Making Sustainability Disclosure Sustainable

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Sustainability is receiving increasing attention from issuers, investors, and regulators. The desire to understand issuer sustainability practices and their relationship to economic performance has resulted in a proliferation of sustainability disclosure regimes and standards. The range of approaches to disclosure, however, limits the comparability and reliability of the information disclosed. The Securities and Exchange Commission (SEC)'s longstanding policy that sustainability is not properly part of financial disclosure has contributed to the current regime. Although the SEC has solicited comment on whether to reverse this policy and require expanded sustainability disclosures in issuers' periodic financial reporting, and investors have communicated broad-based support for such expanded disclosures, the SEC to date still has not required general sustainability disclosure.

This Article argues that claims about the relationship between issuer sustainability practices and risk management, business plans, and economic vulnerability warrant incorporating sustainability information into SEC-mandated financial reporting. Perhaps even more important, in light of the growing pressure for issuers to adopt sustainable business practices and the responsiveness of many issuers to this pressure, is the need for issuers, investors, and regulators to obtain the information necessary to evaluate claims about the economic impact of sustainability initiatives.

Drawing upon the existing narrative disclosure frameworks in SEC-mandated reporting requirements, this Article offers an innovative proposal for sustainability disclosure—a sustainability discussion and analysis, or "SD&A," section of the annual report. This Article identifies the critical components necessary to make mandated sustainability disclosure both practical and cost-effective and offers a workable first step for integrating sustainability disclosure into issuer financial reporting.

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INTRODUCTION

In January 2018, Larry Fink, CEO of BlackRock, made headlines when he called upon corporations to pay greater attention to sustainability and societal impact in his annual letter to CEOs.[1] As Fink explained, "[A] company's ability to manage environmental, social, and governance matters demonstrates the leadership and good governance that is so essential to sustainable growth, which is

1. *See, e.g.*, Sarah Krouse, *BlackRock CEO to Companies: Pay Attention to 'Societal Impact,'* WALL ST. J. (Jan. 16, 2018, 3:11 PM), https://www.wsj.com/articles/blackrock-ceo-to-companies-pay-attention-to-societal-impact-1516120840 [https://perma.cc/QEY5-YKPH] (reporting Fink's letter); Andrew Ross Sorkin, *BlackRock's Message: Contribute to Society, or Risk Losing Our Support*, N.Y. TIMES: DEALBOOK (Jan. 15, 2018), https://www.nytimes.com/2018/01/15/business/dealbook/blackrock-laurence-fink-letter.html [https://nyti.ms/2FHQonI] (same).

why we are increasingly integrating these issues into our investment process."[2] One reporter termed the letter "a watershed moment on Wall Street."[3]

Fink's letter was a high-profile example of a leading institutional investor expressing concern about corporate sustainability, but it was not an isolated occurrence. Investor focus on sustainability is accelerating.[4] Even Martin Lipton has acknowledged that "sustainability has become a major, mainstream governance topic."[5] The debate over sustainability is leading investors, executives, and directors to rethink how corporations engage in long-term value creation.[6]

The extent to which corporations should incorporate sustainability objectives into their operational decisionmaking is highly contested, as is the relationship between societal impact and economic value.[7] Indeed, the Department of Labor subsequently issued new guidelines for retirement plans cautioning that "[f]iduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision."[8] At the same time, however, issuers are modifying their operations in response both to investor demands and to the claim that sustainable business practices lead to improved economic performance.[9] Being able to assess an issuer's sustainability

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2. Larry Fink, *Larry Fink's Annual Letter to CEOs: A Sense of Purpose*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter [https://perma.cc/YA6G-5ZKE] (last visited Mar. 7, 2019).

3. Sorkin, *supra* note 1.

4. *See, e.g.*, GREGORY UNRUH ET AL., MIT SLOAN MGMT. REV., INVESTING FOR A SUSTAINABLE FUTURE: FINDINGS FROM THE 2016 SUSTAINABILITY GLOBAL EXECUTIVE STUDY AND RESEARCH PROJECT 3 (2016), http://marketing.mitsmr.com/offers/SU2016/57480-MITSMR-BCG-Sustainability2016.pdf?utm_source=WhatCounts%2c+Publicaster+Edition&utm_medium=email&utm_campaign=surpt16&utm_content=Download+the+Report+(PDF)&cid=1 [https://perma.cc/9SD6-TC5E] ("[A] growing number of investors are paying attention to ESG performance, as evidence mounts that sustainability-related activities are material to the financial success of a company over time.").

5. Martin Lipton, *Spotlight on Boards 2018*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 31, 2018), https://corpgov.law.harvard.edu/2018/05/31/spotlight-on-boards-2018/ [https://perma.cc/J4H2-4ZF7]. Sustainable investing has even been embraced by several activist hedge funds such as Jana and Trian. *See* Charles M. Nathan, *On Governance: ESG Investing Takes on New Meaning for Activist Hedge Funds and Corporate Boards*, CONF. BD. (Jan. 29, 2018), https://www.conference-board.org/blog/postdetail.cfm?post=6697 [https://perma.cc/XGF4-6JK2] (exploring and critically evaluating the ESG strategies of Trian Partners and Jana Partners).

6. *See* UNRUH ET AL., *supra* note 4, at 7 (reporting survey results indicating that "more than 80% of investor respondents indicate that good sustainability performance increases a company's potential for long-term value creation").

7. *See, e.g.*, Robert G. Eccles, Ioannis Ioannou & George Serafeim, *The Impact of Corporate Sustainability on Organizational Processes and Performance*, 60 MGMT. SCI. 2835, 2836 (2014) (describing study finding that companies which voluntarily adopted sustainability policies by 1993 outperformed their counterparts over the long term).

8. John J. Canary, *Field Assistance Bulletin No. 2018-01*, U.S. DEP'T OF LABOR (Apr. 23, 2018), https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01 [https://perma.cc/RDZ9-9SBU].

9. *See, e.g.*, KPMG, ESG, STRATEGY, AND THE LONG VIEW: A FRAMEWORK FOR BOARD OVERSIGHT 7 (2017), https://assets.kpmg.com/content/dam/kpmg/lu/pdf/lu-en-esg-strategy-framework-for-board-oversight.pdf ("Some of the largest U.S. corporations are publicly emphasizing the strategic importance of ESG to their businesses . . . ."); *The UN Global Compact—Accenture Strategy CEO Study*,

practices is critical to evaluating the effect of sustainability practices on economic value. For investors and capital markets to consider the societal impact of a firm's operations—and to determine the consequences of that impact—they must have access to adequate sustainability disclosure.

Therein lies the problem. Although the focus on increasing sustainability disclosure is accelerating both in the United States and globally,[10] investors continue to report dissatisfaction with existing disclosures.[11] Recognizing this dissatisfaction, the SEC has raised the question of whether it should require increased sustainability disclosure as part of its "Disclosure Effectiveness Initiative."[12] The SEC received thousands of responses urging it to do so.[13] Investors continue to request the SEC to "initiate rulemaking to develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful environmental, social, and governance information."[14]

One reason for concern with current disclosure practices is that most existing sustainability reporting is voluntary, which means that individual issuers choose

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ACCENTURE (2016), https://www.accenture.com/us-en/insight-un-global-compact-ceo-study [https://perma.cc/39W3-MHMN] ("Eighty-five percent of CEOs say they have embedded sustainability into the business even where they cannot quantify the benefits.").

10. "Thousands of companies around the world, including 95 percent of the Global Fortune 250, voluntarily report on their environmental, societal, and economic impacts." Adam Sulkowski & Sandra Waddock, *Beyond Sustainability Reporting: Integrated Reporting Is Practiced, Required and More Would Be Better*, 10 U. ST. THOMAS L.J. 1060, 1061 (2013).

11. For example, a 2014 PWC survey reported levels of investor dissatisfaction with existing sustainability disclosures ranging from thirty-eight percent in Europe to sixty-one percent in the United States and as high as eighty-three percent in the Middle East and North Africa. PWC, SUSTAINABILITY GOES MAINSTREAM: INSIGHTS INTO INVESTOR VIEWS 7 (2014), https://www.pwc.com/us/en/pwc-investor-resource-institute/publications/assets/pwc-sustainability-goes-mainstream-investor-views.pdf. Michael Bloomberg, who chairs the Sustainability Accounting Standards Board, stated in 2015 that "for the most part, the sustainability information that is disclosed by corporations today is not useful for investors or other decision-makers." Bloomberg, IMPACT REPORT UPDATE 2015, at 2 (2016), https://data.bloomberglp.com/company/sites/39/2018/03/Impact_Report_2015.pdf.

12. *See, e.g.*, Rick A. Fleming, Investor Advocate, U.S. Sec. & Exch. Comm'n, Moving Forward with the Commission's Disclosure Effectiveness Initiative, Speech at the NASAA Corporation Finance Training, Houston, Texas (Nov. 19, 2016), https://www.sec.gov/news/speech/moving-forward-with-the-disclosure-effectiveness-initiative.html [https://perma.cc/6TNH-N8X5] (describing the initiative as partially a response to legislation ordering the SEC to revise Regulation S–K but explaining that the initiative is "broader in its objectives and scope"). The SEC issued a staff report on the effectiveness of the disclosure requirements in Regulation S–K in December 2013. U.S. SEC. & EXCH. COMM'N, REPORT ON REVIEW OF DISCLOSURE REQUIREMENTS IN REGULATION S–K (2013), https://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf. In April 2016, the SEC issued a concept release on disclosure effectiveness, which, in part, invited comment on the extent to which SEC rules should mandate sustainability disclosure. Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916 (proposed Apr. 22, 2016).

13. *See generally* TYLER GELLASCH, AFL–CIO ET AL., TOWARDS A SUSTAINABLE ECONOMY: A REVIEW OF COMMENTS TO THE SEC'S DISCLOSURE EFFECTIVENESS CONCEPT RELEASE (2016), https://www.citizen.org/sites/default/files/sustainableeconomyreport.pdf (summarizing responses to the SEC's Concept Release on Disclosure Effectiveness).

14. Cynthia A. Williams & Jill E. Fisch, *Request for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure*, U.S. SEC. & EXCH. COMM'N 16 (Oct. 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf [hereinafter *Petition for Rulemaking*].

which information to disclose. The resulting lack of standardization means that issuer disclosures vary substantially, which impedes comparability.[15] A second concern is that sustainability reporting is typically characterized as "non-financial" reporting[16] and is distinct in location, format, and rigor from other investor-oriented information. Finally, sustainability reporting varies widely in quality, and its accuracy is rarely audited or monitored, reducing its effectiveness as a tool for improving accountability.[17]

These limitations impede the ability of investors and researchers to evaluate the sustainability practices of issuers and to analyze the relationship between sustainable practices and economic performance. Investors are demanding greater sustainability, and issuers are responding to these demands, without reliable evidence of sustainability's economic impact. One possible solution is to continue the reliance on private ordering but seek common standards to facilitate comparability.[18] A variety of standard setters are assisting in the process by developing and publishing sustainability metrics, ratings, and guidelines.[19] This variety is itself a problem, in that it increases search costs for investors and makes it challenging to compare information from different providers.[20] The quality of third-party information is diminished because most standard setters rely on information voluntarily supplied by issuers, either directly to the standard setter or through

15. By way of example, both General Motors and Ford provide differing information on the same topic: their respective electric vehicle developments. General Motors describes the number of electric vehicles it intends to bring to market by 2023 and the number of miles driven in its electric vehicles. *See 2017 Sustainability Report: 2017 Highlights*, GEN. MOTORS, https://www.gmsustainability.com/aspire/highlights.html [https://perma.cc/C9QU-GTR6] (last visited Sept. 10, 2018). Ford reports on the number of hybrid and fully-electric vehicles it intends to bring to market by 2022, the size of its investment in electric vehicles, and the progress of several specific global partnerships on electrified vehicles. *See Sustainability Report 2017/18: Scaling Up Electrification*, FORD, https://corporate.ford.com/microsites/sustainability-report-2017-18/driving-change/electrification.html [https://perma.cc/QN7M-UWPQ] (last visited Feb. 13, 2019).

16. NASDAQ, ESG REPORTING GUIDE: A SUPPORT PROGRAM FOR NASDAQ ISSUERS FOCUS AREA: NORDIC & BALTIC MARKETS 10 (2017), http://business.nasdaq.com/media/ESG-Reporting-Guide_tcm5044-41395.pdf.

17. *See* Patrick Odier, *Why Lack of Data is the Biggest Hazard in 'Green Investing,'* FIN. TIMES (Mar. 6, 2017), https://www.ft.com/content/be8e5db2-0249-11e7-aa5b-6bb07f5c8e12 [https://perma.cc/5NB5-U55D] ("[D]ata on the real-world impact that companies exert is poor, incomplete, non-standardised, or inaccessible.").

18. For example, the Sustainability Accounting Standards Board (SASB) has been engaged in a multi-year project, in conjunction with issuers and investors, to develop common standards for disclosure of material sustainability information. *See generally Standards Overview*, SASB, https://www.sasb.org/standards-overview/ [https://perma.cc/BEP2-E5R7] (last visited Feb. 13, 2019) (describing the development of the SASB's sustainability standards).

19. Elisse B. Walter, *The Future of Sustainability Disclosure: What Remains Unchanged in an Environment of Regulatory Uncertainty?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 7, 2016), https://corpgov.law.harvard.edu/2016/12/07/the-future-of-sustainability-disclosure-what-remains-unchanged-in-an-environment-of-regulatory-uncertainty/ [https://perma.cc/QBH9-TWB6].

20. *See, e.g.*, Charles E. Merrill, *The SEC Revisits Sustainability: Will Sustainability Reporting Become Mandatory for Publicly-Traded U.S. Corporations?*, LEXOLOGY (Oct. 7, 2016), https://www.lexology.com/library/detail.aspx?g=8148a821-b3d0-4e23-b7de-55b06f9ed7da [https://perma.cc/UZA4-YFRU] ("[T]he current patchwork of ESG reporting methods does not make such information readily accessible.").

public disclosures. In addition, to the extent that standard setters use proprietary methodologies or information that is not publicly available, the significance of their ratings is not transparent and is difficult to evaluate.

Another option is mandatory sustainability disclosure. Several jurisdictions have imposed or are considering imposing mandatory disclosure requirements related to specific sustainability issues.[21] One example of the move toward mandatory sustainability disclosure is the 2014 European Union (EU) Directive on the Disclosure of Non-Financial and Diversity Information, which required certain issuers to begin providing specific sustainability disclosures in 2018.[22]

Commentators in the United States have repeatedly called upon the SEC to do more to formalize sustainability disclosure.[23] The incorporation of sustainability reporting into the disclosure requirements of the federal securities laws faces obvious political obstacles, particularly under a presidential administration that publicly embraces a deregulatory approach.[24] Apart from the political obstacles, however, there are concerns about the practicability of developing a workable structure for mandatory disclosure. Sustainability disclosures must be specific enough to provide investors and capital markets with meaningful and readily

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21. *See infra* notes 114–17 and accompanying text.

22. Directive 2014/95, of the European Parliament and of the Council of Oct. 22, 2014, art. 1, 2014 O.J. (L 330/1) 1, 5 (EU). The Directive requires non-financial reporting by 1) large companies, 2) "public-interest" entities, and 3) companies with more than 500 employees per year, on average. CSR EUR. & GRI, MEMBER STATE IMPLEMENTATION OF DIRECTIVE 2014/95/EU, at 8 (2017), https://www.globalreporting.org/resourcelibrary/NFRpublication%20online_version.pdf (explaining these criteria).

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

23. *See, e.g.*, Heather Slavkin Corzo, Dir., Office of Inv., AFL–CIO, Comment Letter on Concept Release Regarding Business and Financial Disclosure Required by Regulation S–K (July 21, 2016), https://www.sec.gov/comments/s7-06-16/s70616-305.pdf ("[G]iven the clear and growing demand from investors for environmental, social and governance ('ESG') information, the Commission must begin requiring ESG related line-item disclosures as well as a process to incorporate emerging ESG metrics into disclosure in the future."); Che Odom, *Investors Want Sustainability Disclosures in SEC Overhaul*, BLOOMBERG (July 21, 2016), https://www.bna.com/investors-sustainability-disclosures-n73014445099/ [https://perma.cc/8AB2-LTH7] ("Investor advocates are making a strong push for the SEC to require annual, uniform sustainability reporting from public companies as part of the overhaul of the agency's disclosure regime.").

