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Beyond Sustainability Reporting: Integrated Reporting is Practiced, Required and More Would Be Better

Adam Sulkowski

Sandra Waddock

ARTICLE

BEYOND SUSTAINABILITY REPORTING: INTEGRATED REPORTING IS PRACTICED, REQUIRED, AND MORE WOULD BE BETTER

ADAM SULKOWSKI
UNIVERSITY OF MASSACHUSETTS DARTMOUTH
CHARLTON COLLEGE OF BUSINESS
DEPARTMENT OF MANAGEMENT AND MARKETING
285 OLD WESTPORT ROAD
NORTH DARTMOUTH, MA 02747
508-999-8037
ASULKOWSKI@UMASSD.EDU

AND

SANDRA WADDOCK*
BOSTON COLLEGE
CARROLL SCHOOL OF MANAGEMENT
CHESTNUT HILL, MA 02467
617-552-0477
WADDOCK@BC.EDU

ABSTRACT

Ninety-five percent of the Global Fortune 250, along with thousands of other companies worldwide, voluntarily report on their environmental, societal, and economic impacts. The practice is variously known as sustainability reporting, corporate responsibility (CR) reporting, corporate social responsibility (CSR) reporting, citizenship reporting, environmental, societal, and governance (ESG) reporting, or triple bottom line (TBL) reporting. A growing number of countries now mandate or provide guidance related to this practice to some extent. For example, in the United States,

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the Dodd-Frank Wall Street Reform and Consumer Protection Act explicitly requires publicly traded companies to disclose data related to their supply chains of certain minerals.

Should greater disclosures be explicitly and specifically required? Should companies begin greater disclosures for their own benefit? Do the basic principles of existing laws already require a greater amount of disclosure in our current context? If so, what would be gained from greater and more explicit guidance from legislators or regulators such as the SEC? We seek to answer these questions.

This article summarizes the history, current state, and motivations and impacts of sustainability reporting and regulation-by-disclosure, along with data on the present needs of investors and recent market trends. It also reviews the definition of materiality under U.S. securities laws and regulations—the key to understanding what data a company must publicly disclose for the benefit of investors. Based on our review of recent history, the current needs of investors, and the definition of materiality, it is clear that existing laws and related rules already require greater disclosure of data on environmental and societal impacts than commonly understood. The article concludes with recommendations for managers, their attorneys, accountants, and policymakers, and provokes further questions for constructive scholarship in the fields of business and law.

I. Introduction

Thousands of companies around the world, including 95 percent of the Global Fortune 250, voluntarily report on their environmental, societal, and economic impacts.[1] This practice is known as sustainability reporting, corporate responsibility (CR) reporting, corporate social responsibility (CSR) reporting, citizenship reporting, environmental, societal, and governance (ESG) reporting, or triple bottom line (TBL) reporting.

While sustainability reporting has expanded rapidly for a variety of reasons reviewed here, some debate remains about whether and how a legal framework should be provided. This article begins with a historical retrospective. It then summarizes existing efforts to require and specify how sustainability reporting is accomplished. The authors go on to review the definition of materiality and the reasons why, correctly understood, U.S. law already requires sustainability reporting from publicly traded companies. The article concludes with a discussion of next steps. The authors

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1. *See, e.g.*, Ernst & Young & The Boston College Center for Corporate Citizenship, *Value of Sustainability Reporting*, http://www.ey.com/Publication/vwLUAssets/ACM_BC/$FILE/1304-1061668_ACM_BC_Corporate_Center.pdf (last visited Jan. 11, 2014) (showing the value of sustainability reporting and indicating why many businesses practice it); *see also* Global Reporting Initiative, *Report or Explain: A Smart EU Policy Approach to Non-financial Information Disclosure* (May 2013), https://www.globalreporting.org/resourcelibrary/GRI-non-paper-Report-or-Explain.pdf (indicating why many businesses practice sustainability reporting).

emphasize that high rates of non-compliance with—and lack of punishment for—violations of existing SEC disclosure rules signals that, at the very least, more enforcement efforts are needed. As with financial disclosures, clear and specific mandatory rules would provide the consistency in disclosure that would serve the interests of the marketplace, investors, and society. As with financial disclosure rules, requiring sustainability reporting through legal mechanisms is analogous to forcing a patient to take a medicine that ultimately the patient should want to take out of her own enlightened long-term self-interest (the reasons why most large companies already see ESG reporting as beneficial are explained below). Managers are urged to not only embrace best practices in integrated reporting, but to cooperate with policymakers to create clear, comparable, comprehensive, and credible guidelines that assist in true, total cost accounting and better management.

II. Sustainability Reporting: Widely Practiced & Why

A. *A Brief History of Regulation-by-disclosure and Sustainability Reporting*

The 1929 stock market collapse highlighted the risks of market failure because of lack of information.[2] It crystallized acceptance of a view that both investors and the rest of society would benefit if publicly traded companies issued regular financial disclosures under the auspices of government enforcement.[3] This led to the passage of the Securities Acts of 1933 and 1934 (hereinafter Securities Acts) and the creation of the Securities and Exchange Commission (SEC).[4]

In 1984, the release of deadly chemical gas from a factory in Bhopal, India catalyzed awareness that public disclosure of hazardous chemical stockpiles could mitigate the risk of calamities.[5] The accident was among the factors that led to passage of the Emergency Planning and Community Right-to-Know Act (EPCRA) of 1986,[6] which, rather than controlling behavior, only requires publication of emergency response plans and the disclosure, through the Toxic Release Inventory (TRI), of stockpiles of

2. Allen L. White, *Why We Need Global Standards for Corporate Disclosure*, 69 Law & Contemp. Probs. 167, 175–76 (2006).

3. Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 Stan. L. Rev. 385, 409 (1990).

4. David Monsma and Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information*, 26 Stan. Envtl. L.J. 137, 145 (2007).

5. Peter H. Sand, *The Right to Know: Freedom of Environmental Information in Comparative and International Law*, 20 Tul. J. Int'l & Comp. L. 203, 209 (2011). Sand also provides a fascinating history of how post-9/11 counterterrorism concerns were used to restrict public access to environmental data about companies gathered by government institutions during the years 2001–2009, though this trend was somewhat reversed in 2009. *Id.* at 222–26.

6. 42 U.S.C. §§ 11001–50 (2000).

specified dangerous chemicals.[7] This simple requirement—measurement and public reporting of hazardous chemical stockpiles—led to dramatic reductions in the amount of dangerous chemicals kept near communities; a third generation of environmental law, known as informational regulation or regulation-by-disclosure, was born.[8]

Since then, corporate leaders have accepted that disclosure of a broad set of measures of social, environmental, and economic impacts serve to benefit companies and their stakeholders.[9] By the second decade of the new millennium, a trend was afoot to merge such disclosures with conventional financial reporting—a practice dubbed integrated reporting—with the hope that such a linkage will help managers, investors, and stakeholders see the synergy between "being good" and "doing well."[10]

B. Current State of Sustainability Reporting

As of 2011, according to KPMG's triennial study of the phenomenon, 95 percent of the largest 250 corporations in the world (the Global Fortune 250 or G250) engaged in sustainability reporting.[11] This fact led KPMG to assert that such reporting had come of age and become *de facto* law for business.[12] Further supporting this assertion is the fact that 70 percent of publicly traded companies in a worldwide sample of 3,400 firms (the largest one hundred in each of thirty-four countries) report corporate responsibility data.[13]

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7. *See id.* §§ 11003, 11022–23.

8. David W. Case, *Corporate Environmental Reporting as Informational Regulation: A Law and Economics Perspective*, 76 U. COLO. L. REV. 379, 384 (2005).

9. *See generally* JOHN ELKINGTON, CANNIBALS WITH FORKS: THE TRIPLE BOTTOM LINE OF 21ST CENTURY BUSINESS (1998) (considering whether holding corporations accountable to a "triple bottom-line" of economic prosperity, environmental quality, and social justice constitutes progress).

10. *See* ROBERT G. ECCLES AND MICHAEL KRZUS, ONE REPORT: INTEGRATED REPORTING FOR A SUSTAINABLE STRATEGY (2010).

11. KPMG, KPMG INTERNATIONAL SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2011 21 (2011), *available at* http://www.kpmg.com/ES/es/ActualidadyNovedades/ArticulosyPublicaciones/Documents/CR_Report_2011.pdf [hereinafter KPMG INT'L SURVEY 2011]. The number of companies in the G250 who had engaged in sustainability reporting (either in a stand-alone report or within the context of an annual report) grew from 64 percent in 2005 to 83 percent in 2008 (or 207 out of the G250). KPMG, KPMG INTERNATIONAL SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2008 15 (2008), *available at* http://www.kpmg.com/EU/en/Documents/KPMG_International_survey_Corporate_responsibility_Survey_Reporting_2008.pdf [hereinafter KPMG INT'L SURVEY 2008]; KPMG, KPMG INTERNATIONAL SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2005 4 (2005), *available at* http://www.gppi.net/fileadmin/gppi/kpmg2005.pdf [hereinafter KPMG INT'L SURVEY 2005].

