement that at least 80% of the fund's investments must reflect the description in the fund's name. Companies have differed as to whether the 80% requirement applies to funds with SEG in the name and the SEC has solicited comments on whether to address this in SEC rulemaking or interpretations. *See* Request for Comments on Fund Names ("The staff has observed that some funds appear to treat terms such as 'ESG' as an investment strategy (to which the Names Rule does not apply) and accordingly do not impose an 80 percent investment policy, while others appear to treat 'ESG' as a type of investment (which is subject to the Names Rule"). Request for Comments on Fund Names, Investment Company Act Release No. IC-33809, 2020 WL 1088604; SEC File No. S7-04-20 (Mar. 2, 2020).

146. *See, e.g.,* Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration*, 90 UNIV. COLO. L. REV. 731, 732 (2019) ("[T]he available data explain why a prudent investor should consider ESG information."). *Cf.* Zachary Barker, Note, *Socially Accountable Investing: Applying* Gartenberg v. Merrill Lynch Asset Management's *Fiduciary Standard to Socially Responsible Investment Funds*, 53 COLUM. J. L. & SOC. PROBS. 283 (2020) (suggesting that fiduciary standards that govern fund managers' performance should be extended beyond financial performance to social accountability).

147. *See, e.g.,* FRANK H. EASTERBROOK & DANIEL P. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 256 (Harvard University Press 1991) (noting disclosure is more efficiently regulated by market forces than by regulators); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2373–81 (1998) (arguing market incentives rather than the SEC should set the standards for disclosure by publicly held companies); Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1465–70 (1997) (advocating a competitive regulatory approach to securities regulation).

148. Andrew A. Schwartz, *Mandatory Disclosure in Primary Markets* 2019, UTAH L. REV. 1069 (2019) (questioning the wisdom of mandatory disclosure regimes).

149. *See, e.g.,* Hester Peirce, *Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures,* HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Feb. 1, 2020), https://corpgov.law.harvard.edu/2020/02/01/statement-by-commissioner-peirce-on-proposed-amendments-to-modernize-and-enhance-financial-disclosures/ [https://perma.cc/U9FV-ZAWQ] ("We ought not step outside our lane and take on the role of environmental regulator or social engineer.").

activism and its impact.[150] However, there does not appear to be any traction for generally eliminating the securities laws' basic premise of requiring full disclosure. Accordingly, the analysis in this article is limited to ESG-related issues within the context of the current mandatory disclosure framework for publicly held companies generally.

A. Specific Line-Item Requirements

As noted above, a report to the SEC recommended that investors would benefit through mandated material ESG disclosure. A decision to mandate ESG disclosures would raise questions as to how to implement the disclosure requirements. One possible approach would be mandating disclosures through specifically drafted disclosures listing the items required to be disclosed. This approach is generally referred to as line-item disclosure.[151] The challenge in creating such a requirement would be specifying the details of what must be disclosed. In contrast, a principles-based approach focusing on materiality alone without more specific line-item guidance would not provide a suitable threshold. This is because, as pointed out above,[152] materiality is highly factual and does not provide a bright line test. Thus, materiality as the sole benchmark would not provide sufficient guidance in identifying the scope of required ESG disclosures. One possible approach would be to follow the same pattern as the disclosure requirements for management discussion and analysis[153] (MD&A) as well as compensation discussion and analysis[154] (CD&A). Both the MD&A and CD&A disclosure requirements are principles-based rather than specific rules regarding what

150. *See, e.g., Corporate Sustainability Reporting: Past, Present, Future*, U.S. CHAMBER OF COM. FOUND. (Nov. 2018), https://www.uschamberfoundation.org/sites/default/files/Corporate%20Sustainability%20Reporting%20Past%20Present%20Future.pdf [https://perma.cc/45YW-PXQU], at 8 (summarizing the Chamber of Commerce's opinion on self-reporting).

151. *See, e.g.,* Form 10-K, SECURITIES AND EXCHANGE COMMISSION, https://www.sec.gov/files/form10-k.pdf [https://perma.cc/X4MF-QDQH] (last visited Feb. 13, 2021) (form for annual report, referencing line-item disclosure requirements). For example, the Biden administration recently recommended that the SEC adopt mandatory disclosures regarding greenhouse emissions. *See* Kelly Lunney, *Proposed SEC Climate Disclosure Mandate Draws Republican's Ire.* BLOOMBERG LAW (Feb. 19, 2021), https://news.bloomberglaw.com/environment-and-energy/proposed-sec-climate-disclosure-mandate-draws-republicans-ire [https://perma.cc/P5U2-UZYU].

152. *See supra* text accompanying notes 79-82.

153. Reg. S–K Item 303(a)(3)(ii), 17 C.F.R. § 229.303(a)(3)(ii) (2020). *See* the SEC's explanation in Management's Discussion and Analysis of Financial Condition, Securities Act Release No. 33–6835 (SEC May 18, 1989).

154. Regulation S-K item 402(b), 17 C.F.R. § 229.402(b) (2020).

must be disclosed and how it should be disclosed. Another advantage to the discussion and analysis approach is that following the courts' approach to the MD&A disclosures, a violation of those requirements would not automatically translate into securities fraud that could form the basis of an action for damages.[155] Thus, it would not expose companies to undue litigation risk.[156]

B. Requiring Disclosure Through Discussion and Analysis

As pointed out above, a discussion and analysis approach can provide a principles-based disclosure mandate. The discussion that follows provides an overview of MD&A and CD&A and then explains how that approach could be adapted to CSR and ESG disclosures.

1. Overview of MD&A

The MD&A requirement is found in Item 303 of Regulation S–K. In the course of its Management's Discussion and Analysis of financial condition and report of operations, management is directed to analyze operations.[157] This analysis includes disclosure of trends and uncertainties that are likely to have a material effect on the company. Among other things, Item 303 requires management to discuss "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from

155. *See, e.g.,* Carvelli v. Ocwen Financial Corp., 934 F.3d 1307, 1331 (11th Cir. 2019) ("Item 303 imposes a more sweeping disclosure obligation than Rule 10b-5, such that a violation of the former does not ipso facto indicate a violation of the latter."); Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 102 (2d Cir. 2015) (identifying that although a violation of Item 303 does not automatically rise to the level of a Rule 10b-5 violation, "a violation of Item 303's disclosure requirements can only sustain a claim under Section 10(b) and Rule 10b–5 if the allegedly omitted information [also] satisfies *Basic's* test for materiality.").

156. *See, e.g.,* Connor Kuratek Joseph A. Hall & Betty M. Huber, *Legal Liability for ESG Disclosures,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 3, 2020), https://corpgov.law.harvard.edu/2020/08/03/legal-liability-for-esg-disclosures/#more-131560 [https://perma.cc/79VL-VK5E] ("The threat of potential litigation should not dissuade companies from disclosing sustainability frameworks and metrics. Not only are companies facing investor pressure to disclose ESG metrics, but such disclosure may also incentivize companies to improve internal risk management policies, internal and external decisional-making capabilities and may increase legal and protection when there is a duty to disclose. Moreover, as ESG investing becomes increasingly popular, it is important for companies to be aware that robust ESG reporting, which in turn may lead to stronger ESG ratings, can be useful in attracting potential investors.") (footnotes omitted).

157. Reg. S–K Item 303, 17 C.F.R. § 229.303 (2020). For a more complete analysis of the MD&A requirement, *see* 2, 3 HAZEN *supra* note 51, §§ 9:50, 12:70.

continuing operations."[158] The MD&A obligation extends to trends and uncertainties that are "known" and thus, it is not enough that they were simply "knowable."[159] MD&A is a mandatory disclosure item but does not define the scope of liability for material misstatements and omissions. Violation of Item 303's disclosure mandate does not necessarily violate SEC Rule 10b-5.[160] As a result, Item 303's disclosure mandate is significantly broader than the disclosure mandate imposed by Rule 10b-5 without necessarily creating civil liability for violations of the MD&A mandate. The MD&A disclosures focus both on current operations and on plans for future operations. The MD&A disclosures are designed to centralize a narrative discussion of the company's financial condition within one portion of the applicable disclosure document.[161] The MD&A disclosures are also designed to give investors an informed basis for assessing a company's future prospects.[162] Although the SEC has indicated that MD&A could have

158. Reg. S–K Item 303(a)(3)(ii), 17 C.F.R. § 229.303(a)(3)(ii) (2020). *See* the SEC's explanation in Management's Discussion and Analysis of Financial Condition and Result of Operations, Exchange Act Release No. 6835, 1989 WL 1092885 (SEC May 18, 1989).

