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One Nation, Indivisible: The Use of Diversity Report Cards to Promote Transparency, Accountability, and Workplace Fairness

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ONE NATION, INDIVISIBLE: THE USE OF DIVERSITY REPORT CARDS TO PROMOTE TRANSPARENCY, ACCOUNTABILITY, AND WORKPLACE FAIRNESS

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Some commentators have suggested that our country's future is at risk because individuals and corporations have engaged in acts that have "betrayed the values of openness, that lie at the heart of a healthy, prosperous" just America.¹ The wave of financial failures and scandals heralded by Enron² has put at risk "the trust that investors, employees

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1. John McCain, *The Free Market Needs New Rules*, N.Y. TIMES, July 8, 2002, at A19. McCain writes: "[t]o love the free market is to loathe the scandalous behavior of those who have betrayed the values of openness that lie at the heart of a healthy and prosperous capitalist system." *Id.* McCain continues his call for increased openness by reminding us that "[w]hat is at risk is the trust that investors, employees and all Americans have in our markets and, by extension, in the country's future." *Id.*

2. Readers who want to review details of recent business scandals should review the work of New York Times reporter Kurt Eichenwald. *See, e.g.*, Kurt Eichenwald, *Operating Profits: Mining Medicare: How One Hospital Benefited from Questionable Surgery*, N.Y. TIMES, Aug. 12, 2003, at A1 (Redding Medical Center); Kurt Eichenwald & John Markoff, *Deception, or Just Disarray, at Enron?*, N.Y. TIMES, June 8, 2003, at A1; Kurt Eichenwald, *For WorldCom, Acquisitions Were Behind Its Rise and Fall*, N.Y. TIMES, Aug. 8, 2002, at A1; Kurt Eichenwald, *Enron's Many Strands: The Accountants; Miscues, Missteps and the Fall of Andersen*, N.Y. TIMES, May 8, 2002, at C1; Kurt Eichenwald, *Enron's Collapse; Audacious Climb to Success Ended in a Dizzying Plunge*, N.Y. TIMES, Jan. 13, 2002, at A1.

Eichenwald has reported on high-profile business scandals and failures for years. Notably, he followed carefully the scandal of Archer Daniels Midland Company, "Supermarket to the World," which in 1995 was accused of violating federal law by

and all Americans have in our markets and, by extension, in our country's future."³ Similarly, a wave of workforce diversity failures and scandals⁴ has put at risk the trust that investors, employees and all Americans have in human resources systems, which are meant to judge and reward employees based upon their effort, initiative, and merit, rather than upon the color of their skin.⁵ This wave of workforce diversity failures has brought to the public's attention evidence that supports Justice Ruth Bader Ginsberg's recent assertion in *Grutter v. Bollinger*,⁶ that "[c]onscious and unconscious race bias. . . remain alive in our land, impeding realization of our highest values and ideals."⁷

engaging in price fixing. See KURT EICHENWALD, *THE INFORMANT* (Broadway Books 2000). He also provided careful reporting of a race discrimination lawsuit we describe later in this article, *Roberts v. Texaco Inc.*, 979 F. Supp. 185 (S.D.N.Y. 1997). Eichenwald also broke the news of "The Texaco tapes," which provided evidence of Texaco's destruction of documents relevant to the case. He also reported that Texaco executives were caught on tape making disparaging remarks about African-American and Jewish employees. See Kurt Eichenwald, *Texaco Executives, On Tape, Discussed Impending Bias Suit*, N.Y. TIMES, Nov. 4, 1996, at A1 [hereinafter *Texaco Executives, On Tape*].