24. The Trump administration and the Republican Congress announced their intention to reduce or repeal existing disclosure requirements such as for resource extraction and conflict minerals. *See* Financial Choice Act of 2017, H.R. 10, 115th Cong. § 862(a) (Discussion Draft 2017), https://financialservices.house.gov/uploadedfiles/choice_2.0_discussion_draft.pdf (proposing a repeal of sections 1502–06 of the Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 2213–22 (2010) (codified as amended in scattered sections of 12 and 15 U.S.C.), relating to "[c]onflict minerals," "[r]eporting requirements regarding coal or other mine safety," "[d]isclosure of payments by resource extraction issuers," "[s]tudy by the Comptroller General," and "[s]tudy on core deposits and brokered deposits"); Press Release, Office of Mgmt. & Budget, Exec. Office of the President, Statement of Administration Policy on Substitute Amendment to H.R. 10 – Financial CHOICE Act of 2017 (June 6, 2017), https://www.whitehouse.gov/sites/whitehouse.gov/files/briefing-room/presidential-actions/related-omb-material/saphr10h_20170606.pdf (expressing the Trump administration's support for the Financial CHOICE Act of 2017 bill).

comparable information. At the same time, relevant sustainability issues vary substantially by issuer and industry, making a detailed line-item approach less feasible.[25] The alternative, a principles-based approach, complicates policing the accuracy of issuer disclosures and risks producing low-quality or boilerplate disclosures.[26]

This Article proposes a solution—mandating a "Sustainability Discussion and Analysis" (SD&A) as part of an issuer's annual report to shareholders.[27] The SD&A would be modeled after existing Management Discussion and Analysis (MD&A) and Compensation Discussion and Analysis (CD&A) and would reflect a similar principles-based approach to those provisions, requiring issuers to address those sustainability issues most important to their operations.[28]

This Article proposes that the SD&A require an issuer to disclose, at a minimum, the three sustainability issues that are most significant for the firm's operations, to explain the basis for that selection, and to explain the impact of those issues on firm performance. The SD&A would centralize sustainability disclosures within an issuer's securities filings. As with the MD&A and CD&A requirements, implementing the SD&A would require that the SEC issue guidance by identifying sustainability issues that are likely to be material to investors and articulating the principles that issuers should apply in preparing their SD&As.[29]

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25. This problem is not insurmountable. Some sustainability issues are arguably common to all firms. *See* Douglas Hoffner, Interim Chief Exec. Officer, Cal. Pub. Emps.' Ret. Sys., Comment Letter on Concept Release on Business and Financial Disclosure Required by Regulation S–K (July 21, 2016), https://www.sec.gov/comments/s7-06-16/s70616-267.pdf (citing gender diversity and the impact of climate change as examples). The SASB has responded to this variation by developing seventy-nine industry-specific standards. *See Standards Overview*, *supra* note 18.

26. *See generally* Cristie L. Ford, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 AM. BUS. L.J. 1, 6–7 (2008) (explaining the difference between a principles-based approach and a rules-based approach and observing that a principles-based approach entails greater flexibility but at the cost of increased uncertainty).

27. The formal requirement would be reflected by including the SD&A as part of Regulation S–K. The SEC adopted the regulation in 1980 to centralize the disclosure requirements of the Securities Act of 1933 (which apply to public offerings) and the Securities Exchange Act of 1934 (which impose periodic reporting requirements on public companies). *See* John C. Coffee, Jr., *Re-Engineering Corporate Disclosure: The Coming Debate Over Company Registration*, 52 WASH. & LEE L. REV. 1143, 1145 (1995) (describing the widespread criticism of the "pointless duplication" in disclosure rules prior to Regulation S–K). The disclosures required by Regulation S–K apply to various securities filings, including registration statements and annual reports. *See* 1 Cristopher Greer et al., FEDERAL SECURITIES ACT OF 1933 § 7.03, LEXIS (database updated 2018) ("The nonfinancial substantive disclosure provisions of Form S-1 rely entirely on the provisions of Regulation S-K and include essentially the same information about the registrant as that required to be reported in an annual report to the Commission filed on Exchange Act Form 10-K." (footnote omitted)).

28. *See, e.g.*, Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,925 (proposed Apr. 22, 2016) ("Many of our rules require disclosure when information is material to investors. These rules rely on a registrant's management to evaluate the significance of information in the context of the registrant's overall business and financial circumstances and determine whether disclosure is necessary. The requirements are often referred to as 'principles-based' because they articulate a disclosure objective and look to management to exercise judgment in satisfying that objective." (footnotes omitted)).

29. *See generally id.* at 23,924–26 (summarizing the rules' disclosure requirements regarding material information).

The SD&A would place responsibility for drafting such disclosures on the personnel who prepare the issuer's financial reporting. It would subject sustainability disclosure to the same regulatory framework that applies to other securities disclosures, including SEC oversight through its review of issuer securities filings and, when applicable, liability exposure for fraudulent misrepresentations.

To ensure the board's involvement in overseeing both the development of issuers' sustainability practices and the disclosure of those practices, this proposal would require directors to certify the accuracy of the disclosures contained in the SD&A. This would establish a framework for effective director oversight and bring accountability to the disclosure regime. The SD&A would thereby address the key investor concern that boards consider sustainability practices with a material impact on, or posing material risks to, the firm's operations and incorporate those considerations into their strategic planning.[30]

Incorporating sustainability disclosure into annual financial reporting would reflect the increasing economic importance of sustainability considerations and the growing concern they pose for investors and capital markets. It would be an important first step toward improving the uniformity, reliability, and comparability of sustainability disclosure and would provide important data to allow the capital markets to evaluate the impact of sustainable business practices.

This Article proceeds as follows. Part I sets the groundwork by describing existing sustainability disclosure practices. Part II identifies the limitations of existing practices and advocates for integrating mandatory sustainability disclosure into financial reporting. Part III proposes a new approach to sustainability disclosure: the SD&A. Part IV identifies advantages and potential limitations of the proposal.

I. Background and Existing Sustainability Disclosure Practices

This Part provides a brief background of corporate sustainability disclosure. It begins with an overview of the scope and rationale for sustainability disclosure. It then outlines the history of the SEC's regulation of sustainability disclosure as well as sources of mandatory sustainability reporting requirements beyond the federal securities laws. Finally, it identifies existing approaches to voluntary disclosure and the institutional players that contribute to the voluntary regime.

A. The Concept of Sustainability Disclosure

Currently, there is no consensus on a precise definition of "sustainability." Use of the term is often traced to a 1987 United Nations (UN) report defining sustainability as "[actions that] . . . meet the needs and aspirations of the present without

30. *See, e.g.*, Dan Konigsburg et al., *Why Sustainability Is a Board-Level Risk*, WALL ST. J. (July 6, 2018, 12:01 AM), https://deloitte.wsj.com/cfo/2018/07/06/why-sustainability-is-a-board-level-risk/ [https://perma.cc/8ZCM-DSKD] (explaining how sustainability disclosure provides investors with insight as to how the issuer is incorporating sustainability its risk policies and strategy).

compromising the ability to meet those of the future."[31] The UN formalized the principles in this report in its UN Global Compact, the "most prominent . . . [o]f the hundreds of international institutional and policy initiatives around corporate social and environmental responsibility and sustainability."[32] The idea behind corporate sustainability is decisionmaking that incorporates social, political, and ethical concerns in addition to traditional financial performance.[33] As J. Robert Brown explained in his comment letter to the SEC: "Sustainability involves matters that can impact the long-term success of the company and the economy."[34] Martin Lipton notes that sustainability "encompasses a wide range of issues, such as climate change and other environmental risks, systemic financial stability, labor standards, and consumer and product safety."[35] Experts also use a variety of terms to describe corporate sustainability and sustainability reporting. Among these are "CSR" (Corporate Social Responsibility),[36] "ESG" (Environmental, Social, and Governance),[37] "triple bottom line,"[38] and "societal impact."[39] Some

31. Rep. of the World Comm'n on Env't & Dev., *Our Common Future*, U.N. Doc. A/42/427, at 51 (1987), http://www.un-documents.net/a42-427.htm [https://perma.cc/NB8C-Y2MF]; *see, e.g.*, Sarah Widder, *Institutionalizing Sustainability: Implementation of Executive Order 13,514 and its Impact on the Environmental, Economic, and Social Performance of Pacific Northwest National Laboratory*, 27 NOTRE DAME J. L. ETHICS & PUB. POL'Y 229, 229–30 (2013) (extolling "[t]he simplicity and breadth of this definition").

32. Thomas Clarke, *The Widening Scope of Directors' Duties: The Increasing Impact of Corporate Social and Environmental Responsibility*, 39 SEATTLE U. L. REV. 531, 551 (2016).

33. *See* Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,970–71 (proposed Apr. 22, 2016) (surveying sustainability considerations).

34. J. Robert Brown, Jr., Professor of Law, Univ. Denver Sturm Coll. Law, Comment Letter on Concept Release on Disclosure Required by Regulation S–K (Oct. 3, 2016), https://www.sec.gov/comments/s7-06-16/s70616-374.pdf. Brown goes on to explain that "[t]hese matters relate to corporate governance, international tax strategies, climate change, political spending, derivatives exposures, investments in human capital, and other areas of demonstrated interest for investors and the public." *Id.* The scope of topics within sustainability continues to evolve. *See, e.g.*, Scott J. Shackelford & Scott Russell, *Operationalizing Cybersecurity Due Diligence: A Transatlantic Case Study*, 67 S.C. L. REV. 609, 626 (2016) (advocating "a wide view of risk management to encompass all of the dimensions of sustainability—economic, environmental, social, and, potentially, [cyber]security").

35. Lipton, *supra* note 5.

36. *See, e.g.*, John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 1 (2005).

37. *See, e.g.*, NASDAQ, *supra* note 16, at 10. The Nasdaq explains that the term sustainability is more commonly used by issuers, while investors commonly use the term ESG. *See id.* ("[W]hile this document primarily uses the term 'ESG' because it is commonly used among investors, the term 'sustainability' is used interchangeably as it is more common among companies.").

38. *See, e.g.*, JOHN ELKINGTON, CANNIBALS WITH FORKS: THE TRIPLE BOTTOM LINE OF 21ST CENTURY BUSINESS (photo reprint 1999) (1997); *see also About*, DBL PARTNERS, http://www.dblpartners.vc/about/ [https://perma.cc/XM6Y-6SQA] (last visited Feb. 13, 2019) (describing a double bottom line investment strategy of seeking "top-tier venture capital returns (First Bottom Line), while working with our companies to enable social, environmental and economic improvement in the regions in which they operate (Second Bottom Line)").

39. *See, e.g.*, Shlomit Azgad-Tromer, *Corporations and the 99%: Team Production Revisited*, 21 FORDHAM J. CORP. & FIN. L. 163, 184 (2016).

also describe sustainability disclosure as "non-financial" reporting.[40]

Demand for corporate sustainability disclosure has traditionally come from special-interest investors, such as religious organizations and ethical investment funds, and non-investor special interests.[41] More recently, however, interest in sustainability disclosure has spread to mainstream investors. Goldman Sachs, describing this trend as the "ESG Revolution," compiled data showing a rise in the ESG focus of traditional investor-directed communications, such as "earnings transcripts, social media and asset manager initiatives."[42] Support for ESG disclosure has extended to a growing percentage of the investor community.[43] For example, at the 2017 annual meeting, Exxon shareholders voted on a shareholder proposal requesting the company to report "the impact on its business of compliance with global climate change guidelines."[44] The proposal received more than sixty-two percent of the votes cast, a tally that included the support of BlackRock and Vanguard.[45] A similar proposal at Occidental Petroleum passed earlier in 2017.[46]

Traditional investors' growing interest in sustainability disclosure is based on a variety of rationales. Many see sustainability information as facilitating their ability to evaluate a firm's operational plan from a longer term perspective.[47]

40. Stu Dalheim, Vice President, Calvert Inv. Mgmt., Inc., Comment Letter on Concept Release on Business and Financial Disclosure Required by Regulation S–K 6 (July 21, 2016), https://www.sec.gov/comments/s7-06-16/s70616-245.pdf ("Investors increasingly consider non-financial factors when assessing companies' long-term performance."). The relevance of sustainability information to economic performance has caused some to argue that this term is misleading. *See, e.g.*, NASDAQ, *supra* note 16, at 10 ("The very term non-financial is a controversial point of reference, because many believe that ESG information is no less relevant or useful to an investor in assessing the financial prospects and operational performance of a company than information channeled through traditional accounting practices.").

41. *See, e.g.*, Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Dissenting Statement at Open Meeting on Resource Extraction (Dec. 11, 2015), https://www.sec.gov/news/statement/piwowar-dissenting-statement-at-open-meeting-resource-extraction.html [https://perma.cc/4ZKX-JVCB] (describing the congressional mandate to disclose resource-extraction payments as responding to the demands of non-shareholder special interest groups).

42. DEREK R. BINGHAM ET AL., Goldman Sachs, A REVOLUTION RISING - FROM LOW CHATTER TO LOUD ROAR [REDACTED] 1 (2018), https://www.goldmansachs.com/insights/pages/new-energy-landscape-folder/esg-revolution-rising/report.pdf.

43. *See generally id.* (describing the growing investor support for ESG disclosure).

44. *Exxon Shareholders Approve Measure on Climate-Change Report*, CNBC (May 31, 2017, 4:37 PM), http://www.cnbc.com/2017/05/31/exxon-steps-up-efforts-to-sway-shareholders-on-climate-report-vote.html [https://perma.cc/9SUH-BP8K].

45. *Id.*

46. *See* Rob Kozlowski, *Occidental Petroleum Shareholders Pass Climate Change Disclosure Proposal*, PENSIONS & INVS. (May 12, 2017, 5:01 PM), http://www.pionline.com/article/20170512/ONLINE/170519941/occidental-petroleum-shareholders-pass-climate-change-disclosure-proposal [https://perma.cc/98HQ-UGAN].

47. *See, e.g.*, Sanford Lewis, No-Action Letter on The Goldman Sachs Group, Inc. Exchange Act Rule 14a-8 (Jan. 23, 2017), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2017/johnharringtongoldman012317-14a8.pdf (explaining that investors use sustainability disclosures to evaluate "long-term value creation and systemic risk").

Investors also use sustainability disclosures to evaluate business risk[48] and have suggested that sustainability disclosure provides insights into a board's level of engagement and oversight, enabling them to determine the extent to which the board is aware of and managing factors that affect the viability of the company's strategy over the intermediate and long term.[49]

These analyses identify a potential relationship between sustainability and economic performance. Although the evidence regarding this is mixed, several studies support the claim that sustainability factors are related to operating performance and share price. A recent Bank of America Merrill Lynch study found that positive ESG factors are associated with higher earnings quality and lower risk of bankruptcy.[50] The report claims that ESG attributes are "a better signal of future earnings volatility than any other measure we have found."[51] Similarly, an academic paper surveying the empirical ESG literature reports that the vast majority of empirical studies document correlations between sustainability practices and economic performance.[52] Notably, these studies are in tension with the Department of Labor's recent suggestion that ESG factors are typically collateral to economic considerations.[53]

To the extent there is a relationship between sustainability and performance, sustainability disclosure would seem to fit within the traditional objectives of the federal securities laws. However, the history of sustainability disclosure within the mandatory disclosure regime in the United States has been fragmented. For the most part, as detailed further in the pages that follow, the SEC has taken the view that sustainability disclosure is ordinarily not material, and that mandatory

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48. *See, e.g.*, Jonas Kron, Senior Vice President, Trillium Asset Mgmt., No-Action Letter on The Middleby Corporation Exchange Act Rule 14a-8 (Mar. 23, 2018), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2018/trilliumassetetal032318-14a8.pdf (arguing in support of shareholder proposal requesting company to provide a sustainability report that ESG reporting "allows companies to better integrate and capture value from existing sustainability efforts, identify gaps and opportunities in policies and practices, strengthen risk management programs, stimulate innovation, enhance company-wide communications, and recruit and retain employees").

49. *See, e.g.*, Ronald P. O'Hanley, *Long-Term Value Begins at the Board*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Mar. 20, 2017), https://corpgov.law.harvard.edu/2017/03/20/long-term-value-begins-at-the-board/ [https://perma.cc/4Y39-P6VT] (describing perspective of State Street Global Advisors).

50. *See* SAVITA SUBRAMANIAN ET AL., BANK OF AM. MERRILL LYNCH, EQUITY STRATEGY FOCUS POINT—ESG PART II: A DEEPER DIVE 2 (2017), http://www.hubsustentabilidad.com/wp-content/uploads/2017/07/equityStrategyFocusPointADeeperDive.pdf.

51. *Id.* at 1.

52. GORDON L. CLARK, ANDREAS FEINER & MICHAEL VIEHS, UNIV. OF OXFORD & ARABESQUE PARTNERS, FROM THE STOCKHOLDER TO THE STAKEHOLDER: HOW SUSTAINABILITY CAN DRIVE FINANCIAL OUTPERFORMANCE 9 (rev. ed. 2015), https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf.

53. *See* Canary, *supra* note 8 (referring to "otherwise collateral ESG issues" but acknowledging that such issues may sometimes "involve business risks or opportunities that are properly treated as economic considerations themselves").

disclosure should be limited to information that is useful to investors.[54] The SEC's approach has had the result of creating a norm that sustainability disclosure is not a component of financial reporting—a norm that this Article seeks to change.

B. THE HISTORY OF SUSTAINABILITY DISCLOSURE UNDER THE FEDERAL SECURITIES LAWS

Efforts by various social and political groups to use the securities laws to obtain greater corporate sustainability disclosure began in the 1960s, partly in response to concerns about the rise of corporate power and its related societal implications.[55] In 1971, the Natural Resources Defense Council (NRDC) and the Project on Corporate Responsibility filed a rulemaking petition asking the SEC to require public companies to make civil rights and environmental disclosures.[56] The SEC refused to adopt the requested rule changes, reasoning that expanded social disclosures were not required under the existing materiality standard.[57] After protracted litigation challenging this decision, the District of Columbia Court of Appeals dismissed the complaint, holding that the SEC's decision not to require specific disclosures and to require disclosure only of information that was reasonably likely to be material to investors was entitled to substantial deference.[58]

The SEC's position—that its disclosure requirements should be limited to information that is economically material to investors—was articulated in a 1977

54. *Cf.* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1247–63 (1999) (challenging the SEC's position that sustainability disclosure is usually not economically material).