159. *See, e.g.,* J & R Marketing, SEP v. General Motors Corp., 549 F.3d 384, 391-92 (6th Cir. 2008) (identifying failure to establish that information was in fact known as opposed to knowable).

160. *See In re* NVIDIA Corp. Securities Litigation, 768 F.3d 1046, 1055 (9th Cir. 2014) ("Management's duty to disclose under Item 303 is much broader than what is required under the standard pronounced in *Basic*."); City of Omaha Police and Fire Retirement System v. Evoqua Water Technologies, Corp., 2020 WL 1529371 (S.D.N.Y. 2020) (finding failure to plead MD&A violations since item 303 does not require disclosure of internal business strategies); relying on Steamfitters' Industrial Pension Fund v. Endo International PLC, 771 F. App'x. 494, 498 (2d Cir. 2019) (determining Item 303 did not require disclosure of an alleged plan to restructure an acquired company's business model by, among other things, laying off executives); Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 105 (2d Cir. 2015) ("[T]he SEC has never gone so far as to require a company to announce its internal business strategies.").

161. *See* Management Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 33, 6835, Exchange Act Release No. 34, 26831, Investment Company Act Release No. IC -16961, 43 S.E.C. Docket 1330, 1989 WL 1092885 (May 18, 1989) ("The MD&A requirements are intended to provide, in one section of a filing, material historical and prospective textual disclosure enabling investors and other users to assess the financial condition and results of operations of the registrant, with particular emphasis on the registrant's prospects for the future.") (footnotes omitted).

162. *See* Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, 52 Fed. Reg 13715, Securities Act Release No. 33-6711, Exchange Act Release No. 34, 24356, 38 S.E.C. Docket 145, 1987 WL 847497 (Apr. 17, 1987) ("The Commission has long recognized the need for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance. MD & A is intended to give the investor an

implications for ESG disclosures, it did not provide meaningful specific guidance beyond that general observation.[163]

2. Overview of CD&A

Regulation S-K's CD&A requires discussion of the methods used by companies in setting management compensation.[164] As a result of changes adopted in 2006, the executive compensation disclosure requirements now have a component analogous to the SEC's MD&A disclosures regarding operations.[165] CD&A is designed to provide a narrative description and analysis of a company's compensation for named executive officers. In particular, the CD&A disclosure requires answers to the following questions:

- What are the objectives of the company's compensation programs?
- What is the compensation program designed to reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount (and, where applicable, the formula) for each element?
- How do each element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements?[166]

As is the case with MD&A, the CD&A disclosures provide a good analogy for requiring discussion and analysis regarding CSR and ESG disclosures. For example, as Professor Jill Fisch astutely points out, a sustainability discussion and analysis (SD&A) regime would mandate public

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opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company. The Item asks management to discuss the dynamics of the business and to analyze the financials.").

163. Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 33-9106, (Feb. 2, 2010).

164. Regulation S-K item 402(b), 17 C.F.R. § 229.402(b). *See* Executive Compensation And Related Person Disclosure, Securities Act Release No. 33, 8732, Exchange Act Release No. 34, 54302, Investment Company Act No. IC - 27444, 2006 WL 2335558 (Aug. 11, 2006).

165. As explained by the SEC:

> [T]he new Compensation Discussion and Analysis calls for a discussion and analysis of the material factors underlying compensation policies and decisions reflected in the data presented in the tables. This overview addresses in one place these factors with respect to both the separate elements of executive compensation and executive compensation as a whole.

Id. at *5.

166. *Id.* at *13.

companies address sustainability in their disclosures while still remaining within the confines of a principles-based requirement.[167] Such a principles-based requirement is far preferable to a more rigid rules-based requirement for ESG disclosures generally.

3. Proposals for CSR and ESG D&A

As noted above, Professor Fisch has proposed a principles-based sustainability discussion analysis requirement (SD&A).[168] Specifically, she concludes that "the relationship between issuer sustainability practices and risk management, business plans, and economic vulnerability warrant incorporating sustainability information into SEC-mandated financial reporting" and creating a requirement for sustainability discussion and analysis.[169] This wise proposal would go a long way towards improving CSR and ESG disclosures and would be a welcome innovation.

A slight variation of Professor Fisch's SD&A proposal would be if the SEC were to go beyond the environmental component of ESG and further require discussion and analysis of other social issues and corporate governance. For example, the SEC could require a company to discuss its approach to CSR and ESG to the extent to which CSR and ESG impact corporate decision-making, and the extent to which these policies have had or are likely to have a material impact on company operations. A CSR or ESG discussion and analysis requirement could also mandate disclosure of company guidelines for CSR and ESG issues, and the extent to which the company and its management are in compliance with those guidelines.[170]

Existing MD&A requirements certainly leave room for expansion with ESG disclosures. In fact, as discussed in a later section, the SEC has issued guidance relating to ESG discussion under the existing MD&A regime.[171] However, as pointed out herein, there are suggestions that this does not go

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167. *See* Fisch, supra *note* 139, at 955.

168. *See* Fisch, supra *note* 139, at 955.

169. *See* Fisch, supra *note* 139, at 923. *See also* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 50 ENVTL. L. REP. 10638, 10643 (2020) ("[T]he SEC should reverse its position that sustainability disclosure is not properly included within financial reporting."). *See generally* Rick A. Fleming & Alexandra M. Ledbetter, *Making Mandatory Sustainability Disclosure a Reality*, 50 ENVTL. L. REP. 10647 (2020) (supporting mandatory disclosure); Veena Ramani & Jim Coburn, *The Need for SEC Rules on ESG Risk Disclosure*, 50 ENVTL. L. REP. 10650 (2020) (same); Thomas L. Riesenberg, Principles plus SASB Standards, 50 ENVTL. L. REP. 10653 (2020) (supporting principles and SASB standardization). *But see generally* Sally R. K. Fisk & Nikki Adame-Winningham, *Sustainability Risk Is Investment Risk,* 50 ENVTL. L. REP. 10644 (2020) (not supporting mandatory ESG disclosure).

170. It is beyond the scope of this article to draft a specific disclosure requirement.

171. *See* the discussion *infra* in the text accompanying note 240.

far enough, and that ESG-related discussion should be required.

This principles-based approach to mandated disclosures would leave it to companies to decide how to frame their CSR and ESG disclosures without unduly exposing themselves to liability under the securities laws' antifraud provisions.[172] Violation of the existing MD&A discussion and analysis requirements already exposes the company to possible SEC initiated sanctions. However, invoking the antifraud rules to create the more serious exposure to private rights of action for damages[173] and potential criminal liability[174] requires a materiality threshold which is not required for an MD&A violation.[175] The antifraud provisions also impose a higher culpability standard encompassed in the scienter[176] requirement. Success in an MD&A securities fraud claim requires showing that the company failed to comply with MD&A requirements and further, that the nondisclosure or misstatement was a material one.[177] Even if the materiality threshold is crossed, the scienter requirement limits liability to companies and their agents who have made intentional or severely reckless statements or omissions. Mere negligence in making the disclosures is not sufficient.[178]

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172. *See, e.g.,* Carvelli v. Ocwen Financial Corp., 934 F.3d 1307, 1331 (11th Cir. 2019) ("Item 303 imposes a more sweeping disclosure obligation than Rule 10b-5, such that a violation of the former does not ipso facto indicate a violation of the latter."); Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 102 (2d Cir. 2015) (explaining that although a violation of Item 303 does not automatically rise to the level of a Rule 10b5 violation, "a violation of Item 303's disclosure requirements can only sustain a claim under Section 10(b) and Rule 10b–5 if the allegedly omitted information [also] satisfies *Basic's* test for materiality").

173. Private rights of action under SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (2011), are discussed in 3-4 HAZEN, *supra* note 51, at 445.

174. *See, e.g.,* United States v. O'Hagan, 521 U.S. 642 (1997) (criminal liability for insider trading in violation of Rule 10b-5).

175. *See* the discussion of materiality *supra* in the text accompanying notes 67-103.

176. A violation of SEC Rule 10b-5 requires a showing of scienter which involves the intent to deceive or acting with severe reckless disregard when making the challenged statements. *See, e.g.,* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007); Aaron v. S.E.C., 446 U.S. 680 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, (1976). There are other liability provisions that can be based on negligence or even strict liability. *See e.g.,* Securities Act § 11, 15 U.S.C. § 77k (discussing liability for material misstatements and omissions in 1933 Act registration statements). Even in a section 11 action, the plaintiff would have to establish more than a violation of MD&A requirements and that the violations rose to the level of material misstatements or omissions.

