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A RESPONSE TO CALLS FOR SEC-MANDATED ESG DISCLOSURE

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ABSTRACT

This Article responds to recent proposals calling for the SEC to adopt a mandatory ESG-disclosure framework. It illustrates how the breadth and vagueness of these proposals obscures the important—and controversial—policy questions that would need to be addressed before the SEC could move forward on the proposals in a principled way. The questions raised include some of the most contested in the field of corporate and securities law, such as the value of interjurisdictional competition for corporate charters, the right way to conceptualize the purpose of the corporation, the proper allocation of managerial power as between the board and shareholders, and the social desirability of fraud-on-the-market class actions.

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INTRODUCTION

The acronym "ESG" is used as shorthand for a dizzyingly broad array of "environmental," "social," and "governance" topics affecting businesses. The topics spanned include climate change, human capital management, supply chain management, human rights, cybersecurity, diversity and inclusion, corporate tax policy, corporate political spending, executive compensation practices, and more.[1] Members of the ESG movement are similarly diverse, in both identity and motivation. They include financially motivated investors and traditional asset managers who believe companies' approach to (at least certain) ESG topics will bear on the companies' long-term performance, or the long-term performance of the investors' or asset managers' broader investment portfolios.[2] They also include values-based investors who care about whether, and how, corporations address (at least

1. *See, e.g.*, Stavros Gadinis & Amelia Miazad, *Corporate Law & Social Risk*, 73 VAND. L. REV. 1401, 1414–15 (2020) (listing within "ESG's wide scope" issues related to privacy, climate change, diversity, workplace relationships, including gender equality and diversity, technology problems like privacy and cybersecurity, and supply chain challenges like humane work conditions, and observing that "ESG's scope expands by the day with new concerns vying for corporate attention, like the use of sugar in packaged foods or children and screen time"); INV. CO. INST., INVESTMENT COMPANY FACT BOOK: A REVIEW OF TRENDS AND ACTIVITIES IN THE INVESTMENT COMPANY INDUSTRY 50 (2020), https://www.ici.org/pdf/2020_factbook.pdf [https://perma.cc/HLZ5-ZN8Q] (observing that ESG "matters vary widely, but are generally considered to include topics related to climate change, diversity and inclusion, human rights, the rights of company shareholders, and companies' compensation structures"). Sometimes the equally broad terms "sustainability" and "non-financial disclosure" are used synonymously to refer to this collection of topics.

2. *See, e.g.*, Larry Fink, *Larry Fink's 2020 Letter to CEOs: A Fundamental Reshaping of Finance*, BLACKROCK (2020) https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter [https://perma.cc/S6JM-YKQW] (stating that BlackRock's "investment conviction is that sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors"); John C. Coffee, *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk* (Eur. Corp. Governance Inst., Working Paper No. 541, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3678197 [https://perma.cc/TD8Q-PWDP] (linking interest in ESG disclosure by managers of diversified index funds to a desire to reduce systematic risk); Jeffrey N. Gordon, *Systemic Stewardship* (Columbia Law and Economics Working Paper No. 640, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3782814 (arguing that index funds' approach to ESG matters can serve the interests of their investors by reducing systematic risk).

certain) ESG topics due to religious or sociopolitical commitments.[3] The ESG umbrella also shelters various non-investor corporate stakeholders and third parties who care about whether, and how, corporations address (at least certain) ESG topics because they are personally affected (e.g., employees vis-à-vis labor practices) or due to religious or sociopolitical commitments (e.g., environmentalists vis-à-vis environmental impact).[4] ESG proponents also include members of an emerging corps of people and institutions who profit from the movement, including corporate sustainability officers,[5] providers of ESG ratings and indices,[6] accounting firms that offer ESG-related services,[7] and managers of specialized ESG-investment vehicles.[8]

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3. Of the 511 funds that the Investment Company Institute categorizes as investing according to ESG criteria in its 2020 Fact Book ("ESG funds"), 141 (28%) fall within the "religious values focus" subcategory. *See* INV. CO. INST., *supra* note 1, at 52. This subcategory represents $104.6 billion (33%) of the $321.3 billion in total net assets managed by ESG funds identified by the Investment Company Institute as of December 2019. *Id*.

4. The ESG movement in this regard is also contributing to the recently reinvigorated debate over corporate purpose. For an attempt to bring greater clarity to that debate, see Edward Rock, *For Whom Is the Corporation Managed in 2020: The Debate over Corporate Purpose* (Eur. Corp. Governance Inst., Working Paper No. 515, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3589951 [https://perma.cc/F5ZF-7Q3U].

5. *See* Kathleen Miller Perkins & George Serafeim, *Chief Sustainability Officers: Who Are They and What Do They Do?*, *in* LEADING SUSTAINABLE CHANGE: AN ORGANIZATIONAL PERSPECTIVE 196, 196–97 (Rebecca Henderson, Ranjay Gulati & Michael Tushman eds., 2015) (noting that "[o]ne recent trend has been the increasing appointment of Chief Sustainability Officers (CSOs) to drive the formulation and execution of an organization's sustainability strategy" and that the "number of CSOs has grown substantially over the past few years").

6. *See* 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, 387 (2020) (observing that "[h]undreds of commercial ESG indices provide ESG ratings of individual companies"); Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1992 (2020) (observing that "[r]ising interest in ESG investing has [] generated a huge market opportunity for the providers of ESG indices and metrics, who are [] capitalizing on this key moment").

7. For examples of ESG-related service offerings by the "Big Four" accounting firms, see *ESG Reporting: It's Vital to How You Tell Your Company's Story*, PRICEWATERHOUSECOOPERS, https://www.pwc.com/us/en/services/audit-assurance/esg-reporting.html [https://perma.cc/CHV4-QEPX]; *ESG Investor Relations Services*, KPMG, https://home.kpmg/xx/en/home/services/advisory/risk-consulting/internal-audit-risk/sustainability-services/esg-investor-relations-services.html [https://perma.cc/Q8YG-EA25]; *Climate Change and Sustainability Services*, ERNST & YOUNG, https://www.ey.com/en_gl/climate-change-sustainability-services [https://perma.cc/6AZ5-D3QS]; *Climate & Sustainability: Guiding Organizations to a More Sustainable Future*, DELOITTE, https://www2.deloitte.com/global/en/covid-19/climate---sustainability.html/?icid=wn_climate---sustainability [https://perma.cc/ENR6-MF5V].

8. According to Morningstar, the ESG/sustainable funds universe grew to 303 open-end and exchange-traded funds in 2019, consisting of three broad types: "ESG Focus," "Impact/Thematic," and "Sustainable Sector." *See* MORNINGSTAR, SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT 2 (2020). At the same time, the number of conventional funds that now say they "consider" ESG factors has grown to 564 funds from 81 in 2018. *See id.* The 564 "ESG Consideration" funds had $933 billion in assets under management at the end of 2019. *See id.* at 6. Using a different classification methodology, the Investment Company Institute reports that, as of December 2019, there were 511 funds that invest according to ESG criteria with a total of $321.3 billion in assets under management. *See* INV. CO. INST., *supra* note 1, at 52.

Even the Business Roundtable, an association of chief executive officers of leading U.S. corporations, seemingly embraced ESG in its 2019 Statement on the Purpose of the Corporation,[9] though some suspect its motivations have more to do with public relations or a desire to protect executives from shareholder discipline than a true commitment to ESG.[10] The stated motivations of others involved in the movement can also be questioned. Traditional asset managers claim their commitment to ESG is motivated by a desire to improve long-term fund performance for the benefit of investors.[11] But agency costs offer an alternative potential explanation: embracing the ESG movement may help asset managers curry political favor, enabling them to fend off greater regulation of the industry;[12] it may

9. *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE (Aug. 19, 2019), https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-Feburary-2021-compressed.pdf [https://perma.cc/XUT6-HRYL].

10. *See, e.g.*, *Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose*, COUNCIL OF INSTITUTIONAL INVS. (Aug. 19, 2019), https://www.cii.org/aug19_brt_response [https://perma.cc/48X9-PFZ8] (warning that "'stakeholder governance' and 'sustainability'" may become "hiding places for poor management"); Editorial, *The 'Stakeholder' CEOs*, WALL ST. J. (Aug. 19, 2019, 5:09 PM), https://www.wsj.com/articles/the-stakeholder-ceos-11566248641 (observing that there is "more than a whiff of pre-emptive politics" in the Business Roundtable's statement and warning that "[a]n ill-defined stakeholder model can quickly become a license for CEOs to waste capital on projects that might make them local or political heroes but ill-serve those same stakeholders if the business falters"); Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 98 (2020) (arguing that the statement is "largely . . . a rhetorical public relations move, rather than the harbinger of meaningful change"); *see also* Elizabeth Demers, Jurian Hendrikse, Philip Joos & Baruch Lev, *ESG Didn't Immunize Stocks Against the COVID-19 Market Crash, but Investments in Intangible Assets Did*, J. BUS. FIN. & ACCT. (forthcoming 2021) (manuscript at 7), https://ssrn.com/abstract=3675920 [https://perma.cc/996E-XR5A] (noting that an "alternative view on corporate ESG investments derives from agency theory," and explaining that this "more skeptical perspective suggests that executives may choose to improve their compan[ies'] ESG scores at the expense of shareholders in order to build their own personal reputations").

11. *See, e.g.*, Fink, *supra* note 2; Ron O'Hanley, *Investor Focus on Sustainability Is About Managing Risk*, STATE ST. (Feb. 2020), https://www.statestreet.com/ideas/articles/investor-focus-on-sustainability-is-about-managing-risk.html [https://perma.cc/M89R-J2HG] ("Sustainable investing is about value, not values . . . .").

12. The embrace of ESG by large asset managers has occurred during a time of increasing public concern regarding the outsized power these managers have over the economy. *See, e.g.*, David McLaughlin & Annie Massa, *The Hidden Dangers of the Great Index Fund Takeover*, BLOOMBERG BUSINESSWEEK (Jan. 9, 2020, 12:40 PM), https://www.bloomberg.com/news/features/2020-01-09/the-hidden-dangers-of-the-great-index-fund-takeover (observing that the biggest three asset managers, BlackRock, Vanguard, and State Street, are "potentially the most powerful force over a huge swath of America Inc." and that "[a]larm bells have begun to go off with some regulators, as well as with an ideologically diverse array of academics and activists"); Matt Egan, *BlackRock and the $15 Trillion Fund Industry Should Be Broken Up, Antimonopoly Group Says*, CNN BUS. (Nov. 24, 2020, 1:25 PM), https://www.cnn.com/2020/11/24/business/blackrock-vanguard-state-street-biden/index.html [https://perma.cc/MKY8-75JM] (reporting that "[c]ritics say BlackRock (BLK), Vanguard and State Street (STT) have become too powerful and that the Biden administration and Congress need to rein them in"); John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* 19–23 (Harv. L. Sch., Working Paper No. 19-07, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337 [https:/

advance the personal sociopolitical commitments of those who run them;[13] or it may offer a way to attract investors to fund offerings without imposing any meaningful limitations on how a fund is managed.[14]

The breadth of topics embraced by ESG, and the breadth of motivations spurring the ESG movement, has created a big tent that has undoubtedly served a purpose in terms of helping the various causes of those involved to gain momentum. But it has also created problems. For example, ESG performance ratings are inconsistent and difficult to decipher. Which of the myriad ESG issues are factored into a rating, how performance on those issues is measured, and the weight each issue is given are subjective, usually non-transparent determinations that vary across ratings providers.[15] The breadth of ESG topics also makes studies that purport to show a positive link between ESG performance and financial performance difficult to interpret. There is no *a priori* reason to believe that a company's approach to climate change and a company's approach to diversity or any other ESG issue will have the same sort of impact on a company's financial performance; yet these studies often bundle ESG issues together to measure ESG performance or rely on ESG performance ratings that themselves bundle the issues together. They therefore leave unanswered which, if any,

/perma.cc/6EBR-WEPZ] (outlining various potential policy responses to the "legitimacy and accountability challenge" posed by the concentration of power "in the hands of a dozen or fewer people" at the largest asset managers).

13. *See, e.g.*, Jill E. Fisch, *The Uncertain Stewardship Potential of Index Funds* 117–18, *in* GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES (Dionysia Katelouzou & Dan W. Puchniak eds., Cambridge University Press, forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3525355 (observing that the heads of institutional intermediaries may use their position to advance their personal policy preferences).

14. *See* Reiser & Tucker, *supra* note 6, at 1992 (discussing the "[d]iverse supply side forces" that "drive ESG asset growth and contribute to ESG market heterogeneity and opacity"); *see also* Michal Barzuza, Quinn Curtis & David H. Weber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020) (arguing that index fund managers' interest in ESG is motivated by a desire to court investment by socially-conscious millennials rather than a concern for shareholder value); *see also* Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, COLUM. BUS. L. REV. (forthcoming) (manuscript 15–18), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3809914 (describing the agency costs in both public and private funds that may cause them to embrace ESG).