55. *See, e.g.*, *id.* at 1246 ("Efforts to use the federal securities laws to promote expanded social disclosure began during the late 1960s, growing out of the anti-war and environmental movements."); *see also* Rob Gray, *The Social Accounting Project and* Accounting Organizations and Society*: Privileging Engagement, Imaginings, New Accountings and Pragmatism over Critique?*, 27 ACCT., ORGS. & SOC'Y 687, 690 (2002) (explaining that, in the mid-to-late 1960s, interest in social accounting grew "contemporaneously, with an apparent growth in anxiety about corporate ethics, corporate power, social responsibility and ecological degradation").

56. For a description of this petition, see *Natural Resources Defense Council, Inc. v. SEC (NRDC I)*, 389 F. Supp. 689, 694 (D.D.C. 1974).

57. *See* Williams, *supra* note 54, at 1248–49. The SEC did issue an interpretive release, calling attention to issuers' obligations to disclose "*matters pertaining to [the] environment*" and "*[c]ertain [c]ivil [r]ights matters*," where material, such as when the existing requirements regarding disclosure of legal proceedings applied. Disclosures Pertaining to Matters Involving the Environment and Civil Rights, Securities Act Release No. 5170, Exchange Act Release No. 9252, 36 Fed. Reg. 13,989, 13,989 (July 29, 1971). Subsequently, the SEC adopted part of the proposal relating to environmental procedures when, in 1973, it codified the requirement that material legal proceedings relating to environmental matters be disclosed. Disclosure with Respect to Compliance with Environmental Requirements and Other Matters, Securities Act Release No. 5386, Exchange Act Release No. 10,166, 38 Fed. Reg. 12,100, 12,100–03 (May 9, 1973). This requirement was subsequently incorporated into Regulation S–K. Adoption of Integrated Disclosure System, Securities Act Release No. 6383, Exchange Act Release No. 18,524, 47 Fed. Reg. 11,380, 11,380, 11,388 (Mar. 16, 1982).

58. *See* Nat. Res. Def. Council, Inc. v. SEC, 606 F.2d 1031, 1049, 1056–57 (D.D.C. 1979) ("[E]nvironmental concerns to some extent run counter to the SEC's primary mandate of financial protection of investors . . . .").

report of the Advisory Committee on Corporate Disclosure, led by then-former SEC Commissioner A. A. Sommer, Jr. (the Sommer Report).[59] The Sommer Report introduced the disclosure framework that has subsequently been implemented through Regulation S–K.[60] As Commissioner Sommer later explained, the Committee concluded that the SEC "should not try to use its powers to compel disclosure concerning, for instance, social or environmental matters, hiring practices, and the like, unless it could be shown that such matters were material to investors."[61]

The SEC has adhered to the approach reflected in the Sommer Report. With limited exceptions, described below, the SEC has not required issuers to disclose specific categories of sustainability information. Instead, the SEC has taken the position that such information needs to be disclosed only to the extent it relates to an existing disclosure requirement or is necessary to prevent a required disclosure from being misleading.[62] The benchmark is whether the information is material to investors.[63] The SEC's usual position is that, in the context of disclosure requirements, the materiality standard[64] should be understood in terms of the information's economic or financial impact.[65] As the then-Director of the SEC's Division of Corporate Finance explained, "In assessing materiality, the SEC staff takes the view that the reasonable investor generally focuses on matters that have affected, or will affect, a company's profitability and financial outlook."[66]

In articulating this standard, the SEC has relied on the definition of materiality first announced in the context of proxy fraud in *TSC Industries, Inc. v. Northway,*

59. ADVISORY COMM. ON CORP. DISCLOSURE, 95TH CONG., REP. TO THE SECURITIES AND EXCHANGE COMMISSION 391–99 (Comm. Print 1977).

60. Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,918 (proposed Apr. 22, 2016). The Sommer Report has served as an ongoing guide to the SEC in evaluating the appropriate scope and structure of the mandatory disclosure regime. *See id.* at 23,918–21 (providing a historical overview of Regulation S–K).

61. A.A. Sommer, Jr., *The U.S. Securities and Exchange Commission Disclosure Study*, 1 J. COMP. CORP. L. & SEC. REG. 145, 149 (1978).

62. *See, e.g.*, Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,970 (proposed Apr. 22, 2016) ("The Commission, however, 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.").

63. *See id.*

64. A related issue, to be explored further, *infra* notes 245–46 and accompanying text, is the relationship between disclosure-related materiality and the scope of issuer liability for securities fraud. *See, e.g.*, Stratte–McClure v. Morgan Stanley, 776 F.3d 94, 100–04 (2d Cir. 2015).

65. For example, according to the SEC, a minority of the Advisory Committee that prepared the Sommer Report believed "that disclosure of social and environmental information is material to an investment decision regardless of its economic impact on the financial performance of the company," in part because that information might reflect on the quality of management. Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,971 n.687 (proposed Apr. 22, 2016).

66. Memorandum from David B.H. Martin, Dir., Div. of Corp. Fin., Sec. & Exch. Comm'n, to Laura Unger, Acting Chair, Sec. & Exch. Comm'n, 2001 SEC No-Act. LEXIS 579 (May 8, 2001), at *15.

Inc.[67] In *TSC*, the Supreme Court defined information as material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote," meaning that there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[68] The scope of this definition is itself unclear because even in the context of investment decisions, investors might reasonably be interested in information that is nonfinancial or only tangentially related to the issuer's financial performance.[69]

Recognizing that the question of what information is material to investors is an evolving one, on several occasions the SEC modified its approach to require more comprehensive disclosure with respect to specific sustainability issues. One example is the SEC's shift toward broadening the required disclosure about executive compensation. After years of taking a restrictive approach in which the SEC regularly went so far as to allow corporations to exclude shareholder proposals seeking to address executive pay,[70] the SEC changed its position and imposed extensive mandatory disclosure requirements.[71] The SEC subsequently modified and expanded these disclosure requirements.[72] Notably, even accepting the view that the size and structure of executive compensation is economically material to investors,[73] some elements of the required disclosure are arguably a stretch, such as the rule that issuers must disclose all executive perquisites valued at $10,000 or more.[74] Nonetheless, the importance of this disclosure is reflected in the SEC's recent enforcement action against Dow Chemical for failing to disclose executive perks adequately.[75]

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67. 426 U.S. 438, 449 (1976).

68. *Id.* The Court subsequently concluded that the *TSC* definition of materiality was applicable in transactional contexts as well. *See* Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988) ("We now expressly adopt the *TSC Industries* standard of materiality for the § 10(b) and Rule 10b–5 context.").

69. By way of example, some investors screen their investments according to social or ethical criteria. Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681, 684–89 (2002) (explaining that some investors screen their investments according to social or ethical criteria).

70. *See, e.g.*, Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1158–59, 1159 n.132 (1993) (describing the SEC policy of permitting the exclusion of such proposals as relating to ordinary business operations).

71. *See* Executive Compensation Disclosure, Securities Act Release No. 6962, Exchange Act Release No. 31,327, 57 Fed. Reg. 48,126, 48,126–59 (Oct. 21, 1992) (imposing extensive disclosure requirements for executive compensation).

72. *See, e.g.*, Kenneth Rosen, *"Who Killed Katie Couric?" and Other Tales from the World of Executive Compensation Reform*, 76 FORDHAM L. REV. 2907, 2912 (2008) (describing the SEC's "significant changes to the existing system of disclosure related to executive and director compensation" in 2006).

73. *See generally* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004) (arguing for the importance to investors of the size and structure of executive compensation packages). *But see* Bevis Longstreth, *A Real World Critique of* Pay without Performance, 30 J. CORP. L. 767, 770–71 (2005) (questioning the materiality of executive compensation to investors).

74. 17 C.F.R. § 229.402(c)(2)(ix)(A) (2018).

75. *See In re* Dow Chem. Co., Exchange Act Release No. 83,581 (July 2, 2018) (imposing a cease-and-desist order and $1,750,000 penalty against Dow Chemical).

The SEC's position has similarly shifted with respect to climate change disclosure. In 2007, twenty-two institutional investors petitioned the SEC asking it to issue guidance on climate change disclosure.[76] The petition asserted that "the risks and opportunities many corporations face in connection with climate change fall squarely within the category of material information that is required to be analyzed and disclosed in many corporate filings."[77] Petitioners argued that, as a result, climate change fell within the existing disclosure requirements of Regulation S–K, but that existing disclosures were both inadequate and inconsistent.[78] In 2010, almost three years later, the SEC issued the requested guidance in an interpretive release.[79] The SEC advised issuers that they were required to disclose material information about their exposure to risks resulting from climate change, explaining that this requirement was based in several existing provisions of Regulation S–K, including the MD&A, the required disclosure of legal proceedings, and the section on risk factors.[80] Issuer disclosure of climate change-related information increased following the interpretive release, although criticism of the disclosure's quality continues,[81] and the SEC's enforcement has been limited.[82]

Climate change disclosure remains limited due in large part to the vagueness of the disclosure obligation and issuers' ability to determine, in their judgment, that a given issue is not material *enough* to warrant disclosure. Exxon's 2017 10–K provides an example of these limitations.[83] Item 3—"Legal Proceedings"—briefly describes three enforcement actions by the federal Environmental Protection Agency (EPA), North Dakota, and the U.S. Treasury Department.[84]

76. Cal. Pub. Emps.' Ret. Sys. et al., Petition Before the U.S. SEC for Interpretive Guidance on Climate Risk Disclosure, at 2 (Sept. 18, 2007), http://www.sec.gov/rules/petitions/2007/petn4-547.pdf.

77. *Id.*

78. *Id.* at 13, 45.

79. *See* Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61,469, 75 Fed. Reg. 6289, 6290 (Feb. 8, 2010) ("The [SEC] is publishing this interpretive release to provide guidance to public companies regarding the Commission's existing disclosure requirements as they apply to climate change matters.").

80. *Id.* at 6293–97. Because the standard focused on materiality, the guidance left the materiality determination, and thus the decision whether to disclose, largely in the hands of the issuer's management.

81. A Ceres 2018 report stated that fifty-one percent of companies disclosed climate change information in their annual financial filings in 2017, as opposed to only forty-two percent in 2014. KRISTEN LANG ET AL., CERES, TURNING POINT: CORPORATE PROGRESS ON THE CERES ROADMAP FOR SUSTAINABILITY 11 (2018), https://www.ceres.org/node/2275 [https://perma.cc/L95Q-WWGM]. The report cautioned, however, that most of this reporting consisted of "boilerplate language [that failed] to provide investors decision-useful information." *Id.*; *see also* Nina Hart, Note, *Moving at a Glacial Pace: What Can State Attorneys General Do About SEC Inattention to Nondisclosure of Financially Material Risks Arising from Climate Change?*, 40 COLUM. J. ENVTL. L. 99, 114 (2015) ("[C]ompanies are treating climate change risks with brevity and superficiality.").

82. *See* Robert Repetto, *It's Time the SEC Enforced its Climate Disclosure Rules*, INT'L INST. FOR SUSTAINABLE DEV. (Mar. 23, 2016), https://www.iisd.org/blog/it-s-time-sec-enforced-its-climate-disclosure-rules [https://perma.cc/EG68-2BKD].

83. *See* ExxonMobil Corp., Annual Report (Form 10–K) (Feb. 28, 2018) (disclosing climate change-related risks of Exxon's business operations).

84. *Id.* at 26.

Later, in the notes to the financial statements, Exxon states that "a variety of claims have been made against ExxonMobil and certain of its consolidated subsidiaries in a number of pending lawsuits."[85] The 10–K does not provide details about the lawsuits, yet it concludes that "[b]ased on a consideration of all relevant facts and circumstances, the Corporation does not believe the ultimate outcome of any currently pending lawsuit against ExxonMobil will have a material adverse effect upon the Corporation's operations, financial condition, or financial statements taken as a whole."[86] Notably absent from the 10–K is any discussion of the high-profile litigation against Exxon by several states that allege its fossil fuel use poses "grave risks" to the planet.[87] The SEC recently closed a related investigation of the manner in which Exxon disclosed the potential impact of climate change on the value of its assets without imposing a penalty.[88]

The SEC has also adopted rules mandating disclosure with respect to specific sustainability issues. In response to a worldwide focus on board diversity,[89] the SEC issued a rule in 2009 requiring issuers to disclose "whether, and if so how, the nominating committee (or board) considers diversity in identifying nominees" for the board of directors.[90] Former SEC Commissioner Mary Jo White observed that this rule has had limited effect, with companies' "generally vague" board diversity disclosures "chang[ing] little" since its adoption.[91]

The Dodd–Frank Act required the SEC to adopt disclosure requirements with respect to two sustainability issues: conflict minerals and resource extraction.[92]

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85. *Id.* at 86.

86. *Id.*

87. Bob Van Voris, *Exxon Sues the Suers in Fierce Climate-Change Case*, BLOOMBERG BUSINESSWEEK (Feb. 13, 2018, 5:00 AM), https://www.bloomberg.com/news/articles/2018-02-13/exxon-sues-the-suers-in-fierce-bid-to-defeat-climate-lawsuits; *see also* Ephrat Livni, *Big Oil Says Government Climate Change Lawsuits Are a "Conspiracy*," QUARTZ (Jan. 12, 2018), https://qz.com/1177685/exxonmobile-says-government-climate-change-lawsuits-are-a-conspiracy-against-the-company/ [https://perma.cc/666J-8AMQ] (describing the allegations and Exxon's response calling the lawsuits a "conspiracy").

88. *See* Dave Michaels & Bradley Olson, *SEC Drops Probe of Exxon's Climate-Change Disclosures*, WALL ST. J. (Aug. 3, 2018, 4:32 PM), https://www.wsj.com/articles/sec-drops-probe-of-exxons-climate-change-disclosures-1533317730?mod=djemalertNEWS [https://perma.cc/J8AZ-DZEH].

89. This resulted in many countries adopting gender quota requirements for corporate boards. *See, e.g.*, AARON A. DHIR, CHALLENGING BOARDROOM HOMOGENEITY: CORPORATE LAW, GOVERNANCE, AND DIVERSITY 3 (2015) (discussing gender quota laws in Norway, Sweden, and Finland). *See generally* Darren Rosenblum & Daria Roithmayr, *More Than a Woman: Insights into Corporate Governance After the French Sex Quota*, 48 IND. L. REV. 889 (2015) (analyzing the impact of France's board diversity quota statute).

90. Proxy Disclosure Enhancements, Securities Act Release No. 9089, Exchange Act Release No. 61,175, Investment Company Act Release No. 29,092, 74 Fed. Reg. 68,334, 68,364 (Dec. 23, 2009). The Rule goes on to provide that, "[i]f the nominating committee . . . has a policy with regard to the consideration of diversity in identifying director nominees, [disclosure of] how this policy is implemented" is required. *Id.* at 68,343–44.

91. Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, Keynote Address at the International Corporate Governance Network Annual Conference: Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability (June 27, 2016), https://www.sec.gov/news/speech/chair-white-icgn-speech.html [https://perma.cc/C5C8-M59H].

92. *See generally* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502(b), 124 Stat. 1376, 2213–18 (2010) (codified as amended in scattered sections of 12 and 15

The SEC adopted rules in accordance with this mandate,[93] although a subsequent Congress effectively eliminated both rules.[94] Importantly, at the time of Dodd–Frank's enactment, the SEC objected to the mandates, claiming that the required disclosures fell outside its core mission and were apparently "geared more toward influencing social policy than informing investors."[95] Indeed, with the limited exceptions described above, the SEC has adhered to the position reflected in the Sommer Report that, as a general matter, sustainability disclosure is not economically material and therefore need not be integrated into financial reporting.

Commentators have called upon the SEC to do more to formalize sustainability disclosure.[96] As part of its Disclosure Effectiveness Initiative,[97] the SEC issued a Concept Release in April 2016.[98] The 341-page release listed various potential reforms to the disclosure system and invited comment on the extent to which SEC rules should mandate sustainability disclosure.[99] Specifically, the release requested comment on the importance of sustainability disclosure for shareholder

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U.S.C.) (covering "Disclosure Relating to Conflict Minerals Originating in the Democratic Republic of the Congo"); *id*. § 1504, 2200–22 (covering "Disclosure of Payments by Resource Extraction Issuers").

93. Conflict Minerals, Exchange Act Release No. 67,716, 77 Fed. Reg. 56,273 (Sept. 12, 2012); Disclosure of Payments by Resource Extraction Issuers, Exchange Act Release No. 67,717, 77 Fed. Reg. 56,365 (Sept. 12, 2012). *But see* David M. Lynn, *The Dodd–Frank Act's Specialized Corporate Disclosure: Using the Securities Laws to Address Public Policy Issues*, 6 J. BUS. & TECH. L. 327, 331, 339 (2011) (criticizing the SEC's implementation of this mandate).