177. *See, e.g.*, Stratte-McClure v. Morgan Stanley, 776 F.3d 94 (2d Cir. 2015) (holding that a failure to make a required disclosure under Item 303 of Regulation S–K, 17 C.F.R. § 229.303(a)(3)(ii) is an omission that can serve as the basis for a Section 10(b) securities fraud claim, if materiality requirement is satisfied).

178. The scienter requirement is spelled out in Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007); Aaron v. S.E.C., 446 U.S. 680 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, (1976). *See also* 3 HAZEN, *supra* note 51, §§ 12:50-12:58.

As noted in the MD&A discussion above, not every discussion and analysis violation crosses the securities laws' materiality threshold. The section that follows explores a parallel to the current code of ethics disclosure requirement as an alternative to a CSR, ESG, or sustainability discussion and analysis requirement.

4. Corporate Codes of Ethics and Governance

Another approach for mandating ESG disclosures would be to draw from existing disclosure requirements with respect to corporate codes of ethics. Under the SEC's definition:

> [T]he term *code of ethics* means written standards that are reasonably designed to deter wrongdoing and to promote:
> (1) Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
> (2) Full, fair, accurate, timely, and understandable disclosure in reports and documents that a registrant files with, or submits to, the Commission and in other public communications made by the registrant;
> (3) Compliance with applicable governmental laws, rules and regulations;
> (4) The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and
> (5) Accountability for adherence to the code.[179]

Corporate codes of ethics and codes of conduct certainly are part of the governance aspects of ESG.

Section 406 of the Sarbanes–Oxley Act directed the SEC to develop rules requiring disclosures relating to public companies' codes of ethics.[180] Neither the statute nor the SEC rules expressly mandate that a publicly held company have a code of ethics,[181] but the disclosure requirements clearly provide a strong incentive to adopt a code.[182] Companies without a code of

179. Regulation S-K item 406(b), 17 C.F.R. § 229.406(b).

180. Sarbanes–Oxley Act of 2002, Pub. Law 107–204 (July 30, 2002) § 406, codified in 15 U.S.C. § 1764.

181. In contrast to publicly held companies generally, an investment adviser who is registered with the SEC under the Investment Adviser Act of 1940 is required to have a code of ethics. Investment Adviser Act Rule 204A, 17 C.F.R. § 275.204A-1. *See* Investment Adviser Code of Ethics, Inv. Adv. Act Rel. No. IA-2256, Inc. Co. Act Rel. No. IC-26492 ("S.E.C. July 2, 2004"), https://www.sec.gov/rules/final/ia-2256.htm [https://perma.cc/5334-4S8S].

182. A code of ethics should be designed to promote compliance with laws, rules, and

ethics must disclose the absence of a code and explain the reasons for not having one.[183] Also, companies that do not have a code of ethics will appear out of line with the many companies that have adopted one.[184] In disclosing the code of ethics and its requirements, companies need to address compliance with the code of ethics and applicable methods of assuring compliance with the code.[185]

Following a strategy it has used before,[186] the SEC does not directly require that a company have a code of ethics. Instead, the company must disclose whether it has a code of ethics in place.[187] A similar requirement could be imposed with respect to ESG generally. The discussion below addresses existing requirements with respect to codes of ethics and the possibility of applying a similar requirement for ESG generally.

Ethical conduct in corporate governance and conduct generally are key

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regulations applicable to the company's business. The code of ethics must identify appropriate reporting procedures within the organization with respect to code violations.

183. *See* Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Securities Act Release No. 33-8177, Exchange Act Release No. 34-47235 ("S.E.C. Jan. 24, 2003"). *See generally* 3 HAZEN, *supra* note 51, § 9:97 (discussing the code of ethics disclosure requirement).

184. See Roberta Riva, *The Good, the Bad, and Their Corporate Codes of Ethics: Enron, Sarbanes–Oxley, and the Problems with Legislating Good Behavior,* 116 HARV. L. REV. 2123, 2134–35 (2003) ("[P]ublic filing of codes, coupled with 8-K disclosures of waivers, will begin a gradual process whereby the investing community will become sophisticated in evaluating codes and distinguishing among them.").

185. *See* Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Sec. Act Rel. No. 33-8177, Exchange Act Release No. 34-47235 ("S.E.C. Jan. 24, 2003").

186. At one time, the SEC proposed requiring a fairness requirement for going private transactions (a transaction that results in the cessation of Securities Exchange Act reporting requirements). However, instead of requiring fairness, the SEC adopted a requirement that in a going private transaction, management must make specified disclosures, including whether management has a reasonable belief in the fairness of the transaction and the basis for such belief. SEC Rule 133-3, 17 C.F.R. § 240.13e-3. Thus, rather than require management to address the transaction's fairness, management has to disclose whether it has a belief that the transaction is fair and if so, why. *See* Going Private Transactions by Public Companies or Their Affiliates, Securities Act Release No. 33-6100, Exchange Act Release No. 34-16075, Inv. Co. Act Rel. No. IC-10805, 44 Fed. Reg. 46736 (Aug. 8. 1979) (adopting Rule 13e-3); Notice of Public Fact-Finding Investigation and Rulemaking Proceeding in the Matter of "Going Private" Transactions by Public Companies or Their Affiliates, Securities Act Release No. 33-5568, Exchange Act Release No. 34-11231, Pub. Util. Holding Co. Act Rel. No. 35-18805, Trust Indenture Act Rel. No. 39-380, Inv. Co. Act Rel. No. IC-8665, 6 S.E.C. Docket 272 (Feb. 6, 1975) (proposing Rule 13e-2 with a fairness requirement).

187. *See* Regulation S-K item 406(a), 17 C.F.R. § 229.406(a) (requiring that the company must "[d]isclose whether the registrant has adopted a code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. If the registrant has not adopted such a code of ethics, explain why it has not done so").

components of any evaluation of a company's governance. In terms of ESG, codes of ethics can be a significant factor in evaluating a company's governance and governance structure.[188] For example, most investors are likely to want to avoid investing in companies with toxic corporate cultures. As observed earlier, today's environment and increased focus on diversity, inclusion, and equity has spurred consumer activism and is likely to create even more investor interest in avoiding companies with toxic corporate cultures.

As explained above, the securities laws and SEC rules do not expressly mandate that a publicly held company have a code of ethics,[189] nor do they mandate the specifics of how to draft a code of ethics.[190] Nevertheless, the

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188. *See, e.g.,* Simon Webley & Andrea Werner, *Corporate Codes of Ethics: Necessary but not Sufficient,* 17 BUS. ETHICS: A EUROPEAN REV. 405, 405 (2008) ("[H]aving such a code is generally regarded as the principal tool of a corporate ethics policy"). For an expanded discussion of corporate codes of ethics, *see generally* HAZEN *supra* note 51. *See also, e.g.,* Krista Bondy, Dirk Matten & Jeremy Moon, *The Adoption of Voluntary Codes of Conduct in MNCs: A Three-Country Comparative Study,* 109 BUS. & SOC. REV. 449, 449 (2004) (noting that companies use "corporate responsibility (CSR) codes of conduct"); Patrick M. Erwin, *Corporate Codes of Conduct: The Effects of Code Content and Quality on Ethical Performance*, 99 J. BUS. ETHICS 535 (2011) ("Corporate codes of conduct are a practical corporate social responsibility (CSR) instrument commonly used to govern employee behavior and establish a socially responsible organizational culture.").

189. In contrast to publicly held companies generally, an investment adviser who is registered with the SEC under the Investment Adviser Act of 1940 is required to have a code of ethics. Investment Adviser Act Rule 204A, 17 C.F.R. § 275.204A-1. *See* Investment Adviser Code of Ethics, Inv. Adv. Act Rel. No. IA-2256, Inc. Co. Act Rel. No. IC-26492, (S.E.C. July 2, 2004) https://www.sec.gov/rules/final/ia-2256.htm [https://perma.cc/6ZTX-PEWU] (S.E.C. July 2, 2004). In addition, the New York Stock Exchange requires listed companies to have codes of ethics. N.Y.S.E., Corporate Governance Listing Standards (Feb. 1, 2019), https://www.novonordisk.com/content/dam/nncorp/global/en/about-us/pdfs/corporate-governance/NYSE-recommendations-2019.pdf [https://perma.cc/D5GR-ALNX]:

> Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. According to NYSE commentary a code of business conduct and ethics should include:
> Conflicts of interest.
> Corporate opportunities.
> Confidentiality.
> Fair dealing.
> Protection and proper use of company assets.
> Compliance with laws, rules and regulations (including insider trading laws).
> Encouraging the reporting of any illegal or unethical behavior.

