Mixed Company: The Audience for Sustainability Disclosures

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INTRODUCTION

In their symposium articles, Professors Sale and Fisch offer mirror-image visions of the role of mandated disclosure. Professor Sale addresses information that is typically relevant to an investing audience and recognizes its importance to the wider public.[1] Professor Fisch, by contrast, addresses information that is most relevant to a *noninvestor* audience but only contemplates its importance to corporate financial performance.[2] The gulf between their approaches highlights one of the significant tensions in our system of securities regulation: the distance between its intended purpose and its current function.

I. THE ACTUAL (AND PURPORTED) PURPOSES OF SUSTAINABILITY DISCLOSURE

The federal securities laws require businesses to file extensive disclosures about their operations, capital structure, and financial performance when they sell securities to the public[3] and to provide periodic updates so long as their securities remain outstanding and publicly traded.[4] These disclosures contribute to an informational commons with well-recognized benefits to investors and capital markets. For example, they reduce information asymmetries between businesses and investors, which in turn both deters fraud and facilitates efficient pricing.[5] They allow investors to distinguish among different investment opportunities and reward more promising businesses with a lower cost of capital.[6] Disclosures also prevent insiders from exploiting informational advantages when trading.[7]

Beyond these informational benefits, disclosure improves corporate governance. Not only does disclosure enable investors to monitor and

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[1] *See* Hillary A. Sale, *Disclosure's Purpose*, 107 GEO. L.J. 1045 (2018).

[2] *See* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923 (2018).

[3] 15 U.S.C. §§ 77e, 77d(a)(2) (2012).

[4] *Id.* § 78m.

[5] *See* Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 732–33 (2006).

[6] *See* Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 822–23 (2006).

[7] Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules that Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151, 180 (2013).

discipline management,[8] but the simple requirement that directors collect, synthesize, and analyze information in the first place acts as an indirect mechanism for ensuring that directors adhere to certain standards of care.[9]

With that said, the potential functions of mandatory disclosure go further. Professor Sale observes that disclosure serves audiences besides investors, "including employees and stakeholders."[10] In today's world, corporations may wield powers that rival those of governments[11]; securities disclosures give the general public insight into that power and provide a mechanism for applying pressure—through allocation of investment dollars, consumer boycotts, lobbying efforts, and the like—to influence how that power is used.[12] These benefits, however, stray from the investor-centric orientation that forms the basis of most U.S. Securities and Exchange Commission (SEC) rulemaking and their inclusion within the SEC's remit remains a source of continuing controversy.[13]

The latest version of this battle is currently being fought on the field of "sustainability" disclosures. Sustainability is an amorphous category that has been defined in myriad ways, but, in its broadest conception, sustainability refers to the corporation's efforts to factor social and environmental concerns into its decision making so as to contribute to

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[8] *See* Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237, 254 (2009).

[9] *See* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 873–74 (2003); *see also* Sale, *supra* note 1, at 1057–61.

[10] *See* Sale, *supra* note 1, at 206; *see also* Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1925 (2013) (discussing how securities disclosures can also be used by noninvestor audiences, including vendors and employees); U.S. Mortg., Inc. v. Saxton, 494 F.3d 833, 837 (9th Cir. 2007) (describing how ordinary lenders relied on securities disclosures to assess creditworthiness of borrower).

[11] *See* Parag Khanna, *These 25 Companies Are More Powerful than Many Countries*, FOREIGN POLICY, https://foreignpolicy.com/2016/03/15/these-25-companies-are-more-powerful-than-many-countries-multinational-corporate-wealth-power/ [https://perma.cc/W6Q2-RHJ6].

[12] *See* Sale, *supra* note 1, at 1066 (explaining that stakeholders' strong reactions against Exxon's climate change omissions from its disclosures "resulted in investigations and further attempts to regulate and control the company's business decisions"); *see also* Hillary A. Sale, *The New "Public" Corporation*, 74 L. & CONTEMP. PROBS. 137, 142 (2011) (discussing an "increased pressure for the government to occupy the governance space" after the financial crisis because corporations did not "recognize their own publicness").