94. In February 2017, the Congressional Review Act (CRA) eliminated the resource extraction rule. *See, e.g.*, Nick Grabar et al., *Congress Rolls Back SEC Resource Extraction Payments Rule*, CLEARY GOTTLIEB M&A & CORP. GOVERNANCE WATCH (Feb. 6, 2017), https://www.clearymawatch.com/2017/02/congress-rolls-back-sec-resource-extraction-payments-rule/ [https://perma.cc/473G-9PV3] (reporting on this action and explaining that such rules gaining congressional disapproval under the CRA are "treated as though [they] had never taken effect"). Later in 2017, Congress suspended funding to enforce the conflict minerals rule. *See, e.g.*, Marc Butler, *Conflict Minerals Compliance & Reporting Requirements Continue to Face Uncertain Future*, INTELLIGIZE (Oct. 12, 2017), https://www.intelligize.com/conflict-mineral-reporting-requirements-continue-face-uncertain-future/ [https://perma.cc/9MJC-YCCK] (reporting this congressional action and SEC Chair Clayton's statement supporting a reduction in the disclosure requirements).

95. Aruna Viswanatha, *SEC Chair Chastises Congress Over New Disclosure Rules*, REUTERS (Oct. 3, 2013, 7:25 PM), https://www.reuters.com/article/us-sec-disclosures/sec-chair-chastises-congress-over-new-disclosure-rules-idUSBRE99215Q20131003 [https://perma.cc/4X5E-96T8].

96. *See* Petition for Rulemaking, *supra* note 14, at 1–2 (explaining how response to SEC's 2016 Concept Release reflected "an enormous pent up demand by disclosure recipients for more and better disclosure" (quoting GELLASCH, *supra* note 13, at 10)).

97. The JOBS Act required the SEC to conduct "a review of Regulation S-K to determine how such requirements can be updated to modernize and simplify the registration process." U.S. SEC. & EXCH. COMM'N, *supra* note 12, at 1 (citing Jumpstart Our Business Startups (JOBS) Act, Pub. L. 112-106, 126 Stat. 306 (2012)). In response, the SEC staff issued a report in December 2013 recommending "a comprehensive review" of disclosure requirements for all public companies, *id*. at 104, which the SEC created a Disclosure Effectiveness Initiative to carry out. Robert Herz, *Disclosure Effectiveness Gains Traction and Momentum*, COMPLIANCE WEEK (Oct. 12, 2016), https://www.complianceweek.com/blogs/robert-herz/disclosure-effectiveness-gains-traction-and-momentum [https://perma.cc/QE69-VXM5].

98. Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916 (proposed Apr. 22, 2016).

99. *Id*. at 23,970.

investment and voting decisions.[100] In response, the SEC received tens of thousands of comments on sustainability disclosure,[101] with a substantial number of investors requesting that the SEC "require annual, uniform sustainability reporting from public companies as part of the overhaul of the agency's disclosure regime."[102] To date, however, the SEC has not acted on that request.

Investors have attempted to remedy these shortcomings by seeking disclosures on a company-specific basis. One mechanism for doing so is the SEC's shareholder proposal rule, Rule 14a-8.[103] For many years, shareholders have used Rule 14a-8 with mixed success to introduce proposals addressed to social policy concerns.[104] Such attempts have raised controversy among critics who contend that these proposals are often brought by special interest groups with limited economic stakes and in fact advance views tangential or even contrary to most shareholders' economic interests.[105]

Two developments have given shareholder proposals a more meaningful role in sustainability disclosure. First, proponents have modified their proposals to concentrate on seeking sustainability disclosure and oversight rather than attempting to cause the company to adopt specific sustainability policies.[106] Second, the proposals are receiving growing support from shareholders in general and from large, mainstream institutional investors in particular.[107]

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100. *See id.* ("[W]e seek 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 considerations that make these disclosures important to investment and voting decisions.").

101. *See, e.g.*, GELLASCH, *supra* note 13, at 10 ("As of August 16, 2016, the SEC had received 26,512 comments in response to its Concept Release.").

102. Odom, *supra* note 23.

103. 17 C.F.R. § 240.14a-8 (2018). The shareholder proposal rule enables shareholders who meet various ownership and procedural requirements to introduce a proposal on which shareholders can vote at the issuer's annual meeting and to have that proposal included in the issuer's proxy statement. *Id.* The rule provides several bases upon which the issuer can seek to exclude the proposal. *Id.* For more on this rule, see Fisch, *supra* note 70, at 1146–47.

104. *See, e.g.*, Scott Hirst, *Social Responsibility Resolutions* (Harv. Law Sch., Discussion Paper No. 2016-06, 2016), https://pcg.law.harvard.edu/wp-content/uploads/2015/11/Scott-Hirst-Social-Responsibility-Resolutions.pdf (describing this practice).

105. Classic examples include the shareholder proposal in *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554 (D.D.C. 1985), asking Iroquois to stop force-feeding the geese used to make *pate de foie gras* and the proposal in Philip Morris Cos., 1990 SEC No-Act. LEXIS 335 (Feb. 13, 1990), seeking to stop Philip Morris from conducting business in tobacco or tobacco products.

106. *See, e.g.*, Devon Energy Corp., 2014 SEC No-Act LEXIS 271 (Mar. 19, 2014) (rejecting issuer's attempt to exclude shareholder proposal requesting "that the company prepare a report on the company's goals and plans to address global concerns regarding the contribution of fossil fuel use to climate change, including analysis of long- and short-term financial and operational risks to the company" and finding that the proposal "does not seek to micromanage the company to such a degree that exclusion of the proposal would be appropriate").

107. *See, e.g.*, Thomas Singer, *Environmental and Social Proposals in the 2017 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 26, 2017), https://corpgov.law.harvard.edu/2017/10/26/environmental-and-social-proposals-in-the-2017-proxy-season/ [https://perma.cc/WB8E-5CUK] ("Large institutional investors, such as BlackRock and Vanguard, are beginning to exert pressure on companies by supporting E&S proposals that call for greater disclosure of issues they deem material to shareholder value.").

A recent Conference Board report observed that almost half of the shareholder proposals brought to a vote during the 2017 proxy season concerned ESG issues and that, although most received limited support, the number of proposals supported by a majority of votes cast continues to increase.[108] For example, during the 2017 proxy season, a majority of shareholders at three leading companies—Occidental Petroleum, PPL, and Exxon Mobil—approved shareholder proposals requesting greater disclosure on the potential effects of climate change.[109] Among the shareholders voting in favor of the proposals were institutional heavyweights BlackRock and Vanguard,[110] both of which hold substantial stakes in most large public companies.[111] The New York City Common Retirement Fund, a cosponsor of the Exxon proposal, described the proposal as economically motivated, explaining that "[c]limate change is one of the greatest long-term risks we face in our portfolio and has direct impact on the core business of ExxonMobil."[112] To the extent that shareholders continue to support proposals for increased sustainability disclosure, issuers will face pressure to provide greater disclosure even in the absence of regulation.[113]

C. SUSTAINABILITY DISCLOSURE REQUIREMENTS BEYOND THE FEDERAL SECURITIES LAWS

Federal securities laws are not the only source of sustainability disclosure requirements, some of which can be found in other areas such as federal

108. *See id.* (describing the Conference Board report findings).

109. *See* Cydney Posner, *Are Shareholder Proposals on Climate Change Becoming a Thing?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 21, 2017), https://corpgov.law.harvard.edu/2017/06/21/are-shareholder-proposals-on-climate-change-becoming-a-thing/ [https://perma.cc/JAV2-KEV6].

110. *See id.*; Steven Mufson, *Financial Firms Lead Shareholder Rebellion Against ExxonMobil Climate Change Policies*, WASH. POST (May 31, 2017), https://www.washingtonpost.com/news/energy-environment/wp/2017/05/31/exxonmobil-is-trying-to-fend-off-a-shareholder-rebellion-over-climate-change/?utm_term=.9579fd3049f6 [https://perma.cc/XVA6-PDDL] ("BlackRock and Vanguard are the biggest shareholders in ExxonMobil, owning 13 percent . . . ."); *cf.* Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298 (2017) (describing BlackRock, Vanguard, and State Street as the "Big Three" of the passive fund industry).

111. *See, e.g.*, Rachel Evans et al., *BlackRock and Vanguard Are Less Than a Decade Away From Managing $20 Trillion*, BLOOMBERG (Dec. 4, 2017, 2:00 AM), https://www.bloomberg.com/news/features/2017-12-04/blackrock-and-vanguard-s-20-trillion-future-is-closer-than-you-think [https://perma.cc/WT9N-8Q3H] (quoting Vanguard founder Jack Bogle as stating that BlackRock, State Street, and Vanguard collectively own about twenty percent of the "biggest U.S. companies").

112. Mufson, *supra* note 110.

113. *See, e.g.*, Ed Crooks, *ExxonMobil Bows to Shareholder Pressure on Climate Reporting*, FIN. TIMES (Dec. 11, 2017), https://www.ft.com/content/8bd1f73a-dedf-11e7-a8a4-0a1e63a52f9c [https://perma.cc/W9U2-RPBQ] (reporting Exxon's announcement that, in response to investor demands, it would "start publishing reports on the possible impact of climate policies on its business").

environmental law,[114] employment law,[115] and consumer law,[116] and in the laws of some states.[117] At best, however, these disclosure requirements operate in a piecemeal manner and do not provide a complete picture of the sustainability issues with a potentially material impact on issuer operations.

Mandatory sustainability disclosure is more common in jurisdictions outside the United States.[118] Since 2006, a four-institution partnership has led a project collecting and reporting data on required sustainability reporting across the

114. *See, e.g.*, David W. Case, *Corporate Environmental Reporting as Informational Regulation: A Law and Economics Perspective*, 76 U. COLO. L. REV. 379, 381–84 (2005) (providing an overview of environmental law disclosure requirements).

115. *See, e.g.*, Cynthia Estlund, *Just the Facts: The Case for Workplace Transparency*, 63 STAN. L. REV. 351, 356 (2011) (advocating the expanded use of disclosure requirements in employment law).

116. *See, e.g.*, Jonathan H. Adler, *Compelled Commercial Speech and the Consumer "Right to Know*,*"* 58 ARIZ. L. REV. 421, 424 (2016) (describing the expanding universe of disclosure requirements based on a "consumer right to know").

117. For example, the California Transparency in Supply Chains Act of 2010 requires any retailer that does business in the state and has annual worldwide gross receipts exceeding $100 million to make specific disclosures on its website about the efforts it makes to "eradicate slavery and human trafficking from [its] direct supply chain." KAMALA D. HARRIS, ATT'Y GEN., CAL. DEP'T OF JUSTICE, THE CALIFORNIA TRANSPARENCY IN SUPPLY CHAINS ACT: A RESOURCE GUIDE, at i (2015), https://oag.ca.gov/sites/all/files/agweb/pdfs/sb657/resource-guide.pdf. The Act requires disclosures on five areas—verification, audits, certification, internal accountability, and training—and even companies that take no actions relating to a given category must disclose that fact. *Id.* at 4. The statute provides no private right of action and is enforceable exclusively by the California Attorney General. *Id.*

Plaintiffs' lawyers have also been using class actions—based on state consumer protection statutes or claims of false advertising—in an effort to create broader sustainability disclosure obligations. In *Barber v. Nestlé USA, Inc.*, plaintiffs sought to impose an obligation on Nestlé to disclose that its cat food likely contained some seafood that was "produced by forced labor." 154 F. Supp. 3d 954, 957 (C.D. Cal. 2015). In *Hodsdon v. Mars, Inc.*, 162 F. Supp. 3d 1016 (N.D. Cal. 2016), plaintiff sought to force Mars to disclose on its chocolate bars that they contained cocoa beans likely picked under conditions of child or slave labor. In *Hall v. SeaWorld Entm't, Inc.*, No. 3:15-CV-660-CAB-RBB, 2015 WL 9659911 (S.D. Cal. Dec. 23, 2015), plaintiffs sought to require SeaWorld to disclose facts concerning the health and welfare of the killer whales it held in captivity. To date, such lawsuits have been largely unsuccessful. *See, e.g.*, Andrew G. Barna, Note, *The Early Eight and the Future of Consumer Legal Activism to Fight Modern-Day Slavery in Corporate Supply Chains*, 59 WM. & MARY L. REV. 1449, 1454 (2018) (reporting that trial courts dismissed each of the initial eight consumer activist suits in California, although, at the time of the article's publication, appeals were still pending in several). In *SeaWorld*, for example, the court dismissed the case, reasoning that applying plaintiffs' theory would expose companies to limitless liability. 2015 WL 9659911, at *7.

118. *See, e.g.*, INITIATIVE FOR RESPONSIBLE INV., CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE EFFORTS BY NATIONAL GOVERNMENTS AND STOCK EXCHANGES (2015), http://iri.hks.harvard.edu/files/iri/files/corporate_social_responsibility_disclosure_3-27-15.pdf (listing legislation adopted in twenty-three countries requiring public companies to disclose environmental or social information); Galit A. Sarfaty, *Regulating Through Numbers: A Case Study of Corporate Sustainability Reporting*, 53 VA. J. INT'L L. 575, 598 (2013) (describing European countries' disclosure requirements).

Although a comprehensive examination of foreign jurisdictions' requirements is beyond the scope of this Article, it is worth noting some of the more interesting approaches to CSR, such as that in India. In 2013, India adopted a requirement that firms develop a board-centered CSR policy and "spend at least two percent of their profits on CSR activities." Afra Afsharipour, *Corporate Social Responsibility and the Corporate Board: Assessing the Indian Experiment*, *in* GLOBALISATION OF CORPORATE SOCIAL RESPONSIBILITY AND ITS IMPACT ON CORPORATE GOVERNANCE 95, 96 (Jean J. du Plessis et al. eds., 2018).

globe.[119] Its 2016 report details evidence of a trend toward mandatory disclosure.[120] It also analyzes mandatory and voluntary disclosures across seventy-one countries.[121] According to the report, many of the reporting requirements are found in areas such as environmental law rather than investor-oriented regulation, but stock exchanges and financial regulators are the source of almost one-third of the requirements, many of which take the form of an obligation to comply or explain.[122]

The EU's 2014 directive mandating sustainability disclosure is perhaps the most notable development in this regard.[123] It required large companies across the EU to publish information on their policies with respect to environmental protection, social responsibility, human rights, anti-corruption, and board diversity, starting in 2018.[124] The directive expressly terms this information part of a company's "non-financial statement" and does not appear to contemplate the integration of these disclosures with issuers' financial reporting.[125]

In June 2017, the EU published guidelines to assist companies in complying with the directive.[126] Although not mandatory, the guidelines clarify that the directive's focus differs importantly from U.S. federal securities disclosure, in that the EU directive is explicitly *stake*holder, rather than *share*holder, oriented.[127] By December 2017, all EU member states had implemented the directive through national legislation, although the form of that legislation varies

119. WIM BARTELS ET AL., KPMG INT'L ET AL., CARROTS & STICKS: GLOBAL TRENDS IN SUSTAINABILITY REPORTING REGULATION AND POLICY (2016), https://www.globalreporting.org/resourcelibrary/Carrots%20and%20Sticks-2016.pdf (summarizing growth in sustainability reporting instruments).

120. *Id.* at 9 (observing that "[m]andatory instruments dominate").

121. *Id.*

122. *Id.* at 13–14; *see also* Virginia Harper Ho, *"Comply or Explain" and the Future of Nonfinancial Reporting*, 21 LEWIS & CLARK L. REV. 317 (2017) (describing the "comply or explain" approach and advocating its adoption in the United States for sustainability reporting); Jerry K.C. Koh & Victoria Leong, *The Rise of the Sustainability Reporting Megatrend: A Corporate Governance Perspective*, 18 BUS. L. INT'L 233, 233–34 (2017) (describing the Singapore Stock Exchange's 2016 amendment to its manual requiring issuers to produce sustainability reports on a "comply or explain" basis).

Stock exchange reporting requirements are especially prevalent in emerging markets. BARTELS ET AL., KPMG INT'L ET AL., *supra* note 119, at 15. *See generally* INITIATIVE FOR RESPONSIBLE INV., *supra* note 118 (reporting that six stock exchanges, including the London Stock Exchange, require social or environmental disclosure); KPMG, BUSINESS RESPONSIBILITY REPORTING (2017), https://assets.kpmg.com/content/dam/kpmg/in/pdf/2017/07/Business-Responsibility-Reporting.pdf (describing the implementation of the Security and Exchange Board of India's requirement that the top one hundred Indian companies include sustainability in their annual financial reporting).

123. Directive 2014/95, of the European Parliament and of the Council of Oct. 22, 2014, art. 1, 2014 O.J. (L 330/1) 1, 5 (EU).

124. *Non-Financial Reporting*, EUROPEAN COMM'N, https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en#how-to-report [https://perma.cc/358V-U6NE] (last visited Feb. 13, 2019).

125. Directive 2014/95, of the European Parliament and of the Council of Oct. 22, 2014, art. 1, 2014 O.J. (L 330/1) 1, 5 (EU).

126. *Communication from the Commission on Guidelines on Non-Financial Reporting (Methodology for Reporting Non-Financial Information)*, 2017 O.J. (C 215), 1, 4 (EU).