For books that describe the recent failures and scandals, see BARBARA LEY TOFFLER & JENNIFER REINGOLD, *FINAL ACCOUNTING: AMBITION, GREED AND THE FALL OF ARTHUR ANDERSEN* (Broadway Books 2003); MIMI SCHWARTZ & SHERRON WATKINS, *POWER FAILURE: THE INSIDE STORY OF THE ENRON COLLAPSE* (Crown Publishers 2003); ARIANA HUFFINGTON, *PIGS AT THE TROUGH: HOW CORPORATE GREED AND POLITICAL CORRUPTION ARE UNDERMINING AMERICA* (Double Day 2003); ROBERT BRYCE & MOLLY IVANS, *PIPE DREAMS: GREED, EGO, AND THE DEATH OF ENRON* (Public Affairs 2002); LOREN FOX, *ENRON: THE RISE AND FALL* (Wiley, John & Sons, Inc. 2002); MONICA LANGLEY, *TEARING DOWN THE WALLS: HOW SANDY WEILL FOUGHT HIS WAY TO THE TOP OF THE FINANCIAL WORLD . . . AND THEN NEARLY LOST IT ALL* (Free Press 2002); LYNN BREWER & MATTHEW SCOTT HANSEN, *HOUSE OF CARDS: CONFESSIONS OF AN ENRON EXECUTIVE* (Virtual Bookworm.com Publishing 2002).

3. McCain, *supra* note 1, at A19.

4. See *infra* notes 210–47 and accompanying text for a description of litigation alleging systemic race discrimination at four American corporations.

5. See EVERETT CARLL LADD, *THE AMERICAN IDEOLOGY: AN EXPLORATION OF THE ORIGINS, MEANING, AND ROLE OF AMERICAN POLITICAL IDEAS* 11 (1994). Ladd describes the core American value of individualism, which emphasizes upward mobility based upon merit. Ladd's monograph was produced by The Roper Center for Public Opinion Research in Storrs, Connecticut. *Id.*

6. 123 S.Ct. 2325 (2003).

7. *Id.* at 2347 (concurring opinion of Justice Ginsberg).

The purpose of this Article is to provide support for the proposition that the Securities and Exchange Commission (SEC) adopt the proposal we outline for improved information gathering and reporting of specific kinds of employment data. Now that the SEC is in the midst of major reform efforts to improve information gathering and reporting of financial data as a response to recent corporate scandals, the agency should also mandate improved information gathering and reporting of workforce diversity and fairness data. Improved information gathering and reporting of financial and employment data allows critical information to bubble up⁸ to the attention of senior management, boards of directors, and other corporate stakeholders, especially investors. Improved information gathering and reporting can benefit all stakeholders.⁹

Section I of the Article draws on academic work in the field of Corporate Social Responsibility (hereinafter CSR)¹⁰ to present the philosophical basis for arguments both in favor of increased corporate transparency and accountability, in general, and specifically in regards to corporate social disclosures (also referred to as social reporting). This section is important because it provides background information that helps the reader understand the remainder of the Article. Section II explains SEC requirements for gathering and reporting financial data, reviews the Sarbanes-Oxley Act of 2002, and explains a framework for determining the circumstances under which the SEC should mandate disclosure of information that is socially relevant, but not typically associated with a company's financial well-being.¹¹ Section III is practical. After reviewing recent workforce diversity failures and

8. Stephen D. Poss, *Counseling the Audit Committee*, NAT'L L.J., July 14, 2003, at 18.

9. See *infra* note 253–54 and accompanying text.

10. For books that outline fundamental principles of Corporate Social Responsibility, see, for example, ADRIAN HODGES & DAVID GRAYSON, *EVERYBODY'S BUSINESS* (DK Publishing 2002); SIMON ZADEK, *THE CIVIL CORPORATION* (Earthscan Publications 2001); AMORY HU PAUL & LOVINS HAWKEN, *NATURAL CAPITALISM* (Little Brown & Company 1999); JOHN ELKINGTON, *CANNIBALS WITH FORKS: THE TRIPLE BOTTOM LINE OF 21ST CENTURY BUSINESS (CONSCIENTIOUS COMMERCE)* (New Society Pub 1998).

11. This section relies on information in Note, *Should the SEC Expand Nonfinancial Disclosure Requirements?* 115 HARV. L. REV. 1433 (2002) [hereinafter *Nonfinancial Disclosure*]. This Harvard Note responds to a seminal article by Cynthia A. Williams that argues in favor of mandatory social disclosure. See *infra* note 21.

scandals, this section sketches a sample Diversity Report Card we believe publicly traded companies should submit as part of their annual filings with the SEC. The section also explains relationships between our proposal and Section II's argument in favor of mandatory social disclosure. Section IV's conclusion brings the reader full circle by tying together the Article's primary themes. The Article concludes that Diversity Report Cards simultaneously promote transparency, accountability, and workplace fairness.