A similar requirement is imposed by the Nasdaq stock market. Nasdaq Stock Market Rule 5610.

190. As explained by the SEC:

> We continue to believe that ethics codes do, and should, vary from company to

disclosure requirements clearly provide a strong incentive for companies without one to adopt a code. Companies without a code of ethics must disclose the absence of a code of ethics and also explain the reasons for not having one.[191] Even before the SEC's disclosure requirements, most publicly held companies had codes of ethics or codes of conduct.[192]

As noted above, under the SEC rules, a "code of ethics" must include "written standards that are reasonably designed to deter wrongdoing."[193] The SEC has avoided providing specific guidance which gives companies the flexibility they need in drafting company-specific codes.[194] In addition, the SEC does not explicitly require a company with a code of ethics to address success or failure in complying with its code of ethics. However, applying traditional materiality concepts, nondisclosure of conduct inconsistent with a company's code of ethics can cross the materiality threshold and therefore be a material omission.[195]

As is the case with MD&A disclosures, violation of the code of ethics disclosure requirement does not automatically translate into a violation of the securities laws' antifraud provisions. Investors have not frequently been successful in stating fraud claims based on these disclosures. The difficulty in establishing materially misleading disclosures regarding codes of ethics is largely due to a corporation's code of ethics being viewed as merely

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> company and that decisions as to the specific provisions of the code, compliance procedures and disciplinary measures for ethical breaches are best left to the company. Such an approach is consistent with our disclosure-based regulatory scheme. Therefore, the rules do not specify every detail that the company must address in its code of ethics, or prescribe any specific language that the code of ethics must include. They further do not specify the procedures that the company should develop, or the types of sanctions that the company should impose, to ensure compliance with its code of ethics. We strongly encourage companies to adopt codes that are broader and more comprehensive than necessary to meet the new disclosure requirements.

Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Sec. Act Rel. No. 33-8177, Sec. Exch. Act Rel. No. 34-47235, 68 Fed. Reg. 5110-01 ("S.E.C. Jan. 24, 2003").

191. Regulation S-K item 406, 17 C.F.R. § 229.406. *See* Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Sec. Act Rel. No. 33-8177, Sec. Exch. Act Rel. No. 34-47235 ("S.E.C. Jan. 24, 2003"). *See generally* 3 HAZEN, *supra* note 51, § 9:97 (discussing the code of ethics disclosure requirement).

192. As of 1998, over ninety percent of Fortune 500 companies were said to have adopted codes of ethics or conduct. *See* Myrna Wulfson, *Rules of the Game: Do Corporate Codes of Ethics Work*, 20 REV. BUS. 12, 12 (1998). As of 2013, ninety-five percent of Fortune 100 companies were identified as having a code of ethics.

193. Regulation S-K item 406, 17 C.F.R. §229.406.

194. *Id.*

195. *See* discussion in the text *infra* accompanying notes 197-207.

aspirational rather than a statement as to the actual conduct of the company and its employees.[196] However, specific statements regarding the company's conduct can be materially misleading in light of a company's code of ethics.[197] For example, in one case a corporation's statements about its code of ethics were held to be susceptible to a finding of material misstatements for failing to disclose the company's alleged participation in a bribery scheme.[198] However, in another case, the court found that the code of conduct's prohibition on bribery was merely aspirational.[199]

It remains true that generalized statements about a company's commitment to ethical conduct likely will be considered aspirational and hence not materially misleading.[200] However, as noted by the Sixth Circuit:

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196. *See, e.g.,* Retail Wholesale & Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co., 845 F.3d 1268 (9th Cir. 2017) (holding that alleged sexual misconduct of officer and alleged violation of ethics code was not material; the court noted that the company's statements promoting the company's code of ethics "were transparently aspirational" and "did not reasonably suggest that there would be no violations of [the code] by the CEO or anyone else"); In re TransDigm Group Securities Litigation, 2020 WL 820823 (N.D. Ohio Feb. 19, 2020) (quoting Bondali v. Yum! Brands, Inc., 620 Fed. Appx. 483, 490 (6th Cir. 2015)) ("'[A] code of conduct is not a guarantee that a corporation will adhere to everything set forth in its code of conduct' and, instead, is simply a 'declaration of corporate aspirations.'").

197. In re Banco Bradesco S.A. Securities Litigation, 277 F. Supp. 3d 600, 659 (S.D.N.Y. 2017) (noting statements in code of ethics may have been aspirational, but "the context in which the statements about Bradesco's Code of Ethical Conduct and its other anti-corruption statements were made persuades the Court that they are not to be treated as immaterial as a matter of law at this stage of the litigation"). *But cf.* In re Sinclair Broadcast Group Inc. Securities Litigation, 2020 WL 571724 (Del. Ch. Feb. 4, 2020) (stating failure to specifically allege illegal conduct that violated company's code of ethics).

198. In re Grupo Televisa Securities Litigation, 368 F. Supp. 3d 711 (S.D.N.Y. 2019) (alleging sufficient material omissions from statements about code of ethics in light of in nondisclosure of company's participation in bribery scheme).

199. Ulbricht v. Ternium S.A., 2020 WL 5517313 at * 9 (E.D.N.Y. 2020) (quoting In re Braskem S.A. Securities Litigation, 246 F. Supp. 3d 731, 756 (S.D.N.Y. 2017) and citing In re PetroChina Co. Ltd. Securities Litigation, 120 F. Supp. 3d 340, 360 (S.D.N.Y. 2015)) (showing a code of conduct prohibition against bribery was aspirational did not imply that company's officers did not engage in bribery, noting "[t]here is an important difference between a company's announcing rules forbidding bribery and its factually representing that no officer has engaged in such forbidden conduct").

200. Das v. Rio Tinto PLC, 332 F. Supp. 3d 786, 806–07 (S.D.N.Y. 2018) (noting statements about code of ethics were immaterial); Employees Retirement System of City of Providence v. Embraer S.A., 2018 WL 1725574, at *8 (S.D.N.Y. Mar. 30, 2018) (stating conduct inconsistent with code of ethics was not material since code was aspirational); SEC v. Kovzan, 807 F. Supp. 2d 1024, 1042 (D. Kans. 2011) ("NIC stated only that it had adopted a code, that all employees were required to follow it, and that any waivers would be disclosed on the company's website. NIC did not suggest thereby that there had been no violations or waivers"). As explained by the Second Circuit:

> It is well-established that general statements about reputation, integrity, and

> This is not to say that statements about a company's reputation for integrity or ethical conduct can never give rise to a securities violation. Some statements, in context, may amount to more than "puffery" and may in some circumstances violate the securities laws: for example, a company's specific statements that emphasize its reputation for integrity or ethical conduct as central to its financial condition or that are clearly designed to distinguish the company from other specified companies in the same industry.[201]

In addition to generalized statements likely being viewed as purely aspirational, generalized statements regarding corporate codes are very susceptible to being characterized as vague generalities[202] and puffery[203] rather than material representations of fact.[204] Courts often find statements about a company's code of ethics and accompanying ethical corporate culture to be mere puffery.[205]

> compliance with ethical norms are inactionable puffery, meaning that they are too general to cause a reasonable investor to rely upon them. This is particularly true where . . . statements are explicitly aspirational, with qualifiers such as "aims to," "wants to," and "should."

City of Pontiac Policemen's & Firemen's Retirement System v. UBS AG, 752 F.3d 173, 185 (2d Cir. 2014); In re Vale S.A. Securities Litigation, 2020 WL 2610979 at *10 (E.D.N.Y. 2020). *See also, e.g.,* Kushner v. Beverly Enterprises, Inc., 317 F.3d 820, 831 (8th Cir. 2003) ("Absent a clear allegation that the defendants knew of the scheme and its illegal nature at the time they stated the belief that the company was in compliance with the law, there is nothing further to disclose.").

201. Indiana Public Retirement System v. SAIC, Inc., 818 F.3d 85, 98 (6th Cir. 2016) (holding that the statements in question were too generalized to be material).

202. *See, e.g.,* Rex & Roberta Ling Living Trust U/A December 6, 1990 v. BV Communications, Ltd., 346 F. Supp. 3d 389 (S.D.N.Y. 2018) (noting statements in company's code of ethics were "vague platitudes" and thus not materially misleading).