127. *See id.* at 9 ("Companies are expected to consider the information needs of all relevant stakeholders.").

"according to local conditions."[128] The EU directive is an important step that reflects an emerging global trend toward mandatory reporting, but it has also faced criticism from those who argue that its approach is likely to have limited efficacy in improving disclosure quality.[129]

D. VOLUNTARY SUSTAINABILITY DISCLOSURE

In the absence of a uniform and universal mandatory regime, market forces continue to fuel the growth of voluntary sustainability disclosure.[130] Most sustainability information is disclosed not in issuer financial or securities filings, but in standalone sustainability reports. The Governance & Accountability Institute reported that, in 2016, eighty-two percent of S&P 500 companies published sustainability or corporate responsibility reports.[131] These reports vary in their length and the range of topics covered. It is increasingly common for sustainability reports to exceed one hundred pages in length, and some issuers produce multiple sustainability reports, each on different topics.[132] For example, in 2017, Apple produced both an environmental responsibility report[133] and a supplier responsibility report,[134] and provided additional descriptions of its inclusion and diversity initiatives on its website.[135]

The dominance of voluntary disclosure and the varied sources of that disclosure have contributed to the growth of global standard setters seeking to promulgate disclosure standards or guidelines, or rate issuers on the quality of their disclosure or sustainability practices. The number of standard setters, data repositories, and ratings organizations is huge and continues to grow.[136] Although a description of all the important and relevant institutions and standards is beyond

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128. *Innovative Implementation of EU Directive*, *supra* note 22.

129. Constance Z. Wagner, *Evolving Norms of Corporate Social Responsibility: Lessons Learned from the European Union Directive on Non-Financial Reporting Transactions*, 19 TENN. J. BUS. L. 619, 624 (2018) ("The element of government regulation embodied in the Directive may not be a sufficient condition to achieve the policy goal of improved CSR reporting.").

130. *See* Walter, *supra* note 19.

131. Governance & Accountability Inst., *Flash Report: 82% of the S&P 500 Companies Published Corporate Sustainability Reports in 2016*, 3BL MEDIA (May 31, 2017, 2:30 PM), https://3blmedia.com/News/Flash-Report-82-SP-500-Companies-Published-Corporate-Sustainability-Reports-2016 [https://perma.cc/YEW9-PEL9].

132. *See, e.g.*, CTR. FOR SUSTAINABILITY & EXCELLENCE, SUSTAINABILITY REPORTING TRENDS IN NORTH AMERICA 16 & fig.9 (2017), https://www.cse-net.org/wp-content/uploads/documents/Sustainability-Reporting-Trends-in-North%20America%20_RS.pdf (reporting that, in its sample of sustainability reports published by North American issuers in 2015–2016, the average report was fifty-seven pages long, and more than ten percent exceeded one hundred pages).

133. APPLE, INC., ENVIRONMENTAL RESPONSIBILITY REPORT: 2017 PROGRESS REPORT, COVERING FISCAL YEAR 2016, at 3 (2017), https://images.apple.com/environment/pdf/Apple_Environmental_Responsibility_Report_2017.pdf.

134. APPLE, INC., SUPPLIER RESPONSIBILITY: 2017 PROGRESS REPORT 2 (2017), https://images.apple.com/supplier-responsibility/pdf/Apple-Progress-Report-2017.pdf.

135. *Inclusion and Diversity*, APPLE, https://www.apple.com/diversity/ [https://perma.cc/XS9J-QZFP] (last visited Feb. 13, 2019).

136. *See, e.g.*, BARTELS ET AL., KPMG INT'L ET AL., *supra* note 119, at 10 (reporting that 2016 research identified 383 sustainability reporting instruments in sixty-four countries).

the scope of this Article,[137] the following discussion highlights a few of the most prominent examples.

One way that private organizations contribute to the quality and usability of sustainability disclosure is by promulgating disclosure standards. The Global Reporting Initiative (GRI), an international organization founded twenty years ago as a U.S. non-profit, is one of the best-known private standard-setting organizations. Companies around the world use the GRI's standards for sustainability reporting in whole or in part.[138] In its 2017 worldwide survey of companies that report sustainability information, KMPG found that seventy-three percent used the GRI standards.[139] The GRI also maintains a free searchable database of more than 46,000 individual issuer sustainability reports.[140]

Another well-known standard-setting organization is the Sustainability Accounting Standards Board (SASB).[141] In contrast to the GRI, the SASB's focus has been to develop disclosure standards that are incorporated into SEC filings rather than separate sustainability reports. To this end, the SASB has developed industry-specific disclosure standards for seventy-seven industries.[142] The SASB's position is that its standards either are or should be incorporated into issuer financial reporting under the current legal requirements.[143] According to the SASB, its "standards focus on known trends and uncertainties that are reasonably likely to affect the financial condition or operating performance of a company and therefore would warrant disclosure under Regulation S–K."[144]

The volume of sustainability information disclosed in accordance with these and other standards complicates the task of evaluating a particular issuer's sustainability practices.[145] A number of organizations offer sustainability rankings or

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137. For a list and brief description of key institutions, see *id*. app.1 at 23–24.

138. *GRI Standards*, GRI, https://www.globalreporting.org/standards [https://perma.cc/7GXM-QK54] (last visited Feb. 13, 2019); *see also* KMPG, THE ROAD AHEAD: THE KPMG SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2017, at 29 (2017), https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2017/10/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf.

In 2010, the GRI and the UN Global Compact signed an accord in which the GRI agreed to integrate the UN Global Compact's reporting framework into its sustainability reporting guidelines. *United Nations Global Compact*, GRI, https://www.globalreporting.org/information/about-gri/alliances-and-synergies/Pages/United-Nations-Global-Compact.aspx [https://perma.cc/93QW-ANTE] (last visited Feb. 13, 2019).

139. KMPG, *supra* note 138, at 29.

140. *Sustainability Disclosure Database*, GRI, http://database.globalreporting.org/ [https://perma.cc/9SWV-JJ3C] (last visited Feb. 19, 2019).

141. *Standards Overview*, *supra* note 18.

142. *Id*.

143. SASB, THE STATE OF DISCLOSURE: AN ANALYSIS OF THE EFFECTIVENESS OF SUSTAINABILITY DISCLOSURE IN SEC FILINGS, at i (2017), https://www.sasb.org/wp-content/uploads/2017/12/2017State-of-Disclosure-Report-web.pdf.

144. *Id*.

145. *See, e.g.*, *Rate the Raters: Understanding the Universe of Corporate Sustainability Rankings*, SUSTAINABILITY, http://sustainability.com/rate-the-raters/ [https://perma.cc/V8SG-ZRXE] (last visited Feb. 13, 2019) ("There are a dizzying number and variety of external ratings, rankings, indices and awards that seek to measure corporate sustainability performance.").

ratings to assist in this endeavor.[146] One of the best-known indices is the Dow Jones Sustainability Index (DJSI).[147] Notably, the DJSI is based not on public disclosures but on information collected directly by invitation from 3,400 worldwide issuers through a questionnaire called the Corporate Sustainability Assessment.[148] The data are based on "approximately 80-120 questions on financially relevant economic, environmental and social factors that are relevant to the companies' success, but that are under-researched in conventional financial analysis."[149] The DJSI rates top companies annually and is billed as the "gold star for corporate sustainability."[150]

Another rating organization, the CDP (formerly the Carbon Disclosure Project), publishes a variety of research based on voluntary environmental disclosures it obtains directly from issuers.[151] According to the CDP, "[r]eporting companies now represent over 50% of global market capitalization."[152] The CDP scores companies based on their transparency and environmentalism, again using the information they supply.[153]

Another rating organization run by *Newsweek* publishes annual sustainability rankings of large issuers, the *Newsweek* Green Rankings.[154] *Newsweek*'s methodology is designed to be replicable by third parties, and it discloses its precise underlying metrics.[155] In addition, unlike the DJSI and the CDP, *Newsweek*'s rankings are based on publicly available data.[156]

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146. The Global Initiative for Sustainability Ratings (GISR), for example, databases hundreds of ratings and indexes. *See, e.g.*, Barry B. Burr, *Global Initiative for Sustainability Ratings Launches Website for Comprehensive ESG Data*, PENSIONS & INVS. (Apr. 2, 2015, 2:49 PM), http://www.pionline.com/article/20150402/ONLINE/150409961/global-initiative-for-sustainability-ratings-launches-website-for-comprehensive-esg-data [https://perma.cc/6H7E-XWCU] (describing the GISR database).

147. For a general description of this comprehensive index, see *About Us*, ROBECOSAM, https://www.sustainability-indices.com/about-us/ [https://perma.cc/2BFG-YLKQ] (last visited Oct. 25, 2018).

148. *See generally Corporate Sustainability Assessment*, ROBECOSAM, https://www.sustainability-indices.com/sustainability-assessment/corporate-sustainability-assessment.html [https://perma.cc/F3DK-BHLP] (last visited Feb. 20, 2019) (describing the Corporate Sustainability Assessment).

149. *Id.*

150. *Top Companies Listed on Dow Jones Sustainability Index*, SEC. NEWSWIRE (Sept. 18, 2017), https://www.securitymagazine.com/articles/88327-top-companies-listed-on-dow-jones-sustainability-index [https://perma.cc/SX8D-2DKP].

151. *About Us*, CDP, https://www.cdp.net/en/info/about-us [https://perma.cc/ADC9-PPP3] (last visited Feb. 13, 2019).

152. *The A List 2018*, CDP, https://www.cdp.net/en/scores-2017 [https://perma.cc/NEN4-76S5] (last visited Feb. 13, 2019).

153. *Id.*

154. *Newsweek Green Rankings 2017 Methodology*, NEWSWEEK (Dec. 7, 2017, 7:38 AM), http://www.newsweek.com/newsweek-green-rankings-2017-methodology-739761 [https://perma.cc/X996-E9EX].

155. *Id.*

156. *Id.*

II. LIMITATIONS OF EXISTING SUSTAINABILITY DISCLOSURE

The structure of the existing voluntary disclosure framework is problematic for several reasons.[157] This Part highlights some of the key problems with this regime to demonstrate why, despite the growth in the volume of sustainability disclosure, private ordering has not been successful in producing sustainability disclosures that meet investors' needs. As Trillium Asset Management explained in a comment letter to the SEC: "While voluntary reporting frameworks are better than nothing at providing ESG information at participating companies they do not provide the consistency, accuracy and completeness that is inherent in securities filings."[158]

Under the current regime, sustainability disclosures are fragmented, of inconsistent quality, and often unreliable.[159] As explained in this Part, issuers are incentivized to focus on the positive aspects of their business practices and to omit unfavorable information. This problem is compounded by a lack of standardization that makes it difficult for investors to compare information across issuers, in addition to the limited regulatory oversight of sustainability disclosure.

These issues stem, in part, from the voluntary nature of the current regime. Because disclosure is voluntary, issuers can choose which issues to address and which reporting metrics to apply.[160] As a result, issuers overwhelmingly disclose only information about the areas in which their business practices are highly sustainable.[161] In many cases, issuers simply omit the issues on which their practices fall short and reporting metrics that would flag shortcomings.[162] This makes their

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157. *See generally* Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 407 (2018) (arguing that "the current state of sustainability disclosure" as implemented through private ordering "is inadequate for investment analysis" and calling for an SEC-mandated disclosure requirement).

158. Jonas Kron, Senior Vice President, Trillium Asset Mgmt. LLC, Comment Letter on Concept Release on Business and Financial Disclosure Required by Regulation S–K (July 21, 2016), https://www.sec.gov/comments/s7-06-16/s70616-276.pdf.

159. *See, e.g.*, Klaus Dingwerth & Margot Eichinger, *Tamed Transparency: How Information Disclosure Under the Global Reporting Initiative Fails to Empower*, 10 GLOBAL ENVTL. POL. 74, 88 (2010) (explaining that information in disclosures is "unbalanced" and "of limited practical use").

160. *See, e.g.*, Markus J. Milne & Rob Gray, *W(h)ither Ecology? The Triple Bottom Line, the Global Reporting Initiative, and Corporate Sustainability Reporting*, 118 J. BUS. ETHICS 13, 17 (2013) (describing the poor quality and incompleteness of many triple bottom line reports, most of which "cover few stakeholders" and "cherry pick elements of news and generally ignore the major social issues that arise from corporate activity").

161. *See, e.g.*, VINTAGE & MERGERMARKET, A QUESTION OF QUALITY: HOW TO IMPROVE SEC DISCLOSURE 11 (2016), https://www.acuris.com/assets/Vintage-Group_Newsletter-3-2016_Final-LR.pdf ("Many companies now produce separate sustainability or corporate social responsibility reports . . . . But sometimes they are selective and basically say, 'Here are all the nice things we did last year' – community activities, reducing their carbon footprint, and various other things. They don't necessarily focus on the issues that really matter in the context of their industry.").

162. For example, in Volkswagen's sustainability reports, the company concentrated heavily on its efforts to reduce CO_2 emissions and included little discussion of its emissions of NO_X, later found to be the main pollutant released by Volkswagen's cars as a result of its emissions-testing modifications. *See, e.g.*, Akmaral Zhakypova, Dissecting Corporate Sustainability Reporting: VW Emissions Scandal Case 22 (2016) (unpublished manuscript), https://nature.berkeley.edu/classes/es196/projects/2016final/

reports poor tools for assessing the extent to which sustainability issues represent material business risks.

The practice of emphasizing positive and omitting negative information to make an issuer's business practices appear to be more sustainable than they actually are is known as "greenwashing."[163] Perhaps the most prominent recent example of greenwashing was Volkswagen, which was long praised as a global leader in corporate social responsibility, based largely on its self-disclosed sustainable practices.[164] In 2015, Volkswagen was named the world's most sustainable car company by the Dow Jones Sustainability Index.[165] Just one week later, U.S. regulators publicly announced the emissions scandal.[166]

Voluntary disclosure also tends to be vague, general, or boilerplate, rather than providing investors with the specific information that would enable comparison of companies' sustainability practices.[167] The corporate desire for generic disclosure is rational—to the extent issuers disclose specifics, investors can more readily identify outliers and pressure a change in their policies.

ZhakypovaA_2016.pdf (describing Volkswagen's discussion of "'CO_2' or 'carbon'" and "'NO_X' or 'nitrogen'" in its 2013 and 2014 sustainability reports).

163. *See, e.g.*, Bryant Cannon, Student Article, *A Plea for Efficiency: The Voluntary Environmental Obligations of International Corporations and the Benefits of Information Standardization*, 19 N.Y.U. ENVTL. L.J. 454, 478 (2012) ("[C]orporate greenwashing allows those companies that falsely, yet effectively, portray an image of environmental responsibility to obtain undeserved benefits . . . ."); *see also* Roel Nieuwenkamp, *Ever Heard of SDG Washing? The Urgency of SDG Due Diligence*, OECD: DEV. MATTERS (Sept. 25, 2017), https://oecd-development-matters.org/2017/09/25/ever-heard-of-sdg-washing-the-urgency-of-sdg-due-diligence/ [https://perma.cc/UV4H-TR3R] ("[T]he term SDG washing points to businesses that use the Sustainable Development Goals to market their positive contribution to some SDGs while ignoring their negative impact on others.").

164. *See, e.g.*, Lauren Hepler, *Volkswagen and the Dark Side of Corporate Sustainability*, GREENBIZ (Sept. 24, 2015, 2:00 AM), https://www.greenbiz.com/article/volkswagen-and-dark-side-corporate-sustainability [https://perma.cc/P9KQ-2L87] (describing Volkswagen's recognition for its sustainability as "following a pattern of high marks for Volkswagen over the years").

165. *See* Press Release, Volkswagen U.S. Media Site, Volkswagen is World's Most Sustainable Automotive Group (Sept. 11, 2015), https://media.vw.com/en-us/releases/566 [https://perma.cc/LDH5-MG4G] ("The Volkswagen Group has again been listed as the most sustainable automaker in the world's leading sustainability ranking."); *see also* Erika Fry, *VW Fooled Everyone. Was It the Only One?*, FORTUNE (Oct. 26, 2015), http://fortune.com/2015/10/26/emissions-testing-software-cheat-volkswagen-scandal/ [https://perma.cc/4J3L-A4SY] ("In early September the Dow Jones Sustainability Index (DJSI) crowned Volkswagen . . . the world's most sustainable car company.").

166. Letter from Phillip A. Brooks, Dir., Air Enf't Div., U.S. Envtl. Prot. Agency, to David Geanacopoulos, Exec. Vice President, Pub. Affairs & Gen. Counsel, Volkswagen Grp. of Am. & Stuart Johnson, Gen. Manager, Eng'g & Envtl. Office, Volkswagen Grp. of Am., Regarding Notice of Violation (Sept. 18, 2015), https://www.epa.gov/sites/production/files/2015-10/documents/vw-nov-caa-09-18-15.pdf. Volkswagen subsequently agreed to a $15.3 billion settlement with U.S. regulators. Margaret Cronin Fisk et al., *Volkswagen Agrees to $15 Billion Diesel-Cheating Settlement*, BLOOMBERG (June 28, 2016, 5:25 PM), https://www.bloomberg.com/news/articles/2016-06-28/volkswagen-to-pay-14-7-billion-to-settle-u-s-emissions-claims [https://perma.cc/H63V-2ZMM].