12. KPMG INT'L SURVEY 2011, *supra* note 11, at 2.

13. *See* Adam J. Sulkowski et al., *Corporate Responsibility Reporting in China, India, Japan, and the West: One Mantra Does Not Fit All*, 42 NEW ENG. L. REV. 787, 796–98 (2008) (explaining that cultural values could color how managers even discussed their motivations, with Western executives being more inclined to openly state that they engage in sustainability reporting for the sake of their shareholders).

The dominant standard for ESG or CR disclosures was developed by the Global Reporting Initiative (GRI); 80 percent of reporting entities among the G250 used GRI guidelines in 2011.[14] The GRI, a multi-stakeholder network of experts, began as a project of two U.S. non-profit organizations, CERES and Tellus, in the 1990s.[15] It expanded under the auspices of the United Nations (U.N.) and in 2002 became an independent non-profit organization based in Amsterdam.[16] The GRI guidelines are intended as a framework for not only reporting but also engaging with external stakeholder groups and are openly available as a public good.[17] Since 2010, the UN Global Compact (UNGC) Secretariat has strongly recommended that the more than 10,000 (as of early 2013) signatories of the UNGC (many of them large corporations) use the GRI's reporting framework in their annually required Communications on Progress.[18]

Some progressive companies have been adopting the "bleeding edge" of reporting—moving toward integrated reporting, which means that a company is blending sustainability-related data into regular financial disclosures. In 2008, only 4 percent of the G250 had adopted this practice; by 2011 over a quarter of the G250—27 percent—were merging sustainability disclosures into their financial reports.[19] Integrated reporting is promoted by the International Integrated Reporting Committee (IIRC), which defines it as "a concise communication about how an organization's strategy, governance, performance and prospects lead to the creation of value over the short, medium, and long term."[20] The IIRC is a global coalition of major accounting firms, the GRI, financial and investment institutions, major corporations, business and accounting associations, academics, U.N. agencies, and other interested parties. Collectively, its members agree that numerous elements beyond the scope of conventional financial statements, such as people, natural resources, intellectual capital, market and regulatory control, competition, and energy security[21] help determine an organization's value, and need to be clearly communicated to stakeholders. Fundamentally, an integrated report combines the material aspects of ESG reporting with more traditional financial reporting into a single integrated report. The reality that more than eighty global businesses (including companies like Coca-Cola,

14. KPMG INT'L SURVEY 2011, *supra* note 11, at 16.

15. GRI, *Sustainability Reporting 10 Years On* 1, *available at* https://web.archive.org/web/20100107174557/http://www.globalreporting.org/NR/rdonlyres/430EBB4E-9AAD-4CA1-9478-FBE7862F5C23/0/Sustainability_Reporting_10years.pdf (last visited Jan. 28, 2014).

16. *Id.* at 2.

17. *Id.*

18. *GRI and UN Global Compact Forge New Alliance*, UN GLOBAL COMPACT WEBSITE, June 24, 2010, http://www.unglobalcompact.org/news/50-06-24-2010 (last visited Jan. 11, 2014).

19. KPMG INT'L SURVEY 2011, *supra* note 11, at 23. KPMG's description is that integrated reporting "has exploded onto the CR agenda." *Id.*

20. INT'L INTEGRATED REPORTING COMMITTEE, http://www.theiirc.org/ (last visited Jan. 11, 2014).

21. *Id.*

Microsoft, Unilever, and Marks and Spencer) and fifty institutional investors, in addition to major accounting entities and their associations, are involved in developing the integrated reporting framework suggests its long-term viability as a standard practice.[22]

C. Drivers & Impacts of Sustainability (Market Trends & Investor Needs)

The rapid and worldwide spread of sustainability reporting suggests that companies see value in at least appearing to provide greater transparency. KPMG's triennial study confirms that managers of reporting entities concur with this opinion. The growth in sustainability reporting can also be attributed to pressure from investors, consumers, and activists.[23]

The triennial KPMG study of executives accountable for sustainability reporting is the best source of data on the drivers of the practice.[24] While the most commonly identified motivations have varied depending on the year of the study and sampling of companies, executives have regularly cited maintaining a reputation or brand, stimulating innovation and learning, employee motivation, and relations with shareholders. Other experts and academics believe that increased disclosure should foster greater transparency, provide incentives for cleaner technologies,[25] and facilitate dialogue concerning the effects of climate change on the business world.[26]

III. Legal Framework of Sustainability Reporting

A. The Legal Theory of Regulation-by-disclosure

As mentioned above, regulation-by-disclosure has been categorized as the third generation of efforts to curb negative side effects of business.[27]

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22. *Id.*

23. *See* Sandra Waddock, *Building a New Institutional Infrastructure for Corporate Responsibility*, 22 Acad. Mgmt. Perspectives 3, 87–108 (2008).

24. *See* KPMG Int'l Survey 2011, *supra* note 11; KPMG Int'l Survey 2008, *supra* note 11; KPMG Int'l Survey 2005, *supra* note 11.

25. *See* Perry E. Wallace, *Disclosure of Environmental Liabilities Under the Securities Laws*, 50 Wash. & Lee L. Rev. 1093, 1124–29, 1144 (1993) (illustrating that environmental disclosure can foster environmental protection by creating an incentive to solve environmental problems to preserve the market value of securities).

26. *See* Andrea M. Matwyshyn, *Material Vulnerabilities: Data Privacy, Corporate Information Security, and Securities Regulation*, 3 Berkeley Bus. L.J. 129, 202–03 (2005) (explaining how, in the context of information security, mandated disclosures increase awareness of problems and supports systemic adoption of best practices for both corporations and consumers); *see also* Adam J. Sulkowski, *Cyber-Extortion: Duties and Liabilities Related to the Elephant in the Server Room*, J.L. Tech. & Pol'y 1, 21–63 (2007) (explaining how cybersecurity breaches, inadequate preventative measures, and related costs and liabilities are more routine than commonly realized, and are under-reported).

27. *See* Case, *supra* note 8, at 428.

Within this taxonomy, the first generation consisted of rule-based systems and the second involved command-and-control regulation.[28]

Some authorities, including KPMG, characterize voluntary disclosure efforts as some form of *de facto* law.[29] The theory of soft law holds that norms of conduct are enforced by a desire to avoid shame rather than a desire to avoid sanctions, yet may achieve the ultimate aim of hard law, which, as Cynthia Williams articulates, is "to coordinate action to a focal point."[30] Williams suggests that soft law approaches be taken seriously.[31]

Others agree that increased disclosure of information has great potential to further regulatory goals but point out that, to be effective, a hard law framework is needed to assure uniformity and reliability. According to David Case, a greater abundance of information should allow stakeholders to more efficiently negotiate with polluters to achieve desired goals.[32] However, as of 2009, Case characterized the scholarship of regulation-by-disclosure as "young" and related legal scholarship as in its "infancy."[33] Mitchell Crusto recently concluded the same, stating that there is "little, if any, critical analysis of increased corporate environmental disclosure in the academy."[34] Scholarship of sustainability reporting has advanced in recent years, for example, with a causative link being demonstrated between having a green reputation and having satisfied employees,[35] and between firm size and age and propensity to disclose ESG information,[36] but the many

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28. *Id.*

29. *See* KPMG INT'L SURVEY 2011, *supra* note 11, at 2 (claiming that sustainability reporting has become "*de facto*" law for big companies).

30. Cynthia A. Williams, *Civil Society Initiatives and "Soft Law" in the Oil and Gas Industry*, 36 N.Y.U. J. INT'L L. & POL. 457, 496 (2004) (citing Anne-Marie Slaughter, *Global Government Networks, Global Information Agencies, and Disaggregated Democracy*, 24 MICH. J. INT'L L. 1041 (2003)).

31. *Id.*

32. Case, *supra* note 8, at 415–27.

33. *Id.* at 427.

34. Mitchell F. Crusto, *Endangered Green Reports: "Cumulative Materiality" in Corporate Environmental Disclosure After Sarbanes-Oxley*, 42 HARV. J. LEGIS. 483, 486 (2005).

35. *See* Cassandra Walsh & Adam J. Sulkowski, *A Greener Company Makes for Happier Employees More So Than Does a More Valuable One: A Regression Analysis of Employee Satisfaction, Perceived Environmental Performance and Firm Financial Value*, 11 INTERDISC. ENVT'L REV. 4, 274–82 (2010).