I. BACKGROUND: CORPORATE SOCIAL RESPONSIBILITY AND CALLS FOR INCREASED TRANSPARENCY AND ACCOUNTABILITY

A. Corporate Social Responsibility

1. The Predominant Perspective

Scholars who study the topic of corporate social responsibility (CSR)¹² provide the broadest endorsements for improved information gathering and reporting of corporate operations. The topic of corporate social responsibility (CSR) answers the question, "What is the purpose

12. See Daniel T. Ostas & Stephen E. Loeb, *Teaching Corporate Social Responsibility* 20 J. LEGAL STUD. EDUC. 62 (2002). Ostas and Loeb explain that most scholars would acknowledge that most academic conversations about the topic of corporate social responsibility or CRS fall under the general topic of business and society. *Id.* at 62. Ostas and Loeb divide this field into three branches. They write:

The descriptive branch [of business and society] examines the relationship between corporations and the society in which they operate. The managerial branch advises managers on how best to achieve social and economic goals once those norms are identified. The CSR branch. . . is normative. It asks the fundamental questions of what goals the firm ought to seek.

Id. Ultimately, Ostas & Loeb write that CSR should be defined in this way: "Corporate managers should seek creative ways to discover and cooperate with the social and ethical norms that underlie and inform the public policies governing the corporation's principle business operations while simultaneously seeking to enhance firm profitability." *Id.* at 71-72. They urge those who teach CSR to refrain from framing the field as we have done in this article, as a debate between shareholder and stakeholder perspectives. See *id.* at 86. Legal scholars, though, still frame the debate in this way. See, e.g., Williams, *infra* note 16.

of a corporation?"¹³ Economists,¹⁴ lawyers,¹⁵ professors/scholars,¹⁶ and social activists¹⁷ have argued for decades about the nature of the

13. Charles Handy, *What's a Business For?*, HARV. BUS. REV. 49 (Dec. 2002). Handy argues in favor of a progressive perspective, pointing out that American-style capitalism has failed to recognize the value in its most important asset—its employees. It has also failed to look out for consumers. Handy writes that, if we fail to ask fundamental questions about what a business is for, “[h]igh-minded talent may start to shun [business] and customers may desert it.” *Id.* at 55.

14. Milton Friedman is the most well-known economist arguing about corporate social responsibility. See Milton Friedman, *The Social Responsibility of Business Is To Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, in BUSINESS ETHICS: AN OPPOSING VIEWPOINTS SERIES 11–17 (Tamara L. Roleff ed. 1996).

15. See, e.g., David Hess, *Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness*, 25 J. CORP. L. 41 (1999). Hess, a lawyer and scholar in the area of business ethics, argues in favor of a progressive model of CSR. *Id.* One clear sign of his preference for this view comes in the two sentences of his article, where he writes: “If people cannot accurately know their world, how can they be expected to act wisely in it. If corporations were required to disclose information about their actions affecting [stakeholders], then pressure would mount to justify those acts; and justifying one’s acts, most ethicists would grant, is the first step toward improving one’s behavior.” *Id.* at 41 (citing Walter Lippman, a 20th century political commentator as the source of the quote in the first sentence and citing business ethicist Thomas Donaldson for the second sentence, at THOMAS DONALDSON, CORPORATIONS & MORALITY 204 (1982)).

16. See, e.g., Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 711–17 (2002) [hereinafter *Era of Economic Globalization*]. Williams, a law professor at the University of Illinois, categorizes the corporate social responsibility literature into three positions. *Id.* She labels them (1) the irresponsible position (a corporation is a legal fiction and, as such, cannot have social or moral obligations), (2) the predominant position (corporate managers should act in the interests of shareholders), and (3) the progressive position (corporate managers should act in the interests of all stakeholders). *Id.* Williams highlights the work of scholars from the field of corporation law to explain the three views she delineates. *Id.* This uses two of Williams’ labels in its analysis, the predominant position and the progressive position.