167. *See, e.g.*, Robyn Bishop, Note, *Investing in the Future: Why the SEC Should Require a Uniform Climate Change Disclosure Framework to Protect Investors and Mitigate U.S. Financial Instability*, 48 ENVTL. L. 491, 500–01 (2018) (explaining that "the majority of climate-related information comes from voluntary reporting" and that many companies "currently include a boilerplate disclosure recognizing climate change as a risk, but say nothing about its impacts on a particular business").

Even when voluntary disclosure is relatively balanced and comprehensive, it has other limitations. The absence of standardized disclosure requirements may lead issuers to disclose such a high quantity of information that it results in information overload.[168] Critics have argued that existing securities disclosure requirements are so excessive as to flood the markets with so much information that investors cannot use the information intelligently;[169] but voluntary sustainability disclosures are, in many cases, far more extensive than mandatory financial disclosures.[170]

Because no centralized regulator or authority is responsible for establishing disclosure standards, even within a single jurisdiction, sustainability disclosure is fragmented rather than standardized. Issuers can choose which metrics or standards to use for their disclosures and which among those standards to report on. The absence of standardization impedes the market's ability to compare issuer sustainability practices, even among similar companies.[171] According to one study, nearly eighty percent of investors were dissatisfied with the "comparability of sustainability reporting between companies in the same industry."[172] In another, only eight percent of investors polled believed that "existing ESG disclosures allow for comparison across companies/peers."[173]

Although third-party ratings and rankings attempt to address the comparability issue, they suffer from some of the same defects,[174] including limitations in coverage, differences in the information used, and heavy reliance on issuer-supplied information.[175] In addition, rating agencies do not produce consistent results, presumably due in part to methodological differences. An analysis comparing "three of the most well-known and [publicly] available CSR rankings published in 2015: Newsweek, Forbes, and CSR Magazine Global" found that only twelve

168. One commentator describes this practice, in the context of sustainability disclosures to consumers, as "information flooding," warning that it enables issuers to bury or even omit bad facts. Karen Bradshaw Schulz, *Information Flooding*, 48 IND. L. REV. 755, 756 (2015).

169. Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 419, 443 (2003).

170. *See supra* notes 132–35 and accompanying text (describing length of voluntary sustainability reports).

171. Comparability of disclosures is a critical attribute for investors' ability to use those disclosures effectively. *Cf.* Letter from Amy C. McGarrity, Chief Inv. Officer, Colo. PERA to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n & Russell G. Golden, Chairman, Fin. Accounting Standards Bd. (Mar. 16, 2018) (on file with author) (expressing concern over lack of comparability among non-GAAP measures of financial performance and calling for the SEC to undertake a standardization project).

172. DELOITTE, SUSTAINABILITY DISCLOSURE: GETTING AHEAD OF THE CURVE 5 (2016), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/risk/us-risk-sustainability-disclosure.pdf.

173. SUBRAMANIAN ET AL., *supra* note 50, at 6.

174. Because third-party ratings appear to be independent, they can be highly influential, making their unreliability and inconsistency particularly problematic. The influence of credit rating agencies prior to the 2008 financial crisis offers a warning. *See, e.g.*, Frank Partnoy, *What's (Still) Wrong with Credit Ratings?*, 92 WASH. L. REV. 1407, 1410, 1412 (2017) (discussing the contribution of credit ratings to the financial crisis).

175. As noted, see *supra* notes 164–66 and accompanying text. Volkswagen successfully concealed car emissions not just from regulators and consumers but also the DJSI, which named Volkswagen the world's most sustainable car company in 2015, just before news of the emissions scandal broke.

percent of companies appeared on all three lists.[176] A *Wall Street Journal* study noted similar disagreement among the "four leading ESG ratings providers," finding they came to completely different conclusions "about what makes a company a 'sustainable' investment."[177] As another *Wall Street Journal* explained, despite these inconsistencies, ESG ratings "are used as though they were some sort of objective truth," although "[i]n reality they are no more than a series of judgments by the scoring companies about what matters."[178]

Finally, sustainability reporting is not reliable. As noted, such reporting mostly occurs in standalone reports that are not integrated with the issuer's securities filings. These reports are often prepared by public relations or marketing personnel and, as a result, contain disclosures that do not meet the standards applied to securities filings. Furthermore, they are not routinely prepared or reviewed by disclosure lawyers, reviewed or certified by the CEO or board of directors, or subject to the oversight of third-party auditors. Finally, unlike securities filings, sustainability reports are not filed with and reviewed by the SEC. Although, in theory, sustainability reports are public disclosures, it is unclear whether greenwashing or other false disclosures in these reports would subject the issuer to liability for federal securities fraud.[179] As a result, issuers may take less care in the preparation of their sustainability disclosures.

These limitations in the existing framework are behind investors' demands for an SEC rule that mandates sustainability reporting. Investors that value sustainability considerations as relevant to economic performance, as well as those that wish to explore the question of their relevance, need quality information. Significantly, sustainability information is important for an evaluation of issues such as board oversight, risk management, and business practices, regardless of the extent to which investors believe an issuer should focus on sustainability in business decisions.[180] Moreover, if sustainability disclosures relate to issues such as financial performance and risk management, those disclosures should be

176. Beixin (Betsy) Lin et al., *Are Sustainability Rankings Consistent Across Ratings Agencies?*, CPA J. (July 2017), https://www.cpajournal.com/2017/07/19/sustainability-rankings-consistent-across-ratings-agencies/ [https://perma.cc/XFZ3-BN4D].

177. Jon Sindreu & Sarah Kent, *Why It's So Hard to Be an 'Ethical' Investor*, WALL ST. J. (Sept. 1, 2018, 7:00 AM), https://www.wsj.com/articles/why-its-so-hard-to-be-an-ethical-investor-1535799601?mod=?mod=itp&mod=djemITP_h [https://perma.cc/K7EH-EBUG].

178. 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 [https://perma.cc/5347-J3UP].

179. *See* Donald C. Langevoort, *Disasters & Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 GEO. L.J. 967, 974 (2019) (questioning whether compliance with voluntary disclosure standards can create an affirmative duty to disclose, thereby subjecting issuers failing to do so to liability for fraud); Cadesby B. Cooper, Note, *Rule 10b-5 at the Intersection of Greenwash and Green Investment: The Problem of Economic Loss*, 42 B.C. ENVTL. AFFS. L. REV. 405, 408 (2015) (exploring the answer to this question as depending in part on the extent to which the misrepresentations "involve information bearing on the future expected cash flows of the company").

180. This Article does not take a position on the normative question of the extent to which corporate decisionmaking should reflect sustainability considerations or, if so, which sustainability issues it should address.

integrated into investor-oriented disclosure documents rather than provided in separate reports as in current practice. Integration would have the added benefit of increasing interfirm comparability and reducing wasteful and duplicative search costs. Critically, SEC action is necessary because investors are allocating capital and businesses are basing operational decisions on sustainability information that is unreliable. As a result, the economic value of sustainability practices cannot be assessed effectively.

However, the challenge in adopting a disclosure mandate for sustainability within the existing securities disclosure framework is in the implementation. As noted, commentators have called for sustainability reporting to address a wide range of issues,[181] but the applicability of any specific issue varies by issuer and industry.[182] In addition, sustainability is a moving target, meaning that the issues that arguably warrant disclosure and their importance continue to evolve. Because of these characteristics, designing a line-item series of disclosures to address sustainability is likely unworkable, and a principles-based approach appears more appropriate.

The SEC's materiality standard is arguably a principles-based requirement in that, to the extent sustainability issues are material to the existing mandated disclosure items—such as an issuer's business plan, financial operations, risk factors, or litigation risk—disclosure of those issues is required. This approach, however, does little to encourage either affirmative disclosures or issuer attention to determining whether sustainability issues are economically significant. In other words, an additional value to an affirmative disclosure requirement is its ability to focus board and management attention on acquiring information and exercising oversight.

This benefit can be analogized to that provided by the CEO and CFO certification requirement established by the Sarbanes–Oxley Act of 2002 (SOX).[183] Section 302 of SOX requires the CEOs and CFOs of public companies personally to certify that the reports filed by their companies with the SEC are both accurate and complete.[184] Among the statute's requirements are that the certifying officers establish, maintain, and evaluate the effectiveness of the company's internal controls.[185] False certifications subject officers to potential liability in an SEC enforcement action, as well as to criminal liability.[186] SOX also contains a

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181. *See* Brown, *supra* note 34 (describing various calls for expanded sustainability disclosure).

182. *See generally* U.S. SEC. & EXCH. COMM'N, *supra* note 12 (describing industry-specific MD&A factors).

183. *Compare* SEC General Rules and Regulations, 17 C.F.R. §§ 240.13a-15, 240.15d-15 (2018), *with* Sarbanes–Oxley Act of 2002 (SOX) § 302(a), 15 U.S.C. § 7241 (2012).

184. SOX § 302(a).

185. *Id.*

186. SOX § 906, 18 U.S.C. § 1350 (2012), imposes criminal liability. *See also* Erin Massey Everitt, *Sarbanes-Oxley's Officer Certification Requirements—Has Increased Accountability Equaled Increased Liability?*, 6 DEPAUL BUS. & COM. L.J. 225, 244–45 (2008) (discussing criminal and enforcement liability). Notably, the provision does not contain a private right of action. *Id.* at 235–36.

provision requiring executives to forfeit incentive compensation and bonuses if their companies must restate their financial statements due to fraud or accounting errors.[187]

Enforcing the SOX certification requirement presents a challenge. Some commentators have characterized the SEC's limited enforcement efforts as "worrisome and problematic,"[188] or have criticized the failure of the provisions themselves to impose liability on private plaintiffs.[189] On the other hand, there is widespread evidence of the certification requirement's effectiveness in encouraging corporate executives to be more engaged in their company's financial reporting and more proactive in seeking out the information necessary to engage in better oversight.[190] In the next Part, this Article offers a proposal for sustainability disclosure designed to encourage greater information flow and board oversight akin to the rationale behind SOX section 302. In the following Part, the Article addresses enforcement of the proposal.

III. SD&A: A PROPOSED APPROACH FOR MANDATED SUSTAINABILITY DISCLOSURE

This Article proposes that the SEC implement a new disclosure requirement of sustainability discussion and analysis as part of Regulation S–K, thereby requiring issuers to include SD&A reporting as part of their annual reports.[191] The SD&A requirement is modeled on the existing MD&A and CD&A reporting requirements, which are described in this first section of this Part. In the second section, this Part then describes the details of the SD&A proposal, including several modifications to the MD&A and CD&A models that both address the specialized issues implicit in sustainability disclosure and enhance the effectiveness of the requirement.[192]

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187. SOX § 304(a), 15 U.S.C. § 7243(a).

188. Allison List, Note, *The Lax Enforcement of Section 304 of Sarbanes-Oxley: Why Is the SEC Ignoring Its Greatest Asset in the Fight Against Corporate Misconduct?*, 70 OHIO ST. L.J. 195, 218 (2009).

189. Everitt, *supra* note 186, at 235–36.

190. *See id.* at 245 ("The officer certification requirements of the Sarbanes-Oxley Act have proven quite effective at prompting executives of publicly traded companies to become more engaged in the financial reporting process.").

191. This Article's proposal for issuers to include a narrative discussion of sustainability issues in the annual report is highly workable. Indeed, Salesforce voluntarily introduced a discussion of environmental, social, and governance information in its 2018 Annual Report. Salesforce, Annual Report 64–65 (Form 10–K) (Feb. 28, 2018), https://s1.q4cdn.com/454432842/files/doc_financials/2018/Salesforce-FY18-Annual-Report.pdf.

192. To the extent that the SEC determines that the SD&A requirement will impose significant new oversight costs on issuers, it may decide to implement the requirement on a delayed or tiered basis for smaller issuers or emerging growth companies. This approach would resemble that taken by the JOBS Act, which exempts emerging growth companies from some of Dodd–Frank's disclosure requirements with respect to executive compensation as well as the non-binding shareholder vote on such compensation. *See, e.g.*, Amy Coleman, Note, *A Plague of Locusts: The JOBS Act as Foe More than Friend*, 16 DUQ. BUS. L.J. 43, 61 (2013) ("[The JOBS Act] negates the separate shareholder vote for executive compensation and the disclosure of executive compensation for median employee income requirement set by Dodd-Frank.").

A. MD&A AND CD&A: THE MODELS FOR AN SD&A REQUIREMENT

The SD&A requirement is modeled on two existing narrative disclosure frameworks: Management Discussion and Analysis (MD&A) and Compensation Discussion and Analysis (CD&A). The MD&A disclosure requirement—contained in Item 303 of Regulation S–K and SEC Interpretive Release Number 6835—was adopted specifically to supplement the line-item disclosures with more flexible and company-specific disclosures.[193] As the SEC explained,

> The Commission has long recognized the need for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance. MD&A is intended to give the investor an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company. The Item asks management to discuss the dynamics of the business and to analyze the financials.[194]

Importantly, Item 303 creates an affirmative and nonspecific duty to disclose material information when management knows of a trend, demand, commitment, or uncertainty.[195] In adopting Item 303, the SEC explicitly disclaimed the application of the court-adopted definition of materiality.[196] Instead, in its 1989 Release, the SEC issued the following guidance: "A disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operation."[197]

The SEC went on to explain that that, when management knows of a trend, demand, commitment, event, or uncertainty, it must "make two assessments":

> (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
>
> (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event

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193. Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427, 22,436 (May 24, 1989); *see also id.* at 22,427–28 (summarizing the background of the MD&A disclosure requirement).

194. Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, Securities Act Release No. 6711, Exchange Act Release No. 24,356, 52 Fed. Reg. 13,715, 13,717 (proposed Apr. 24, 1987).

195. Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427, 22,429 (May 24, 1989).

196. *See id.* at 22,430 n.27 ("The probability/magnitude test for materiality approved by the Supreme Court in *Basic, Inc. v. Levinson*, 108 S. Ct. 978 (1988), is inapposite to Item 303 disclosure.").

197. *Id.* at 22,429.

> or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur.[198]

The importance of MD&A disclosure continues to grow. As explained in one article, "[T]he MD&A is fast becoming the primary disclosure vehicle for management to relate its unique insider's critique of the registrant's financial performance and operations to help predict future performance."[199] Another explains that "[t]oday, the MD&A is widely considered to be the primary form of narrative disclosure that is reviewed, together with financial statements, for investment decision making."[200] On the other hand, the vague and flexible standard makes the requirement difficult for issuers to comply with.[201] In one high-profile case, the SEC brought an enforcement action against Caterpillar for failing to disclose, in its MD&A, the importance of its Brazilian subsidiary to the firm's financial results and the likely impact of political changes in Brazil on future results.[202] *Caterpillar* has been characterized a "message case" indicating that the SEC intends to require improved disclosure.[203]

The CD&A is a more recent disclosure requirement, modeled on the MD&A. The SEC adopted the CD&A requirement in 2006 as part of its executive compensation disclosure reforms.[204] Issuers are required to provide the CD&A as part

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198. *Id.* at 22,430. Former SEC Commissioner Edward H. Fleischman stated that the "reasonably likely" standard "suggests a likelihood of about forty percent." Mark S. Croft, *MD&A: The Tightrope of Disclosure*, 45 S.C. L. REV. 477, 485 (1994) (citing Edward H. Fleischman, Comm'r, U.S. Sec. & Exch. Comm'n, The Intersection of Business Needs and Disclosure Requirements: MD&A, Address to the Eleventh Annual Southern Securities Institute (Mar. 1, 1991), https://www.sec.gov/news/speech/1991/030191fleischman.pdf).

199. John W. Bagby, Paula C. Murray & Eric T. Andrews, *How Green Was My Balance Sheet?: Corporate Liability and Environmental Disclosure*, 14 VA. ENVTL. L.J. 225, 299 (1995).

200. Henry T.C. Hu, *Disclosure Universes and Modes of Information: Banks, Innovation, and Divergent Regulatory Quests*, 31 YALE J. REG. 565, 594 (2014).

201. *See* Rick E. Hansen, *Climate Change Disclosure by SEC Registrants: Revisiting the SEC's 2010 Interpretive Release*, 6 BROOK. J. CORP. FIN. & COM. L. 487, 495 (2012) ("[C]rafting an MD&A that is responsive to the SEC's rules is arguably among the most difficult aspects of preparing a quarterly or annual report and has prompted the SEC to issue MD&A-specific guidance on several occasions.").

202. *In re* Caterpillar, Inc., Exchange Act Release No. 30,532, [1992 Transfer Binder] 7 Fed. Sec. L. Rep. (CCH) ¶ 73,830 (Mar. 31, 1992). Notably, the SEC's enforcement action was based on section 13(a) of the Exchange Act, not the antifraud provision. *See id.*

203. Suzanne J. Romajas, Note, *The Duty to Disclose Forward-Looking Information: A Look at the Future of MD&A*, 61 FORDHAM L. REV. 245, 258 (1993).