36. *See* Christopher Hughey & Adam J. Sulkowski, *More Disclosure = Better CSR Reputation? An Examination of CSR Reputation Leaders and Laggards in the Global Oil & Gas Industry*, 12 J. ACAD. BUS. & ECON. 2, 24–34 (2012); Jia Wu, Linxiao Liu & Adam J. Sulkowski, *Environmental Disclosure, Firm Performance, and Firm Characteristics: An Analysis of S&P 100 Firms*, 10 J. ACAD. BUS. & ECON. 4, 73–84 (2011); Lu Wei, Wang Wenjun, Adam J. Sulkowski & Jia Wu, *The Relationships Among Environmental Management, Firm Value and Other Firm Attributes: Evidence from Chinese Manufacturing Industry*, 10 INT'L J. ENVTL. & SUS. DEV. 1, 78–95 (2011); Adam J. Sulkowski & D. Steven White, *Financial Performance, Pollution Measures and the Propensity to Use Corporate Responsibility Reporting: Implications for Business and Legal Scholarship*, 21 COLO. J. INT'L ENVTL. L. & POL'Y 3, 491–514 (2009). For examples of how sustainability data can help identify business opportunities or reveal problems worth correcting, see Adam J. Sulkowski & Nicholas Vardaro, *Sid Wainer & Son: A Growing Realization*,

questions related to the drivers and benefits of sustainability reporting still await answers.

B. Within the United States

1. Securities Laws

In the United States, securities laws—either explicitly or by interpretation—require sustainability-related disclosures inasmuch as such information is relevant to financial performance and meets the threshold standard of materiality, as elaborated below. Some assert that SEC guidelines have already improved transparency (and hence, comparability of corporate performance), with regard to corporate greenhouse gas emissions.[37] Further, as indicated by statistics cited later in this article, companies often ignore even explicit rules and guidance.

In addition to financial data,[38] the regulations required by the Securities Acts also mandate that companies publish non-financial information, including data related to market conditions,[39] litigation,[40] and trends and events likely to affect financial results.[41] Since 1971, the SEC has required the filing of environmental information as part of mandatory annual reports under Form 10-K.[42] Relevant guidance includes:

PROCEEDINGS OF THE ACADEMY OF LEGAL STUDIES IN BUSINESS 2011, *available at* http://alsb.roundtablelive.org/Default.aspx?pageId=1175951 (last visited Jan. 11, 2014); Adam J. Sulkowski et al., *What Aspects of CSR Really Matter: An Exploratory Study Using Workplace Mortality Data*, INTERNATIONAL ACADEMY OF BUSINESS AND ECONOMICS PROCEEDINGS 2011; Adam J. Sulkowski, *Helping the Beast See the Carrot: A Research Agenda Concerning Corporate Responsibility Reporting*, *in* INNOVATION IN MANAGEMENT: GLOBAL PARTNERSHIP 177 (Charles Wankel, Peter Odrakiewicz & William Strnad eds., 2010).

37. *See* Elizabeth E. Hancock, Note, *Red Dawn, Blue Thunder, Purple Rain: Corporate Risk of Liability for Global Climate Change and the SEC Disclosure Dilemma*, 17 GEO. INT'L ENVTL. L. REV. 233, 233–34 (2005); Jeffrey M. McFarland, *Warming Up to Climate Change Risk Disclosure*, 14 FORDHAM J. CORP. & FIN. L. 281, 281–301 (2009); Perry E. Wallace, *Climate Change, Fiduciary Duty, and Corporate Disclosure: Are Things Heating Up in the Boardroom?*, 26 VA. ENVTL. L.J. 293, 293–99 (2008).

38. Item 301 of Regulation S-K, 17 C.F.R. § 229.301 n.2 (2006).

39. *See* Regulation S-K, 17 C.F.R. § 229.301 (2006).

40. *Id.* § 229.103.

41. *Id.* § 229.303.

42. For the latest in SEC guidance on disclosure issues, see *Researching the Federal Securities Laws Through the SEC Website*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/investor/pubs/securitieslaws.htm (last visited Oct. 8, 2012). *See* Elizabeth Anne Glass Geltman, *Disclosure of Contingent Environmental Liabilities by Public Companies Under the Federal Securities Laws*, 16 HARV. ENVTL. L. REV., 129, 129–30 (1992); Perry E. Wallace, *Disclosure of Environmental Liabilities Under the Securities Laws: The Potential of Securities-Market-Based Incentives for Pollution Control*, 50 WASH. & LEE L. REV. 1093, 1093 (1993); MARK MANSLEY, FRIENDS OF THE EARTH, OPEN DISCLOSURE: SUSTAINABILITY AND THE LISTING REGIME 34 (2003); ROBERT REPETTO ET AL., COMM'N FOR ENVTL. COOPERATION, ENVIRONMENTAL DISCLOSURE REQUIREMENTS IN THE SECURITIES REGULATIONS AND FINANCIAL ACCOUNTING STANDARDS OF CANADA, MEXICO AND THE UNITED STATES iv (2002); Robert H. Feller, *Environmental Disclosure and the Securities Laws*, 22 B.C. ENVTL. AFF. L. REV. 225, 225–39 (1995).

> Appropriate disclosure shall also be made as to the material effects that compliance with federal, state, and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings, and competitive position of the registrant and its subsidies.[43]

Arguably, other provisions, by requiring mention of managerial training related to legal standards, by extension require the mention of foreign minimum mandated disclosures.[44]

Disclosures are mandated by the SEC in at least one context related to human rights: companies must publish whether they are active in operations against which the United States has imposed sanctions.[45]

On January 27, 2010, the SEC provided public companies with interpretive guidance for climate-change-related disclosure requirements.[46] It clarified that businesses should disclose to investors any serious risks due to climate change or related policies, regulations, legislation, international accords, or business trends.[47] Existing rules have mandated reporting on the "reasonably likely material costs" of complying with environmental statutes and regulations.[48] Interpretive guidance does not add new requirements, but

43. 17 C.F.R. § 229.101(c)(xii) (2010). *See* Gerard A. Caron, Comment, *SEC Disclosure Requirements for Contingent Environmental Liability*, 14 B.C. ENVTL. AFF. L. REV. 729 (1987); Michael A. Neloy, *Disclosure of Environmental Liability in SEC Filings, Financial Statements, and Debt Instruments: An Introduction*, 5 VILL. ENVTL. L.J. 315 (1994); Mark A. White, *SEC Disclosure of Environmental Matters*, *in* THE GREENING OF AMERICAN BUSINESS 255 (Thomas F.P. Sullivan ed., 1992).

44. Peter H. Sand, *The Right to Know: Freedom of Environmental Information in Comparative and International Law*, 20 TUL. J. INT'L & COMP. L. 203, 227 n.144 (2011).

45. Eric Engle, *What You Don't Know Can Hurt You: Human Rights, Shareholder Activism and SEC Reporting Requirements*, 57 SYRACUSE L. REV. 63, 84 n.135 (2006).

46. Press Release, U.S. Sec. & Exch. Comm'n, SEC Issues Interpretive Guidance on Disclosure Related to Business or Legal Developments Regarding Climate Change (Jan. 27, 2010), *available at* http://www.sec.gov/news/press/2010/2010-15.htm (last visited Jan. 18, 2014).

47. Comm'r Mary Schapiro, SEC Chairperson, Statement Before the Open Commission Meeting on Disclosure Related to Business or Legislative Events on the Issue of Climate Change (Jan. 27, 2010); Nickolas M. Boecher, *SEC Interpretive Guidance for Climate-Related Disclosures*, 10 SUSTAINABLE DEV. L. & POL'Y 43, 43 (2010); *see* Jeffrey A. Smith et al., *The SEC's Interpretive Release on Climate Change Disclosure*, 4 CARBON & CLIMATE L. REV. 147, 147 (2010); *see also* BETH YOUNG ET AL., ENVTL. DEF. FUND, CLIMATE RISK DISCLOSURE IN SEC FILINGS: AN ANALYSIS OF 10-K REPORTING BY OIL AND GAS, INSURANCE, COAL, TRANSPORTATION AND ELECTRIC POWER COMPANIES iv (2009); Camden D. Burton, Recent Development, *An Inconvenient Risk: Climate Change Disclosure and the Burden on Corporations*, 62 ADMIN. L. REV. 1287, 1287–89 (2010).