15. *See, e.g.*, Rajna Gibson, Philipp Krueger & Peter Steffen Schmidt, *ESG Rating Disagreement and Stock Returns* 5–8 (Swiss Fin. Inst., Working Paper No. 19-67, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3433728 [https://perma.cc/YG4W-Y4WQ] (explaining that, "[g]iven the complexity of measuring a firm's non-financial or ESG performance, the validity of these ratings has been debated critically" and providing an overview of the literature on ESG ratings divergence); *see also* James Mackintosh, *Is Tesla or Exxon More Sustainable? It Depends Whom You Ask*, WALL ST. J. (Sept. 17, 2018, 11:58 AM), https://www.wsj.com/articles/is-tesla-or-exxon-more-sustainable-it-depends-whom-you-ask-1537199931 (explaining how the same company's ESG score can vary widely depending on the methodology employed by the ESG rating provider and observing that ESG ratings "are no more than a series of judgments by the scoring companies about what matters – and investors who blindly follow their scores are buying into those opinions, mostly without even knowing what they are").

discrete corporate policies related to ESG actually impact financial performance.[16]

Regulators have also pointed out problems with use of the term "ESG." SEC officials have expressed concerns regarding its use in mutual fund advertising, because its vagueness can leave fund investors with misimpressions regarding what exactly they are buying into.[17] Rule changes may follow.[18] The Department of Labor (DOL) cited a lack of clarity regarding the goals of ESG investment funds as a basis for a recent rule

16. *See* Magali A. Delmas, Dror Etzion & Nicholas Nairn-Birch, *Triangulating Environmental Performance: What Do Corporate Social Responsibility Ratings Really Capture?*, 27 ACAD. MGMT. PERSPS. 255, 256 (2013) (observing that "while there appears to be agreement that environmental and social performance is multidimensional and that the strength of the relationship between each dimension and financial performance may vary, there is little consensus in the literature on what each dimension represents and thus what corporate social responsibility ratings actually measure"); Jon Entine, *The Myth of Social Investing: A Critique of Its Practice and Consequences for Corporate Social Rerformance Research*, 16 ORG. & ENV'T 352, 354–56 (2003) (critiquing a popular rating used by academic researchers of corporate social performance (CSP) as "hopelessly flawed" and observing that "[a]lthough there is general agreement that CSP is a multidimensional construct, there are no agreed-on standards or theoretical rationale or way to aggregate and therefore compare multiple dimensions across or within industries"); *see also* Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L. J. 407, 419 (2018) (reviewing the empirical literature supporting the materiality of ESG information and noting that the literature "shows that the financial materiality of many specific ESG indicators varies by industry sector" and that "large-scale studies do not answer the question of *which* ESG indicators are material to a particular firm's investors") (emphasis added). Some posit that corporations that embrace ESG activities can build social capital and trust, positioning the firm to better weather periods of crises, see, e.g., Paul C. Godfrey, Craig B. Merrill & Jared M. Hansen, *The Relationship Between Corporate Social Responsibility and Shareholder Value: An Empirical Test of the Risk Management Hypothesis*, 30 STRATEGIC MGMT. J. 425 (2009), or that the engagement with stakeholders that ESG activities promote may help surface risks leading to better risk management practices, see, e.g., Gadinis & Miazad, *supra* note 1. These claims are empirically contested, see, e.g., Demers, et al., *supra* note 10, and like more general assertions that ESG contributes to better firm financial performance, they leave unanswered just *which* of the myriad activities that fall under the ESG heading lead to the hypothesized effects.

17. *See* Elad L. Roisman, Comm'r, SEC, 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/A5YV-8ZL5]; Juliet Chung & Dave Michaels, *ESG Funds Draw SEC Scrutiny*, WALL ST. J. (Dec. 16, 2019, 7:05 AM), https://www.wsj.com/articles/esg-funds-draw-sec-scrutiny-11576492201; Pippa Stevens, *'Fooling Ourselves' to Focus on 'Amorphous' Social Investing Factors, Says SEC Commissioner Peirce*, CNBC (Dec. 17, 2019, 3:49 PM), https://www.cnbc.com/2019/12/17/sec-commissioner-hester-peirce-calls-for-oversight-of-esg-funds.html [https://perma.cc/3XEQ-2T7W]. Recent empirical work by Professors Dana Brakman Reiser & Anne Tucker substantiates these concerns. *See* Brakman Reiser & Tucker, *supra* note 6, at 1927 (concluding that "the ESG label acts more as a product signal and branding mechanism than it does a promise of a specific investment strategy or avoided externalities"). *See also* SEC, Division of Examinations, *Risk Alert: The Division of Examinations Review of ESG Investing* (April 9, 2021), https://www.sec.gov/files/esg-risk-alert.pdf (highlighting deficiencies and internal control weaknesses identified during examinations of advisers and funds related to ESG investing).

18. *See, e.g.*, Request for Comments on Fund Names, 85 Fed. Reg. 13221, 13222–25 (March 6, 2020); *see also* Andrew Ramonas, *Asset Managers Need More ESG Vote Transparency, SEC's Lee Says*, BLOOMBERG LAW (March 17, 2021) (reporting on then-acting SEC Chair Allison Lee's comment that the SEC should update rules and guidance on disclosures related to asset managers' ESG voting records).

proposal that would have clarified that ERISA plan fiduciaries cannot offer or invest in a fund if the fund's strategy allows it to prioritize non-economic ESG benefits or risks at the expense of financial returns.[19] The proposed rule was severely criticized by ESG proponents, who contended that it would discourage ESG investing.[20] The final rule, issued late last year, continues to require that ERISA plan fiduciaries focus only on pecuniary factors when making investment decisions, but removed any specific references to "ESG."[21] In the preamble to the final rule, the DOL explained that "'ESG' terminology, although used in common parlance when discussing investments and investment strategies, is not a clear or helpful lexicon for a regulatory standard."[22] The DOL found fault with the term in part because "by conflating unrelated environmental, social, and corporate governance factors into a single term, ESG invites a less than appropriately rigorous analytical approach in evaluating whether any given E, S, or G consideration presents a material business risk or opportunity to a company that corporate officers and directors should manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations in evaluating an investment in that company."[23]

In this Article I address one manifestation of what we might call the "ESG fuzziness problem." The SEC has recently come under pressure to mandate ESG disclosures by public companies in their SEC filings, and a recent House bill would require it to do so.[24] Although a large percentage of public companies voluntarily disclose ESG-related information in stand-alone sustainability reports,[25] they utilize divergent frameworks developed by private standard-setters, and the disclosures may not be produced in the same careful manner as disclosures in SEC filings. Proponents of an SEC-mandated ESG disclosure regime argue it would enhance investors' ability

19. *See* Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39113, 39114 (proposed June 30, 2020). The proposed rule also highlighted the documentation requirements an ERISA plan fiduciary must comply with if they choose an ESG investment under the "all things being equal" test, which allows ERISA fiduciaries to select an investment on non-pecuniary grounds if it is economically indistinguishable from alternatives. For discussions of how ERISA affects ESG investing by fund trustees, see Schanzenbach & Sitkoff, *supra* note 6, at 404–11, and Coffee, *supra* note 2, at 22–34.

20. *See, e.g.*, John Sullivan, *Dem Senators Oppose DOL's ESG Investing Rule*, 401K SPECIALIST MAG. (July 16, 2020), https://401kspecialistmag.com/dem-senators-oppose-dols-esg-investing-rule/ [https://perma.cc/K79W-ZM4V].

21. *See* Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72,846 (Nov. 13. 2020) (codified at 28 C.F.R. § 2550.404a-1 (2020)).

22. *Id.* at 72,857.

23. *Id.*

24. *See infra* Part I.

25. *See generally* KPMG, THE TIME HAS COME: THE KPMG SURVEY OF SUSTAINABILITY REPORTING 2020 (2020), https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf [https://perma.cc/JH69-4747].

to compare companies on ESG dimensions, combat the problem of selective ESG disclosure (also known as "greenwashing"), and improve the quality of ESG disclosures.[26] I offer no opinion as to whether the SEC *ought* to mandate disclosure of information related to any particular ESG topic, or whether it should—as recent proposals advocate—adopt a mandatory ESG disclosure framework. My purpose, rather, is to illustrate how the breadth and vagueness of the recent proposals obscure the important—and controversial—policy questions that would need to be addressed before the SEC could move forward on the proposals in a principled way. The questions raised include some of the most contested in the field of corporate and securities law, such as the value of interjurisdictional competition for corporate charters, the right way to conceptualize the purpose of the corporation, the proper allocation of managerial power as between the board and shareholders, and the social desirability of fraud-on-the-market class actions.

I. RECENT CALLS FOR SEC-MANDATED ESG DISCLOSURE

On April 15, 2016, the SEC issued a concept release seeking input on whether the disclosure requirements in Regulation S-K elicit the information that investors need for investment and voting decisions, how registrants can most effectively present the information, and the costs and benefits of disclosure requirements for companies and investors.[27] Some of the questions that the SEC sought feedback on concerned "the importance of sustainability and public policy matters to informed investment and voting decisions."[28] The release explained that the Commission "has determined in the past that disclosure relating to environmental and other matters of social concern should not be required of all registrants unless appropriate to further a specific congressional mandate or unless, under the particular facts and circumstances, such matters are material."[29] It thus asked that commentators provide "feedback on which, if any, sustainability and public policy disclosures are important to an understanding of a registrant's business and financial condition and whether there are other

26. *See infra* Part I.

27. *See* Press Release, SEC, SEC Solicits Public Comment on Business and Financial Disclosure Requirements in Regulation S-K (April 15, 2016), https://www.sec.gov/news/pressrelease/2016-70.html [https://perma.cc/AAA7-WGTD]. This was part of a broader initiative by the SEC's Division of Corporation Finance to review the disclosure requirements applicable to public companies.

28. Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,970 (Apr. 22, 2016).

29. *Id.* (referencing Environmental and Social Disclosure, 40 Fed. Reg. 51,656 (Nov. 6, 1975)); *see also id.* at 23,971–72 (discussing the SEC's past approach to social and environmental disclosure).

considerations that make these disclosures important to investment and voting decisions," as well as the "potential challenges and costs associated with compiling and disclosing this information."[30] The Concept Release elicited over 25,000 comments.[31] According to one review, 348 of those comments were unique while the rest were form comments solicited in response to public interest campaigns run by Public Citizen and Americans for Tax Fairness.[32] Professor Harper Ho reports that "[t]he vast majority of the public comments to the Concept Release focused to some extent and often exclusively on ESG disclosure issues."[33] Many commentators expressed support for ESG disclosure reform.[34]

On October 1, 2018, Professors Cynthia Williams and Jill Fisch served the SEC with a formal petition for rulemaking on ESG disclosure.[35] The petition, which was "signed by investors and associated organizations representing more than $5 trillion in assets under management," argues that the "response to the Concept Release strongly suggests that it is time for the Commission to engage in a rulemaking process to develop a framework for public reporting companies to use to disclose specific, much higher-quality ESG information than is currently being produced pursuant either to voluntary initiatives or current SEC requirements."[36] The petition does not define what "ESG information" is, although it references specific examples such as climate change, political spending, gender pay ratios, human rights, and tax disclosure.[37] Nor does it claim that all such information is financially material, instead citing studies that purportedly confirm "the financial materiality of *much* ESG information."[38] Neither the petition nor the underlying studies cited specify which subset of ESG information is

30. *Id.* at 23,970; *see also id.* at 23,971 (listing specific requests for comment).

31. *See* SEC, Comments on Concept Release: Business and Financial Disclosure Required by Regulation S-K, https://www.sec.gov/comments/s7-06-16/s70616.htm [https://perma.cc/4U38-Y39C].

32. TYLER GELLASCH, TOWARDS A SUSTAINABLE ECONOMY: A REVIEW OF COMMENTS TO THE SEC'S DISCLOSURE EFFECTIVENESS CONCEPT RELEASE 15 (2016), https://www.ussif.org/Files/Public_Policy/Comment_Letters/Sustainable_Economy_Report.pdf [https://perma.cc/H9ED-DVPU].

33. Virginia Harper Ho, *Disclosure Overload? Lessons for Risk Disclosure & ESG Reform from the Regulation S-K Concept Release*, 65 VILL. L. REV. 67, 77 (2020).

34. *See* SUSTAINABILITY ACCT. STANDARDS BD., THE STATE OF DISCLOSURE 2016: AN ANALYSIS OF THE EFFECTIVENESS OF SUSTAINABILITY DISCLOSURE IN SEC FILINGS 4 (2016), https://www.sasb.org/knowledge-hub/state-of-disclosure-2016/ [https://perma.cc/87LN-MS5C] (reporting that two-thirds of non-form comment letters received addressed sustainability-related concerns and that eighty percent of those called for improved disclosure of sustainability-related information in SEC filings). For an in-depth analysis of these comments, see Harper Ho, *supra* note 33.

35. Request for Rulemaking from Cynthia A. Williams & Jill E. Fisch to Brent J. Fields, Sec'y, SEC (Oct. 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf [https://perma.cc/E6FP-TRBE].

36. *Id.* at cover letter, 2.