17. See, e.g., RALPH ESTES, TYRANNY OF THE BOTTOM LINE: WHY CORPORATIONS MAKE GOOD PEOPLE DO BAD THINGS (1996). Estes is Emeritus Professor of Accounting at American University. He leads an organization called The Stakeholder Alliance, which “seeks to change the corporate system to make it responsible to all stakeholders, instead of only to stockholders, and thus return corporations to their original public purpose.” Information about the Stakeholder Alliance is available at <http://www.stakeholderalliance.org/sa-desc.html> (last visited Oct. 26, 2003). For this organization’s views on disclosure of equal employment opportunity data, see <http://www.stakeholderalliance.org/equity.html> (last visited Oct. 26, 2003).

corporation's relationship with and obligations to society, including their obligations to gather and report accurate information to a variety of stakeholders.¹⁸ General debates about the appropriate relationship between the corporation and society inform and underlie arguments about the worth of increased corporate transparency and accountability as objectives.¹⁹ The debate also triggers more practical questions, such as whether, with regard to the information gathering and reporting process: (1) outside auditors should play a role,²⁰ (2) standards should be voluntary or mandated by government agencies acting on behalf of the public,²¹ and (3) particular drawbacks might make increased transparency and accountability undesirable.²² How an individual responds to both the broad, philosophical questions about CSR and practical questions about information gathering/reporting depends upon whether that individual believes that corporate actors should act primarily in the interests of the shareholders, or whether they should act in the interests of a broad range of constituents, including shareholders, employees, customers, suppliers, and communities.²³

Milton Friedman articulated the shareholder or predominant perspective in 1970.²⁴ He believes that the primary purpose of business is to maximize profits for shareholders.²⁵ He explains that managers

18. For a thorough review of academic literature in the field of CSR, see Ostas & Loeb, *supra* note 12, at 64–76.

19. See generally Handy *supra* note 13.

20. See, e.g., Jerry W. Markham, *Accountants Make Miserable Policemen: Rethinking the Federal Securities Laws*, 28 N.C. J. INT'L L. & COM. REG. 725 (2003) (questioning the extent to which accountants can police themselves).

21. For an argument in favor of mandatory disclosure, see Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1266 (1999). Williams' article is probably the leading article to date that explores the corporate social relationship. This article compares financial disclosure to social disclosure and argues in favor of social disclosure as a way to promote corporate accountability. *Id.*

22. See, e.g., Markham, *supra* note 20.

23. See Ostas & Loeb *supra* note 12.

24. Ostas & Loeb trace the development of this concept back to the 1950's. See Ostas & Loeb, *supra* note 12, at 64. This Article follows Cynthia A. Williams' lead in labeling Friedman's perspective the predominant position. See Williams, *supra* note 16.

25. Friedman, *supra* note 14. Friedman writes that:

A corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct business in accordance with their desires, which generally will be to make as much money as

must act as agents of the company's owners/investors.²⁶ Their "one and only one responsibility. . . is to use [the corporation's] resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."²⁷

It is important to note two of Friedman's preferences and assumptions, as they inform current debates about links between CSR and information gathering and reporting.²⁸ First, Friedman's work shows a preference for the value of freedom.²⁹ He generally wants business to operate free of rules imposed by others.³⁰ Second, Friedman does not trust government actors.³¹ He writes in pejorative terms about "control. . . by external forces" and "the iron fist of government bureaucrats."³²

Those who place the value of freedom above other ethical norms while at the same time assuming government actors are bureaucrats rather than public servants, generally do not like the idea of outside auditors stepping in to look at corporate records.³³ These same writers may also argue that any attempt to gather information and disclose it to the company should be voluntary, not imposed by the government's iron fist.³⁴ Finally, advocates of a predominant view of CSR will see drawbacks with regard to increased transparency and accountability that

possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.

Id. at 12.