48. Comm'n Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6,295–97 (Feb. 8, 2010) (to be codified at 17 C.F.R. pt. 211, 231, 241) [hereinafter Comm'n Guidance]. The four areas in which climate change may result in disclosure obligations: Legislation and Regulation; International Accords; Indirect Consequences of Regulation or Business Trends; and Physical Impacts of Climate Change.

rather clarifies expectations.[49] Only one commissioner objected to this clarification, arguing that climate risks are beyond the expertise of the SEC.[50]

2. *Environmental Protection Agency*

Some steps by the Environmental Protection Agency (EPA), in cooperation with the SEC, have been characterized as steps forward in regulation-by-information, but they do not mandate disclosures by companies. For example, the EPA has shared information with the SEC about enforcement with the aim of identifying companies that fail to report actions against them. The effort fell short of expectations because the EPA tracks violators by facility while the SEC tracks registrants by company.[51]

The EPA has been taking steps to mandate the measurement and reporting of greenhouse gas emissions. On January 1, 2010, it began, for the first time, to require large emitters of greenhouse gases to collect and report data with respect to their greenhouse gas emissions.[52] This reporting requirement is expected to cover 85 percent of the nation's greenhouse gas emissions generated by roughly 10,000 facilities.[53] In December 2009, the EPA issued an "endangerment and cause or contribute finding" for greenhouse gases under the Clean Air Act, which will allow the EPA to craft rules that directly regulate greenhouse gas emissions.[54]

3. *Dodd-Frank Wall Street Reform and Consumer Protection Act*

While the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereinafter the Dodd-Frank Act) primarily regulates the financial sector, its Title XV or "Miscellaneous Provisions" contain specialized disclosure requirements intended to improve the behavior of companies.[55] Section 1502 requires an annual audited-and-certified disclosure of the use of—and

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49. Schapiro, Statement Before Open Commission, *supra* note 47.

50. Nickolas M. Boecher, *SEC Interpretive Guidance for Climate-Related Disclosures*, Feature, 10 SUSTAINABLE DEV. L. & POL'Y 43, 43 (2010).

51. Michael J. Viscuso, Note, *Scrubbing the Books Green: A Temporal Evaluation of Corporate Environmental Disclosure Requirements*, 32 DEL. J. CORP. L. 879, 891 (2007).

52. *See* Mandatory Reporting of Greenhouse Gases, 74 Fed. Reg. 56260 (Oct. 30, 2009).

53. *See* Press Release, EPA, EPA Finalizes the Nation's First Greenhouse Gas Reporting System/Monitoring to begin in 2010 (Sept. 22, 2009), *available at* http://yosemite.epa.gov/opa/admpress.nsf/d985312f6895893b852574ac005f1e40/194e412153fcffea8525763900530d75!OpenDocument.

54. Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act, 74 Fed. Reg. 66496 (Dec. 15, 2009). The Clean Air Act is codified at U.S.C. § 7401 et seq.

55. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010) [hereinafter The Dodd-Frank Act]. For an overview and discussion of the law, 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 (2011). *See* Emily Veale, *Is There Blood On Your Hands-Free Device?: Examining Legislative Approaches to the Conflict Minerals Problem in the Democratic Republic of Congo*, 21 CARDOZO J. INT'L & COMP. L. 503, 544 (2013).

due diligence related to—"conflict minerals" extracted from the Democratic Republic of the Congo or an adjoining country.[56] Section 1503 requires disclosure in each periodic report filed with the SEC information related to any mining health and safety violations, including their number, related orders, and citations received from the Mine Safety and Health Administration (MSHA), in addition to findings of patterns of violations.[57] Section 1504 requires companies involved in mining and oil and gas development to disclose payments to governments.[58] Dodd-Frank also requires the SEC to make available online a collection of such disclosed information.[59]

4. *The Materiality Principle*

The materiality principle, correctly understood from both a historical and contemporary perspective, further compels publicly traded companies to disclose information related to sustainability. The SEC defines materiality as information related to "those matters about which an average prudent investor ought reasonably to be informed."[60] This is consistent with the Supreme Court's seminal ruling on the issue in *TSC Industries v. Norway, Inc.*, in which the Court stated that a fact is material if there is "a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available."[61] The standard of "reasonableness" is the focus of an inquiry by Steve Lydenberg who points out that, in the context of torts, a reasonable person is careful with respect to creating risks of harm, and a reasonable investor (as opposed to a profit-maximizing investor) has these same concerns.[62] The key point with respect to investors, however, is that unless the relevant information is available to them, they may well be unable to make a reasonable assessment of their investments.

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56. *Specialized Corporate Disclosure*, U.S. SEC. AND EXCH. COMM'N, http://www.sec.gov/spotlight/dodd-frank/speccorpdisclosure.shtml; *see also* The Dodd-Frank Act, § 1502, 124 Stat. at 2213–18 (discussing conflict minerals).

57. *Specialized Corporate Disclosure*, *supra* note 56; *see also* The Dodd-Frank Act, § 1503, 124 Stat. at 2218–20. Section 1503 of the Dodd-Frank Act is entitled "Reporting Requirements Regarding Coal or Other Mine Safety."

58. *Specialized Corporate Disclosure*, *supra* note 56; The Dodd-Frank Act § 1504, 124 Stat. at 2220–22. Section 1504 of the Dodd-Frank Act is entitled "Disclosure of Payments by Resource Extraction Issuers."

59. *Specialized Corporate Disclosure*, *supra* note 56 ("Information must be provided in an interactive data format [to permit the SEC to compile the information electronically and provide the information online]."). *See also* The Dodd-Frank Act, § 1504(q)(3), 124 Stat. at 2221–22 ("To the extent practicable, the Commission shall make available online, to the public, a compilation of the information required to be submitted under the rules issued under paragraph (2)(A).").

60. STEVE LYDENBERG, INITIATIVE FOR RESPONSIBLE INV., HAUSER CTR. FOR NONPROFIT ORGS. AT HARVARD UNIV., ON MATERIALITY AND SUSTAINABILITY: THE VALUE OF DISCLOSURE IN THE CAPITAL MARKETS 12, *available at* http://www.sasb.org/wp-content/uploads/2012/10/On-Materiality-and-Sustainability.pdf (last visited Feb. 5, 2014).

61. *Id.*

62. *Id.* at 13.

Rule 10b-5 is also critically relevant.[63] As explained by Rachel Cherington, "Rule 10b-5 requires veracity in corporate statements, even when there is no affirmative duty to disclose such information, the rule reaches a broader cross-section of corporate statements than those required in the periodic and annual statements."[64] Misstatements or major omissions, even with regard to information that is voluntarily proffered, can potentially amount to a fraud upon investors.[65] Beyond academia and the SEC, practitioners have also gone on record that environmental risks are material.[66]

Some have focused more on the question of what existing regulatory structures require. Perry Wallace has argued that, given the likely catastrophic consequences of climate change and existing fiduciary duties of managers, companies should, given existing rules and principles, make greater non-financial disclosures.[67] This line of reasoning, agreed upon by David Monsma and Timothy Olson, holds that company responses to climate change are material knowledge to investors and that regulation S-K, correctly interpreted, requires related disclosures.[68] Jeffrey McFarland agrees with this logic, stating that U.S. securities laws should be interpreted as requiring at least a disclosure of liability exposure, including amounts of

63. *See* 17 C.F.R. 240.10b-5 ("It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.").

64. *See* Rachel Cherington, *Securities Laws and Corporate Social Responsibility: Toward an Expanded Use of Rule 10b-5*, 25 U. PA. J. INT'L ECON. L. 1439, 1448 (2004).

65. This strong possibility—at least in theory—of eventually being accused of defrauding investors for withholding or misrepresenting data on ESG and sustainability performance stands in strong contraposition to an apparent lack of consequences (to date) for constructing LEED-certified buildings that may not actually perform as expected. Adam J. Sulkowski, *LEEDigation: The Risks, Why We Don't See More, and Practical Guidance Related to Green Building Contracts*, 39 REAL EST. L.J. 192, 201–02 (2010).

66. Eric Engle, *What You Don't Know Can Hurt You: Human Rights, Shareholder Activism, and SEC Reporting Requirements*, 57 SYRACUSE L. REV. 63, 89 n.60 (2006) (citing to a letter from the Honorable John B. Stephenson, Ranking Minority Member, Committee on Environment and Public Works, to Senator Jon S. Corzine (D.-N.J.) (July 14, 2004) reprinted in GAO-04-808, *Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information* (2004) ("Environmental risks and liabilities are among the conditions that, if undisclosed, could impair the public's ability to make sound investment decisions. For example, the discovery of extensive hazardous waste contamination . . . [or] impending environmental regulations could affect a company's future financial position.")).

67. Perry E. Wallace, *Climate Change, Fiduciary Duty, and Corporate Disclosure: Are Things Heating Up in the Boardroom?,* 26 VA. ENVTL. L.J. 293 (2008).

68. David Monsma & Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search For a Duty to Disclose Material Non-Financial Information*, 26 STAN. ENVTL. L.J. 137, 147–61 (2007).

emissions and actions taken to reduce the risk of related possible losses.[69] As further evidence that U.S. securities laws—correctly interpreted—require extensive reporting on the side effects of doing business, some point to instances where disclosures in the U.S. were greater than in countries that have explicitly stipulated what must be reported[70] to such an extent that some think that—again correctly interpreted and applied—U.S. standards are even worthy of emulation.[71]

5. *Investor Demands: Proof That Materiality Behooves Disclosures*

Perhaps most persuasively, the argument that the materiality principle behooves greater ESG reporting is supported by the amount of demand for such disclosures by investors. Seven hundred twenty-two investors controlling $87 trillion in assets have expressed a desire through the Carbon Disclosure Project for greater climate-related disclosure, and the amount of investments represented continues to grow.[72] Investors have submitted reports suggesting that current climate-related disclosure is insufficient.