37. *See generally id.*

38. *Id.* at 6 (emphasis added).

financially material. The petition argues, however, that the level of interest investors have expressed in ESG supports the conclusion that ESG information is material.[39] Voluntary ESG disclosure is inadequate to meet investor demands for this information, the petition explains, due to its poor quality and variability, which prohibits comparability across companies.[40] The petition therefore requests that the SEC "initiate rulemaking to develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful environmental, social, and governance information."[41] The petition notes that a number of "promising" ESG disclosure frameworks have already been developed by private standard setters, but does not endorse any particular one.[42]

On May 21, 2020, the SEC Investment Advisory Committee (IAC) similarly recommended that the SEC embark on an initiative to develop "an ESG disclosure framework," explaining that the "message that we have heard consistently is that investors consider certain ESG information material" and that, "despite a plethora of data, there is a lack of material, comparable, consistent [ESG] information available." [43] The recommendation defines ESG "as a broad set of subjects germane to businesses as highlighted by The Business Roundtable August 19, 2019 in its Statement of Purpose: customers, employees, suppliers, the community (environment), and shareholders."[44] Like the Williams & Fisch petition, the recommendation points the SEC to existing ESG disclosure frameworks to "help shape its thinking," but stops short of "recommending or endorsing any particular standard."[45]

A bill titled the "ESG Disclosure Simplification Act" was reported out of the House Financial Services Committee in January 2020,[46] and after reintroduction earlier this year passed in the House on June 16th by a one vote margin.[47] The bill would require public companies to provide in their annual proxy statements a description of the company's views "about the link between ESG metrics and the long-term business strategy" of the company and any process the company "uses to determine the impact of

39. *Id.* at 6–9.
40. *Id.* at 10.
41. *Id.* at 16.
42. *Id.* at 12.
43. Investor-as-Owner Subcomm., SEC Inv. Advisory Comm., Recommendation Relating to ESG Disclosure 1–2 (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/T52H-666X].
44. *Id.* at 1 n.1.
45. *Id.* at 10.
46. ESG Disclosure Simplification Act of 2019, H.R. 4329, 116th Cong. (2020).
47. ESG Disclosure Simplification Act of 2021, H.R.1187, 117th Congress (2021).

ESG metrics on the long-term business strategy."[48] The bill would also require the SEC to require public companies "to disclose environmental, social, and governance metrics" in any filing that requires audited financial statements.[49] The bill does not define "ESG metrics." Instead, it requires the SEC to promulgate a definition through rulemaking.[50] The bill does state, however, that "[i]t is the sense of Congress" that (as-yet undefined) ESG metrics "are *de facto* material for purposes of disclosures under the Securities Exchange Act of 1934 and the Securities Act of 1933."[51] The bill also authorizes the SEC to, as it may deem appropriate, "incorporate any internationally recognized, independent, multi-stakeholder environmental, social, and governance disclosure standards" when it promulgates a definition of ESG metrics.[52] Like the Williams & Fisch petition and IAC recommendation, the bill does not endorse any particular existing set of ESG disclosure standards.

In the wake of recent Democratic electoral victories and the Senate's confirmation of Gary Gensler to replace Jay Clayton as Chairman of the SEC, we can expect the foregoing proposals to receive more serious attention than they have previously. Indeed, under the interim leadership of Commissioner Allison Lee pending Gensler's confirmation earlier this year, the SEC created and staffed a new position titled "Senior Policy Advisor for Climate and ESG."[53] The Press Release announcing this move explained that the new advisor will "advise the agency on [ESG] matters and advance related new initiatives across [the SEC's] offices and divisions."[54] Acting Chair Lee also requested public comment on climate change disclosure, indicating that "[i]n addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental,

48. *Id.* § 2(a).
49. *Id.* § 2(b)(1)(A).
50. *Id.* § 2(b)(1)(B).
51. *Id*. § 2(b)(3).
52. *Id*. § 2(b)(4). The bill also calls for the creation of a permanent "Sustainable Finance Advisory Committee" which would, inter alia, be tasked with recommending "policy changes to facilitate the flow of capital towards sustainable investments, in particular environmentally sustainable investments." *Id.* § 3. "Sustainable finance" is defined to mean "the provision of finance with respect to investments taking into account environmental, social, and governance considerations." *Id.* Several other bills have been introduced in the House and Senate related to ESG disclosure. "These bills include disclosures on a variety of issues such as information regarding sexual harassment claims, financial and business risks associated with climate change, and the racial, ethnic, and gender composition of the board of directors and executives." GAO, PUBLIC COMPANIES: DISCLOSURE OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCE FACTORS AND OPTIONS TO ENHANCE THEM 38 n.52 (2020), https://www.gao.gov/assets/710/707949.pdf [https://perma.cc/7R7T-ZZUS].
53. Press Release, SEC, Satyam Khanna Named Senior Policy Advisor for Climate and ESG (Feb. 1, 2021), https://www.sec.gov/news/press-release/2021-20 [https://perma.cc/7R7T-ZZUS].
54. *Id.*

social, and governance, or ESG, matters."[55] Among the questions that comment is sought on are whether climate-related disclosures should be "one component of a broader ESG disclosure framework" and how the SEC should "craft climate-related disclosure requirements that would complement a broader ESG disclosure standard."[56] Professor John Coates, the Acting Director of the SEC's Division of Corporation Finance, has also expressed his view that "[t]he SEC should help lead the creation of an effective ESG disclosure system,"[57] and has indicated that the SEC is poised to move "promptly" on ESG rulemaking in 2021.[58]

II. THE SEC'S TYPICAL APPROACH TO MANDATORY DISCLOSURE

If information were costless to produce and costless to process, a strong case could be made for mandating full transparency on all issues related to a reporting company's operations in its SEC filings, including the myriad topics that fall under the ESG umbrella, subject to countervailing competitive and privacy interests. In reality, of course, information is costly to produce and costly to process. To disclose information, companies must first collect it. This consumes resources that could otherwise be spent on the company's core productive activities. The resources U.S. public companies spend collecting and assuring the accuracy of information required to be included in SEC filings is significant, not just because of the volume of information that companies are required to disclose, but also because of the unique liability risk that U.S. public companies face for inaccuracies in those filings. Although the point can be overstated, it is also the case that investors face cognitive limitations on their ability to process information,

55. Allison Lee, Public Statement, Public Input Welcomed on Climate Change Disclosures (March 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures [https://perma.cc/HCC8-SB5Z].

56. *Id.* In March the SEC also announced the creation of a 22-member "Climate and ESG Task Force" in the Division of Enforcement. According to the Press Release, the Task Force, "[c]onsistent with increasing investor focus and reliance on climate and ESG-related disclosure and investment, [] will develop initiatives to proactively identify ESG-related misconduct." Press Release, SEC, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (March 4, 2021), https://www.sec.gov/news/press-release/2021-42 [https://perma.cc/3TCE-5NMB].

57. John Coates, Public Statement, ESG Disclosure – Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets, https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121?utm_medium=email&utm_source=govdelivery [https://perma.cc/AE9A-DDH5].

58. Andrew Ramonas, *SEC to Move 'Promptly' on ESG Rulemaking in 2021, Official Says*, BLOOMBERG.COM (April 30, 2021).

meaning more information can sometimes detract from informed decision making.[59]

Because information is costly to produce and process, the SEC has never required anything close to full disclosure in SEC filings. As a first cut, the SEC typically limits disclosure to items that meet a materiality threshold. The SEC defines material information as information that a "reasonable investor" would be substantially likely to consider important in making an investment decision.[60] Who should count as a "reasonable investor" for purposes of this test is certainly debatable as a policy matter.[61] But the SEC has taken the view that a reasonable investor is a rational investor who cares primarily about the financial performance of his or her investments. In rejecting past pleas to expand disclosure obligations to encompass matters primarily of social concern, the SEC has repeatedly emphasized its commitment to a financial conception of materiality.[62] It is likely for this reason that many of the recent proposals calling for SEC-mandated ESG disclosure emphasize the ESG-financial performance link.[63] But not even

59. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 448–49 (1978) (observing that burying shareholders "in an avalanche of trivial information . . . is hardly conducive to informed decisionmaking"); *see also* Harper Ho, *supra* note 33, at 119 (noting that 96% of issuers who provided comments on the SEC's Concept Release argued that ESG disclosure would overwhelm investors with immaterial information, while 63% of investors who commented disagreed).

60. Rule 12b-2 of the Exchange Act provides that the term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered. *See* 17 C.F.R. § 240.12b-2. The SEC adopted this definition of materiality in 1982 so it would align with the Supreme Court's definition of materiality in securities litigation; the SEC previously defined as material "those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered." Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,925 (Apr. 22, 2016).

61. *See* Amanda M. Rose, *The "Reasonable Investor" of Federal Securities Law: Insights from Tort Law's "Reasonable Person" & Suggested Reforms*, 43 J. CORP. L. 77, 89–93, 110–13 (2017).

62. *See* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1246–63 (1999) (recounting this history).

63. *See* Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. 499, 554 (2020) (observing that "[b]ecause the SEC has taken the position that 'materiality' refers to information that has economic significance, most appeals for new rulemaking focus on the relevance of the requested information to corporate performance, regardless of the advocate's true interest"). Some have described the shift toward the ESG lexicon as a "rebranding" of the socially responsible investing movement of the 1970s and 1980s. *See* Schanzenbach & Sitkoff, *supra* note 6, at 388 (observing that "ESG investing finds its roots in the socially responsible investing (SRI) movement" and that in the late 1990s and early 2000s "proponents of SRI rebranded the concept as ESG by adding corporate governance factors (the G in ESG), and they asserted that ESG investing could improve risk-adjusted returns"); *see also* Mariana Pargendler, *The Rise of International Corporate Law*, 98 WASH. U. L. REV 1764, 1795 (2021) ("Although socially responsible investing (especially focused on divestitures) had a long history, the ESG framing helped eliminate the traditional separation between socially responsible investment and mainstream investment."). In addition to addressing

the most ardent ESG supporters would contend that *all* ESG information is material, as the securities laws currently define that term. Corporations' approach to certain ESG topics may impact their financial performance in a material way, whereas their approach to other ESG topics may not. Variations undoubtedly exist amongst industries and amongst companies within industries.[64] Without specifying the particular topic that disclosure is sought on, it is impossible to assess whether the information is likely material under traditional conceptions of that term.

Even with respect to material information, the SEC does not always mandate disclosure. Information need not be disclosed unless there is a specific duty to disclose it, or the information is both material and necessary to make other statements made not misleading. The decision to create a duty to disclose requires a weighing of, inter alia, the cost to companies of producing the information and the magnitude of the benefit to investors of the information's production (not all material information is of equal importance). This requires a fact-specific, contextual analysis. For example, if the information is readily accessible given existing information systems, the cost of mandating disclosure will be less than if disclosure would require companies to create entirely new information systems. The appropriate form disclosure should take also necessitates a fact-specific, contextual analysis. Some ESG topics may lend themselves to principles-based disclosure, whereas others may warrant a more prescriptive form. There are well-recognized tradeoffs between these two approaches, and those tradeoffs can only be assessed and debated in a concrete setting.[65]

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challenges related to the SEC's conception of materiality, this rebranding made plausible arguments that ESG investing is consistent with an ERISA trustee's fiduciary duties. *See* Coffee, *supra* note 2, at 25 (arguing that rebranding SRI as ESG "enabled law firms to opine to their clients that ESG investing was fully compatible with the trustee's fiduciary obligations").

64. As the Sustainability Accounting Standards Board (SASB) has explained, "[s]ustainability issues are not material for all companies, and when they are material, they manifest in unique ways and require industry-specific metrics." SUSTAINABILITY ACCT. STANDARDS BD., BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K: THE SEC'S CONCEPT RELEASE AND ITS IMPLICATIONS 3 (2016), https://www.sasb.org/wp-content/uploads/2016/09/Reg-SK-Comment-Bulletin-091416.pdf [https://perma.cc/Z3RJ-3UDB]. Through a consultation process that spanned several years, SASB developed standards for over seventy industries that identify the subset of sustainability topics that are likely to be financially material for a company in that industry as well as recommended metrics for reporting on those topics; the standards recognize that whether a particular topic is in fact material is a judgment that can only be made at the firm level. For a description of SASB's standard-setting process, see *Standard-Setting Process*, SUSTAINABILITY ACCT. STANDARDS BD., https://www.sasb.org/standards/process/ [https://perma.cc/S75M-KRDT].