204. *See* Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, Exchange Act Release No. 54,302A, Investment Company Act Release No. 27,444A, 71 Fed. Reg. 53,158, 53,164 (Sept. 8, 2006) ("We are adopting a new Compensation Discussion and Analysis Section."). Jeffrey Gordon, a Columbia law professor, argued in a 2005 law review article that "the SEC should require proxy disclosure of a 'Compensation Discussion and Analysis' statement (CD&A) signed by the members of the compensation committee." Jeffrey N. Gordon, *Executive Compensation: If There's a Problem, What's the Remedy? The Case for "Compensation Discussion and Analysis,"* 30 J. CORP. L. 675, 677 (2005).

of their executive compensation disclosure in the proxy statement.[205]

The CD&A is intended "to provide to investors material information that is necessary to an understanding of the [company's] compensation policies and decisions,"[206] focusing on "the most important factors relevant to analysis of those policies and decisions."[207] Specifically, the CD&A is intended to be principles-based and to avoid boilerplate.[208] Item 402, the SEC rule that governs executive compensation disclosure, sets out the requirements for the CD&A in two ways. First, Item 402(b)(1) lists a variety of "mandatory principles-based topics" that issuers must address.[209] The rule identifies a variety of components of the required CD&A disclosure, including the objectives of the compensation program and how each element of compensation is determined.[210] Item 402(b)(2) then acknowledges that "the material information to be disclosed under Compensation Discussion and Analysis will vary depending upon the facts and circumstances,"[211] and lists fifteen "examples" of "material information" that may be included in the CD&A.[212]

Both the MD&A and CD&A disclosures are primarily principles-based. As such, they offer flexibility that both permits tailoring the disclosures to the issuer's particular circumstances and allows the disclosures to evolve in response to changes in issuer and market conditions. As the SEC staff explained with respect to its MD&A requirement: "[T]he flexible nature of this requirement has resulted in disclosures that keep pace with the evolving nature of business trends without the need to continuously amend the text of the rule."[213]

The flexibility of the existing MD&A and CD&A disclosures is a primary reason to use them as the model for an SD&A requirement. At the same time, these disclosures suffer from several disadvantages relative to line-item disclosure requirements.[214] First, because they are premised on a materiality determination by management, the disclosures offer management substantial discretion that is

205. *See* 17 C.F.R. § 240.14a-101, Item 8(b) (2018) (setting forth the required disclosure of the compensation of directors and executive officers). The details of the CD&A requirement are included in *id.* § 229.402(b)(1), which is cross-referenced in Regulation 14A.

206. *Id.* § 229.402, Instructions to Item 402(b), ¶ 1.

207. *Id.* ¶ 3.

208. *See id.* (noting that the CD&A "should focus on the material principles underlying the registrant's executive compensation policies and decisions and the most important factors relevant to analysis of those policies and decisions" and "shall avoid boilerplate language").

209. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Securities Act Release No. 9178, Exchange Act Release No. 63,768, 76 Fed. Reg. 6010, 6015 & n.76 (Feb. 2, 2011).

210. 17 C.F.R. § 229.402(b)(1) (2018).

211. *Id.* § 229.402(b)(2).

212. *Id.*

213. Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61,469, 75 Fed. Reg. 6289, 6294 (Feb. 8, 2010).

214. *See generally* Brief of Professors at Law and Business Schools as Amicus Curiae in Support of Respondents, Leidos, Inc. v. Ind. Pub. Ret. Sys., 137 S. Ct. 1395 (2017) (No. 16-581), 2017 WL 8291737 [hereinafter *Leidos* Amicus Brief] (detailing the shortcomings of the MD&A requirement in providing meaningful information).

often exercised in favor of failing to disclose. Even well-meaning insiders may evaluate the materiality standard differently. Second, the disclosures are not as readily comparable as quantitative disclosure requirements. The SEC itself has criticized existing MD&A disclosure as "less detailed" than desired and in need of "greater analysis" and "additional explanation."[215] One SEC official offered the view that "in too many MD&As . . . . [t]here is too much elevator music, and not enough really useful analysis."[216] As a result, it is worth considering whether, in adopting the MD&A model for sustainability disclosure, that model can be refined to enhance its effectiveness.

B. THE SD&A PROPOSAL

The SD&A requirement proposed by this Article would require issuers to include a discussion of sustainability in their annual financial reporting. Issuers would be required, in their SD&A, to identify and explain the three sustainability issues most significant to their operations.[217] The required disclosure would include a discussion of the potential impact of those sustainability issues on the issuer's economic performance,[218] as well as an explanation of the basis for the issuer's determination of significance.[219] Analogous to the MD&A, the SD&A disclosure would be premised on known risks, trends, and opportunities, in that the requirement would be framed in terms of known or reasonably knowable sustainability issues. This would include risks, trends, and opportunities that, in the opinion of the board of directors, are material to the issuers' business plan or operations.

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215. Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,946–47 (proposed Apr. 22, 2016).

216. Alan L. Beller, Remarks Before the SEC Historical Society at The Roundtable on the Integration of the 1933 and 1934 Acts 126 (Mar. 21, 2002), http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/programs/int1933_1934Transcript.pdf.

217. Although this requirement may seem arbitrary, including three sustainability issues is a cost-effective way of capturing the most significant risks without making the disclosure requirement unduly burdensome. Anecdotal evidence suggests that it also reflects existing practice. For example, at a September 2018 public program, NYU Law's Investors and ESG Conference, a high-level public company executive identified three primary subjects in discussing his corporation's approach to sustainability.

218. This proposal focuses on sustainability that is "internal" in the sense that it is focused on the issuer's operational practices and not on an issuer's engagement efforts aimed at general societal improvements such as volunteerism or donating to charity. Some commentators have distinguished between internal and external CSR, although the use of these terms varies. *See, e.g.*, Olga Hawn & Ioannis Ioannou, *Mind the Gap: The Interplay Between External and Internal Actions in the Case of Corporate Social Responsibility*, 37 STRATEGIC MGMT. J. 2569 (2016) (empirically analyzing issuer engagement in internal and external CSR as well as the gap between external and internal actions).

219. Robert Eccles and Tim Youmans have proposed that boards voluntarily issue a sustainability statement in their annual reports through what they term a "Statement of Significant Audiences and Materiality." Robert G. Eccles & Tim Youmans, *Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality* 6 (Harvard Bus. Sch., Working Paper No. 16-023, 2015), https://www.hbs.edu/faculty/Publication%20Files/16-023_f29dce5d-cbac-4840-8d5f-32b21e6f644e.pdf. Like the SD&A, the Eccles and Youmans statement would increase board involvement in and oversight of sustainability issues, but their proposal differs from the one developed in this Article in several key aspects, including perhaps most importantly its focus on stakeholder significance. *See id.* at 1, 6.

The requirement that issuers identify and discuss the three most significant sustainability issues responds to the range of challenges that have been brought against mandated sustainability disclosure.[220] By requiring the SD&A to focus on the specific issues that are most important to a particular issuer's operations, the proposal addresses the difficulty in articulating a precise definition of materiality or determining an appropriate materiality standard. Although the SD&A does not provide a comprehensive level of disclosure, it is a workable starting point that enables boards and investors to identify and evaluate those practices most likely to have a substantial economic impact. In addition, as discussed further in the pages that follow, a requirement that issuers disclose the three most material issues reduces the potentially burdensome impact associated with a more ambitious disclosure requirement, while providing more objectivity than the generic but un-cabined materiality standard currently reflected in the SEC's approach to MD&A disclosure. Thus, the proposal is arguably superior to a standard that would require disclosure of all material sustainability issues or condition disclosure requirements in terms of a minimum dollar threshold of anticipated economic impact.[221]

The proposal contemplates that the SEC's adopting release would provide additional guidance with respect to the nature and scope of sustainability issues, similar to the guidance it provided for CD&A. Specifically, the guidance would identify the range of topics that have been identified within the framework of sustainability, such as "climate change, resource scarcity, corporate social responsibility, and good corporate citizenship,"[222] but would note that the identification of material sustainability issues is industry- and issuer-specific. The release would also note that the materiality of specific sustainability issues can evolve over time and is a product of a variety of considerations, including the relevance of the issue to earnings quality and volatility, reputational and regulatory risk, and the quality of board oversight and internal controls.

The SD&A proposal would modify the guidelines of Item 303 to place responsibility for the determination of what sustainability issues require disclosure in

220. Because the SD&A requirement would not require issuers to adhere to specific language in characterizing their sustainability practices, it is also consistent with the First Amendment concerns expressed in the D.C. Circuit's decision on conflict minerals disclosure, holding that the requirement that issuers certify their products as "not . . . found to be 'DRC conflict free'" violated the First Amendment. Nat'l Ass'n of Mfrs. v. SEC, 748 F.3d 359, 373 (D.C. Cir. 2014), *aff'd on reh'g*, 800 F.3d 518 (D.C. Cir. 2015).

221. Such an alternative approach could provide, for example, that trends or risks that the board estimates are reasonably likely to affect revenues by more than one million dollars annually are presumptively material. This guidance would be roughly analogous to Item 404's disclosure requirement for related party transactions, which requires disclosure of all such transactions in which the amount involved exceeds $120,000. 17 C.F.R. § 229.404(a) (2018). Given the difficulty of ascertaining the impact of ESG considerations, this Article takes the position that such an approach is less workable.

222. Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,970 (proposed Apr. 22, 2016).

the hands of the board of directors, rather than management.[223] This is consistent with one of the main reasons proffered by investors for requiring sustainability disclosure: that such disclosure provides them with valuable insight into the board's familiarity with and oversight of critical issues such as risk management. In addition, the SEC recently highlighted the expertise of the board in evaluating the significance of particular issues to the company's business.[224] The board or a sustainability committee of the board[225] would also be required to sign the SD&A.[226] Like the CEO and CFO certification requirements of Sarbanes–Oxley, the certification requirement would encourage issuers to develop systems for collecting and communicating the information necessary for the board to meet this obligation.[227]

The rationale for requiring both board responsibility and certification is to ensure that the process of preparing the SD&A enhances the board's role in understanding and overseeing the issuer's sustainability practices. From an investor's perspective, the key issues are whether the directors are aware of the sustainability issues that may materially affect the issuer's operations and whether they have incorporated those issues into their strategic planning and oversight. Placing specific responsibility on directors enables investors to ensure that the board is performing this role and to hold the board accountable for doing so.

Finally, as detailed later, this Article contemplates that the SD&A requirement would be enforced through a combination of public and private enforcement. The SEC staff would review and comment on issuers' SD&A disclosures as part of its review of securities filings and would have the authority to bring enforcement

223. This board-centered approach follows that of India, which, through legislation, placed primary responsibility for development and oversight of an issuer's CSR policy in the board of directors. *See* Afsharipour, *supra* note 118, at 101–04 (discussing India's approach). This Article's focus on the board's role is limited to disclosure oversight, with the expectation that such oversight would broaden the information available to the board for purposes of risk management and strategic planning.

224. *See, e.g.*, *Staff Legal Bulletin No. 14I (CF)*, U.S. SEC. & EXCH. COMM'N (Nov. 1, 2017), https://www.sec.gov/interps/legal/cfslb14i.htm [https://perma.cc/RZL5-TUA2] (observing that, in the context of determining the application of the ordinary business exemption to shareholder proposals, "[a] board acting in this capacity and with the knowledge of the company's business and the implications for a particular proposal on that company's business is well situated to analyze, determine and explain whether a particular issue is sufficiently significant").

225. *See, e.g.*, Jayne W. Barnard, *At the Intersection of Corporate Governance and Environmental Sustainability*, 2 WM. & MARY BUS. L. REV. 207, 207 (2011) (articulating "several advantages to having a board-level sustainability committee").

226. This requirement was part of Jeffrey Gordon's proposal for CD&A but was not adopted. *See* Gordon, *supra* note 204, at 695 ("This CD&A should . . . be signed by the members of the committee (or the independent directors, as the case may be).").

227. *See, e.g.*, Robert Charles Clark, *Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too*, 22 GA. ST. U. L. REV. 251, 266 (2005) ("[A] fair number of public company CEOs have already expressed the view that the process of getting ready for section 404 attestation has helped them improve their management information systems."); *see also* Robert A. Prentice & David B. Spence, *Sarbanes-Oxley as Quack Corporate Governance: How Wise is the Received Wisdom?*, 95 GEO. L.J. 1843, 1898–1907 (2007) (discussing the impact of Sarbanes–Oxley's certification requirements).

actions against issuers and individual directors for failure to comply.[228] In addition, fraudulent misrepresentations and omissions in an issuer's SD&A would be actionable under Rule 10b-5,[229] and shareholders could, in appropriate cases, pursue private litigation.[230]

IV. ADVANTAGES AND LIMITATIONS OF SD&A

This Part identifies the key advantages of the SD&A proposal as well as the principal potential objections. Importantly, SD&A is a modest starting point for sustainability disclosure, and the proposal advanced in this Article is intended as a first step that will enable issuers, investors, and regulators to asses the utility of sustainability disclosure and provide data to evaluate claims of the relationship of sustainability to economic value. This Article does not make the claim that the SD&A will provide investors and the markets with comprehensive sustainability information or that it will or should displace existing voluntary disclosure regimes. Rather, for the reasons set out in the sections that follow, integrating sustainability disclosure into traditional financial reporting provides several advantages.

A. THE SD&A PROPOSAL IS A WORKABLE FIRST STEP

A key advantage to the SD&A proposal is its workability. One of the challenges in formulating a mandatory sustainability disclosure requirement is that the topic of sustainability is vast and open-ended. Private organizations such as GRI and SASB have identified dozens of disclosure items, and current sustainability reports commonly exceed one hundred pages in length. The cost of developing and complying with comparable mandatory disclosure requirements would place a heavy burden on issuers.[231] As a result, issuers might reasonably question the extent to which specific disclosure issues were relevant to their operations. And the utility of such extensive disclosures for investors—for whom the overall volume of mandatory disclosure is already overwhelming—is questionable.[232]

Increasing the number of issues addressed, requiring issuers to provide hard sustainability data, and formulating line-item disclosure requirements would

228. The mandatory nature of the SD&A requirement is critical for enhancing comparability and incentivizing the board to take its responsibility seriously. *Cf.* Eccles & Youmans, *supra* note 219, at 8 (proposing to mobilize investors to "ask company boards to issue The Statement"). For the reasons previously detailed, this Article takes the view that boards will be unwilling to provide meaningful sustainability information in the financial statements unless required to do so.

229. 17 C.F.R. § 240.10b-5 (2018).

230. *See generally* Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333 (discussing private securities fraud litigation).

231. *Cf.* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at the Economic Club of New York (July 12, 2017), https://www.sec.gov/news/speech/remarks-economic-club-new-york [https://perma.cc/T2EW-YDPZ] ("There are circumstances in which the Commission's reporting rules may require publicly traded companies to make disclosures that are burdensome to generate, but may not be material to the total mix of information available to investors.").

232. *See, e.g.*, *id.*; Paredes, *supra* note 169 (explaining how increasing the quantity of required disclosures reduces their value to investors).

potentially increase the informational content of sustainability disclosure. That increase would come, however, at a substantial cost both to issuers preparing the information and to investors relying on it. Instead, the SD&A proposal offers a balance between informational value and workability. In particular, the requirement that issuers determine which sustainability issues are most important and explain the basis for their determination might reduce the propensity of issuers to engage in duplicative or boilerplate disclosure that is likely to be uninformative.[233]

In addition, a more comprehensive disclosure requirement would embroil issuers and regulators in difficult determinations of the appropriate scope of disclosure. It would force regulators to assess which sustainability issues warrant line-item disclosure requirements and to evaluate contested claims about the economic materiality of the required information. At the same time, it would exacerbate the risk of information overload by requiring issuers to provide extensive boilerplate disclosures rather than identifying the specific issues on which investors should focus.

The SD&A requirement creates an explicit, although limited, affirmative reporting obligation rather than simply leaving sustainability issues within the ambiguous materiality assessment applicable to an issuer's overall MD&A and risk-factor disclosure. As the previous discussion demonstrates, it is a mistake to attempt to load sustainability disclosure into these general disclosure frameworks, and the SEC's decision to do so has had the effect of unduly limiting both issuer consideration and disclosure of sustainability issues. At the same time, the mandate would have the practical effect of requiring issuers to examine and evaluate the impact of a broader range of sustainability issues than those covered by the three most significant mandated disclosures, because this evaluation would be necessary to determine which issues to disclose. Accordingly, the proposal's effect on information reporting and board oversight would be substantially greater than requiring the company to consider just three disclosure items.

The SEC's adoption of an SD&A requirement would reverse its prior position that distinguished sustainability issues from financial performance and encourage a norm in which issuers and their boards view sustainability considerations as part of their operational strategy. It would also encourage the evaluation of sustainability factors from a financial perspective.