[13] *See* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1201–04 (1999) (evaluating whether the SEC "has the power to require social as well as financial disclosure by public reporting companies to promote corporate social transparency"); *see also* Onnig H. Dombalagian, *Principles for Publicness*, 67 FLA. L. REV. 649, 681–82 (2015) (discussing whether the SEC is the right governing body to oversee social disclosures); Guttentag, *supra* note 7, at 194 (explaining that a "better solution to address the relationship between disclosure rules and these larger societal objectives would be to treat these objectives and the information required to be disclosed to ameliorate these problems as providing the basis for an alternative disclosure scheme").

"long-term human flourishing."[14] Sustainability disclosures pertain to the organization's efforts to "meet[] the needs of the present without compromising the ability of future generations to meet their own needs."[15]

There are many different types of information relevant to sustainability and, certainly, at least some are relevant to corporate financial performance.[16] The importance of climate change information, for example, is difficult to deny. Warmer temperatures threaten the world's supply of chocolate,[17] coffee, and wine,[18] interfere with air travel,[19] and contribute to wildfires and coastal flooding, with associated loss of life and property damage.[20] As a result, businesses have begun to adapt by relocating operations[21] and even genetically engineering new weather-resistant crops.[22] Long-term investors may want assurances that companies have evaluated any environmental risks and developed appropriate responses.

Additionally, attention to sustainability may serve as a useful proxy for good corporate governance.[23] Businesses that address social and environmental risks may exhibit greater discipline and commitment to long-term planning than peers. Investors may therefore seek out sustainability information as part of a holistic evaluation of management quality.

But the elephant in the room is that this is not the only reason why investors—and the public—urge greater transparency around sustainability. Much of the movement is not predicated on the idea that sustainable

[14] Matthew T. Bodie, *NASCAR Green: The Problem of Sustainability in Corporations and Corporate Law*, 46 WAKE FOREST L. REV. 491, 496 (2011).
[15] *Id.* at 492 (quoting Rep. of World Comm'n on Env't & Dev., 14th Session, June 8–19, 1987, *Our Common Future*, Ch. 2, ¶ 1, U.N. Doc. A/43/427 (1987)).
[16] *See* Emily Steinbarth, *Materiality Matters: Targeting the ESG Issues That Can Impact Performance*, RUSSELL INVESTMENTS (Mar. 2018), https://russellinvestments.com/us/insights/articles/materiality-matters [https://perma.cc/T6UT-J22S].
[17] Erin Brodwin, *Chocolate Is on Track to Go Extinct in 40 Years*, BUSINESS INSIDER (Dec. 31, 2017), https://www.businessinsider.com/when-chocolate-extinct-2017-12 [https://perma.cc/5L52-5L8Q].
[18] David Gelles, *Falcons, Drones, Data: A Winery Battles Climate Change*, N.Y. TIMES (Jan. 5, 2017), https://www.nytimes.com/2017/01/05/business/california-wine-climate-change.html [https://perma.cc/M9CG-FGX8].
[19] Zach Wichter, *Too Hot to Fly? Climate Change May Take a Toll on Air Travel*, N.Y. TIMES (June 20, 2017), https://www.nytimes.com/2017/06/20/business/flying-climate-change.html [https://perma.cc/89C4-RDGS].
[20] Niki Kitsantonis et al., *In Greece, Wildfires Kill Dozens, Driving Some into the Sea*, N.Y. TIMES (July 24, 2018), https://www.nytimes.com/2018/07/24/world/europe/greece-fire-deaths.html [https://perma.cc/S28A-6SQB]; Kendra Pierre-Louis, *Does Climate Change Have Anything to Do with Floods in Thailand?*, N.Y. TIMES (July 11, 2018), https://www.nytimes.com/2018/07/11/climate/climate-change-thailand-floods.html [https://perma.cc/8KBQ-Z5ZU].
[21] *See* Lisa Palmer, *Vineyards Take Action as Climate Change Threatens Wines and Livelihoods*, GUARDIAN (Oct. 3, 2013), https://www.theguardian.com/sustainable-business/blog/vineyards-climate-change-threat [https://perma.cc/P4XT-KXEX].
[22] Brodwin, *supra* note 17.
[23] *See* Michael J. Vargas, *In Defense of E. Merrick Dodd: Corporate Social Responsibility in Modern Corporate Law and Investment Strategy*, 73 BUS. L. 337, 369 (2018).