65. As the SEC recounted in the Concept Release:

> Limiting prescriptive disclosure requirements and emphasizing principles-based disclosure could improve disclosure by reducing the amount of information that may be irrelevant, outdated or immaterial. Because prescriptive disclosure requirements may result in disclosure

Specificity is also required in order to assess whether a new mandatory disclosure obligation is necessary to elicit the information sought. Public companies are already required to disclose information on a variety of "ESG" topics. Extensive disclosures are required in annual proxy statements related to executive compensation and governance practices, for example.[66] Pursuant to Congressional mandate, the SEC has also required companies to disclose information related to mine safety and the use of conflict minerals.[67] In addition, in 2010 the SEC issued guidance instructing that Items 101, 103, 303, and 503(c) of Regulation S-K can sometimes require disclosure of risks and costs posed by climate change, environmental regulation, and environmental litigation.[68] In 2011, it issued guidance explaining that information related to cybersecurity risks and breaches may need to be disclosed under these same provisions; that guidance also

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> that is not necessarily material or important to investors, greater use of principles-based disclosure requirements may allow registrants to more effectively tailor their disclosure to provide only the information about their specific business and financial condition that is important to investors. A principles-based approach also may allow registrants to readily adapt their disclosure to facts and circumstances that may change over time.
>
> On the other hand, reducing prescriptive disclosure requirements and shifting towards more principles-based disclosure requirements may limit the comparability, consistency and completeness of disclosure. Also, in the absence of clear guidelines for determining when information is material, registrants may have difficulty applying principles-based disclosure requirements, and the disclosure provided may not give investors sufficient insight into how registrants apply different principles-based disclosure thresholds. Potentially important information that may be disclosed in response to a prescriptive disclosure requirement might not be included in response to a principles-based disclosure requirement. . . .

Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,927 (Apr. 22, 2016) (footnotes omitted). The SEC also described a third "objectives-oriented" approach that the SEC staff had proposed in a prior study for developing new accounting standards. "Under this approach, standard setters would develop new rules by clearly articulating the accounting objective of the standard and providing sufficient detail and structure so that the standard can be applied on a consistent basis." *Id.*

66. *See* ELIZABETH A. ISING, KRISTA P. HANVEY, GEOFFREY E. WALTER, HEATHER MARSHALL & BRIAN MYERS, DONNELLEY FIN. SOLS., EXECUTIVE COMPENSATION DISCLOSURE HANDBOOK: A PRACTICAL GUIDE TO THE SEC'S EXECUTIVE COMPENSATION DISCLOSURE RULES (2020), https://www.dfinsolutions.com/insights/guide/executive-compensation-disclosure-handbook [https://perma.cc/H4L7-NPXT].

67. *See* Press Release, SEC, SEC Adopts Dodd-Frank Mine Safety Disclosure Requirements (Dec. 21, 2011), https://www.sec.gov/news/press/2011/2011-273.htm [https://perma.cc/KAQ5-HD2R]; Fatima Alali & Sophia I-Ling Wang, *Conflict Minerals Disclosure Requirements and Corporate Social Responsibility: Trends, Challenges, and Opportunities*, CPA J. (July 2018), https://www.cpajournal.com/2018/07/18/conflict-minerals-disclosure-requirements-and-corporate-social-responsibility/ [https://perma.cc/ZK24-FV2W]. "Conflict minerals" are defined as those originating in the Democratic Republic of the Congo or an adjoining country. 15 U.S.C. § 78m(p). It was "the sense of Congress that the exploitation and trade of conflict minerals . . . is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein." Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502, 124 Stat. 1376, 2213 (2010).

68. Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6289 (Feb. 8, 2010).

explains how cybersecurity-related information may impact disclosures in a company's financial statements and in its discussion of the effectiveness of disclosure controls and procedures required by Item 307 of Regulation S-K.[69] The SEC revisited and augmented its cybersecurity guidance in 2018, noting that Item 407(h) of Regulation S-K and Item 7 of Schedule 14A can also create disclosure obligations concerning cybersecurity.[70]

The general disclosure obligations cited in the SEC's climate change and cybersecurity guidance may also, depending on the facts and circumstances, call for disclosures related to a variety of other topics that fall under the ESG umbrella. For example, Item 105 of Regulation S-K requires a registrant to provide, under the heading "Risk Factors," a discussion of the material factors that make an investment in the registrant speculative or risky; Item 303 of Regulation S-K (Management's Discussion and Analysis of Financial Condition and Results of Operations, also known as the "MD&A"), requires issuers, inter alia, to identify and disclose known trends, events, demands, commitments, and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance; and Item 407(h) of Regulation S-K and Item 7 of Schedule 14A require a company to disclose the extent of its board's role in the risk oversight of the company, such as how the board administers its oversight function and the effect this has on the board's leadership structure.[71] With respect to the latter, the SEC has instructed that "disclosure about the board's involvement in the oversight of the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company," as well as a description of how the board administers its risk oversight function.[72]

If reasonable investors believe these obligations are failing to elicit sufficient disclosure on a particular ESG topic, the logical first question they should ask is *why*? Depending on the nature of the problem, the appropriate policy response may differ. Perhaps beefed-up surveillance of the topic as part of the SEC's ongoing disclosure review program is in order.[73] Perhaps

69. *CF Disclosure Guidance: Topic No. 2 – Cybersecurity*, SEC (Oct. 13, 2011), https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm [https://perma.cc/578N-XRV3].

70. Commission Statement and Guidance on Public Company Cybersecurity Disclosures, 83 Fed. Reg. 8166 (Feb. 26, 2018).

71. 17 C.F.R. §§ 229.105, 229.303, 229.407, 240.14a–101.

72. Proxy Disclosure Enhancements, 74 Fed. Reg. 68333, 68345 (Dec. 23, 2009).

73. While serving as Acting Chair, Commissioner Lee recently directed the SEC's Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings. *See*

additional interpretative guidance is called for, or perhaps a more prescriptive line-item disclosure obligation ought to be created. These are difficult questions that cannot be intelligently discussed in the abstract.

Petitions that the SEC mandate disclosure of specific ESG topics, or provide interpretive guidance related thereto, have been introduced in the past, with mixed success. The climate change guidance mentioned above was adopted after a coalition of investors and environmental non-profits requested formal guidance in petitions filed with the Commission in 2007, 2008, and 2009.[74] Petitions calling for mandated disclosure of, inter alia, gender pay ratios[75] and corporate political spending[76] have not, by contrast, prompted SEC action to date.[77] The SEC's response to a recent petition seeking greater disclosure on human capital management illustrates well the difficult questions a decision to mandate disclosure on a specific ESG topic will necessarily raise.

On July 6, 2017, the Human Capital Management Coalition (HCMC), comprised of institutional investors with roughly $3 trillion in assets, filed a petition seeking enhanced human capital management disclosure;[78] the IAC followed suit with a recommendation that the SEC recognize the significance of human capital management to investors and incorporate

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Public Statement, Allison Herren Lee, Acting SEC Chair, Statement on the Review of Climate-Related Disclosure (Feb. 24, 2021), https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure [https://perma.cc/HCZ8-MWWG].

74. *See* Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6289, 6291 n.20 (Feb. 8, 2010).

75. *See* Letter from Sallie Krawcheck & Joseph F. Keefe, Chair and Chief Exec. Officer, Pax Ellevate, to Mary Jo White, Chair, SEC (Feb. 1, 2016), https://www.sec.gov/rules/petitions/2016/petn4-696.pdf [https://perma.cc/TJH2-A79J].

76. *See* Letter from Comm. on Disclosure of Corp. Pol. Spending, to Elizabeth M. Murphy, Sec'y, SEC (Aug. 3, 2011), https://www.sec.gov/rules/petitions/2011/petn4-637.pdf [https://perma.cc/9LQV-MZ8L].

77. A December 2020 policy rider to an appropriations law currently prevents the SEC from issuing disclosure mandates related to political spending, but a bill introduced in the House in January would repeal that roadblock if enacted into law. *See* Transparency in Corporate Political Spending Act, H.R. 403, 117th Cong. (2021). At his confirmation hearing, Chairman Gensler expressed his view that the SEC should consider mandating disclosure on political spending (Zachary Warmbrodt, *Gensler: SEC Should Consider Corporate Political Spending Disclosures*, POLITICO (March 2, 2021, 2:07 PM), https://www.politico.com/news/2021/03/02/gensler-sec-corporate-political-spending-472607), and the Acting Director of the SEC's Division of Corporation Finance is a long-time advocate for such disclosure (see, e.g., John C. Coates & Taylor Lincoln, Opinion, *Fulfilling the Promise of 'Citizens United'*, WASH. POST (Sept. 6, 2011), https://www.washingtonpost.com/opinions/fulfilling-the-promise-of-citizens-united/2011/09/02/gIQAa4np7J_story.html).

78. *See* Letter from Hum. Cap. Mgmt. Coal., to William Hinman, Dir., Div. of Corp. Fin., SEC (July 6, 2017), https://www.sec.gov/rules/petitions/2017/petn4-711.pdf [https://perma.cc/PF5P-TDWC]. The petition generated a substantial number of comments supporting increased disclosure of human capital management policies and specific human capital metrics. *See Comments on Rulemaking Petition to Require Issuers to Disclose Information About Their Human Capital Management Policies, Practices and Performance*, SEC, https://www.sec.gov/comments/4-711/4-711.htm [https://perma.cc/A68J-VBVS].

enhanced disclosures as part of its overall efforts to modernize corporate reporting and disclosure.[79] In August 2019, the SEC proposed amendments to Items 101, 103, and 105 of Regulation S-K.[80] In recognition of the fact that human capital has grown in importance as a resource and driver of performance for certain companies since the time Regulation S-K was first adopted, the SEC included among the proposed changes to Item 101 (description of business) a new obligation requiring "[a] description of the registrant's human capital resources, including in such description any human capital measures or objectives that management focuses on in managing the business."[81] The proposed amendment provided as examples, "depending on the nature of the registrant's business and workforce, measures or objectives that address the attraction, development, and retention of personnel."[82]

Notably, the proposed rule called for purely principles-based disclosure and was cabined with a materiality qualifier. By contrast, the HCMC petition had favored coupling principles-based disclosure with obligations to disclose a wide array of specific workforce-related information, including:

> (1) Workforce demographics (number of full-time and part-time workers, number of contingent workers, policies on and use of subcontracting and outsourcing); (2) Workforce stability (turnover (voluntary and involuntary), internal hire rate); (3) Workforce composition (diversity, pay equity policies/audits/ratios); (4) Workforce skills and capabilities (training, alignment with business strategy, skills gaps); (5) Workforce culture and empowerment (employee engagement, union representation, work-life initiatives); (6) Workforce health and safety (work-related injuries and fatalities, lost day rate); (7) Workforce productivity (return on cost of workforce, profit/revenue per full-time employee); (8) Human rights commitments and their implementation (principles used to evaluate risk, constituency consultation processes, supplier due diligence); [and] (9) Workforce compensation and incentives (bonus metrics used for employees below the named executive officer level,

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79. *See* SEC, *Recommendation of the Investor Advisory Committee, Human Capital Management Disclosure* (Mar. 28, 2019), https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf. [https://perma.cc/A82U-3YYB]. Many comment letters submitted in response to the SEC's April 15, 2016, Concept Release on Regulation S-K also expressed desires for improved disclosures related to human capital management. *See supra* note 31.

80. Modernization of Regulation S-K Items 101, 103, and 105, 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239 & 240).

81. *Id.* at 44,370, 44,388.

82. *Id*.

> measures to counterbalance risks created by incentives).[83]

The petition argued that prescriptively requiring this information would make it easier for investors to extract through an automated process and would promote consistency and comparability.[84]

In defense of its principles-based approach, the SEC explained that:

> In assessing the best way to approach disclosure regarding human capital, we were mindful that each industry, and even each company within a specific industry, has its own human capital considerations, and that those considerations may evolve over time. In light of this fact, and with the principle of materiality in mind, it is our view that prescribing fixed, specific line item disclosures in this area for all registrants would not resu lt in the most meaningful disclosure.[85]

Instead, the SEC concluded "that investors would be better served by understanding how each company looks at its human capital and, in particular, where management focuses its attention in this space."[86]

The public comments the proposed rule elicited raised numerous issues.[87] Some commentators argued there was no need for any new disclosure obligations related to human capital, due to sufficient voluntary disclosure and/or existing disclosure obligations under Items 105 and 303 that would be triggered if the topic presented a material risk to the company.[88] Some highlighted the costs associated with compliance, including the potential need to disclose competitively sensitive information.[89] Others supported the principles-based nature of the rule but saw no need for calling out specific examples of measures or objectives companies might report, while still others wanted additional examples.[90] Many commentators expressed the need for more prescriptive requirements along the lines suggested by HCMC.[91] Some favored the issuance of interpretative guidance rather than rule change.[92] On August 26, 2020, the

83. Letter from Hum. Cap. Mgmt. Coal., *supra* note 78, at 26–27 (punctuation altered) (footnote omitted).

84. *Id.* at 27.

85. Modernization of Regulation S-K Items 101, 103, and 105, 84 Fed. Reg. at 44,370.

86. *Id.*

87. *See generally* Doreen E. Lilienfeld & Max Bradley, *Securities Disclosure: Human Capital Management Disclosure*, 33 INSIGHTS 24 (2019) (describing the proposed rule and summarizing the comments received).

88. *See id.* at 26–27.

89. *See id.* at 27.

90. *See id.* at 27–29.

91. *See id.* at 27–28.

92. *See id.* at 28.