203. Carvelli v. Ocwen Financial Corp., 934 F.3d 1307 (11th Cir. 2019) (holding statements regarding progress the company was making toward state regulatory compliance were puffery); Barilli v. Sky Solar Holdings, Ltd., 389 F. Supp. 3d 232 (S.D.N.Y. 2019) (holding statements in prospectus regarding company's code of ethics were mere puffery).

204. On the other hand, as noted earlier, the SEC has indicated that management integrity is always likely to be material. In the Matter of Franchard Corp., 423 S.E.C. 163, 172 (1964); *see* the discussion *supra* accompanying note 15. Thus, to the extent that code of ethics or code of conduct discussions implicate management integrity, there is a greater likelihood that they will be deemed material.

205. *See, e.g.,* Singh v. Cigna Corporation, 918 F.3d 57 (2d Cir. 2019) (noting statements in corporation's code of ethics expressing its commitment to regulatory compliance were puffery and could not support securities fraud claims); Sinclair Broadcast Group Securities Litigation, 2020 WL 571724 (D. Md. 2020) ("[S]tatements in corporate codes of conduct can be characterized as inactionable 'puffery': statements of a company's ideals rather than representations of past or present fact."); Barilli v. Sky Solar Holdings, Ltd., 389 F. Supp. 3d 232 (S.D.N.Y. 2019) (holding statements in prospectus regarding company's code of ethics were mere puffery and thus not actionable); Lopez v. CTPartners, 173 F. Supp. 3d 12, 28–29

Forty-five years ago, an SEC official cautioned against defining materiality too broadly:

> Materiality is a concept that will bear virtually any burden; it can justify almost any disclosure; it can be expanded all but limitlessly. But we must constantly bear in mind that overloading it, unduly burdening it, excessively expanding it, may result in significant changes in the role of the Commission, the role of other enforcement agencies, and our ability to carry out our statutory duties.[206]

The concern over an overly broad definition of materiality still resonates today. An overly inclusive approach with respect to codes of ethics would, in essence, punish companies for adopting a code of ethics.[207] Accordingly, the courts must strive for a delicate balance in applying materiality principles without deterring adoption of codes of ethics altogether.

Unfortunately, the uncertainty regarding materiality is palpable, especially since there is inconsistency in the case law. For example, lawsuits have been brought based on claims that omission of sexual harassment or misconduct were material in light of the company's code of ethics. Some claims have been dismissed,[208] while others have survived the materiality

(S.D.N.Y. 2016) (holding statements about the code of ethics and ethical corporate culture were immaterial puffery); Cement & Concrete Workers District Council Pension Fund v. Hewlett Packard Company, 964 F. Supp. 2d 1128 (N.D. Cal. 2013) (Noting CEO's misconduct and firing did not render company's code of ethics which he violated materially misleading). *See also, e.g.,* Gaines v. Haughton, 645 F.2d 761, 779 (9th Cir. 1981) ("[D]irector misconduct of the type traditionally regulated by state corporate law need not be disclosed in proxy solicitations for director elections."); Kooker v. Baker, 2020 WL 6287248 at *4 (D. Del. 2020) (quoting Craftmatic Sec. Litig. v. Kraftsow, 890 F.2d 628, 639 (3d Cir. 1989)) ("[A]llegations of failure to disclose mismanagement alone do not state a claim under federal securities law.").

206. A.A. Sommer, *The Slippery Slope of Materiality*, SEC (Dec. 8, 1975), https://www.sec.gov/news/speech/1975/120875sommer.pdf [https://perma.cc/Y6ZV-HQMU]. *See also, e.g.,* Hester Peirce, *Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures,* quoted *supra* note 149.

207. *See, e.g.,* Ferris v. Wynn Resorts, 2020 WL 2748309 at *14 (D. Nev. 2020) (quoting Andropolis v. Red Robin Gourmet Burgers, Inc., 505 F. Supp. 2d 662, 686 (D. Colo. 2007)) ("[I]t simply cannot be that every time a violation of that code [of conduct] occurs, a company is liable under federal law for having chosen to adopt the code at all, particularly when the adoption of such a code is effectively mandatory.").

208. *See, e.g.,* Retail Wholesale & Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co., 845 F.3d 1268 (9th Cir. 2017) (finding omissions were not material); Oklahoma Law Enforcement Retirement System v. Papa John's International, Inc., 2021 WL 371401 (S.D.N.Y. 2021) (holding that failure to adequately allege company had affirmative duty to disclose information about alleged sexual misconduct).

threshold.[209] Further, allegations of omitting to disclose that the company had a pervasive culture enabling sexual harassment were found immaterial in one case, with the court describing the statements about the code as "quintessential puffery."[210] In contrast, in another case from the same federal district, the court found that similar allegations were capable of being considered materially misleading.[211] If a corporate culture contrary to the code of ethics involves serious misconduct, that misconduct could result in the wrongdoer's dismissal or forced resignation.[212] Regardless of whether a company has a code of ethics, if those wrongdoers are high profile, then nondisclosure of conduct that could lead to their dismissal or resignation could well be a material omission.[213] In other contexts, omission of facts likely to impact a CEO's or other high profile manager's longevity with a company may be recognized as material.[214]

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209. In re Signet Jewelers Ltd. Securities Litigation, 389 F. Supp. 3d 221 (S.D.N.Y. 2019) (denying defendant's motion to dismiss).

210. Oklahoma Law Enforcement Retirement System v. Papa John's International, Inc., 2020 WL 1243808 (S.D.N.Y. Mar. 16, 2020) (holding statements regarding the company's code of ethics were not materially misleading notwithstanding alleged corporate culture enabling sexual harassment). *But cf.* Construction Laborers Pension Trust for Southern California v. CBS Corp., 2020 WL 248729 at *13–*15 (S.D.N.Y. 2020) (holding that although company had no duty to disclose CEO's alleged misconduct as part of its MD&A or risk factors discussion, CEO's statements about the #MeToo movement and specific denials of sexual misconduct were materially misleading in light of his alleged misconduct).

211. In re Signet Jewelers Ltd. Securities Litigation, 389 F. Supp. 3d 221, 226 (S.D.N.Y. 2019) (quoting In re Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 508 (S.D.N.Y.)) (holding that statements in company's code of conduct were not mere puffery with regard to company's alleged pervasive culture of sexual harassment; defendant's motion to dismiss denied; the court noted, "While generalized, open-ended or aspirational statements do not give rise to securities fraud (as mere puffery), statements contained in a code of conduct are actionable where they are directly at odds with the conduct alleged in a complaint").

212. For example, there was a scathing expose in the New York Times about rampant sexual harassment at Victoria's Secret. *See* Jessica Silver-Greenberg, Katherine Rosman, Sapna Maheshwari & James B. Stewart, *"Angels" in Hell: The Culture of Misogyny Inside Victoria's Secret,* N.Y. TIMES (Feb. 1, 2020), https://www.nytimes.com/2020/02/01/business/victorias-secret-razek-harassment.html [https://perma.cc/4K35-4CH2]. Once the news of the company's toxic culture was exposed, the longtime CEO relinquished control. *See* Sapna Maheshwari, *Embattled L Brands Appoints Sarah Nash as Chair,* N.Y. TIMES (Mar. 12, 2020), https://www.nytimes.com/2020/03/12/business/l-brands-sarah-nash-les-wexner.html [https://perma.cc/XT6N-JNVE]; Ed Hammond & Jonathan Roeder, *Wexner Said in Talks to Step Down, Break Up L Brands,* BLOOMBERG LAW (Jan. 29, 2020), https://www.bloomberg.com/news/articles/2020-01-29/victoria-s-secret-owner-jumps-on-report-wexner-may-sell-brand [https://perma.cc/A6ES-YHKG].

213. *Cf.* In the Matter of Franchard Corp., 423 S.E.C. 163 (1964) (stating CEO's pledges of his own stock was material since foreclosure on those pledges could lead to a change in the company's management).

214. For example, the SEC investigated whether Apple's delayed disclosure of Steve Jobs'

Even apart from the company's code of ethics, a toxic corporate culture may provide a basis for shareholder suits. Paralleling the challenges to corporate conduct under the securities laws, a recent tactic of plaintiffs has been to challenge a toxic corporate culture and sexual harassment under state law. For example, in one recent filing, a shareholder sought access to a company's books and records relating to alleged widespread sexual harassment within the company and suspected companion breaches of fiduciary duty.[215] If turned over to the requesting shareholder, the company's books and records might well provide sufficient specific conduct that could form the basis of a securities law claim for material omissions of fact.