Finally, a sustainability disclosure requirement is a way of managing expectations. Although a wide range of sustainability issues may be relevant to investors, formalizing the type and quantity of such disclosure that is required enhances predictability and investor confidence. Moreover, there is evidence that qualitative disclosure can provide substantial value to the market. For example, a recent

233. *But see* INV'R RESPONSIBILITY RES. CTR. INST., THE CORPORATE RISK FACTOR DISCLOSURE LANDSCAPE 3 (2016), https://www.weinberg.udel.edu/IIRCiResearchDocuments/2016/01/FINAL-EY-Risk-Disclosure-Study.pdf (criticizing the narrative format of the risk-factor disclosure requirement as "tend[ing] to represent a listing of generic risks, with little to help investors distinguish between the relative importance of each risk to the company").

empirical study of the effect of the SEC's 2005 mandate that firms include a "risk factor" section in their annual reports found that, contrary to the assertions of critics, "managers provide useful risk factor disclosures and investors incorporate this information into market values."[234]

B. SD&A REPORTING WILL PROMOTE COMPARABILITY

In addition, the SD&A proposal will promote the comparability of sustainability disclosure. Concededly, a disclosure obligation that admits to issuer-specific variation offers less comparability than a set of one-size-fits-all disclosure requirements. Because each issuer's board determines the most significant sustainability issues independently, there is likely to be substantial variation among the issues addressed. As a result, the market may learn little by comparing, for instance, Volkswagen's discussion of emissions with PepsiCo's discussion of water conservation. At the same time, including sustainability disclosures within an issuer's securities filings and subjecting those disclosures to SEC staff review and comment is likely to have a significant effect on comparability. The SEC staff currently reviews more than half of issuer 10–Ks filed each year.[235] The SEC's comments focus on not just the hard numbers in the 10–K but also the narrative components—the MD&A, CD&A, and the staff review subjects these disclosures to meaningful scrutiny.[236]

In addition, although only a small percentage of those 10–Ks receive staff comment letters, a variety of industry participants review the letters and report to issuers on trends in SEC policies and concerns with respect to 10–K disclosure.[237] These reports and the SEC reviews themselves lead to revisions and refinements of the narrative disclosures in the MD&A and CD&A.[238] This review process is likely to generate common disclosure policies among issuers, particularly for those in the same or related industries.[239] In particular, because the SEC staff

234. John L. Campbell et al., *The Information Content of Mandatory Risk Factor Disclosures in Corporate Filings*, 19 REV. ACCT. STUD. 396, 439 (2014).

235. ERNST & YOUNG, SEC REPORTING UPDATE: 2017 TRENDS IN SEC COMMENT LETTERS 5 (2017).

236. *Cf. id.* at 6–7 (reporting that in 2016 and 2017, comments on the MD&A represented forty-three percent of comments overall).

237. *See, e.g.*, *id.* (describing trends in SEC comment letters); DELOITTE, SEC COMMENT LETTERS — INCLUDING INDUSTRY INSIGHTS: WHAT "EDGAR" TOLD US, at viii (9th ed. 2015), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-aers-sec-comment-letters-including-industry-insights-what-edgar-told-us-102015.pdf (reporting the top ten topics discussed in SEC comment letters).

238. *See* ELIZABETH A. ISING ET AL., DONNELLEY FIN. SOLS., EXECUTIVE COMPENSATION DISCLOSURE HANDBOOK: A PRACTICAL GUIDE TO THE SEC'S EXECUTIVE COMPENSATION DISCLOSURE RULES 12 (rev. ed. 2016), https://www.gibsondunn.com/wp-content/uploads/documents/publications/Ising-Mueller-Hanvey-Executive-Compensation-Disclosure-Handbook-Donnelley-Financial-Solutions-Oct-2016.pdf ("[C]ompanies are increasingly seeing their peers make favorable changes to their disclosures and, regardless of prior say-on-pay votes, those that see this may be inclined to take a fresh look at their own CD&A simply to avoid falling behind.").

239. *See generally* Stephen V. Brown et al., *The Spillover Effect of SEC Comment Letters on Qualitative Corporate Disclosure: Evidence from the Risk Factor Disclosure*, 35 CONTEMP. ACCT. RES. 622 (2018) (documenting the spillover effect on the disclosures made by companies in related industries).

have access to all issuers' disclosures, they will be able to identify situations in which an issuer has not addressed a subject apparently important to its peer firms or within its industry. The staff comment letters themselves will generate information about an issuer's evaluation of sustainability issues and the risks they present. And issuers will learn from and be able to emulate the disclosures made by their peers.

C. SD&A WILL IMPROVE SUSTAINABILITY DISCLOSURE RELIABILITY

Finally, SD&A will improve the reliability of sustainability disclosure over the current system. Here is arguably where this Article's proposal has the most to offer. First, it is important to recognize the substantial methodological impact of integrating sustainability disclosure into traditional securities reporting. Under this proposal, sustainability disclosures will be prepared by disclosure attorneys rather than marketing personnel and subjected to the same verification requirements as traditional financial disclosures.[240]

Furthermore, the SD&A proposal will lead to the board of directors being accountable for sustainability disclosures in a way in that they are not in the current system. The board's role in overseeing and certifying the sustainability disclosures will require that they set up reporting systems to receive information about the issues addressed in the SD&A and their impact on operations. This reporting process 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. In addition, it will enable the board to incorporate sustainability considerations into its analysis of strategic issues and operational risk management. By contrast, in the current system, the degree of board oversight of sustainability issues is unclear, and there is no direct link between the board or even high-level executives and the choice of issues addressed in an issuer's sustainability reports.

Even if some firms make high-quality sustainability disclosures under the voluntary system, a mandatory system is likely to improve the quality of sustainability disclosure more broadly. In an analogous examination of the shift from voluntary to mandatory disclosure of risk factors, Nelson and Pritchard found that, although those firms facing significant litigation risk made substantial disclosures under a voluntary regime, mandatory disclosure improved the quality of disclosure for other firms.[241]

The value of mandatory disclosure in ensuring quality disclosure depends critically on its enforcement; the risk of liability for noncompliance is what gives teeth to the statutory disclosure provisions. Accordingly, if the goal of the SD&A

240. For a discussion of the preparation of traditional securities filings, see *supra* notes 235–39 and accompanying text.

241. *See generally* Karen K. Nelson & A.C. Pritchard, *Carrot or Stick? The Shift from Voluntary to Mandatory Disclosure of Risk Factors*, 13 J. EMPIRICAL LEGAL STUD. 266, 287–95 (2016) (empirically analyzing the effect of mandated disclosure of risk factors).

is to improve the reliability of sustainability disclosures, it is necessary to give attention not just to the disclosure requirement itself but to the way it is enforced.

The disclosure requirements of Regulation S–K do not themselves "create[] an independent private right of action."[242] Thus, an issuer's failure to disclose a known trend in violation of Item 303 can only be enforced by the SEC.[243] On the other hand, the federal courts have universally recognized a private right of action for federal securities fraud under Rule 10b-5.[244] Accordingly, to the extent that an issuer makes an affirmatively false disclosure, that conduct is arguably actionable through private litigation. Courts have typically held both that Regulation S–K creates an affirmative obligation to disclose and that failure to comply with that requirement can provide the basis for a private securities fraud suit.[245]

As a result, inclusion of SD&A within securities filings would subject issuers' sustainability disclosures to SEC oversight and enforcement and clarify that fraudulent misrepresentations and omissions are actionable as securities fraud. Notably, the structure of the SD&A proposal increases the likely reliability of the disclosure by making the issuer's affirmative disclosure requirement explicit.[246] Issuers cannot greenwash their SD&As to avoid addressing issues likely to cause the market concern[247] because, to the extent those issues are potentially among the three most significant, an issuer's decision to omit them would constitute not just an omission but a fraudulent misrepresentation—a representation that the omitted issue is not among the three most significant.

242. Oran v. Stafford, 226 F.3d 275, 287 (3d Cir. 2000).

243. *Cf. id.*

244. *See, e.g.*, Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811, 815 (2009) ("The federal courts have recognized an implied private right of action under section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, and have used federal common law to define the contours of the cause of action." (footnotes omitted)).

245. *See, e.g.*, Ind. Pub. Ret. Sys. v. SAIC, Inc., 818 F.3d 85, 94 n.7 (2d Cir. 2016) ("Item 303 imposes an 'affirmative duty to disclose . . . [that] can serve as the basis for a securities fraud claim under Section 10(b).'" (quoting Stratte–McClure v. Morgan Stanley, 776 F.3d 94, 101 (2d Cir. 2015) (alteration in original))).

246. There is ongoing debate about the extent to which all material omissions under Item 303 are actionable as securities fraud, centered on the question of whether the materiality standard for Item 303 is lower than that under *Basic Inc. v. Levinson*. *See, e.g.*, *Oran*, 226 F.3d at 288 ("[A] violation of SK–303's reporting requirements does not automatically give rise to a material omission under Rule 10b–5."); *see also* Matthew C. Turk & Karen E. Woody, Leidos *and the Roberts Court's Improvident Securities Law Docket*, 70 STAN. L. REV. ONLINE 89, 92 (2017), https://review.law.stanford.edu/wp-content/uploads/sites/3/2017/11/70-Stan.-L.-Rev.-Online-89-Turk-and-Woody.pdf ("A consequence of the slightly lower materiality threshold for Item 303 is that it reduces the range of claims that private investors may bring based on firms' incomplete disclosure of required MD&A information.").

The Supreme Court was positioned to address this question when it granted certiorari in *Leidos* last year. Leidos, Inc. v. Ind. Pub. Ret. Sys., 137 S. Ct. 1395 (2017), but that case was settled before oral argument, Turk & Woody, *supra*, at 89.

247. The SD&A requirement is therefore more constraining than the risk-factor disclosure requirement. *Cf.* Edward A. Morse, Vasant Raval & John R. Wingender, Jr., *SEC Cybersecurity Guidelines: Insights into the Utility of Risk Factor Disclosures for Investors*, 73 BUS. LAW. 1, 20–21 (2017–2018) (finding that most issuers failed to disclose cybersecurity risks after the SEC's release of new guidelines and that the market apparently viewed disclosing such risk as a negative signal).

This Article contemplates that implementation and enforcement of the SD&A would take place primarily through SEC oversight and, when appropriate, enforcement action. As described, because of the review process, the SEC staff would be well-positioned to identify critical weaknesses in an issuer's MD&A—by allowing the staff to ask Exxon, for example, why it has failed to address climate change in its SD&A considering disclosures by peer firms like Occidental Petroleum and BP.

There are advantages to relying on the SEC to undertake most SD&A enforcement. First, the SEC may have greater expertise, enabling it to choose more accurately the cases in which enforcement is most consistent with the purposes of federal regulation.[248] Second, public enforcement may be more efficient.[249] Third, public enforcement is unlikely to be affected by the incentives that have the potential to produce abusive and excessive litigation, such as the high fees that plaintiffs' attorneys can recover.[250] Thus, for example, private litigants have rarely targeted individual defendants because of their lack of "deep pockets"; but the prospect of SEC enforcement is likely to focus corporate directors' attention on ensuring the accuracy of their sustainability disclosures.[251] Finally, the government can often send a message by bringing a limited number of high-profile cases, such as the SEC's enforcement action against Caterpillar.[252]

There are problems, however, with limiting enforcement to the SEC. A variety of courts, including the U.S. Supreme Court, commentators, and the SEC itself, have acknowledged the valuable role that private efforts play in supplementing

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248. *See, e.g.*, James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CALIF. L. REV. 115, 124 (2012) (describing the argument that public enforcement may be premised on "the idea that the SEC is a better securities enforcer than private parties because of its expertise with respect to the securities laws"); *see also* Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 1023–24 (1994) (suggesting, in light of these considerations, that the SEC eliminate private litigation as a means to enforce Rule 10b-5).

249. *See* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 118 (2011) (advocating "stepped-up SEC enforcement capability as a cost-effective substitute" for private litigation).

250. *See, e.g.*, Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 535–36 (1997) (describing potential of incentives such as multi-million-dollar fee awards, to produce abusive litigation).

251. *See* Bradley Bondi, *A Brief History of SEC Enforcement Actions Against Directors*, LAW360 (Oct. 16, 2015, 1:59 PM), https://www.law360.com/articles/714967/a-brief-history-of-sec-enforcement-actions-against-directors [https://perma.cc/HGA5-77JD] ("Though rare, enforcement actions against directors are a key component of the SEC's targeting of misconduct by 'gatekeepers' . . . ."). A relatively small number of SEC actions involving individual directors can be effective in increasing directors' attention to their oversight responsibilities. *See, e.g.*, *SEC Sharpens Focus on Disclosure of Executive Perks*, SHEPPARD MULLIN: CORP. & SEC. LAW BLOG (June 22, 2005), https://www.corporatesecuritieslawblog.com/2005/06/sec-sharpens-focus-on-disclosure-of-executive-perks/ [https://perma.cc/R2YZ-PY3U] (advising that one message from SEC's enforcement actions against Tyson Foods and GE is that members of compensation committees face "personal liability for inaccurate or incomplete [compensation] disclosure[s]").

252. *In re* Caterpillar, Inc., Exchange Act Release No. 30,532, [1992 Transfer Binder] 7 Fed. Sec. L. Rep. (CCH) ¶ 73,830 (Mar. 31, 1992).

public enforcement.[253] The government may have limited resources available to address wrongdoing. In addition, SEC enforcement efforts are vulnerable to both political pressures and shifting administrative priorities.[254] The risk of underenforcement is illustrated by the SEC's limited track record with respect to MD&A disclosure; it has brought less than one hundred enforcement cases alleging violations since Regulation S–K's adoption.[255]

Accordingly, private enforcement is likely to serve as a valuable supplement to public enforcement. Although concerns have been raised about the potential for excessive or burdensome securities fraud litigation,[256] that risk is likely to be especially limited under the SD&A proposal. There are three reasons for this. First, the SD&A requirement is explicit and limited—issuers are only required to disclose the three most significant sustainability issues. As a result, the requirement does not open the door to efforts to characterize additional sustainability issues as fraudulent omissions. Second, to succeed in a securities fraud lawsuit, private litigants must establish loss causation and damages, meaning that they must show that the issuer's misrepresentation or omission had an economic impact on the value of their shares.[257] As interpreted by the courts, the loss causation requirement requires affirmative proof that the fraud impacted stock price.[258] Thus, only the most economically significant of sustainability disclosure-related failures could trigger private litigation.[259] Third, to bring a securities fraud suit, a

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253. *See, e.g.*, Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313 (2007) ("[P]rivate actions . . . are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission (SEC)."); James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 738 (2003) ("Since the inception of the federal securities laws, the government's broad enforcement authority has been complemented by private causes of action."); *see also* A.C. Pritchard, *The SEC at 70: Time for Retirement?*, 80 NOTRE DAME L. REV. 1073, 1085 (2005) ("With a few minor exceptions . . . the SEC has sided with the plaintiffs' bar in the courts.").

254. *See* Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 YALE J. REG. 149, 279 (1990) ("[A]ny projection of future SEC enforcement trends is highly dependent upon the accuracy of prognostications about the prevailing political climate.").

These concerns can be mitigated if public enforcement by multiple regulators is possible. *See, e.g.*, John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 763 (2009) ("[S]tate Attorneys General have played an aggressive role in prosecuting securities fraud and have pushed the SEC to be more vigorous in its own enforcement efforts.").

255. *Leidos* Amicus Brief, *supra* note 214, at 26–27.

256. This risk is potentially heightened with respect to sustainability disclosure due to uncertainty about issues such as the definition of sustainability, the determination of economic materiality, and the difficulty for even a well-intentioned issuer in evaluating the economic impact of a known risk or trend. *See, e.g.*, Langevoort, *supra* note 179, at 970–71 (discussing the difficulty of determining the extent of the duty to disclose disaster-related risks).

257. Jill E. Fisch, *The Trouble with* Basic*: Price Distortion After* Halliburton, 90 WASH. U. L. REV. 895, 914–16 (2013) (describing the Supreme Court's articulation of the loss causation requirement in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005)).

258. *See id.* at 915 (terming this "'ex post' price distortion").

259. Because the relative significance of sustainability issues can change over time, it may be worthwhile for the SEC to consider a safe harbor providing that, under appropriate circumstances, an issuer's identification of a new sustainability issue does not subject it to liability for previously failing to discuss that issue. *See, e.g.*, BARBARA NOVICK ET AL., BLACKROCK, EXPLORING ESG: A PRACTITIONER'S PERSPECTIVE 9 (2016), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-exploring-

private litigant must be a purchaser or seller of the securities.[260] As a result, private litigation could not be used by environmental groups or other non-shareholder stakeholders to promote noneconomic objectives.

CONCLUSION

Despite the growing quantity of corporate sustainability disclosures, the existing disclosure system is fragmented, unreliable, and incomplete. In light of the worldwide debate over sustainability practices and investor claims regarding the necessity of quality sustainability disclosures for an adequate evaluation of issuer operations, it is necessary for the SEC to reverse its position that sustainability disclosure is not properly included within financial reporting. This Article proposes that the SEC adopt a principles-based disclosure approach through a narrative sustainability disclosure and analysis reporting requirement. It argues that the SD&A is a cost-justified approach that is well-suited to improve the availability of corporate sustainability information for investors, and that SD&A quality can be enhanced by a liability and enforcement structure with direct incentives for board involvement and oversight.

It is too early to determine the extent to which sustainable business practices impact economic performance, or the degree to which boards that engage with sustainability can exercise better risk management and monitoring. SD&A disclosure represents a valuable first step that would enable investors and researchers to weigh those questions with minimal burden on corporate issuers.

esg-a-practitioners-perspective-june-2016.pdf (proposing "safe harbor provisions that ensure that companies which initiate ESG factor reporting do not face retrospective litigation").

260. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 735–36 (1975).