SEC adopted the proposed rule substantially as proposed, with Democratic Commissioners Lee and Caroline Crenshaw dissenting.[93]

III. ISSUES RAISED BY CALLS FOR AN SEC-MANDATED ESG DISCLOSURE FRAMEWORK

The recent proposals described in Part I do not request that the SEC mandate disclosure on any specific ESG topic, and thus do not purport to provide answers to the series of difficult questions a more targeted request would trigger: Is the topic financially material? To all companies, or just some? Why is sufficient information on the topic not being produced pursuant to existing disclosure obligations? Is rulemaking the best fix? What form should a new rule take and, relatedly, what is the associated cost? Instead, the proposals invite the SEC to adopt a comprehensive ESG disclosure framework. Requesting that the SEC adopt a framework for companies to use to disclose information on a broad set of topics, without establishing that any one of those topics is in fact financially material, is an unusual foray into SEC rulemaking. The most compelling justification for grouping ESG topics in this way, rather than treating each ESG issue discretely—like any other business practice or risk that may (or may not) warrant mandatory disclosure—is that the topics are *already* grouped together under existing ESG reporting frameworks created by private standard setters.

These existing frameworks, however, were not—with one exception—designed with the SEC's disclosure regime in mind. The most popular framework, cited as an exemplar the SEC might look to in both the Williams & Fisch petition and the IAC recommendation, was developed by the non-profit Global Reporting Initiative (GRI). The "modular, interrelated GRI Standards are designed primarily to be used as a set, to prepare a sustainability report focused on material topics,"[94] with a "material topic" defined as a topic "that reflects a reporting organization's significant economic, environmental and social impacts; or that substantively influences the assessments and decisions of stakeholders."[95] The

93. *See* Modernization of Regulation S-K Items 101, 103, and 105, 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239 & 240). For an academic critique of the form the final rule took, see George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 TULANE L. REV. 639, 713–723 (2021).

94. *How to Use the GRI Standards*, GRI, https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/ [https://perma.cc/J9JU-CXXQ].

95. GRI, GRI STANDARDS GLOSSARY 14 (2020). Stakeholders are defined as "entit[ies] or individual[s] that can reasonably be expected to be significantly affected by the reporting organization's

Sustainability Accounting Standards Board (SASB) is a non-profit standard setter that has uniquely developed a set of industry-specific sustainability standards tethered (at least for now) to the SEC's definition of materiality.[96] Neither the Williams & Fisch petition nor the IAC recommendation nor the House Bill endorse the SASB standards over the GRI standards, however, suggesting that the proponents behind these proposals are not especially concerned about financial materiality.[97] In a subsequent paper, Professor Fisch candidly admits that the link between ESG performance and firm performance is highly contested, arguing that enhanced ESG disclosure is nevertheless appropriate because it will help investors determine *whether* sustainability practices materially impact firm performance.[98] The House Bill is clear about its willingness to have the SEC adopt an ESG disclosure

activities, products and services," including "those who are invested in the organization (such as employees and shareholders), as well as those who have other relationships to the organization (such as other workers who are not employees, suppliers, vulnerable groups, local communities, and NGOs or other civil society organizations, among others)." *Id.* at 20.

96. *See* SUSTAINABILITY ACCT. STANDARDS BD., SASB CONCEPTUAL FRAMEWORK 9 (2017), https://www.sasb.org/wp-content/uploads/2020/02/SASB_Conceptual-Framework_WATERMARK.pdf [https://perma.cc/EQ83-KRD9] ("In identifying sustainability topics that are reasonably likely to have material impacts, the SASB applies the definition of 'materiality' established under the U.S. securities laws."); *see also* SUSTAINABILITY ACCT. STANDARDS BD., *supra* note 64. SASB is in the process of revising its definition of materiality "to more effectively communicate the global nature of the concept of financial materiality … [and] to align as much as reasonably possible with the definition of 'materiality' used by the standard setters and other organizations who, like SASB, have a focus on the information needs of the providers of capital." SUSTAINABILITY ACCT. STANDARDS BD., PROPOSED CHANGES TO THE SASB CONCEPTUAL FRAMEWORK & RULES OF PROCEDURE 7 (2020), https://www.wlrk.com/docs/SASB_Proposed_Changes.pdf. Specifically, the proposed revision states that information "is financially material if omitting, misstating, or obscuring it could reasonably be expected to influence investment or lending decisions that users make on the basis of their assessments of short-, medium-, and long-term financial performance and enterprise value." *Id.* Commentators have argued that SASB's proposed incorporation of time horizons into its materiality definition represents a "deliberate step" toward the concept of "dynamic materiality," which "is viewed in Europe as a far more 'forward-looking and proactive' approach than the traditional U.S. definition" of materiality. David A. Katz & Laura A. McIntosh, *'Materiality' in America and Abroad*, HARV. L. SCH. FRM. CORP. GOVN. (May 1, 2021), https://corpgov.law.harvard.edu/2021/05/01/corporate-governance-update-materiality-in-america-and-abroad/ [https://perma.cc/7ECC-APEX] (explaining that the concept of "dynamic materiality" originated with a 2020 white paper by the World Economic Forum and describes a process whereby "[w]hat is financially immaterial to a company or industry today can become material tomorrow").

97. A preference for prescriptive, mandatory ESG disclosures may also help explain this. SASB's standards offer guidance to companies in assessing their *existing* disclosure obligations under Regulation S-K, specifically as it relates to their MD&A. *See* SUSTAINABILITY ACCT. STANDARDS BD, *supra* note 96, at 1 ("SASB standards are designed for voluntary use in disclosures required by existing U.S. regulation in filings with the [SEC], such as Forms 10-K and 20-F."). SASB's standards describe industry-specific sustainability topics that may present known trends and uncertainties reasonably likely to materially affect financial condition or operating performance and offer metrics for reporting on those topics. *Id.* at 9. SASB leaves it to companies to make the call whether a particular sustainability topic is in fact material, *id.*, and it has taken the position that additional line-item ESG disclosures are not appropriate, see SUSTAINABILITY ACCT. STANDARDS BD., *supra* note 64, at 3.

98. Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923, 925–26 (2019).

framework that extends beyond traditional notions of financial materiality—it expressly permits the SEC to "incorporate any internationally recognized, independent, multi-stakeholder environmental, social, and governance disclosure standards" when it promulgates a definition of ESG metrics, declaring such metrics to be "*de facto* material."[99]

If the SEC were to codify, perhaps with tweaks and modifications, an existing ESG-disclosure framework that has been developed by private standard-setters without strict regard for traditional securities-law conceptions of what counts as material, what would be the implications? Proponents argue that a large number of companies are already collecting and disclosing ESG information and publishing it in sustainability reports, and that requiring the information to be standardized and placed in SEC filings would promote the consistency, comparability, and credibility of those disclosures.[100] This would, to the extent the ESG information is financially material, be helpful to "reasonable" investors, as that term is currently understood, even if some of the information produced would be important only to values-based investors or other stakeholders. These arguments are not without weight, but such a request raises significant questions.

Most obviously, what will it cost to achieve the envisioned benefits to users of ESG information? An SEC-mandated ESG disclosure regime would impose new information-gathering and reporting obligations on companies that today do not prepare sustainability reports pursuant to whatever framework the SEC were to adopt. Even companies that do currently utilize that framework when preparing sustainability reports would bear additional costs, because the process for preparing SEC filings is much more rigorous and involved.[101]

Deeper, more philosophical questions lurk as well. For example, questions of institutional competence and democratic accountability loom large. When the SEC mandates disclosure of information because of its demonstrable importance to companies' financial performance, it clearly acts within the scope of both its expertise and authority. Asking the SEC to choose an ESG disclosure framework based in part on considerations that

99. *See* ESG Disclosure Simplification Act of 2019, H.R. 4329, 116th Cong. § 2(b)(3)–(4) (2019).

100. *See supra* Part I.

101. *See* Fisch, *supra* note 98, at 959 (observing that "[p]rivate organizations such as GRI and SASB have identified dozens of disclosure items, and current sustainability reports commonly exceed one hundred pages in length," and noting that the "cost of developing and complying with comparable mandatory disclosure requirements would place a heavy burden on issuers").

extend into the realm of politics thrusts the SEC into a less familiar and more controversial role. Is the SEC the right institution to do this?[102]

Questions of institutional competence and democratic accountability are particularly significant because advocates for ESG disclosure clearly see it as a mechanism for promoting certain types of corporate behavior and discouraging others.[103] Mandating that such disclosures appear in SEC filings would amplify this effect by involving the board and executives who certify SEC filings in the ESG disclosure process. Advocates view this as a benefit of SEC-mandated ESG disclosure.[104] As is often pointed out, this would not be first time the SEC has adopted a position that appears to be at

102. SEC Commissioner A. A. Sommer, Jr. raised this concern in response to pressure in the mid-1970s to expand the concept of materiality to capture social disclosures. *See* A. A. Sommer Jr., Comm'r, SEC, Address at the Practising Law Institute: The Slippery Slope of Materiality (Dec. 8, 1975), https://www.sec.gov/news/speech/1975/120875sommer.pdf [https://perma.cc/89YR-WX36] (warning that "overloading [the concept of materiality], 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"). SEC Commissioner Hester Peirce echoed the concern in a speech responding to calls for greater ESG disclosure last year. *See* Public Statement, Hester M. Peirce, Comm'r, SEC, Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures (Jan. 30, 2020), https://www.sec.gov/news/public-statement/peirce-mda-2020-01-30 [https://perma.cc/LPJ5-MM7T] ("Securities regulators of this generation must not grow weak-kneed in defending the concept of materiality, which continues to play a central role in ensuring the vibrancy of our capital markets. We ought not step outside our lane and take on the role of environmental regulator or social engineer."); *see also* Mahoney & Mahoney, *supra* note 14, at 2–3 (arguing that the SEC "has neither the expertise nor the political accountability to pursue climate, diversity, and other public policy goals" and warning that if the SEC adopts an ESG disclosure regime it risks "eroding public trust in its capacity and willingness to serve as an apolitical technocratic regulator of the capital markets"); *cf.* Yoon-Ho Alex Lee, *Beyond Agency Core Mission*, 68 ADMIN. L. REV. 551, 558 (2016) (arguing that "the concept of agency core mission, as such, should no longer have a prominent role in critically evaluating agency regulations or Congress's regulatory assignments").

103. *See, e.g.*, Lipton, *supra* note 63, at 532 (asserting that "[t]he goal, in short, is to *make* sustainability information relevant to financial performance, even if it is not currently, by empowering noninvestor groups to pressure corporations into improving their behavior" and that, "[f]ar from pursuing investor wealth, much of the sustainability movement is designed to make corporate profits difficult to achieve unless management attends to the needs of noninvestor stakeholders"); Mahoney & Mahoney, *supra* note 14, at 8–12 (arguing that the goal of ESG proponents is to change firm behavior in socially motivated directions); *see also* Virginia Harper Ho, *Non-Financial Reporting & Corporate Governance: Explaining American Divergence & Its Implications for Disclosure Reform*, 10 ACCT., ECON., & L. 1, 12 (2020) (observing that "disclosure is widely recognized as a soft form of regulation, incentivizing changes in corporate behavior where direct regulation may be difficult to achieve or enforce").

104. *See, e.g.*, Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 56 AM. BUS. L.J. 645, 669 (2019) (warning that "as long as sustainability disclosure remains separate from required disclosure, changes in corporate conduct will be few and slow"); Fisch, *supra* note 98, at 962 (explaining that SEC-mandated sustainability disclosures "will lead to the board of directors being accountable for sustainability disclosures in a way in that they are not in the current system" and that the "board's role in overseeing and certifying the sustainability disclosures will require that they set up reporting systems" which, in turn "will both improve the reliability of the disclosures and provide the board with a greater role in overseeing and understanding the issuer's sustainability practices," enabling it "to incorporate sustainability considerations into its analysis of strategic issues and operational risk management").

least in part motivated by a desire to affect corporate behavior.[105] Its position on the qualitative materiality of information related to management integrity (including managers' involvement in illegal activity) is one commonly cited example.[106] But when the SEC has gone down this path in the past it has sparked considerable controversy, because using disclosure rules to influence corporate behavior operates to blur the line between the domains of federal securities regulation and state corporate law.[107] Critics contend that federalizing aspects of corporate governance inhibits the ability of states to compete for corporate charters, thus undermining the "genius" of American corporate law.[108]

Moreover, when the SEC has done this in the past, the behavioral changes sought have been at least ostensibly compatible with underlying principles of state corporate law. For example, it is a breach of fiduciary duty under Delaware corporate law for directors and officers to knowingly

105. *See* Request for Rulemaking from Cynthia A. Williams & Jill E. Fisch, *supra* note 35, at 7; *see also* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859 (2003) (exploring how federal securities law and enforcement via securities fraud class actions plays an important role in regulating corporate governance); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 373 (2013) (surveying "where we think the securities law responsibilities of public companies have motivations and explanations not strictly confined to their contributions to investor protection or capital formation").

106. *See* Williams, *supra* note 62, at 1265–66.