26. *Id.*

27. *Id.* at 17. Of course, the economy has changed since Friedman wrote his essay. For instance, the relationship between markets and government action has changed, especially in light of the role of nonprofit organizations in taking over tasks traditionally undertaken by the government. See William J. Lynk, *Nonprofit Hospital Mergers and the Exercise of Market Power*, 38 J. LAW & ECON. 437 (1995). An additional significant change is that the economy is much more global. See Nancy L. Kaszak, *Practicing Law in the Global Economy*, 22 N. ILL. U.L. REV. 1 (2001).

28. Friedman, *supra* note 14, at 17.

29. Friedman writes in favor of a "free society." *Id.* at 16. See also generally MILTON FRIEDMAN & ROSE D. FRIEDMAN, *CAPITALISM AND FREEDOM* (1963, reprinted in 2002).

30. Friedman, *supra* note 14, at 17.

31. *Id.*

32. *Id.*

33. See, e.g., Markham, *supra* note 20 (arguing that the SEC has failed).

34. *Id.*

might make new requirements seem undesirable.³⁵ For those who adhere to the predominant view, the costs of increased transparency and accountability might outweigh the benefits.³⁶

2. The Progressive Perspective

The rationale that underlies the stakeholder or progressive perspective originates from the history of U.S. corporate charters.³⁷ U.S. corporations were, in fact, not originally chartered by society to merely provide a return to shareholders.³⁸ “Corporations in colonial America were originally given charters in order to serve the public good.”³⁹ More specifically, the progressive view, best articulated,

[S]uggests that corporate managers’ underlying social obligations are more extensive than maximizing shareholders’ wealth within the confines of the law. . . . [D]irectors ought to consider the impact of their decisions on a wider range of constituents than shareholders, and thus ought to consider the implications of their actions on employees, consumers, suppliers (in some cases), the community, and the environment.⁴⁰

Some writers have suggested that, considering the growing presence of corporations in our lives, it seems difficult, if not irresponsible, to advocate for a system of corporate governance solely reliant on the predominant perspective.⁴¹ In citing Professor Lawrence Mitchell, Douglas M. Branson provides insightful parameters to the debate:

[N]o institution other than the state so dominates our public

35. *Id.*

36. *Id.*

37. Ralph Estes, *What You Count, You Get*, IN CONTEXT, no. 41 (1995), reprinted in BUSINESS ETHICS, at 30–31, *Corporations Must Serve the Public Interest* (Tamara L. Roleff ed., 1996)

38. *Id.*

39. *Id.*

40. See Williams, *supra* note 16, at 716.

41. Douglas M. Branson, *Corporate Governance “Reform” and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 606 (2001) (discussing the primacy of the shareholder versus stakeholder debate to the current discourse regarding CSR).

discourse and our private lives. . . . [C]orporations make most everything we consume. Their advertising and products fill almost every waking moment of our lives. They give us jobs, and sometimes a sense of identity. They define communities, and enhance both our popular and serious culture. They present the investment opportunities that send our children to college, and provide for our old age. They fund our research.

Individually and collectively, though, large corporations' presence may also harm us:

They pollute our environments. They impoverish our spirits with the never-ending messages of the virtues of consumerism. They provide a living, but often not a meaning. And sometimes they destroy us; our retirement expectations are unfounded, our investment hopes are dashed, our communities are left impoverished. The very power that corporations have over our lives means that, intentionally or not, they profoundly affect our lives.⁴²

In light of the pervasiveness of corporations in our lives, advocates of the progressive perspective argue that corporations must view themselves beholden to both shareholders and stakeholders.⁴³

Utilizing the progressive perspective regarding corporate disclosure reveals improved responses to the current crisis in corporate transparency and accountability.⁴⁴ Prevalent problems with bad corporate actors are not new, of course.⁴⁵ Indeed, it is because of unethical corporate actors that the *laissez-faire* character of Friedman's position proves unworkable.⁴⁶ As a practical matter, the necessity of

42. *Id.* at 640–41 (citing Lawrence E. Mitchell, *PROGRESSIVE CORPORATE LAW*, at xii (Lawrence E. Mitchell ed. 1995)).