Even though ESG disclosures may not be sufficiently material to result in liability for false statements, they do provide investors with important ESG discussion in a company's disclosures. Thus, even though noncompliance in many cases would not result in liability, mandating ESG disclosures by following the pattern currently used for corporate codes of ethics can provide investors with important information without creating significant risks of civil liability for violations. Accordingly, fashioning a similar requirement for companies to disclose the extent of a commitment, if any, to ESG principles would provide useful information without subjecting companies to undue litigation risks. This can be seen as a variation of the "comply or explain" approach to disclosure that has been used by the United Kingdom and other countries in their public reporting requirements.[216]

The existing disclosure requirement relating to codes of ethics addresses only the "G" in ESG and leaves out sustainability issues. Going beyond the existing code of ethics disclosure requirement would be

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cancer violated the securities laws. *See, e.g.,* Staci D. Kramer, *Apple Being Investigated by SEC Over Way Steve Jobs' Health Handled? It Should Be*, CBS NEWS (Jan. 21, 2009), https://www.cbsnews.com/news/apple-being-investigated-by-sec-over-way-jobs-health-handled-it-should-be/ [https://perma.cc/285C-FL7L]. *See also, e.g.,* Susan S. Muck, David A. Bell & Michael S. Dicke, *Best Practices for Disclosing Executive Health Issues*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Jan. 8, 2020), https://corpgov.law.harvard.edu/2020/01/08/best-practices-for-disclosing-executive-health-issues/ [https://perma.cc/BXT6-9SRV].

215. *See* Jeff Montgomery, *Investor Sues Victoria's Secret Parent Over "Toxic Culture,"* LAW 360 (June 4, 2020) https://www.law360.com/delaware/articles/1280141/investor-sues-victoria-s-secret-parent-over-toxic-culture-?nl_pk=d8e8e675-b3ae-488e-b86a-15d04b0b8d13&utm_source=newsletter&utm_medium=email&utm_campaign=delaware [https://perma.cc/S9N3-7Z6D] (seeking corporate records relating to "alleged 'toxic culture' of sexual harassment and intimidation"). The complaint alleges breaches of fiduciary duty by the company's directors and a lack of director independence from the company founder, chairman and CEO.

216. *See, e.g.,* Virginia Harper Ho, *"Comply or Explain" and the Future of Financial Reporting*, 21 LEWIS & CLARK L. REV. 317 (2017) (discussing comply or explain disclosure as it applies to nonfinancial disclosures and urging the U.S. adopt this approach for ESG).

beneficial with respect to ESG disclosures generally. For example, borrowing from the code of ethics disclosure requirement, the SEC could mandate that companies disclose their ESG and social responsibility generally, and to describe the company's approach. Specifically, this could include a statement as to the ways in which the company uses ESG factors or metrics in its decision making.

A stand-alone mandate that companies address ESG more generally would not impose overly burdensome disclosures, nor would it expose companies to undue litigation risk. As is currently the case with code of ethics disclosures, requiring a company to state whether it has ESG policies or guidelines would allow the company to fashion its own approach to ESG consistent with the approach taken by the current voluntary disclosure regime.

5. Proposal for an ESG Safe Harbor Rule to Encourage Voluntary Disclosure

The various proposals for mandatory disclosure that are discussed above have considerable merit. There is no doubt that some form of mandatory disclosure would help improve CSR and ESG disclosures. However, the SEC has been very slow to respond to the supporters calling for mandatory disclosure. Also, as discussed above, crafting a mandated ESG disclosure regime has its detractors and could be problematic in formulating the specifics of the disclosure requirements. Nevertheless, the advocates for mandatory disclosure appear to have the better case. In the event that mandatory disclosure is not on the horizon for the foreseeable future, this article suggests that an effective way to encourage ESG disclosures, short of a disclosure mandate, would be for the SEC to adopt a safe harbor rule. Such an ESG safe harbor rule would be consistent with the securities laws' approach with respect to forward-looking statements and projections.[217] Additionally, having a safe harbor rule in place would be advisable even if mandatory disclosures are adopted. The safe harbor would help mitigate against litigation risks that could otherwise arise out of a mandatory CSR and ESG disclosure regime.

Over the years, the SEC has adopted many interpretative rules. Unlike the SEC rules promulgated pursuant to specific statutory delegation,[218]

217. *See generally* 3 HAZEN *supra* note 51 §§12:71-12:75 (discussing safe harbors and the bespeaks caution doctrine that can minimize liability exposure for forward-looking statements).

218. The SEC's general antifraud prohibition in Rule 10b-5 is one such example. 17 C.F.R. § 1240.10b-5.

interpretative rules do not carry the force of law. Instead, interpretive rules simply reflect the Commission's interpretation of the law created by the statute.[219] A distinct variety of SEC interpretative rules are the safe harbor rules.[220] A safe harbor rule establishes conditions under which the SEC will take the position that the law has been complied with, and therefore will not bring an enforcement action. Compliance with the requirements of a safe harbor rule will thus assure that those who comply are safe from SEC prosecution with regard to the disclosures or transactions in question. The rules are designed to help provide for certainty in planning transactions in order to comply with the applicable securities laws. Safe harbor rules thus provide some certainty for instances in which the statute and case law otherwise could lead to uncertainty. Safe harbor rules have been described as a way to address general principles and provide a degree of objectivity.[221] ESG disclosures arise in a climate where statements of principles and objectivity are welcome. A safe harbor rule premised on good faith and having a reasonable basis for the statements made is not the sole way to comply with the law but rather provides a path to safety. The existence of a safe harbor rule, in turn, encourages transactions that conform to the parameters set out in the rule – in this case, ESG disclosures based on good faith and reasonable basis.

In the 1970s, the SEC made the determination that forward-looking statements can benefit investors.[222] This represented an about-face from the SEC's former position discouraging projections of future economic performance.[223] The change in position on forward-looking statements was triggered in large part by investors' interest in receiving such information,[224]

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219. *See generally* 1 HAZEN *supra* note 51 §§ 1:30-1:33 (discussing various approaches to SEC rulemaking).

220. Examples of SEC safe harbor rules include Rule 144 (exemption for secondary transactions), Rule 147 (exemption for intrastate offerings), Rule 175 (forward-looking statements), and 506 (exemption for offerings by an issuer not involving a public offering), 17 C.F.R. §§ 230.144, 230.147, 230.175, 230.506.

221. Andrew Stumpff Morrison, *Case Law, Systematic Law, and a Very Modest Suggestion*, 35 STATUTE L. REV. 159, 162 (2013). *See also* Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974).

222. *See, e.g.,* Guides for Disclosure of Projections of Future Economic Performance, Exchange Act Release 33-5992, 43 Fed. Reg. 53,246 (Nov. 7, 1978) (detailing the SEC's rationale for favoring forward-looking statements).

223. *See, e.g.,* A.A. Sommer Jr. et al., *New Approaches to Disclosure in Registered Security Offerings,* 28 BUS. LAW. 505, 529–30 (1973) (supporting the SEC's opposition to forward-looking statements).

224. *See, e.g.,* Guides for Disclosure, *supra* note 222; Homer Kripke, *The SEC, The Accountants, Some Myths and Some Realities*, 45 N.Y.U.L. REV. 1151, 1197–99 (1970) (supporting forward-looking statements).

much in the same way investors today support better CSR and ESG disclosures. In response to similar investor interest, the SEC adopted the safe harbor rules to encourage companies to make forward-looking statements.[225] These rules, which have since been codified by Congress,[226] provide that forward-looking statements made in good faith with a reasonable basis will not be actionable.[227]

The rationale for adopting the safe harbor rule was that investors consider forward-looking statements important, and rather than mandate such disclosures, the SEC opted to simply encourage them.[228] An ESG safe harbor could go even further and define specific steps a company can take to insulate their ESG disclosures from litigation risks. For example, in addition to generally protecting ESG disclosures made in good faith and having a reasonable basis, the safe harbor could include some of the steps outlined in the SEC guidelines discussed in the next section. For example, the rule could also include and protect metrics that comply with the terms of existing SEC guidance on metrics and ESG.[229] SEC inclusion of specific guidance in the safe harbor would provide companies with a meaningful roadmap to ESG compliance. This would be preferable to limiting the suggested ESG safe harbor to the general provisions found in the forward-looking statement safe harbor that have been criticized as too general to provide meaningful help to companies crafting forward-looking statements.[230]

Creating a stand-alone ESG safe harbor following the SEC pattern for forward-looking statements would simultaneously provide protection for statements and show the SEC's desire to encourage ESG disclosures. However, this could be somewhat of an illusory protection since the general nature of the rule could still generate litigation over what is a reasonable basis and what constitutes good faith.[231] With respect to safe harbor rules generally, a chief advantage is the ability to combine a statement of general principles with specifically identified means for complying with the rule. As

225. 17 C.F.R. §§ 230.175, 240.3b-6.