companies produce greater returns but is instead predicated on the idea that investors may *care about things other than* financial returns.[24] Matters pertaining to how well corporations treat their employees; how they deal with issues of gender, race, and sexual orientation discrimination; their concern for the environment; their respect for consumers' privacy, are all elements of "publicness"—namely, the societal demand that corporate managers make decisions with due concern for their impact on the country as a whole.[25] Yet they may only minimally, if at all, contribute to investor wealth. When investors seek disclosure of this kind of information, at least part of the reason is *not* to protect their economic investment but to enable coordination with other constituencies to press for change. This is the awkward reality of the sustainability movement: even its advocates often feel uncomfortable being candid about their true motives.

That coyness is traceable to the larger legal framework in which disclosure operates. While human investors may admit that they prefer to invest in companies that "do good"—or that at least do no harm—institutions often do not possess this freedom. Institutional investors are frequently vehicles for retirement savings and are thus governed either by the federal Employee Retirement Income Security Act (ERISA) or by parallel state law standards.[26] Though the matter is subject to some debate, ERISA is often interpreted to require that fund managers act only to maximize the fund's wealth, regardless of social concerns.[27] For example, even if a union pension fund wished to avoid investing in companies that mistreated their workers, ERISA would, under some interpretations, prohibit it from doing so if the non-union companies offered superior financial returns.

These standards influence even non-ERISA accounts because a single large mutual fund will often sell shares to many different types of investors, some (but not necessarily all) of which are covered by ERISA. As a result,

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[24] *See generally* Paul Weitzel & Zachariah J. Rodgers, *Broad Shareholder Value and the Inevitable Role of Conscience*, 12 N.Y.U. J.L. & BUS. 35 (2015) (arguing for a broader view of shareholder value than purely wealth maximization); *Sustainable Investing: The Millennial Investor*, EY (2017), https://www.ey.com/Publication/vwLUAssets/ey-sustainable-investing-the-millennial-investor-gl/$FILE/ey-sustainable-investing-the-millennial-investor.pdf ("Demand for sustainable investments is being driven, in part, by millennials who prefer to invest in alignment with personal values."); Letter from Heather Slavkin Corzo, Dir., Office of Inv., American Fed'n of Labor and Congress of Indus. Labor Orgs., to Brent J. Fields, Sec'y, Sec. and Exch. Comm'n 7–8 (July 21, 2016) https://www.sec.gov/comments/s7-06-16/s70616-305.pdf (urging the SEC to adopt a legal standard for materiality that does not depend on financial relevance).

[25] *See* Sale, *supra* note 1, at 1065.

[26] *See* David H. Webber, *The Use and Abuse of Labor's Capital*, 89 N.Y.U. L. REV. 2106, 2119–21 (2014).

[27] *See id.* at 2125; *see also* U.S. DEP'T OF LABOR, FIELD ASSISTANCE BULL. NO. 2018-01 (2018) ("[ERISA] plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals.").

if fund managers want to see their funds included in ERISA portfolios, they must also seek fund wealth maximization.