43. *See* Williams, *supra* note 16, at 707. Williams argues that: [t]he corporation is both: an economic and a social entity; a private actor and a public actor; an entity that depends upon and gives particular legal consideration to shareholders; and an entity that depends upon and is composed of the specific inputs and relationships with multiple stakeholders and which gives consistent, pragmatic consideration to those stakeholders.

Id.

44. *Id.* at 716.

45. Ostas & Loeb, *supra* note 12, at 66.

46. *Id.* at 66. In Ostas's and Loeb's discussion of Howard Bowen's *Social Responsibilities of the Businessman*, they note that the rise of government regulation of business ethics was a response to widespread unethical corporate behavior:

outside auditors verifying corporate disclosures is an essential response to the failings of *laissez faire* practices.⁴⁷ Particularly in terms of corporations disclosing information on their compliance with anti-discrimination laws, what Hess calls “social reporting,” verification by outside auditors is a must.⁴⁸ Such social reporting, if it is to be meaningful, must be mandatory.⁴⁹ Corporations may provide a myriad of

Bowen argued that the viability of a *laissez faire* social system presupposed a system of business ethics. Ethical duties included, among other things, tacit obligations:

(1) to observe the rules of property; (2) to honor contracts; (3) to refrain from deception and fraud; (4) to be efficient and to promote economic progress; (5) to protect life, limb, and health of workers and of the general public; (6) to compete vigorously, and in [the absence] of competition to act with restraint

Bowen illustrated how business practices in the late nineteenth and early twentieth centuries failed to meet these standards. By the 1950's, the natural consequences of this failure was the growth of government regulation seeking to impose legal obligations on businesses that in Bowen's view had previously been addressed by business ethics

Id. Reflecting on this failure, Bowen wrote: “[S]ince government has become, and will necessarily continue to be, a partner in all economic affairs, ‘the businessperson’ is expected to cooperate with government in the formulation and execution of public policy.” *Id.* (citations omitted).

47. *Id.* at 66–67.

48. See Hess, *supra* note 15 at 70–71. Hess discusses the necessity of outside auditors verifying a corporation's social report in a similar fashion that a corporation's financial reports are verified: “An independent and accredited auditor must verify the social report. This will ensure that the report is a truthful and accurate assessment of the corporation's performance, and that the appropriate procedures and policies are in place and are being meaningfully followed.” Hess also appropriately addresses the importance of verification in (re)gaining the public's trust:

Verification will also allay the public's concern that the report is only a public relations campaign or marketing ploy that exaggerates the company's social performance and hides less desirable aspects of the company's activities. A self regulatory body under the supervision of the government should be responsible for accrediting the independent verifiers. Overall, the verification of social reports would be similar to the auditing of corporate financial statements, and the lessons learned there are very applicable to developing a system for accrediting independent verifiers for social reports.

Id. (citations omitted).

49. See *id.* at 67. Hess states:

As opposed to a voluntary report, where firms can choose to file a report only when they are proud of their conduct, an annual report forces a firm to present a complete picture of its behavior. A social report is not intended to be a one-time ‘snapshot’ of a firm, but to provide a means for the company and the public to measure the company's progress over time towards meeting the demands society places on it.

arguments against increased disclosure.⁵⁰ Though, in terms of apprehensions regarding time consuming collection of new data, disclosing information on compliance with anti-discrimination laws, for example, requires some steps that corporations are currently taking.⁵¹ Finally, viewed through the prism of CSR, advocates of a progressive perspective argue that the long-term effects and benefits of transparent and accountable social reporting would offset any extra costs for collating and disclosing this information.⁵² Given that US corporations were originally chartered in the interests of the public good, perhaps the most credible argument is “that the benefits accruing to society from a social reporting requirement would certainly justify these costs.”⁵³

B. Predominant and Progressive Perspectives Converge to Support Increased Transparency and Accountability

In an idealistic sense, it is nice to posit and believe in Friedman’s oft-cited quote: “there is one and only one social responsibility of

Id. Hess further goes on to state the substantive utility and necessity of mandatory social reporting:

The mandatory requirement also allows corporations and the public to compare the social performance of all corporations, and to make that comparison on the basis of industry, geographic region, or any other desired categorization. In addition to providing information on any specific company’s social performance, the regular publication of the reports facilitates the transfer of information between firms, and to the public generally, regarding solutions to various social problems. Information on the process of conducting a social report can also be transferred through the reports themselves, and thereby improve the quality of the reports.