107. *See, e.g.*, Lipton, *supra* note 63, at 549 (explaining that the SEC's treatment of issues related to management integrity as qualitatively material "kicked off years of controversy, with detractors arguing that the SEC was using securities disclosure to shape corporate behavior in a manner that went beyond investor and market protection, and champions defending the practice for the same reason" and citing contributions to the debate) (footnotes omitted); *see also* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 635 (2003) (explaining that "[a]bsent a constitutional bar to federal involvement in corporate affairs, the federal government can determine, has determined, and will determine many critical elements of corporate governance" at the expense of historical state control).

108. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993). For an overview of the arguments for and against charter competition, see Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525, 536–39 (2005). *See also* Hester Peirce, SEC, Public Statement, *Rethinking Global ESG Metrics* (April 14, 2021), https://www.sec.gov/news/public-statement/rethinking-global-esg-metrics [https://perma.cc/Q945-QDJZ] (warning that common ESG disclosure metrics "will drive and homogenize capital allocation decisions" with detrimental effects on society); Hans B. Christensen, Luzi Hail & Christian Leuz, *Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review*, 3, 58–70 (Eur. Corp. Governance Inst., Fin. Working Paper No. 623, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3427748 (observing that new disclosure mandates are popular because viewed as less intrusive and more politically expedient than traditional regulation, but warning that mandatory disclosure regimes can have negative unintended consequences and outlining the potential effects on firm behavior of mandatory ESG disclosure mandates); Mahoney & Mahoney, *supra* note 14, at 23–24 (warning that SEC-mandated ESG disclosure may harm retail investors by reducing incentives for current public companies to remain public and for privately-held business to go public).

cause the company to violate positive law.[109] The behavior sought to be promoted by ESG disclosure, by contrast, conflicts with Delaware corporate law to the extent it promotes the prioritization of non-shareholder constituencies in corporate decision-making.[110] Even if the behavior sought can be defended as promoting "long-term" shareholder interests,[111] ESG topics veer far deeper into matters of traditional business judgment than the SEC has ever waded before.

Of course, those who support SEC-mandated ESG disclosure may not be ardent supporters of shareholder primacy. And they may even support the complete federalization of corporate law. Thus, these observations may not change their views. That is not my intent. Rather, it is to focus attention on the fact that broad calls for SEC-mandated ESG disclosure raise some of the most contested questions in the field of corporate law, such as the value of interjurisdictional competition for corporate charters,[112] the right way to conceptualize the purpose of the corporation,[113] and the proper allocation of managerial power as between the board and shareholders.[114]

The ESG disclosure mandates that have been imposed on listed companies in the EU since 2018[115] are explicitly tied to the EU's substantive

109. *See* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2019–21 (2019) (discussing jurisprudence holding that directors and officers who act with intent to violate positive law breach their duty of good faith).

110. This is, at least, the predominant view. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 444–51 (2001) (describing this as the "consensus" view); *cf.* Rock, *supra* note 4 (noting the reinvigorated debate over corporate purpose). *See also* Hans, *et al.*, *supra* note 108, at 94 (observing that "if the goal is to drive change in firm behavior" for social ends, an ESG standard setting process requires "a broader democratic legitimization than what financial reporting standard setting usually has; it needs to be more akin to what we require for other major regulatory interventions (e.g., taxes or emission limits)").

111. *Cf.* Mark J. Roe & Roy Shapira, *The Power of the Narrative in Corporate Lawmaking* (Harv. L. Sch., Working Paper No. 20-21, 2020), https://ssrn.com/abstract=3703882 [https://perma.cc/42MT-YDSL] (questioning the politically popular narrative that corporate short-termism is a pervasive problem).

112. *See* Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 43 n.33 (2006) (observing that "[f]or thirty-odd years, corporate scholars have debated whether corporate charter competition benefits investors or only self-serving firm managers," and citing the seminal works addressing whether there is a "race-to-the-top" or "race-to-the-bottom" in American corporate law).

113. *See* A. A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 36–39 (1991) (tracing the history of this vigorous debate); *see also* Rock, *supra* note 4 (discussing the debate in current times).

114. For a recent overview of the debate between those who favor board primacy and those who favor shareholder primacy, as well as references to leading works, see Simone M. Sepe, *Board and Shareholder Power, Revisited*, 101 MINN. L. REV. 1377, 1386–91 (2017).

115. Since 2018, listed companies in the EU have been required to include information in their annual reports on the topics of environmental protection, social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery, and diversity on company boards (in terms of age, gender, educational, and professional background). *See Non-Financial Reporting*, EUR.

policy embrace of the United Nation's Sustainable Development Goals.[116] Moreover, they were promulgated pursuant to a call by the European Parliament to create disclosure requirements that

> take account of the multidimensional nature of corporate social responsibility (CSR) and the diversity of the CSR policies implemented by businesses matched by a sufficient level of comparability to meet the needs of investors and other stakeholders as well as the need to provide consumers with easy access to information on the impact of businesses on society.[117]

The SEC would be acting, by contrast, without predicate acts by political bodies endorsing the substantive ends sought.[118]

Notably, the EU has not yet chosen to mandate any particular ESG reporting framework, instead issuing non-mandatory guidelines on how to present the required information while giving companies the option to instead use "international, European or national guidelines according to their own characteristics or business environment."[119] The inability of the EU, which has been actively considering sustainability issues for many years, to settle on a single disclosure framework highlights the difficulties the SEC will confront should it move forward with the pending requests.

Placing responsibility for developing an ESG disclosure framework on the SEC also raises questions about resource allocation. If the SEC mandates disclosure on a topic, it assumes a responsibility for ensuring compliance, either through its screening of SEC filings or through enforcement. Proponents view this as a benefit, given that it promises to

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COMM'N, https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en [https://perma.cc/QJ8M-RTMH].

116. Communication from the Commission on Guidelines on Non-Financial Reporting (Methodology for Reporting Non-Financial Information), 2017 O.J. (C 215) 1, 2 (EU).

117. Directive 2014/95, of the European Parliament and of the Council of 22 October 2014 Amending Directive 2013/34/EU as Regards Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups, 2014 O.J. (L 330) 1, 1.

118. *See* Harper Ho, *supra* note 103, at 9 (observing that "the institutional foundations of emerging non-financial reporting and sustainability-oriented policies outside the U.S. include an emphasis on stakeholder interests, a comfort with the government's guiding role in the economy, and a far greater reliance on flexible principles-based disclosure approaches and on regulatory enforcement rather than on prescriptive rules and enforcement through shareholder litigation," and that "all of these stand in stark contrast to the norms and practices that shape the perspectives of U.S. regulators, legislators, and reporting companies themselves").

119. EUR. COMM'N, *supra* note 115. *But see EFRAG Mandated to Provide Recommendations on Possible European Non-Financial Reporting Standards*, EUR. FIN. REPORTING ADVISORY GRP. (Feb. 7, 2020), https://www.efrag.org/News/Public-243/EFRAG-mandated-to-provide-recommendations-on-possible-European-Non-Financial-Reporting-Standards [https://perma.cc/8EC4-RRUN] (reporting that the European Commission has mandated EFRAG to undertake preparatory work for the elaboration of possible EU non-financial reporting standards).

promote the integrity and completeness of companies' ESG disclosures, combatting the problem of "greenwashing" that many believe is prevalent today.[120] But unless the SEC's budget is increased, this will necessarily divert resources from other SEC priorities. That diversion may be warranted, but it is a cost that must be explicitly weighed in the discussion.[121]

Placing ESG disclosures in SEC filings also heightens the private liability risk faced by companies and directors and officers. This is perhaps the biggest elephant in the room. While ESG disclosures in stand-alone sustainability reports can theoretically give rise to private securities fraud liability, mandating that such disclosures be included in SEC filings heightens that risk considerably. First, stand-alone sustainability reports are not subject to the certification requirements imposed by the Sarbanes-Oxley Act that operate to heighten the liability exposure of CEOs and CFOs.[122] Disclosures in stand-alone sustainability reports also avoid exposure to Section 11 liability and to Rule 14a-9 liability, because Section 11 applies only to misrepresentations and omissions in a company's registration statement filed with the SEC in connection with a public offering[123] and Rule 14a-9 applies only to misrepresentations and omissions in a company's proxy solicitation materials.[124] Such disclosures are also less exposed to litigation under Rule 10b-5.[125] This is because sustainability reports have multiple audiences, so it remains open to a company to argue that a topic covered in such a report was not material within the meaning of the securities laws and did not affect its stock price. Companies also have freedom to couch statements in sustainability reports in aspirational or vague terms, which can help to reduce liability risk.[126] Indeed, some law firms recommend that companies phrase ESG disclosures in these terms for

120. *See* Fisch, *supra* note 98, at 963 (arguing that sustainability disclosures should be included within securities filings in part because it "would subject issuers' sustainability disclosures to SEC oversight and enforcement and clarify that fraudulent misrepresentations and omissions are actionable as securities fraud").

121. *See* Sommer, *supra* note 102, at 20 (warning that "[t]he hasty expansion of materiality concepts [to encompass matters of social concern] may well result in a strain on the resources of the Commission that will impair seriously its ability to do that which it has classically done so well—police the disclosure system and the securities markets").

122. 17 C.F.R. §§ 240.13a-14, 240.15d-14.

123. 15 U.S.C. § 77k.

124. 17 C.F.R. § 240.14a-9.

125. 17 C.F.R. § 240.10b-5.

126. *See* Thomas Lee Hazen, *Social Issues in the Spotlight: The Increasing Need to Improve Publicly-Held Companies' CSR and ESG Disclosures*, 33 U. PA. J. BUS. L. (forthcoming 2021) (manuscript at 33), https://ssrn.com/abstract=3615327 [https://perma.cc/4EHK-23Q2] (observing that "generalized statements about a company's commitment to ethical conduct likely will be considered aspirational and hence not materially misleading").

precisely this reason.[127] SEC-mandated disclosure would likely reduce this flexibility. As a consequence of the foregoing, it would be more difficult for a company to argue against the materiality of ESG information, at least in a manner that might support a motion to dismiss. Indeed, the House bill would render ESG disclosures "*de facto*" material.[128]

Some may perceive this as a benefit.[129] But others would view it as a major cost. The debate over the social value of "fraud-on-the-market" securities-fraud class actions is long-standing and passionate.[130] Fraud-on-the-market class actions threaten to impose massive damages on defendants and thus may have settlement value out of proportion to their merits, inviting strike suit litigation that taxes companies—and ultimately shareholders—and threatens to affect corporate disclosure practices in socially undesirable ways.[131] Concerns over strike suit litigation led to the adoption of the Private Securities Litigation Reform Act (PSLRA) in 1995, which makes it more difficult for a securities-fraud class action to get past a motion to dismiss.[132] Most importantly, the PSLRA requires plaintiffs to plead particularized facts giving rise to a strong inference of scienter and imposes a discovery stay until after a motion to dismiss has been decided.[133] It also contains a safe harbor for forward-looking statements accompanied by meaningful cautionary language or made without actual knowledge of their falsity.[134] The predictable form lawsuits related to ESG disclosures

127. *See, e.g.*, SOC'Y FOR CORP. GOVERNANCE & GIBSON, DUNN & CRUTCHER LLP, LEGAL RISKS AND ESG DISCLOSURES: WHAT CORPORATE SECRETARIES SHOULD KNOW 16–17 (2018), https://www.gibsondunn.com/wp-content/uploads/2018/06/Ising-Garbow-Meltzer-McPhee-White-Assaf-Legal-Risks-and-ESG-Disclosures-What-Corporate-Secretaries-Should-Know.pdf [https://perma.cc/5E6C-SA4G]; JONES DAY, MANAGING LEGAL RISKS FOR ESG DISCLOSURES UNDER U.S. LAW 3 (2019), https://www.jonesday.com/en/insights/2019/07/managing-legal-risks-for-esg-disclosures-us-law [https://perma.cc/8B9Z-GT6D]. This suggests that another potential way to achieve more robust ESG disclosure is to insulate such disclosures from liability exposure rather than heightening such exposure. *Cf.* Hazen, *supra* note 126, at 36–40 (suggesting that the SEC adopt a liability safe harbor rule to encourage ESG disclosures).

128. *See* ESG Disclosure Simplification Act of 2019, H.R. 4329, 116th Cong. § 2(b)(3) (2020).

129. *See, e.g.*, Fisch, *supra* note 98, at 965 (taking the position that, when it comes to policing SEC-mandated ESG disclosures, "private enforcement is likely to serve as a valuable supplement to public enforcement").

130. For an overview of the debate, see Amanda Marie Rose, *The Shifting Raison d'Etre of the Rule 10b-5 Private Right of Action*, in RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 39 (Sean Griffith, Jessica Erickson, David H. Webber & Verity Winship, eds., 2018).

131. *See id.*; *see also* Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1326–49 (2008) (exploring why private enforcement of Rule 10b-5 may lead to overenforcement and how it can complicate efforts to approximate optimal deterrence).

132. Private Securities Litigation Reform Act, Pub. L. No 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).

133. 15 U.S.C. § 78u–4(b).

134. 15 U.S.C. § 78u–5.

will take are of a sort, however, that are often immune from the PSLRA's protections against abusive litigation.