Over 1,000 financial firms with assets under management of approximately $33 trillion had signed on to the U.N.'s six Principles for Responsible Investment (PRI) as of 2012.[73] Among other things, the signatories committed to incorporate environmental, social, and governance (ESG) issues into their investment analyses and decision making, be active owners around these issues, seek appropriate ESG disclosure by companies in which they invest, and collaborate to promulgate the PRI broadly, while reporting on their own activities.[74]

Twelve percent of managed assets are invested in stocks that are currently screened based on ethical criteria.[75] The U.S. SIF (Social Investment Forum) reported in its 2012 Trends Report that some $3.74 trillion is now under the responsible investment umbrella, with $3.3 trillion (out of a total

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69. Jeffrey M. McFarland, *Warming Up to Climate Change Risk Disclosure*, 14 FORDHAM J. CORP. & FIN. L. 281, 285–92 (2009).

70. *See* CHRIS HIBBIT, LIMPERG INSTITUUT, EXTERNAL ENVIRONMENTAL DISCLOSURE AND REPORTING BY LARGE EUROPEAN COMPANIES 36 (2004) (citing British Petroleum's 1998 report to the SEC on potential impacts of the Kyoto Protocol).

71. For a proposal to "globalize" the SEC disclosure rules, see Patricia Romano, *Sustainable Development: A Strategy That Reflects the Effects of Globalization on the International Power Structure*, 23 HOUS. J. INT'L L. 91, 108 (2000). For potential recourse to the Aarhus Convention see Nikzad Oraee-Mirzamani & Zen Makuch, *Corporate Environmental Disclosure Law, Fiduciary Duties and the Aarhus Convention*, 20 EUR. ENERGY & ENVTL. L. REV. 18–22 (2010).

72. CARBON DISCLOSURE PROJECT, ARE UK COMPANIES PREPARED FOR THE INTERNATIONAL IMPACTS OF CLIMATE CHANGE? 6 (2013), *available at* http://www.pwc.co.uk/en_UK/uk/assets/pdf/cdp-ftse350-climate-change-2013.pdf (last visited Jan. 19, 2014).

73. UNEP FIN. INITIATIVE, UNITED NATIONS PRINCIPLES FOR RESPONSIBLE INVESTMENT ANNUAL REPORT 2012, 4, *available at* http://www.unpri.org/viewer/?file=files/Annual%20report%202012.pdf (last visited Jan. 19, 2014).

74. *Id.* at 24.

75. Jeroen Derwall et al., *The Eco-Efficiency Premium Puzzle*, 61 FIN. ANALYST J. 3, 3 (2005).

of $33.3 trillion total investment) incorporating ESG data.[76] The investors and fund managers associated with these funds, and with the PRI, are now at least in theory making investment decisions partially based on non-financial but potentially material disclosures, and firms may be responding to this market demand for more information. Such investors are becoming more vocal—of 600 shareholder resolutions being tracked by Ernst & Young in 2013, 44 percent related to environmental and societal issues.[77]

One measure that investors are taking ESG disclosures seriously is that a large and growing share of G250 companies goes further than investing in measuring and publishing such data. Almost half pay for third-party verification, with a majority of these engaging one of the major international accountancy firms.[78] One-third of the G250 issued restatements regarding their ESG data, indicating that they perceived a critical mass of stakeholders—including shareholders—follow and actually pay attention to the veracity and reliability of this information.[79] Another indicator that companies realize there is a demand for this data is the widespread drive to make it more accessible across multiple communications media; only 20 percent communicate their sustainability data solely through stand-alone sustainability reports.[80]

Forty-seven percent of the G250 companies report financial gains from their ESG activities, most often citing improvements in revenue and cost savings as the underlying factors.[81] Perhaps the biggest indicator that investors care—and are one of the biggest drivers of the sustainability reporting movement—is that companies listed on stock exchanges are the most likely to report such data (as opposed to state- or foundation-controlled or privately-held or family-owned companies or co-operatives). Investors have spoken, experts and authorities have opined, and company actions have reflected that ESG data is material—to such an extent that it appears on Bloomberg screens. Reasonable investors consider it essential to the mix of information upon which they rely.

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76. SOC. INV. FORUM, 2010 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 10 (2010); *see also Socially Responsible Investing Facts*, US SIF, https://web.archive.org/web/20111011143540/http://ussif.org/resources/sriguide/srifacts.cfm (last visited Feb. 12, 2014). US SIF, 2012 TRENDS REPORT (2012).

77. Avery Fellow, *Investors Demand Climate-Risk Disclosure in 2013 Proxies*, BLOOMBERG, Feb. 25, 2013, http://www.bloomberg.com/news/2013-02-25/investors-demand-climate-risk-disclosure-in-2013-proxies.html.

78. KPMG, KPMG INTERNATIONAL SURVEY OF CORPORATE RESPONSIBILITY REPORTING (2011).

79. *Id.*

80. *Id.*

81. *Id.* Sustainability reporting, for example, helps managers identify and eliminate waste and track the returns on investments in efficiency and improved products and services. *See* Adam J. Sulkowski, *There's Gold in Them Thar Brownfields: The Legal Framework of Brownfield Redevelopment and Some Tips for Getting Started*, 39 REAL EST. L.J. 100, 111–12 (2010).

C. Outside the United States

Since 1995 Denmark has required corporations to disclose societal and environmental impacts. Since then, listed corporations have been required to disclose environmental impact information in France, the Netherlands, Norway, Spain, Sweden, and the United Kingdom.[82] Germany has also begun to require disclosure of societal and environmental impacts, and Sweden requires state-owned enterprises to publish company reports in accordance with the GRI.[83] South Africa now requires integrated reporting, which combines ESG data in required financial reports.[84] These environmental disclosure requirements are considered to be the most effective "multiplier" instruments because they affect all public companies.[85]

Directive 90/313/EEC on Freedom of Access to Information on the Environment requires national transparency legislation in all EU countries. The recommendation of the EU Commission in 2001,[86] and the EU Accounts Modernisation Directive of 2003,[87] indicate that more precise environmental disclosure standards for financial accounting are anticipated, especially in the context of future EU emissions trading for greenhouse gases.[88] An intergovernmental working group of experts on International Standards of Accounting and Reporting (ISAR which is under the auspices of the U.N. Conference on Trade and Development in Geneva) started in 1990 to integrate environmental costs and liabilities into traditional accounting and auditing methods.[89]

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82. For comparative overviews, see U.N. Econ. Comm'n for Europe, Supporting Frameworks for Corporate Environmental Reporting, U.N. Doc. ECE/CEP/AC.10/2009/7 (June 19, 2009), and TAREQ EMTAIRAH, INT'L INST. FOR INDUS. ENVTL. ECON., CORPORATE ENVIRONMENTAL REPORTING: REVIEW OF POLICY ACTION IN EUROPE 2 (2002). *See also* Thomas P. Lyon & John W. Maxwell, *Greenwash: Corporate Environmental Disclosure Under Threat of Audit*, 20 J. ECON. & MGMT. STRATEGY 3–4 (2011). However, the French rules have been criticized as relatively lacking in environmental disclosure requirements, and no penalties have been established for non-compliance. Lucien J. Dhooge, *Beyond Volunteerism: Social Disclosure and France's Nouvelles Régulations Économiques*, 21 ARIZ. J. INT'L & COMP. L. 441, 445 (2004).

83. Carlos Noronha, Si Tou, M.I. Cynthia & Jenny J. Guan, *Corporate Social Responsibility Reporting in China: An Overview and Comparison with Major Trends*, 20 CORP. SOC. RESP. & ENVTL. MGMT. 30 (2012).

84. Jem Bendell et al., *Public Policies for Scaling Corporate Responsibility Standards: Expanding Collaborative Governance for Sustainable Development*, 2 SUSTAINABILITY ACCT., MGMT. & POL'Y J. 263, 280 (2011).

85. *See* Mark D. Abkowitz et al., *Environmental Information Disclosure and Stakeholder Involvement: Searching for Common Ground*, 6 CORP. ENVTL. STRATEGY 415, 415–16 (1999).

86. Commission Recommendation 2001/453/EC, on the Recognition, Measurement, and Disclosure of Environmental Issues in the Annual Accounts and Annual Reports of Companies, 2001 O.J. (L 156) 33 (EC).

87. Council Directive 2003/51/EC, on the Annual and Consolidated Accounts of Certain Types of Companies, Banks and Other Financial Institutions and Insurance Undertakings, 2003 O.J. (L 178) 16–17 (EC).