Id. (citations omitted).

50. *See id.* at 80–81.

51. *See id.* (“[A] substantial amount of the work necessary to complete the social report is already being done by many corporations. Corporations are already required by law to collect some of the information, such as OSHA reports and EEOC reports.”).

52. *See id.* at 81. Hess argues that costs involved in social reporting can be offset in the following ways:

First, the corporation will benefit from stronger relationships with critical suppliers, customers, and employees. Second, the corporation will have a better understanding of any potential legal liability it may face, either from failure to comply with government regulations or from civil lawsuits . . . [e.g., race discrimination]. Third, the long-term survival and profitability of the company is dependent upon understanding and meeting the expectations of consumers, as well as other members of the general public.

Id.

53. *See id.*

business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”⁵⁴ Those with a *laissez-faire* conception of corporations, which corresponds closely with the predominant view, expect corporations to simply follow this maxim.⁵⁵ The central problem, however, is that corporations are managed by humans. Given the current erosion of public trust in corporate America due to recent corporate scandals, it is academically irresponsible to argue for a view that fails to adequately address the transparency and accountability challenges that exists within U.S. corporations.⁵⁶ Furthermore, as to corporate disclosure of employment discrimination/diversity practices, the debate over what the purpose is of a corporation must move beyond the dichotomous choice between the predominant and progressive views.⁵⁷ Indeed, when properly framed, these views actually converge.⁵⁸

A closer read of Milton Friedman’s quote that the responsibilities of corporate managers are “to conduct the business in accordance with their

54. Friedman, *supra* note 14, at 17.

55. See Thomas W. Dunfee, *Corporate Governance in a Market with Morality*, 62 LAW & CONTEMP. PROBS. 129, 132 (1999) (stating that Friedman’s view characterizes a purely economic perspective of the role of corporations).

56. See Patrick McGeehan, *Goldman Chief Urges Reforms in Corporations*, N.Y. TIMES, June 6, 2002, at A1 (discussing the detrimental effect corporate scandal has had on the public’s regard for business).

57. See Dunfee *supra* note 55, at 137–40.

58. *Id.* at 157. While Dunfee acknowledges that the notion that there is no substantive disagreement between the predominant and progressive viewpoints is a wild oversimplification, he does suggest that a convergence does exist between these two views when properly considered:

Managers will more effectively satisfy their primary duty to shareholders when they respond to signals of significant moral preferences within capital, consumer, and labor markets relevant to the firm. Managers have a further obligation, based on a social contract, to act consistently with mandatory marketplace morality and manifest universal norms.

Id. at 157. See also Cheryl F. Wade, *Racial Discrimination and the Relationship Between the Directorial Duty of Care and Corporate Disclosure*, 63 U. PITT. L. REV. 389 (2002). Wade describes Mehri’s work from the perspective of corporate governance. *Id.* She discusses corporate disclosures regarding its employment discrimination/diversity practices as a policy that is both responsive to market forces and widely held social and ethical norms. *Id.* Wade describes such a policy as “profit-maximizing.” *Id.* at 440.

[shareholder's] desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom,"⁵⁹ reveal the point of convergence. Though Friedman fails to explicitly consider ethical rules and their interplay with the law, law and ethical custom are, in fact, interdependent.⁶⁰ However unintentional it may be, Friedman's recognition of the ethical customs of society and the law as reins on business self-interest establishes the foundation of the argument that corporate managers can and should find ways to both cooperate with widely held social ethical norms and enhance shareholder wealth.⁶¹ In essence, advocates of both predominant and progressive viewpoints of CSR can find a common ground where efforts to improve information gathering and reporting are mutually beneficial.