Imagine a company that has an industrial accident, or finds itself embroiled in a sexual harassment scandal, or experiences a cybersecurity breach. These are events that even the most prudently managed corporation cannot completely protect against, at least not at acceptable cost. They are also events that, when made public, can result in a meaningful stock-price decline. Imagine also that the company has in the past made representations in its SEC filings that speak to the company's management of workplace safety, human relations, or cybersecurity risks, as the case may be. Imagine further that a Rule 10b-5 class action is filed alleging that the relevant disclosures were misleading half-truths that helped the company maintain an artificially inflated stock price, because the company did not disclose facts available to the board which, at least in hindsight, appear to have suggested the unfortunate event was likely to occur or that the risk management strategies the company was undertaking were inadequate.

Cases like this—commonly referred to as "event-driven" securities litigation—have increased in prevalence in recent years,[135] and SEC-

135. *See* Kevin LaCroix, *First, Wildfires. Then What? Securities Litigation, of Course*, D&O DIARY (Nov. 18, 2018), https://www.dandodiary.com/2018/11/articles/securities-litigation/first-wildfires-securities-litigation-course/ [https://perma.cc/G8FD-334W] (explaining that fewer financial frauds have led to more event-driven securities class actions, where "the plaintiffs seek to rely on problems the defendant companies have experienced in their operations that caused their share price to drop," and that the rise in these suits is "one of the significant factors explaining why the number of securities lawsuits filings is so high above historical norms"); John C. Coffee, Jr., *Securities Litigation in 2017: "It Was the Best of Times, It Was the Worst of Times"*, COLUM. L. SCH. BLUE SKY BLOG (Mar. 19, 2018), https://clsbluesky.law.columbia.edu/2018/03/19/securities-litigation-in-2017-it-was-the-best-of-times-it-was-the-worst-of-times/ [https://perma.cc/FEV9-7LVN] (describing the "new trend" of "event-driven" class actions, where an adverse event like "an explosion, a crash, a mass torts episode (such as a toxic drug with a side effect)" will trigger a securities class action alleging that "investors were injured by the defendant company's failure to disclose its misconduct or negligence"); ELISA MENDOZA & JEFFREY LUBITZ, ISS SEC. CLASS ACTION SERVS., EVENT-DRIVEN SECURITIES LITIGATION: THE NEW DRIVER IN CLASS ACTION GROWTH (2020), https://www.issgovernance.com/file/publications/ISS-SCAS-Event-Driven-Securities-Litigation.pdf [https://perma.cc/9GUN-43XY] (documenting the rise in event-driven securities class actions and discussing examples of recent cases); U.S. CHAMBER INST. FOR LEGAL REFORM, A RISING THREAT: THE NEW CLASS ACTION RACKET THAT HARMS INVESTORS AND THE ECONOMY 12 (2018), https://instituteforlegalreform.com/wp-content/uploads/2020/10/A_Rising_Threat_Research_Paper-web_1.pdf [https://perma.cc/N8R6-TNEN] [hereinafter RISING THREAT] (explaining that event-driven securities class actions "typically contend that the defendant company's statements before the adverse event occurred misrepresented the risk that an oil platform would explode, that its products would be the subject of tort litigation, or that its systems containing employee or customer information would be hacked" or, alternatively, "that the company was obligated to disclose the risk of the adverse event and failed to do so"); U.S. CHAMBER INST. FOR LEGAL REFORM, CONTAINING THE CONTAGION: PROPOSALS TO REFORM THE BROKEN SECURITIES CLASS ACTION SYSTEM (2019), https://instituteforlegalreform.com/research/containing-the-contagion-proposals-to-reform-the-broken-securities-class-action-system/ [https://perma.cc/9KMG-8MN7] (arguing that the number of event-driven securities class actions continues to rise and offering regulatory and legislative solutions that the SEC and Congress could adopt to address the perceived problem).

mandated ESG disclosure would only accelerate this trend. Event-driven securities class actions can be difficult to get dismissed on the pleadings, even when of dubious merit.[136] Although it may be highly doubtful that the alleged omissions were material to investors or that the defendant corporation acted with the requisite scienter, courts may (and often do) allow cases like this to proceed past a motion to dismiss.[137] Unless the statement alleged to be misleading was so vague as to be considered puffery, questions of materiality are often treated by courts as raising factual questions inappropriate for resolution on a motion to dismiss. And whereas the PLSRA's heightened scienter pleading requirement creates a real barrier to frivolous claims alleging that defendants knew, or were reckless in not knowing, the falsity of an affirmative misstatement, scienter may not be rigorously examined in half-truth cases. This is because scienter will turn on whether the defendants knew, or were reckless in not knowing, that a reasonable investor would have viewed the challenged statement as misleading in light of the omission of some allegedly material fact. Whether a statement is misleading, and whether an omitted fact is material, turns on the perspective of a "reasonable investor," raising factual questions that courts may be reluctant to examine on a motion to dismiss.[138]

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136. *See* MENDOZA & LUBITZ, *supra* note 135, at 5 (the arguments made in event-driven litigation, "even if tenuous, do survive motions to dismiss"); JEFFREY A. DAILEY & NEAL ROSS MARDER, WILLIS TOWERS WATSON, THE RISE IN EVENT-DRIVEN SECURITIES LITIGATION: WHY IT MATTERS TO DIRECTORS AND OFFICERS 2 (2018), https://www.akingump.com/a/web/99361/aokuj/the-rise-in-event-driven-securities-litigation-why-it-matters-to.pdf [https://perma.cc/2GAP-D4G9] (explaining that despite their weakness, "not all [event-driven] cases are dismissed, and even those that are dismissed come with significant cost and disruption to a company"); Emily Strauss, *Is Everything Securities Fraud?*, UNIV. IRVINE L. REV. (forthcoming) (manuscript at 15–16), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3664132 [https://perma.cc/9ZFX-8G6E] (reporting regression results of empirical study indicating that securities class actions arising from misconduct where the most direct victims are not shareholders have significantly lower dismissal rates than cases where the primary victims are shareholders).

137. *See* John C. Coffee, Jr., *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, COLUM. L. SCH. BLUE SKY BLOG (Jan. 22, 2019), https://clsbluesky.law.columbia.edu/2019/01/22/the-changing-character-of-securities-litigation-in-2019-why-its-time-to-draw-some-distinctions/ [https://perma.cc/7PA5-QB66] (explaining that "[w]hen the risk seemed remote at the time the corporate issuer made its disclosures, both the materiality of the issuer's omission and its alleged scienter would seem open to serious challenge," but that although "many cases should and will be dismissed, this category of cases may remain viable"); Strauss, *supra* note 136; *see also id.* at 22 ("Many of the catastrophes that result in [event-driven] lawsuits may truly be black swan events, such that the risk that they might occur was so slight as to be immaterial, and thus disclosure of the risk was not required under the securities laws. Alternatively, even if the risk ultimately was material, managers may not have perceived it to be so, and therefore did not disclose the risk not because they thought they had anything to hide, but because they honestly and un-recklessly misjudged the likelihood that the disaster would occur. Under 10b-5, this constitutes mistake, rather than fraud, because the managers lacked scienter. In both of these situations, the fact of the underlying disaster opens the door to hindsight bias, potentially increasing pressure on defendants to settle.").

138. *See* Rose, *supra* note 61, at 101.

It can also be difficult to defeat class certification in event-driven litigation. To overcome individualized issues of reliance that would otherwise preclude class certification, plaintiffs in Rule 10b-5 class actions typically invoke the so-called "fraud-on-the-market" (FOTM) presumption of reliance first recognized by the Supreme Court in *Basic v. Levinson*.[139] The FOTM presumption proceeds from the notion that investors who did not actually read corporate disclosures nevertheless indirectly relied on them if the misrepresentation impacted the price that they paid for their securities. To invoke the presumption a plaintiff must prove that: the alleged misrepresentations were publicly known; the stock traded in an efficient market; and the plaintiff traded the stock between when the misrepresentations were made and when the truth was revealed.[140] Plaintiffs must also plead—but need not prove until trial—that the misrepresentations were material.[141] As the Supreme Court has explained:

> Each of these requirements follows from the fraud-on-the-market theory underlying the presumption. If the misrepresentation was not publicly known, then it could not have distorted the stock's market price. So too if the misrepresentation was immaterial—that is, if it would not have "been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"—or if the market in which the stock traded was inefficient. And if the plaintiff did not buy or sell the stock after the misrepresentation was made but before the truth was revealed, then he could not be said to have acted in reliance on a fraud-tainted price.[142]

The Supreme Court has held that even though defendants cannot rebut the presumption at class certification by arguing that the misstatement was immaterial (an issue that must await resolution until summary judgment or trial), defendants are entitled to present evidence of a lack of "price impact" to do so—*viz.*, evidence that the asserted misrepresentation (or its correction) did not in fact affect the market price of the defendant's stock.[143]

In traditional securities fraud cases alleging, for example, misrepresented financial results, defendants attempt to rebut price impact by presenting an event study showing either the lack of a statistically significant abnormal stock price increase at the time the challenged statement was made or the

139. Basic Inc. v. Levinson, 485 U.S. 224 (1988). The Supreme Court recently was asked to overturn its holding in *Basic* but declined. *See Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014).

140. *Halliburton*, 573 U.S. at 277–78.

141. *Id.* at 278.

142. *Id.* at 278 (quoting *Basic, Inc.*, 485 U.S. at 231–32).

143. *Id.* at 283.

lack of a statistically significant abnormal stock price decline on the date that the falsity of the alleged misstatement was revealed (the so-called "corrective date"). In event-driven litigation, however, both routes are typically unavailing. As to the former, plaintiff's theory is not that the misleading statement inflated the stock price at the time it was made, but that it operated to *maintain* the company's already inflated stock price. As to the latter, the "corrective date" will be the date on which a negative event occurred triggering a meaningful stock price decline—while all or most of that drop will reflect a "materialization of the risk and not the amount by which the price was previously inflated because the market was fooled into believing the risk was lower than it really was," that is not something that an event study can easily establish.[144]

An alternative potential way to establish a lack of price impact would be to argue that the statements at issue were too generic to have had any impact on the stock price. The Second Circuit recently held, however, that this is impermissible, reasoning that allowing this type of evidence would effectively permit a defendant to smuggle in evidence on materiality at class certification that should await consideration until summary judgment or trial.[145] The Supreme Court has agreed to review the Second Circuit's decision; in its cert petition the defendant argued that review was warranted in part because under the Second Circuit's reasoning "[t]he ease with which inflation-maintenance plaintiffs will be able to obtain class certification will further incentivize the troubling practice of 'event-driven securities litigation.'"[146]

The difficulties associated with terminating event-driven securities litigation at the motion to dismiss or class certification stage, coupled with the costs of discovery and extremely large potential damage awards typical in this sort of litigation,[147] means that the risk of vexatious litigation is

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144. Merritt B. Fox & Joshua Mitts, Calamity: The Hazards of Event-Driven Securities Litigation 4 (August 28, 2020) (manuscript on file with author); *see also* RISING THREAT, *supra* note 135, at 14 (explaining that the "'event' invariably causes a very large drop in the company's stock price," and that while "all or most of that drop will be attributable to the adverse event itself, and the consequences for the company's future profitability," the "securities class action complaint will assert that the price drop resulted from the supposed 'correction' of prior false statements or material omissions" and "that the potential damages in the securities case are tied to that very large price drop, which the plaintiffs' lawyers will use to argue for a large settlement, if the case proceeds past the motion to dismiss").

145. Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc., 955 F.3d 254, 268 (2d. Cir. 2020), *cert. granted sub nom.*, Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys., 2020 WL 7296815 (U.S. Dec. 11, 2020) (No. 20-222).

146. Petition for Writ of Certiorari, Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys., 2020 WL 5040492, at *26 (No. 20-222).

147. Donald C. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 GEO. L.J. 967, 971 (2019) (observing that "there is a feverish effort by

high.[148] This has led many to voice concerns about event-driven litigation.[149] These critics include not just groups like the U.S. Chamber Institute for Legal Reform that have a vested interest in reducing corporate liability exposure,[150] but also respected scholars[151] and even shareholder-oriented groups like Institutional Shareholder Services.[152] Any serious

the plaintiffs' lawyers to maximize the size of the class—and the resulting recovery—by identifying as many false or misleading statements tied to the disaster, as far back in time as possible").

148. Strauss, *supra* note 136, at 18 (arguing that "[t]he pressure to settle even claims with a low probability of success is compounded in event-driven cases for several reasons," including that: (1) "such firms are typically fighting battles on multiple fronts" and "might not have the resources to devote to battling out a shareholder lawsuit of even unclear merit, particularly when doing so will likely keep the initial misconduct in the news cycle and the stock price depressed"; and (2) "the application of 10b-5 jurisprudence in event-driven securities cases has been inconsistent, leading to great uncertainty for defendants"). Proponents of mandatory ESG-disclosure have downplayed the associated private liability risk by pointing out that plaintiffs bear the burden of proving that they suffered a loss as a result of a misleading half-truth, see, e.g., Fisch, *supra* note 98, at 965, but plaintiffs' burden to prove loss causation does little to mitigate the risk of vexatious litigation. Loss causation is an issue that generally cannot be resolved prior to the completion of discovery: it can be averred generally in the complaint, and the Supreme Court has held that defendants cannot present evidence of a lack of loss causation in opposition to class certification. *See* Erica P. John Fund, Inc. v. Halliburton Co., 563 U.S. 804 (2011).