88. *See* AXEL HESSE, DAS KLIMAWANDELTSICH: INTEGRATION VON KLIMACHANCEN UND -RISIKEN IN DIE FINANZ-BERICHTERSTATTUNG 12 (2d ed. 2004).

89. *See* PHILIPPE SANDS, PRINCIPLES OF INTERNATIONAL ENVIRONMENTAL LAW 864 (2d ed. 2003); Ted L. McDorman, *Access to Information Under Article 9 of the OSPAR Convention (Ire-*

The World Bank has also moved away from its inclination toward secrecy, opting for a more transparent approach similar to that of other multilateral development banks.[90] International institutions now see information disclosure as a legal instrument that helps to anticipate and control environmental risks, "inevitably whittling down traditional business secrecy defenses in the process."[91] Disclosure of environmental risks to the public became part of the information policies of multilateral development banks in the 1990s.[92] Simultaneously, the United Nations Environment Programme's (UNEP) "Finance Initiative" launched a global partnership with the private financial sector to promote best practices related to environmental credit risks.[93] More than 190 financial institutions (including banks, insurers, and fund managers) have joined the initiative worldwide, within the

land v. United Kingdom), 98 AM. J. INT'L L. 330, 330–31 (2004). Regarding an earlier UNEP survey of various multinational companies' environmental auditing practices, see Survey, *Environmental Auditing*, INDUSTRY & ENV'T, Oct.–Dec. 1988, at 3–21; PETER H. SAND, LESSONS LEARNED IN GLOBAL ENVIRONMENTAL GOVERNANCE 33–34 (1990). On further recent developments, see Andreas Nölke, *International Accounting Standards Board*, *in* HANDBOOK OF TRANSNATIONAL GOVERNANCE: INSTITUTIONS AND INNOVATIONS 66, 66–70 (Thomas Hale & David Held eds., 2011).

90. OPERATIONS POLICY AND COUNTRY SERVICES, TOWARD GREATER TRANSPARENCY THROUGH ACCESS TO INFORMATION: THE WORLD BANK'S DISCLOSURE POLICY 1–2 (2009), *available at* http://siteresources.worldbank.org/EXTINFODISCLOSURE/Resources/R2009-0259-2.pdf. *See* Paul J. Nelson, *Transparency Mechanisms at the Multilateral Development Banks*, 29 WORLD DEV. 1835, 1835 (2001); Graham Saul, *Transparency and Accountability in International Financial Institutions*, *in* THE RIGHT TO KNOW, THE RIGHT TO LIVE: ACCESS TO INFORMATION AND SOCIO-ECONOMIC JUSTICE 127, 127–37 (Richard Calland & Alison Tilley eds., 2002); *Cf.* TRANSPARENCY INT'L, COMMENTS ON THE EUROPEAN INVESTMENT BANK'S PUBLIC DISCLOSURE POLICY DATED MAY 2009 (2009), *available at* http://www.eib.org/attachments/consultations/ti-comments-23072009.pdf; Reza Moghadam, *Freedom of IMFormation*, INTERNATIONAL MONETARY FUND (Sept. 17, 2009), *available at* http://blog-imfdirect.imf.org/2009/09/17/freedom-of-imformation.

91. Peter H. Sand, *The Right to Know: Freedom of Environmental Information in Comparative and International Law*, 20 TUL. J. INT'L & COMP. L. 203, 231 (2011).

92. *See* GÜNTHER HANDL, MULTILATERAL DEVELOPMENT BANKING: ENVIRONMENTAL PRINCIPLES AND CONCEPTS REFLECTING GENERAL INTERNATIONAL LAW AND PUBLIC POLICY 47, 87 (2001); Saul, *supra* note 90, at 127–37 (discussing environmental disclosures as an important aspect of transparency). The World Bank Group's International Finance Corporation (IFC) has since 1998 required public disclosure of investment-related environmental information as part of its Environmental and Social Review Summaries (ESRS). *See* IFC, INTERNATIONAL FINANCIAL CORPORATION'S POLICY ON DISCLOSURE OF INFORMATION 4 (2006).

93. The "Principles for Responsible Investment" (PRI) developed and institutionalized in this context include observance of Impact Reporting and Investment Standards (IRIS) for measuring and reporting social and environmental performance. *See* PRINCIPLES FOR RESPONSIBLE INV, UNIVERSAL OWNERSHIP: WHY ENVIRONMENTAL EXTERNALITIES MATTER TO INSTITUTIONAL INVESTORS 3 (A. Garfunkel ed., 2010). For criticism, see Surya Deva, *Global Compact: A Critique of the U.N.'s "Public-Private" Partnership for Promoting Corporate Citizenship*, 34 SYRACUSE J. INT'L L. & COM. 107 (2006); Evaristus Oshionebe, *The U.N. Global Compact and Accountability of Transnational Corporations: Separating Myth from Realities*, 19 FLA. J. INT'L L. 1, 13–30 (2007).

framework of the U.N. Global Compact.[94] Finally, the Basel Committee on Banking Supervision (originally established by the central bank governors of the G-10 countries and currently composed of representatives of twenty-seven central banks) now requires all banks in its member countries to "monitor the risk of environmental liability arising in respect of the collateral, such as the presence of toxic material on a property."[95]

The growing importance and materiality of climate change, sustainability, and corporate responsibility issues, combined with calls from a wide range of stakeholders for greater transparency, mean that companies increasingly will be expected to disclose material aspects of ESG along with their financial reports. Doing that effectively may well mean that "understanding the links between financial results and sustainability impacts is critical for business managers, and increasingly connected to long- and short-term business success."[96] Almost of necessity, that speaks to the need for integrated reporting.

IV. Next Steps in the Move Toward Integrated Reporting

A. *So If Integrated Reporting Is Already to Some Extent Required By Law and Demanded by Markets, What is the Problem?*

1. *Widespread Violations, Lack of Enforcement*

Over two decades of data document a consistently high rate of non-compliance with minimal and clear guidelines on what must be reported with regard to financial repercussions related to ESG issues.[97] Based on studies by governments, academia, and the private sector, it appears that companies routinely ignore SEC guidance.[98] A 1992 Price Waterhouse survey found that 62 percent of respondents' financial statements failed to follow SEC rules requiring the reporting of environmental fines in excess of $100,000.[99] The same study found that a majority of companies failed to report material considerations with respect to climate change and other ESG

94. *See About UNEP FI*, UNEPFI.ORG, http://www.unepfi.org/about/index.html (last visited Jan. 10, 2014); *About the PRI Intiative*, UNPRI.ORG, http://www.unpri.org/about-pri/about-pri/ (last visited Jan. 10, 2014).

95. Bank for Int'l Settlements, International Convergence of Capital Measure and Capital Standards: A Revised Framework 112 (2006), *available at* http://www.bis.org/publ/bcbs128.pdf. On further action by the Basel Committee on Banking Supervision ("Basel III Framework"), see Kevin Young, *Basel Committee on Banking Supervision*, *in* Handbook of Transnational Governance: Institutions and Innovations, *supra* note 89, at 39–45.

96. *Integrated Reporting*, Global Reporting Initiative, https://www.globalreporting.org/information/current-priorities/integrated-reporting/Pages/default.aspx (last visited Jan. 13, 2014).

97. Sulkowski & White, *supra* note 36, at 504–05.

98. *Id.*

99. Price Waterhouse, Accounting for Environmental Compliance: Crossroads of GAAP, Engineering and Government – Second Survey of Corporate America's Accounting for Environmental Costs 10–11 (1992).

issues.[100] A 1996 academic study found that 54 percent of companies with potential liabilities for hazardous waste sites failed to disclose this in their initial public offering registration statements, and 61 percent of currently registered companies known to have potential liabilities for hazardous waste sites failed to disclose this fact.[101] A governmental study found that 74 percent of corporations in its sample fail to comply with disclosure requirements.[102]

This pattern of uneven compliance with specific SEC guidance continues. One recent study concluded that "60% or more of large public companies, including those that make up the S&P 500 and the FT 100, may be failing to comply with one or more SEC requirements in Regulation S-K filings."[103] A 2008 report, submitted by an institutional investor, surveyed over six thousand annual filings by Standard & Poor's 500 companies and found that 76.3 percent of 2008 filings failed to mention climate change.[104] The SEC has reportedly not made significant efforts to investigate or penalize such rampant violations of its rules and guidance.[105] The SEC even failed to investigate when fines of $270–300 million related to hazardous waste sites were not mentioned in Viacom's 10-K report.[106]

2. *Misleading Practices*

Even if the letter of the law is followed and appropriate ESG disclosures are made, some complain that sustainability reporting often amounts to propaganda best characterized as greenwashing. Speaking on the condi-

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100. Case, *supra* note 8, at 410 (citing to Memorandum from Mary Kay Lynch, Director, EPA Office of Planning and Policy Analysis, and Eric V. Schaeffer, Director, EPA Office of Regulatory Enforcement, to Office of Enforcement and Compliance Assurance Directors, et al. (Jan. 19, 2001), *available at* www.epa.gov/compliance/resources/policies/incentives/programs/secguidedistributionofnotice.pdf).