226. 15 U.S.C. §§ 77z-2, 78u-5.

227. *Id.*

228. Safe Harbor Rule for Projections, Exchange Act Release No. 33-6084, 44 Fed. Reg. 38,810 (July 2, 1979).

229. *See, e.g.,* Commission Guidance, *supra* note 65 at 4 (setting forth specific recommendations).

230. *See, e.g.,* Allan Horwich, *Cleaning the Murky Safe Harbor for Forward-Looking Statements: An Inquiry into Whether Actual Knowledge of Falsity Precludes the Meaningful Cautionary Statement Defense,* 35 J. CORP. L. 519, 523–34 (2010) (discussing how the generalized safe harbor was supplemented by the more specific protection for forward-looking statements with sufficient cautionary language).

231. The safe harbor for forward-looking statements has been criticized on this basis. *See id.*

pointed out by one observer:

> The safe-harbor formulation is at least potentially a way of combining the opposed advantages of generality and objectivity. . . . At the same time the rule-writer can identify the specific situations expected to arise most frequently, and address them with specifically tailored, objective safe-harbor (or unsafe-harbor) rules. Those objective rules can be written to avoid at least the most foreseeable hard cases associated with objective guidelines ("emergency vehicles on official business are permitted in the park"), and anything falling outside safe-harbor contours can be left to be captured by the standard. The safe and unsafe harbors are analogous to the specific cases – factual scenarios – for which judicial answers have been provided under a caselaw system. Safe-harbor-based rule systems could be regarded as a kind of "synthetic case law;" they are like writing case law in advance, and including it within a systematic law structure.
>
> Safe harbor systems offer the possibility of preserving accessibility without sacrificing either completeness, on one hand, or objective criteria for most fact patterns, on the other.[232]

The goal of combining general principles with specific guidance was accomplished to some extent in the context of securities disclosure when Congress supplemented the reasonable basis and good faith requirements by establishing that sufficient cautionary language can protect forward-looking statements.[233] In the ESG context, a cautionary statement that the goals are aspirational could have the same impact.

Since an increasing number of investors have shown interest in ESG-related disclosures, it would be appropriate for the SEC to adopt some type of safe harbor rule to encourage such disclosures made in good faith and with a reasonable basis. The good faith and reasonable basis requirements would

232. Morrison, *supra* note 221 at 14–15.

233. 15 U.S.C. §§ 77z-2, 78u-5. This is known as the bespeaks caution doctrine that was developed in the case law and then incorporated into the statutory safe harbors. *E.g.,* Carvelli v. Ocwen Fin. Corp., 934 F.3d 1307 (11th Cir. 2019) (holding that sufficient cautionary language precluded securities claim); Paradise Wire & Cable Defined Benefit Pension Plan v. Weil, 918 F.3d 312 (4th Cir. 2019) (holding that extensive specifically tailored cautionary language precluded a finding of materiality). For some of the cases that preceded the statutory safe harbors s*ee, e.g., In re* Worlds of Wonder Securities Litigation, 35 F.3d 1407 (9th Cir. 1994); Kline v. First Western Government Securities, Inc., 24 F.3d 480 (3d Cir. 1994); Rubinstein v. Collins, 20 F.3d 160 (5th Cir. 1994); *In re* Donald J. Trump Casino, 7 F.3d 357 (3d Cir. 1993); Sinay v. Lamson & Sessions Co., 948 F.2d 1037 (6th Cir. 1991). For commentary on the bespeaks caution doctrine, *see, e.g.,* Horwich, *supra* note 78; Jennifer O'Hare, *Good Faith and the Bespeaks Caution Doctrine: It's not Just a State of Mind*, 58 U. PITT. L. REV. 619 (1997).

provide adequate protection against liability for material misstatements. The safe harbor would thus have a significant impact by effectively encouraging disclosures without unduly exposing the company to risks of liability.[234]

As noted above, the securities laws' materiality concept makes meaningful specific guidance difficult. The necessarily vague nature of the SEC guidance, including the guidance specifically addressing ESG and metrics,[235] makes it difficult for companies to have confidence in their ability to draft compliant ESG disclosures. As the sole benchmark for when to discuss, ESG creates challenges in drafting since, with its fact-specific nature, materiality alone provides no real guidance.

The challenges in drafting ESG disclosures warrant implementation of a safe harbor rule along the lines of the one suggested herein. This would encourage such disclosures by limiting the litigation risks associated thereto. It is important to note that while a safe harbor rule limits litigation risk, it does not eliminate the risk completely—nor should it. If a company does not comply with the good faith and reasonable basis components of the suggested rule, then the disclosures should be subject to antifraud scrutiny with respect to material inaccuracies.

The advisability of an ESG-related safe harbor rule is not limited to the current regime under which ESG disclosures are voluntary. As noted earlier, a mandatory disclosure requirement would help eliminate some of the problems that exist in the current voluntary disclosure environment. If the SEC opts for some version of mandatory ESG disclosures, the safe harbor rule suggested herein would be a valuable companion to encourage better disclosures without placing undue burdens on publicly held companies. The difficulty in crafting CSR and ESG disclosures and determining materiality justify a safe harbor rule to mitigate the litigation risks that could arise with the implementation of either a mandatory or voluntary CSR and ESG disclosure regime.

C. Encouraging Voluntary Disclosure with SEC Guidelines

Another approach that could be combined with a safe harbor rule or implemented without one is to continue the current regime under which ESG disclosures are voluntary, with the SEC providing guidance as to the content of ESG disclosures for companies that elect to do so.[236] The SEC has taken

234. *See, e.g.,* Novick et al., *supra* note 128 at 9 (recommending a safe harbor for ESG disclosures).

235. *See* the discussion *infra* in the text accompanying notes 241-243.

236. *See, e.g.,* Keith F. Higgins, et al., *The SEC and Improving Sustainability Reporting*, 29 J. APP. CORP. FIN. 22 (2017) (discussing improving ESG disclosures with improved

some steps in this direction. As noted above, the SEC has encouraged companies to make a materiality assessment with regard to ESG issues.[237] However, due to the fact-based approach for making materiality determinations, the SEC guidance does not offer bright-line instructions.

If the company elects to make CSR and ESG-related disclosures, it must keep materiality considerations in mind. When making voluntary disclosures under the securities laws, the choice is either full disclosure or no disclosure. A company cannot simply pick and choose to disclose the good about its ESG compliance and at the same time ignore inconsistent conduct. As discussed earlier, materiality considerations prevent making a statement and omitting inconsistent material facts.

The ESG guidance given by the SEC clearly encourages companies to make sustainability-related disclosures. For example, in 2019, the SEC issued a memorandum regarding sustainability-related disclosures.[238] Among other things, the SEC explained:

> Disclosures should also be accompanied by a management approach which describes the management of material sustainability issues. This includes explaining how the organization (1) avoids, mitigates, or remediates negative impacts to the economy, environment, and society, and enhances positive ones, and (2) addresses its climate-related issues. The management approach also includes an assessment of material risks and opportunities associated with sustainability, management and oversight of such opportunities and risks at the highest level of the organization and performance assessment, using key performance indicators. These approaches can be in the form of organization policies, commitments, goals and targets, responsibilities, resources, grievance mechanisms as well as processes, projects, programs, and initiatives. See *GRI 103* for more guidance on the management approach.[239]

In 2020, the SEC issued guidance for ESG metrics discussion in connection with MD&A disclosures.[240] This guidance recognizes that there are many approaches to ESG metrics, and thus reinforces the lack of universal standardization in the ESG provider industry. The guidance goes on to suggest that in making ESG disclosures, the company should explain the basis of the metrics used:

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guidance).

237. SEC, *supra* note 94, at 16 (2019).

238. SEC, *supra* note 94, at 16 (2019).

239. SEC, *supra* note 94, at 16 (2019).

240. Commission Guidance, *supra* note 65.

We would generally expect, based on the facts and circumstances, the following disclosures to accompany the metric:

- A clear definition of the metric and how it is calculated;
- A statement indicating the reasons why the metric provides useful information to investors; and
- A statement indicating how management uses the metric in managing or monitoring the performance of the business.