149. *See, e.g.*, Kevin LaCroix, *Scrutinizing Event-Driven Securities Litigation*, D&O DIARY (Mar. 27, 2018), https://www.dandodiary.com/2018/03/articles/securities-litigation/scrutinizing-event-driven-securities-litigation/ [https://perma.cc/XQM8-TLU3] ("I have been sounding the alarm on event-driven cases for some time now. While on the one hand, these cases often lack merit (for example, they are often fatally deficient on scienter or causation allegations), on the other hand, their sheer volume means cost and vexation for companies and their insurers. The fact is that in the ebb and flow off [*sic*] day to day business, many companies face setbacks or hit unexpected operational hurdles. It is bad enough that these companies must deal with the adverse circumstances; increasingly they must also deal with a resulting securities lawsuit as well."); JEFFREY A. DAILEY & NEAL ROSS MARDER, *supra* note 136, at 1 ("The inherent problem in all event-driven securities litigation is that just because something bad happened does not mean that the company or its directors and officers committed fraud. Because many of these events relate to business or operational risks that are known or already subject to a company's risk disclosures, many of the event-driven suits are based on the tenuous theory that the occurrence or the event upon which the case is based was the materialization of an under-disclosed or downplayed risk.").

150. RISING THREAT, *supra* note 135, at 2 (arguing that these cases "are powerful weapons for extorting settlements, regardless of the merits, due to the cost of defending the case in court and the reputational harm to the defendant company were the underlying event to appear in the headlines"); *cf.* Julie G. Reiser & Steven J. Toll, *Event-Driven Litigation Defense*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (May 23, 2019), https://corpgov.law.harvard.edu/2019/05/23/event-driven-litigation-defense/ [https://perma.cc/4U9B-L8ND] (reacting to the Chamber's position and arguing that "event-driven cases serve as a deterrent to companies who might otherwise conceal or misrepresent their operations because they recognize that investors will hold them accountable for doing so").

151. Coffee, Jr., *supra* note 135 (observing that the "trend in 'event-driven' litigation appears to be to file early, soon after the stock drop, and without the more elaborate investigation that the larger established plaintiff's firms today employ in securities litigation [focused on more traditional financial frauds]"); Fox & Mitts, *supra* note 144, at 2 ("[T]oo many event-driven suits have survived past the motion to dismiss stage when the allegations in their complaints should have been found insufficient with respect to either loss causation or materiality.").

152. MENDOZA & LUBITZ, *supra* note 135, at 2 ("[T]he new trend of event-driven securities class action litigation is on the rise and resulting in more and more recoveries for shareholders, despite more tenuous arguments being the basis of the lawsuits."); *id.* at 4 (observing that "[e]vent-driven suits are based on a more tenuous argument than core accounting" cases).

discussion regarding the adoption of a broad SEC-mandated ESG disclosure regime cannot ignore these concerns.

It should also be recognized that investors have alternative tools at their disposal to achieve greater consistency and credibility in corporate ESG disclosures, raising the question of why a mandatory regulatory solution should be favored over a market-based solution. Investors can submit precatory proposals under Rule 14a-8 requesting greater board involvement in ESG disclosure practices or ESG risk oversight, for example.[153] If investors can reach a consensus on which ESG disclosure framework they prefer, they can also use Rule 14a-8 or informal engagement to promote its use. They could use similar techniques to encourage integrated ESG reporting in SEC filings, if they view that as independently important.

It appears that these techniques are already bearing considerable fruit. During the 2019 proxy season, Glass Lewis found that "approximately 43% of Russell 1000 companies had established some sort of board oversight of ESG issues."[154] Moreover, in Larry Fink's 2020 letter to CEOs he asked the companies Blackrock invests in to: (1) publish a disclosure in line with industry-specific SASB guidelines by year-end, or disclose a similar set of data in a way that is relevant to the particular business; and (2) disclose climate-related risks in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).[155] Other leading asset managers, such as State Street and Vanguard, have similarly called on

153. 17 C.F.R. § 240.14a-8. SEC Rule 14a-8 permits shareholders of publicly held companies to require management to include shareholder-sponsored proposals in management's proxy statement if certain procedural requirements are met and the substance of the proposal does not fall within one of several enumerated bases for exclusion. *See* Harwell Wells, *"Corporation Law Is Dead": Heroic Managerialism, Legal Change, and the Puzzle of Corporation Law at the Height of the American Century*, 15 U. PA. J. BUS. L. 305, 340 (2013) ("SEC Rule 14a-8 . . . was first adopted in 1942, in what could be seen as a late burst of New Deal enthusiasm for grassroots (shareholder) democracy; the requirement is still sometimes referred to as the 'Town Hall rule.'"). In recent years, "shareholders have enjoyed considerable success under the [] rule in requiring management to include shareholder proposals relating to social issues." Thomas Lee Hazen, *Corporate and Securities Law Impact on Social Responsibility and Corporate Purpose*, 62 B.C. L. REV. (forthcoming 2021) (manuscript at 37), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542833 [https://perma.cc/XF9R-CC6T]; *see also id.* at 37 nn.220–22 (citing examples of instances where the SEC staff has refused to allow management to exclude shareholder proposals "relating to sustainability, climate change, and ESG"); *cf.* Stephen M. Bainbridge, *Revitalizing SEC Rule 14a-8's Ordinary Business Exclusion: Preventing Shareholder Micromanagement by Proposal*, 85 FORDHAM L. REV. 705 (2016) (critiquing this trend). While the SEC recently tightened the ownership requirements for submitting shareholder proposals and heightened the level of shareholder support a proposal must receive to be eligible for resubmission, it did not broaden the substantive bases upon which management can exclude shareholder proposals. *See* Press Release, SEC, SEC Adopts Amendments to Modernize Shareholder Proposal Rule (Sept. 23, 2020), https://www.sec.gov/news/press-release/2020-220 [https://perma.cc/S5YR-8U97].

154. *Proxy Talk: How Corporate Boards Can Oversee ESG Issues*, GLASS LEWIS (Apr. 29, 2020), https://www.glasslewis.com/proxy-talk-how-corporate-boards-can-oversee-esg-issues/ [https://perma.cc/W7WF-BG9M].

155. Fink, *supra* note 2.

companies to align their ESG disclosures with the SASB standards and TCFD recommendations.[156] Moreover, calls for greater consistency and comparability in ESG disclosures have led major standard setters to begin efforts at harmonization.[157] While the proposals seeking an SEC-mandated ESG disclosure framework have emphasized the failure of market forces over the past several decades to produce "consistent, comparable, highly-reliable ESG information," they may have spoken too soon.[158]

A final point is in order. The concerns raised thus far are likely to resonate most strongly with those who possess a free-market orientation. But progressive scholars have also warned against the tendency to try to

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156. *See, e.g.*, RON O'HANLEY, STATE ST., THE ESG OPPORTUNITY FOR CORPORATE DIRECTORS: FIVE QUESTIONS FOR ESG BOARD OVERSIGHT 8 (2021), https://www.statestreet.com/content/dam/statestreet/documents/Articles/ron-ohanley-esg-opportunity-for-corporate-directors.pdf [https://perma.cc/VT78-7CXZ] ("State Street, like other large investors, has endorsed SASB and TFCD as two market-driven frameworks that ask companies to provide decision-useful information in a consistent way"). Companies appear to be listening. *See* Larry Fink, *Larry Fink's 2021 Letter to CEOs*, BLACKROCK (2021), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter [https://perma.cc/KZ63-CBDK] ("We are greatly encouraged by the progress we have seen over the past year – a 363% increase in SASB disclosures and more than 1,700 organizations expressing support for the TCFD."). While the influence of asset managers weakens the case for SEC-mandated ESG disclosure, it raises controversies of its own. *See supra* note 12; *see also* Saura Masconale & Simone M. Sepe, Corporate Conformism (Eur. Corp. Governance Inst., L. Working Paper No. 568, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3793035 (arguing that investor-induced corporate conformism on contested moral issues undermines pluralistic values). An examination of these controversies falls outside the scope of this Article.

157. *See SASB & Other ESG Frameworks: The Sustainability Reporting Ecosystem*, SUSTAINABILITY ACCT. STANDARDS BD., https://www.sasb.org/about/sasb-and-other-esg-frameworks/ [https://perma.cc/8TZ5-5K3X] (reporting that in "September 2020, five leading framework and standard-setting organizations—CDP, CDSB, GRI, IIRC and SASB—announced a shared vision for a comprehensive corporate reporting system that includes both financial accounting and sustainability disclosure, connected via integrated reporting," and that in "response to global market demands for convergence, in November 2020 the IIRC and SASB announced their intention to merge into a unified organization, the Value Reporting Foundation"); *see also* Press Release, Int'l Integrated Reporting Council, IIRC and SASB Announce Intent to Merge in Major Step Towards Simplifying the Corporate Reporting System (Nov. 25, 2020), https://integratedreporting.org/news/iirc-and-sasb-announce-intent-to-merge-in-major-step-towards-simplifying-the-corporate-reporting-system/ [https://perma.cc/4524-X3RB]; IMPACT MGMT. PROJECT, WORLD ECON. F. & DELOITTE, STATEMENT OF INTENT TO WORK TOGETHER TOWARDS COMPREHENSIVE CORPORATE REPORTING (2020), https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf [https://perma.cc/Z3UQ-EXRK]; Sustainability Acct. Standards Bd., Promoting Clarity and Compatibility in the Sustainability Landscape: GRI and SASB Announce Collaboration (July 12, 2020), https://www.sasb.org/blog/gri-and-sasb-announce-collaboration-sustainability-reporting/ [https://perma.cc/H3HT-5KVB]; Oliver Cann, *Measuring Stakeholder Capitalism: World's Largest Companies Support Developing Core Set of Universal ESG Disclosures*, WORLD ECON. F. (Jan. 22, 2020), https://www.weforum.org/press/2020/01/measuring-stakeholder-capitalism-world-s-largest-companies-support-developing-core-set-of-universal-esg-disclosures [https://perma.cc/CN9E-3RLS].

158. Request for Rulemaking from Cynthia A. Williams & Jill E. Fisch, *supra* note 35, at 12; *see also* Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 431–56 (2018) (arguing that private ordering is insufficient to address investors' need for ESG-related information).

expand the scope of the federal securities laws in service of non-financial interests. In a recent article, Professor Ann Lipton warns of the "detrimental effects of relying on investor-oriented disclosure to serve the needs of the general public."[159] She argues that funneling demands for ESG disclosure through the SEC encourages advocates for information disclosure geared toward stakeholder audiences to conceal their true motives and that this prevarication comes at real cost, as the "need to emphasize financial risk and shareholder return inhibits a fuller discussion of the *societal* need for such information" and risks "contributing to a discourse that suggests that investors are the only members of society who matter."[160] She also points out that SEC-mandated ESG disclosure would fail to reach a growing number of large and socially impactful private companies, not subject to SEC-imposed disclosure obligations.[161] A better approach, in Lipton's view, is to push for a generalized disclosure system designed for stakeholder as opposed to investor interests.[162]

CONCLUSION

Henry Kissinger is credited with coining the idea of "constructive ambiguity" as a negotiating tactic, one that employs the deliberate use of ambiguous language on sensitives topics to advance some political purpose. But ambiguity can be destructive as well, particularly if the end sought is sound public policy. Whether the SEC ought to mandate "ESG" disclosure, and if so, how, can be approached and debated on a discrete, topic by topic basis, like any other item of arguably material information. If the call instead is for the SEC to adopt a broad ESG disclosure framework modeled on frameworks designed to meet the informational needs of stakeholder-inclusive audiences, then the significance of the request should be recognized and the difficult questions it raises openly addressed.

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159. Lipton, *supra* note 63, at 504.

160. *Id.* at 555, 560.

161. *See id.* at 519–26.

162. *Id. See also* David W. Case, *Corporate Environmental Reporting as Informational Regulation: A Law and Economics Perspective*, 76 U. COLO. L. REV. 379, 383, 410 (2005) (advocating for the use of "informational regulations," defined as "government mandated public disclosure of information on the environmental performance of regulated entities," to supplement command-and-control environmental regulatory strategies, but observing that "the SEC is not the appropriate agency, nor federal securities law the appropriate vehicle, to develop a comprehensive informational regulatory approach to environmental protection based on a paradigm of formal corporate environmental reporting"); *cf.* Bebchuk & Tallarita, *supra* note 10, at 58–66 (arguing that taking a stakeholder view of corporate governance could harm society by insulating corporate leaders and impeding policy reforms that would offer stakeholders greater protection); Matteo Gatti & Chrystin Ondersma, *Can A Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera*, 46 IOWA J. CORP. L. 1 (2020) (arguing that stakeholderism will hurt not help the intended beneficiaries).