101. *Id.*

102. *Id.*

103. *See* Linda M. Lowson, *SEC ESG Noncompliance: Where the Rubber Meets the Road, CSR Insight*, 24 J. APPLIED CORP. FIN. 57, 57–64 (2012) ("According to the findings of the landmark CSR Insight™ Study, an estimated 75% of large public company U.S. and non-U.S. SEC filers are in violation of one or more SEC disclosure requirements on ESG issues, causing many SEC filings currently to be materially misleading, inaccurate, or even fraudulent. A second key finding of this study was that this corporate SEC noncompliance on ESG issues triggers serious liabilities and risks not only for the C-Suite, but also for the Board, the Independent Auditor, the Asset Manager, and a broad range of capital market transactions.") (quote from unpublished portion of the study on file with Governance & Accountability Institute, Inc.).

104. Kevin L. Doran et al., RECLAIMING TRANSPARENCY IN A CHANGING CLIMATE: TRENDS IN CLIMATE RISK DISCLOSURE BY THE S&P 500 FROM 1995 TO THE PRESENT, CERES 1 (2009), *available at* http://www.ceres.org/resources/reports/reclaiming-transparency-in-a-changing-climate-1/view.

105. Case, *supra* note 8, at 410–11.

106. *Id.* Potentially more worrisome are the illegalities themselves and the admissions by a majority of corporate legal counsels that their corporate clients have been in violation of environmental laws. *See, e.g.*, Marianne Lavelle, *Environmental Vise: Law, Compliance*, NAT'L L.J., Aug. 30, 1993, at S1.

tion of anonymity, one spokesperson for a company whose brand is built on sustainable products rhetorically asked, "How many pictures of smiling brown babies can you look at before you realize this [sustainability reporting] is bullshit?"[107] Putting aside the most egregious examples where photographic displays overshadow data to the point of self-parody, data can still be selectively emphasized or deemphasized. Charts, graphs, and other visual representations of data can be deliberately drafted to convey a false narrative rather than objectively portray reality. Another phenomenon could be characterized as "over-reporting"—the practice of disclosing many dozens or hundreds of pages of data so as to effectively conceal the most essential material risks and liabilities. As with financial disclosures, best practices can be codified to protect investors, improve the functioning of the marketplace, and serve the public interest.

B. *Why Should More Disclosure Be Encouraged or Required?*

As mentioned above, David Case provides a review of the economic and legal theories that suggest that greater disclosure of non-financial data should bring about the same outcomes as traditional regulatory approaches.[108] Companies manage what they measure. And markets with better information more efficiently lead to either constructive negotiated solutions or punishment of bad actors by investors and consumers for creating risks and liabilities.

Shortcomings of environmental policies are directly attributable to information gaps, according to authors like Daniel Esty.[109] He points out that, rather than taking the precautionary approach, the U.S. regulatory approach allows activities until they are proven to be harmful.[110] It logically follows that, in some contexts, there may be a counterincentive to even measuring negative impacts of products and processes.[111] Esty is among those who point out that even unambiguous guidance from the Federal Accounting Standards Board and the SEC are not rigorously enforced, and are often ignored.[112] One of Esty's main points, therefore, is that information can assist stakeholders in negotiating acceptable solutions and tolerable compromises with companies that pollute, but only if regulation of disclosures becomes more stringent and demanding.[113]

David Case has also argued that external CR reporting has the greatest potential to reduce the environmental harms related to corporate activity

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107. Telephone Interview (May 2006).
108. *See* Case, *supra* note 8, at 415–27.
109. Daniel C. Esty, *Environmental Protection in the Information Age*, 79 N.Y.U. L. Rev. 115, 115 (2004).
110. *Id.* at 203.
111. *Id.* at 204.
112. *Id.* at 205–06.
113. *Id.* at 210.

when it is deployed in tandem with internal environmental management systems.[114] This makes intuitive sense: Measuring and generating reports with data is a useful step, but the data, as in any context, must be acted upon to change behaviors and outcomes.[115] Informational regulation has also been shown to help consumers make decisions to avoid exposing themselves to risk, especially when other governmental intervention has been lacking.[116] Finally, a key means through which CR reporting is intended to ameliorate negative externalities is by catalyzing more dialogue with stakeholders; there is evidence that CR reporting can indeed facilitate this dialogue.[117] This evidence supports the economic theories mentioned above that hold that CR reporting should lead to more efficiently-negotiated agreements between companies and stakeholders.

In 2005, the law firm of Freshfields Bruckhaus Deringer produced a report (the Freshfields report) for UNEP's Finance Program that addressed the legal framework for the integration of ESG issues into institutional investment.[118] The report was meant to counter resistance to incorporating ESG issues into financial reports because of a belief that institutional investors were legally prohibited from doing so. The firm was asked to examine seven countries (France, Germany, Italy, Japan, Spain, the United Kingdom, and the United States), and extended their study to Australia and Canada.

Acknowledging the dominance of modern portfolio theory fueled by neoclassical economics, the report argued that fiduciary duties (primarily prudence and loyalty to purpose) imposed on decision makers represent the main limitation on investment discretion in common law jurisdictions, including the United States. According to the report, the modern prudent investor rule within a context of modern portfolio theory provides, among other things, that "there is no duty to 'maximize' the return of individual investments, but instead a duty to implement an overall investment strategy that is rational and appropriate to the fund."[119]

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114. David W. Case, *Changing Corporate Behavior Through Environmental Management Systems*, 31 WM. & MARY ENVTL. L. & POL'Y REV. 75, 111 (2006).

115. *See* Adam J. Sulkowski, *The Growing Trend of Voluntary Corporate Responsibility Disclosure and Its Implications for Real Estate Attorneys*, 38 REAL EST. L.J. 475, 475–81 (2010).

116. *See* Katherine Renshaw, Note, *Sounding Alarms: Does Informational Regulation Help or Hinder Environmentalism?*, 14 N.Y.U. ENVTL. L.J. 654 (2006) (discussing regulation of mercury-contaminated seafood).

117. *See* Timothy Riley, *Unmasking Chinese Business Enterprises: Using Information Disclosure Law to Enhance Public Participation in Corporate Environmental Decision Making*, 33 HARV. ENVTL. L. REV. 177, 189 (2009).

118. *See* FRESHFIELDS BRUCKHAUS DERINGER, UNEP FINANCE INITIATIVE, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT (2005), *available at* http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.

119. *Id.* at 8.

Importantly, the report concludes (with respect to U.S. institutional investors) that there is not only no prohibition against incorporating ESG considerations into investment decisions, but also that "as with all considerations, ESG considerations must be taken into account wherever they are relevant to any aspect of the investment strategy."[120] This takes us back to the materiality issue posed by Lydenberg's discussion of the reasonable investor who would presumably want to know about issues of material concern to the firm. Indeed, the Freshfields report, making a distinction between value (following the correct process) and values (pursuing a proper objective) concludes that "decision makers are required to have regard (at some level) to ESG considerations in every decision they make" because of the growing evidence of the materiality of such criteria to investment value.[121]

Despite these arguments, however, there is still no unanimity that more mandated disclosure, on its own, will lead to better behavior.[122] Allison Snyder suggests that informational regulation alone will be inadequate to improve corporate societal and environmental performance and that more conventional enforcement mechanisms will be required to either reduce negative externalities or generate positive externalities.[123] More stringent and clearer requirements would be better since they allow for less manipulation, and research shows that voluntary reporting works better against a backdrop of stronger mandates.[124]

C. *Solutions and Next Steps*

As explained above, materiality reporting requirements, if correctly understood and fully enforced, could potentially increase transparency around ESG matters in companies and enhance the ability of investors to make better decisions. However, even existing explicit guidelines are insufficiently enforced. Extant explicit disclosure rules are also distributed among a variety of different statutes that lack standardization and coherence. Below we articulate several steps and supporting rationale for how to improve upon the current situation.

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120. *Id.*

121. *Id.* at 10–11.

122. *See* Allison M. Snyder, Survey, *Holding Multinational Corporations Accountable: Is Non-Financial Disclosure the Answer?*, 2007 COLUM. BUS. L. REV. 565, 611 (2007).

123. *Id.* at 611–13.

124. Issachar Rosen-Zvi, *You Are Too Soft!: What Can Corporate Social Responsibility Do For Climate Change?*, 12 MINN. J. L. SCI. & TECH. 527, 557–58 (2011).