Institutional investors caught in this regime are subject to conflicting demands: the general public—and many of their clients—may insist that they use their power as investors to press for improved attention to sustainability issues regardless of the effects on fund returns.[28] But if these institutions admit that their concerns extend beyond the financial, they risk running afoul of their legal obligations and jeopardizing their market position. More broadly, corporate managers themselves are usually viewed as obligated to maximize shareholder wealth.[29] With shareholder involvement in corporate governance still contested and fragile,[30] any open admissions by large investors that they are advocating for non-wealth-maximizing action would only hand managers additional leverage in the fight to persuade state and federal regulators to minimize shareholder power.[31]

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[28] *See* Andrea Vittorio, *Vanguard's Votes on Climate Change up for Their Own Vote*, BLOOMBERG BNA (July 18, 2017), https://www.bna.com/vanguards-votes-climate-n73014461913/ [https://perma.cc/T9FR-TBD7]; *see also* Julia Horowitz, *Parkland Activist David Hogg Calls for Boycott of BlackRock and Vanguard*, CNN BUSINESS (Apr. 17, 2018), https://money.cnn.com/2018/04/17/news/companies/david-hogg-vanguard-blackrock-boycott/index.html [https://perma.cc/FZE5-DPBR]; Ross Kerber, *Exclusive: BlackRock Vows New Pressure on Climate, Board Diversity*, REUTERS (Mar. 13, 2017), https://www.reuters.com/article/us-blackrock-climate-exclusive/exclusive-blackrock-vows-new-pressure-on-climate-board-diversity-idUSKBN16K0CR [https://perma.cc/P843-YJ5W]; Annie Massa*, Larry Fink Confronted by Anti-Gun Protesters at Yahoo Summit*, BLOOMBERG (Sept. 20, 2018), https://www.bloomberg.com/news/articles/2018-09-20/larry-fink-confronted-by-anti-gun-protesters-at-yahoo-summit [https://perma.cc/NWD3-F5L6].

[29] DAVID YOSIFON, CORPORATE FRICTION: HOW CORPORATE LAW IMPEDES AMERICAN PROGRESS AND WHAT TO DO ABOUT IT 67–83 (2018).

[30] *See generally* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010) (arguing that increased shareholder power will cause managers to focus on short-term stock prices rather than long term value creation); Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870 (2017) (arguing that activist shareholders seek quick profits via financial engineering at the expense of sustainable business development); Maureen Farrell, *Tech Founders Want IPO Riches Without Those Pesky Shareholders*, WALL ST. J. (Apr. 3, 2017), https://www.wsj.com/articles/control-geeks-tech-founders-want-ipo-investors-not-their-input-1491236464 [https://perma.cc/V2CF-MMWP] (Snap's IPO gave new shareholders no voting rights); Gretchen Morgenson, *Meet the Legislation Designed to Stifle Shareholders*, N.Y. TIMES (June 16, 2017), https://www.nytimes.com/2017/06/16/business/wells-fargo-clawback-fair-choice-act-shareholders.html [https://perma.cc/WMF7-MKJZ] (the proposed Financial Choice Act reduces shareholders' ability to influence corporate policy).

[31] The balance of power between managers and shareholders is dramatically affected by the state and federal regulatory apparatus (including common law rulemaking). For example, at the federal level, rules pertaining to proxy communications have an enormous impact on shareholders' level of influence. *See generally* John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 559–61 (2016) (discussing the SEC's evolving rules regarding proxy solicitations and the "impact on shareholder speech and dissent"). Evidence that

In sum, sustainability disclosures are often championed for noneconomic reasons, but they are filtered through a disclosure system that is not designed to accommodate anything other than a preference for economic returns. Some investors may factor noneconomic information into their investment strategy, but their interest stems from their status as members of the polity; their concerns are not investor-specific. It is precisely for this reason that the SEC has resisted calls for greater disclosures in the areas of sustainability and political spending. These matters may well be legitimate objects of public attention, but the SEC—with its mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation"[32]—has no special expertise to set ground rules for their disclosure.[33]

II. FITTING A SQUARE PEG INTO A ROUND HOLE

As the above discussion demonstrates, there is a fundamental mismatch between the purposes for which disclosure is sought and the legal basis for requiring that disclosure. The incongruity ripples throughout the securities regulation framework with unfortunate results.