The company should also consider whether there are estimates or assumptions underlying the metric or its calculation, and whether disclosure of such items is necessary for the metric not to be materially misleading.[241]

The SEC's 2020 guidance certainly is helpful for companies electing to make ESG-related disclosures. Further, the SEC's guidance on the use of metrics supports the use of both qualitative and quantitative ESG discussion.[242] The guidance regarding metrics generally indicates that some voluntary ESG disclosures will require both qualitative and quantitative analysis.[243] The SEC also reminds companies of the general requirement for disclosures that mandate a company have a system in place that establishes effective controls to assure accuracy in disclosure.[244] The SEC further

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241. Commission Guidance, *supra* note 65at 4. *See, e.g.,* Lee T. Barnham, Donna Mussio & Mary Beth Houloihan, *Potential Impact of New SEC Guidance on Performance Metrics on Disclosure of ESG Metrics*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Mar. 6, 2020), https://corpgov.law.harvard.edu/2020/03/06/potential-impact-of-new-sec-guidance-on-performance-metrics-on-disclosure-of-esg-metrics/ [https://perma.cc/Y3K8-EZUT] ("The Metrics Guidance provides that public companies disclosing metrics (whether financial or non-financial) in MD&A should consider whether additional disclosure is necessary to ensure that such metrics are not misleading, and further reminds companies to maintain disclosure controls and procedures with respect to such metrics. Although public reporting companies typically disclose environmental, social and governance ("ESG") metrics in voluntary sustainability reports, some companies also disclose certain key ESG data in their Exchange Act filings. Companies that choose to disclose such ESG performance data in their MD&A should be mindful of the Metrics Guidance going forward.").

242. Commission Guidance *supra* note 65 at 3 n.7 ("The company should provide a narrative that enables investors to see a company 'through the eyes of management,' so these metrics should not deviate materially from metrics used to manage operations or make strategic decisions.").

243. *See, e.g.,* Lee Barnum, Donna Mussio & Mary Beth Houilihan, *Will the New SEC Guidance on Performance Metrics Impact Disclosure of ESG Metrics*, 24 WALL. ST. LAW. 9, 11 (Mar. 2020) ("While the Metrics Guidance addresses ESG metrics only via footnote, it is consistent with the recommendations in certain voluntary sustainability frameworks that require both qualitative and quantitative disclosure associated with ESG metrics.").

244. The SEC generally requires companies to have procedures and controls in place to assure compliance with the securities laws' disclosure requirements. *See* Rules 13a-15; Rule 15d-15, 17 C.F.R. §§ 240.13a-15, 240.15d-15. As explained by the SEC:

> Pursuant to Exchange Act Rules 13a-15 and 15d-15, a company's principal executive officer and principal financial officer must make certifications

emphasizes that this is especially important for both generalized CSR and more metrics-driven ESG-related disclosures.[245]

Some of the SEC's earlier guidance is quite lengthy, making it more difficult to identify specific guidance for companies when drafting their ESG disclosures.[246] Over ten years ago, the SEC issued guidance on climate change disclosures which, among other things, noted that climate change issues could become a known trend or uncertainty that would trigger an MD&A discussion.[247] That interpretative release also highlighted the difficulty of making materiality determinations in this regard.[248] Additional specific SEC guidance would be welcome. In fact, one SEC Commissioner criticized the Commission for not making more strides in trying to improve climate change disclosures.[249]

Presumably, companies that follow SEC guidelines will, to some extent, minimize litigation risks that are tied to ESG. However, the adherence to SEC guidelines does not provide the more reliable protection that would follow by incorporating the disclosure guidelines into a safe

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> regarding the maintenance and effectiveness of disclosure controls and procedures. These rules define "disclosure controls and procedures" as those controls and procedures designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is (1) "recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms," and (2) "accumulated and communicated to the company's management . . . as appropriate to allow timely decisions regarding required disclosure."

Commission Guidance, *supra* note 65, at 5 n. 12.

245. Commission Guidance, *supra* note 65, at 5 ("Effective controls and procedures are important when disclosing material key performance indicators or metrics that are derived from the company's own information. When key performance indicators and metrics are material to an investment or voting decision, the company should consider whether it has effective controls and procedures in place to process information related to the disclosure of such items to ensure consistency as well as accuracy.").

246. For example, SEC, *supra* note 94 contains useful information but is 47 pages long.

247. Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 163.

248. Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 163, at 17–18.

249. Statement of Allison Herren Lee, Commissioner, Sec. and Exch. Comm'n, "Modernizing" Regulation S-K: Ignoring the Elephant in the Room (Jan. 30, 2020), https://www.sec.gov/news/public-statement/lee-mda-2020-01-30 [https://perma.cc/3VNE-XABK] ("The Commission last addressed climate change disclosure in 2010. In that guidance we identified four existing items in Regulation S-K that may require disclosure related to climate change: description of business, legal proceedings, risk factors, and management's discussion and analysis of financial condition and results of operations, or MD&A. We have now proposed to "modernize" every one of these four items without mentioning climate change or even asking a single question about its relevance to these disclosures.") (footnote omitted).

harbor rule. As discussed in the previous section of this article, it would be even more helpful if the SEC were to incorporate these guidelines into a safe harbor rule.

The most recent SEC developments impacting ESG disclosures can be found in its recent amendments to Regulation S-K's disclosure requirements.[250] For example, companies must make disclosures relating to the workplace environment and human capital that are material to investors. Unfortunately, while highlighting the work environment, the disclosure mandate is based on the amorphous materiality threshold, instead of taking a more proactive approach to encouraging disclosures relating to the S in ESG.

VIII. CONCLUSION

The SEC's existing disclosure requirements for issues relating to environmental, social, and governance considerations provide investors with some useful information. However, the existing required disclosures do not provide the more holistic approach to ESG issues that investors want. The increasing investor interest in ESG disclosures is undeniable. Publicly held companies in the U.S. are continuing to face increased pressure to make meaningful ESG disclosures and there is no indication that this momentum is likely to subside. ESG disclosures, including metrics, can be problematic in large part due to the unpredictable nature of identifying materiality. The current landscape consists of voluntary ESG disclosures and the SEC has issued some guidance for companies in framing these disclosures. However, the efforts to date do not go far enough. The SEC announced plans to increase its focus on climate-related disclosures.[251] This increased SEC focus on ESG should consider the recommendations made in this article in general, and in particular, the adoption of a safe harbor rule to further encourage ESG disclosures.

The SEC should do more to encourage meaningful ESG disclosures. A key component to encouraging companies to make ESG disclosures is the safe harbor rule suggested by this article. Many observers believe that the

250. *See* Modernization of Regulation S-K Items 101, 103, and 105, Exchange Act Release Nos. 33-10825; 34-89670, 2020 WL 5076727 (Aug. 26, 2020) (implementing a principles-based approach to various disclosure requirements).

251. *See, e.g., Statement of Acting SEC Chair Allison Herren Lee on the Review of Climate-Related Disclosure,* https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure [https://perma.cc/QMN6-8Y6D] (Feb. 24, 2021) (directing the Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings).

SEC should go further and mandate ESG disclosure. This article has analyzed various approaches to mandatory disclosure. One approach discussed above is an ESG discussion and analysis approach similar to the MD&A requirement. Another approach would be to follow the pattern that is used for corporate codes of ethics and require companies to disclose whether they have ESG policies, and if so, what they are. Both of these seem to be viable approaches if the SEC elects to pursue mandatory disclosures, as many have called for.

The foregoing analysis identifies and explains a number of ways in which the SEC could enhance CSR and ESG disclosures. This article supports the suggestions mentioned above that would encourage or require CSR and ESG disclosures. However, as discussed earlier, there are arguments against requiring ESG disclosures rather than continuing the current system of the SEC encouraging voluntary disclosure. Regardless of whether the SEC institutes some form of mandatory CSR and ESG disclosure, it should strengthen its encouragement of voluntary disclosures. One way to do this would be to provide more guidance as to how to improve and standardize ESG disclosures. This article recommends that regardless of whether the SEC adopts some form of mandatory disclosures or takes other steps to encourage more meaningful voluntary disclosure, the SEC should adopt a safe harbor rule. As suggested herein, the safe harbor rule would minimize litigation risk from ESG disclosures by providing that no liability would result from ESG-related disclosures made in good faith and having a reasonable basis.

A safe harbor rule would promote meaningful ESG disclosure while minimizing, but not eliminating, liability risks resulting from deficient disclosures. In the event the SEC is persuaded to adopt mandatory CSR and ESG disclosures, a safe harbor rule will provide protection against undue litigation risk resulting from those disclosures. Consequently, whether as the sole response or as a supplement to other SEC initiatives, the SEC should adopt a safe harbor rule for CSR and ESG disclosures.