1. Steps for Policymakers

i. Enforce Existing Rules

An uncontroversial first step would be enforcing already-existing disclosure laws, regulations, and guidance, since failure to do so is unfair to companies that follow legal obligations and leads to investors and fund managers being misled when large liabilities and risks are assumed to have been disclosed but are actually kept secret. One could argue that failure to enforce disclosure rules amounts to being complicit in defrauding investors. It has been long since proven and accepted that inadequate information leads to the failure of markets to function as expected and can result in economic collapse as witnessed in the 1930s and 2008. One scholar writing about the Dodd-Frank Act stated that the Great Recession of 2008 stemmed from four information failures: (1) the dissemination of information that is false or misleading; (2) the ability to abuse regulatory gaps; (3) the willingness to exploit credulous consumers; and (4) the use of corporate size to privatize profits and socialize losses.[125] These problems are compounded if there are false assurances from authorities and a groundless sense of security on the part of market participants that certain specific and significant risks and liabilities will be disclosed if they exist.

ii. Interpret and Enforce the Correct and Contemporary Meaning of Materiality

As explained above, markets, investors, corporate leaders, and expert authorities have already essentially declared, started conducting themselves, or at least are making extensive efforts to appear to conduct themselves as if ESG data was material. Consistent with a proper understanding of materiality, one important step for policy makers would be to recognize the need to interpret and enforce existing disclosure laws and regulations to level the playing field. This would be fairer to regulated entities and protect investors, particularly in the case of massive—and clearly material—risks that can be estimated, such as the potential for increasingly intense weather patterns that result in costly damage that affects insurers, or cleanup costs associated with risky practices like deep ocean drilling or extended high-pressure pipelines for oil companies. Trust in markets is contingent upon policymakers establishing and upholding rules of the game by which companies compete.

iii. Mandate More ESG Reporting to Deal with Outliers

As described above, sustainability reporting has become a *de rigeur* mainstream corporate practice—*de facto* law according to KPMG. Some might ask why, if a practice is adopted by 95 percent of a given population,

125. Reza Dibadj, *Dodd-Frank: Toward First Principles?*, 15 CHAP. L. REV. 79, 79 (2011).

that group of entities should be forced by law to do something that they practically all already do. For one thing, while 95 percent of the G250 may be issuing sustainability reports, not all publicly traded companies are. And beyond that universe, there are an estimated 75,000 or more transnational corporations, plus hundreds of thousands of subsidiaries and millions of small-and medium-sized enterprises that are not yet reporting in the ways that their larger and more visible counterparts are.[126]

However, even if 95 percent of all businesses are already doing something good for investors, themselves, and the world, the question of "why mandate" goes to the core philosophical question of why and whether to have codified law. Even if more than 99 percent of a population does not commit murder, rape, or theft, no one would seriously suggest removing criminal sanctions applicable to those who do. Laws exist in some cases solely to punish and coerce outliers rather than to guide the majority. Laws often reflect the cultural mores already embraced by a majority of regulated beings (whether in the sphere of humans or business entities). Therefore, specifically mandating certain ESG disclosures is needed to make outliers play by the same rules that the vast majority of mainstream companies already see as pragmatic (for whatever reasons). Mandating integrated reports is also needed to avoid putting reporters at a competitive disadvantage, especially given that proper disclosure can negatively affect stock price in cases where there is negative information to share.

iv. Mandate Integrated Reporting with Specificity to Protect Investors

The current system of voluntary disclosures has created an uneven playing field, with, as mentioned above, some companies vigorously and clearly informing investors and others under-reporting, over-reporting (in a way that drowns out salient information in a sea of gratuitous data), greenwashing, or otherwise producing misleading propaganda rather than straightforward information that communicates progress and alleviates problems of concern to stakeholders. The next logical step would therefore be to follow the lead of other countries that specify what ESG data must be disclosed. This would further protect investors from effectively being misled by the failure to report, by under-reporting, or by over-reporting in a way that hides material risks and liabilities.

Further, given the growing global interest in creating a single report that combines financial and ESG disclosures, it may be time to consider requiring integrated reports of all companies, or perhaps of all companies beyond a certain size, and therefore impact, as measured by revenue or

126. This statement is partly logical deduction—whatever statistic can be located for the total number of companies in the world would be fine—the point is: 4,000 organizations (using GRI) is a small minority of all organizations globally.

number of employees. Such a move would recognize the increased attention that investors and other stakeholders are already placing on ESG disclosures. Given that all of the large U.S. accounting firms, the GRI, numerous major companies, and global accounting bodies of all sorts are involved in developing integrating reporting, it makes sense to harmonize and create certainty about the direction and outcomes of this movement. Encouraging harmonization of standards with those of other countries would enhance comparability across companies in global markets. From the point of view of companies, the certainty provided by regulatory guidelines may be highly preferable to the current state of flux and ambiguity.

3. *Steps for Managers, Attorneys, and Accountants*

i. *Implement Integrated Reporting*

For several reasons, managers (with the help of their attorneys and accountants) could benefit in several ways from implementing integrated reporting before their competitors or before it becomes mandatory. First, there are typical first-mover advantages including the (ideally, rightfully earned) perception that the company is transparent, cognizant of stakeholder concerns, innovative, and cutting-edge. Other benefits include the expertise and efficiency that naturally accrues with adopting and practicing a methodology every year.

In the future, companies that fail to report on material ESG considerations may find themselves at a competitive disadvantage in their relationships with key stakeholders, particularly so-called socially responsible investors, over 11 percent of the present investment population.[127] Other stakeholders, including activists, community members, employees, and customers may—with increasing efficiency thanks in part to mobile technology and social media—target, protest, and boycott companies that fail to be transparent with respect to ESG issues. For those companies that are violating existing clear reporting guidance, it would be especially advisable to start respecting minimum mandates to avoid embarrassing and potentially costly legal action on the part of shareholders to force such disclosure.[128]

Further, mandating integrated reporting may be forestalled if enough companies voluntarily adopt integrated reporting. To retain credibility and investor trust, companies should adhere to the best available standards. Today those standards include those of the GRI. In the future, they will likely include the reporting criteria now in development by the Integrated Reporting Committee and another new entity, the Sustainability Accounting Standards Board (SASB), which is developing industry-specific sustainability

127. *SRI Basics*, USSIF.ORG, http://www.ussif.org/sribasics (last visited Jan. 13, 2014).

128. *See* Adam J. Sulkowski, *Ultra Vires Statutes: Alive, Kicking, and a Means of Circumventing the Scalia Standing Gauntlet in Environmental Litigation*, 24 J. OF ENVTL L. & LITIG. 75, 75–118 (2009) (discussing corporate liability under ultra vires suits brought by shareholders).

accounting standards in the U.S. SASB hopes to create standards that can be used in standard financial disclosures, including the 10-K and 20F forms, and that can ultimately standardize integrated reporting for all publicly listed U.S. companies.[129]

ii. Constructively Engage Regulators to Codify Best Practices

The final recommendation for managers and their lawyers and accountants is to actively and constructively engage with the SEC and any other governmental bodies in the development of specific and mandatory minimum ESG disclosure guidelines. Expertise about best practices already exists, and more is being developed by companies at the leading edge of integrated reporting. Rather than resisting regulation and having something imposed that potentially is suboptimal, these leading companies could assure that the most effective and efficient practices become standard.

V. Conclusion

Sustainability reporting is well-established. It is a mainstream practice of most large corporations around the world and is spreading beyond the world of business into public sector management and the world of academia. Researchers still have many questions related to the motivations and effects of this phenomenon, but it clearly has many benefits beyond branding. It is now expected by stakeholders as diverse as investors, customers, employees, communities, and policymakers. Indisputably, a critical mass of managers and investors already consider sustainability reporting indispensable.

The next step—integrated reporting—is already required in various countries. In the United States, several rules, laws, and items of guidance are beginning to stipulate that various pieces of information related to sustainability be disclosed in annual financial reports. Correctly understood, the materiality principle of existing U.S. disclosure laws already requires integrated reporting. This disclosure is important both because of the clear demand for sustainability information from investors and the compelling public policy benefits of companies disclosing this data.

But integrated reporting is not yet uniformly adopted and practiced. To maximize benefits to investors and the larger society—including stewardship of our natural life support systems—integrated reporting must be comprehensible, credible, and comparable. No one would seriously suggest that publicly-traded companies should not be mandated to disclose their financial performance; the same argument is salient in the context of requiring disclosures related to sustainability.

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129. *Why is it Important?*, SASB.org, http://www.sasb.org/materiality/important/ (last visited Jan. 13, 2014).

More explicit standards are needed in the form of laws that codify and standardize what some 95 percent of the G250 companies already do. Just as the investing and business communities support penalties for violators in other contexts, clear penalties are needed to keep outliers from breaking accepted norms and defrauding or misleading investors by withholding or misrepresenting information. For regulated entities, cooperation is the best approach to codifying what the mainstream already does. Guidelines based on best practices and consequences for violations of commonly-accepted norms would be the most constructive way forward.