First, so long as a company does not make its securities available to the public—something that is easier and easier to do[34]—no disclosures are required, even if such information has the same societal relevance as the sustainability disclosures currently being demanded of public companies.[35]

Second, the discourse surrounding these issues constantly has to be filtered through the language of financial return; disclosure can only be advocated to the extent some connection to wealth maximization can be plausibly identified.[36] Shareholders concerned with sustainability are left trying to square the circle, which usually means finding a financial "hook" to justify a social concern. For example, the UAW Retiree Medical Benefits

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shareholders use their power to *decrease* corporate wealth—however salutary their motives—could easily persuade regulators to tilt the balance against them.

[32] *What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/Article/whatwedo.html [https://perma.cc/HHY6-QDHV].

[33] *See* Dombalagian, *supra* note 13, at 682.

[34] *See* Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165, 169–78 (2017) (discussing the "[f]ading [a]llure of the IPO" in light of new sources of capital).

[35] *See* Jennifer S. Fan, *Regulating Unicorns: Disclosure in the New Private Economy*, 57 B.C. L. REV. 583, 599–601 (2016) (lamenting the limited information available about private companies that have significant economic impacts, such as Airbnb and Uber).

[36] *See* Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, COLUM. L. REV. (forthcoming) (manuscript at 68), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3147130 [https://perma.cc/EL5L-29CQ] (filtering issues of sexual harassment through the lens of shareholder harm "runs the risk of equating the negative economic externalities of sexual harassment with the human tragedy that victims endure. Relatedly, framing sexual harassment in terms of harm to shareholders might be criticized as commodifying the employees who bear the brunt of sexual harassment's costs.").

Trust—a fund that provides health care plans to union members[37]—recently sought to force certain pharmaceutical companies to provide shareholders with more extensive explanations for the usurious rates often charged for specialty drugs.[38] The Trust justified its proposal on the ground that these pricing strategies may anger the public and cause legislative backlash, to the ultimate detriment of the companies that employ them.[39] But was that truly the Trust's motivation? It seems far more plausible that the Trust—which must fund medical expenses incurred by its beneficiaries—simply wanted to keep drug prices down. However, the current regime discouraged the Trust from making a full-throated argument to that effect.

Finally, the legal system offers few protections for investors who factor social concerns into their decision making. As Professor Fisch points out, if corporate disclosures prove false, investors may only seek damages to the extent they can prove they experienced monetary losses as a result of the lie.[40] Disclosures with little financial relevance—though perhaps important to the investor—may not be able to satisfy this standard. Ethical investment is thus a legally unrecognized and unprotected category.[41]

CONCLUSION

If our society is to truly recognize corporations' publicness—their status as public actors who are accountable to society and whose governance mechanisms are properly the subject of general scrutiny—sustainability disclosures cannot be limited to matters of financial relevance. We may need to create a new disclosure framework attuned not just to the informational needs of investors, but also to the informational needs of the general public—perhaps under the aegis of a regulatory body designed for that purpose. Proposals along these lines have been offered since the dawn of the giant corporations;[42] it may now be appropriate to revisit those old ideas.

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[37] *History of the Trust*, UAW RETIREE MEDICAL BENEFITS TRUST, http://www.uawtrust.org/history [https://perma.cc/VS8S-FWAY].

[38] *See* Vertex Pharmaceuticals, Inc., SEC No-Action Letter, 2015 WL 109832, at *2–3 (Feb. 25, 2015); Gilead Sciences, Inc., SEC No-Action Letter, 2014 WL 6984699, at *9 (Feb. 23, 2015).

[39] *See Vertex*, 2015 WL 109832, at *3–10; see also *Gilead*, 2014 WL 6984699, at *3–5, *10–15.

[40] Fisch, *supra* note 2, at 965.

[41] To some extent, it may even be actively disdained by courts. *See* Ann M. Lipton, *Reviving Reliance*, 86 FORDHAM L. REV. 91, 133 (2017).

[42] *See* Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53, (1990) (explaining that the corporate income tax was originally proposed as a mechanism for forcing corporations to disclose information to the public).