In 1998, under the American chairpersonship of Ira Millstein, The Organisation for Economic Co-operation and Development (OECD) advisory group released a report, lending credence to the notion that shareholder and stakeholder interests can be convergent.⁶² Although the OECD report clearly favors the predominant viewpoint, it also suggests that a nexus does exist between the predominant and progressive views.⁶³

59. Friedman, *supra* note 14, at 12.

60. Ostas & Loeb, *supra* note 12, at 68. Ostas and Loeb explain that:

Law is, at least in part, a function of ethical custom. As customs evolve, the law also evolves, often with a lag. Law can also change ethical custom. For example, the desegregation decisions in the mid-1950s and 1960s helped to change societal norms regarding the ethics of a segregated society. Both law and ethical custom are ever-changing systems of social ordering that evolve together and diverge and coincide to differing degrees in differing contexts.

Id. (citations omitted).

61. Ostas & Loeb, *supra* note 12, at 71–72. Ostas and Loeb explain the confluence of a progressive viewpoint of CSR and Friedman's narrow viewpoint of CSR stating that:

Corporate managers should seek creative ways to discover and cooperate with the social and ethical norms that underlie and inform the public policies governing the corporation's principle business operations while simultaneously seeking to enhance firm profitability. This proposition locates the source of a firm's social obligations while simultaneously limiting the scope of those obligations. It also suggests that social and economic goals can often be pursued simultaneously.

Id.

62. Peter Nobel, *Social Responsibility of Corporations*, 84 CORNELL L. REV. 1255, 1263 (1999).

63. See *id.* at 1263–64; Hess, *supra* note 15, at 47.

The OECD Report's chapter headings illustrate this unusually wide approach:

Chapter 2. Defining the Mission of the Corporation in the Modern Economy. . .

Chapter 3. Ensuring Adaptability of Corporate Governance Arrangements. . .

Chapter 4. Protecting Shareholder Rights. . .

Chapter 5. Enabling Active Investing. . .

Chapter 6. Aligning the Interests of Shareholders and Other Stakeholders. . .

Chapter 7. Recognising Societal Interests. . .⁶⁴

Note that the Report separates 'Aligning the Interests of Shareholders and Other Stakeholders' from 'Recognising Societal Interests,' indicating that the authors view the two subjects as separate issues.⁶⁵ Much in line with Friedman's dictate that the ethical customs of society and the law must serve as reins on business self-interest:⁶⁶

[T]he OECD advisory group explains its views on the importance of recognizing societal interests as follows: Companies do not act independently from the societies in which they operate. Accordingly, corporate actions must be compatible with societal objectives concerning social cohesion, individual welfare and equal opportunities for all. Attending to legitimate social concerns should, in the long run, benefit all parties, including investors.⁶⁷

64. Friedman, *supra* note 14, at 17.

65. See Nobel, *supra* note 62, at 1264.

66. Friedman, *supra* note 14, at 12.

67. Nobel, *supra* note 62, at 1264 (footnote omitted); see also Branson, *supra* note 41:

The question then becomes: how best can corporate managers adjust to such an evolving, conflicting and imprecise set of social and ethical norms that underlie and inform the corporation's legal environment, finding creative ways to enhance shareholder wealth in the face of such uncertainty?⁶⁸ Corporate managers can institutionalize a process through which they will be able to survey the social issues facing the corporation, evaluate the corporation's current practices, reflect on alternatives, and implement action.⁶⁹ What Hess refers to as "social reporting" is the mechanism by which corporate managers can keep abreast of their socio-economic environment by finding creative

In selecting and monitoring their investments, the large activist institutional investors have placed corporate social responsibility on their agendas. TIAA-CREF, CALPERS, NYCERS, as well as the labor union pension funds such as the textile workers . . . or the carpenter's union pension funds, have become up front socially responsible investors. Today according to one authority, there are 144 "socially and environmentally responsible" mutual funds, with ninety-six billion dollars under management in 1997.

The growth rate of mutual funds that, while not organized solely around a theme of social or environmental responsibility, utilize various "social screens" in making investments, is three times the growth rate of funds generally. Thus "socially screened" mutual funds' assets grew 227 percent from \$162 billion to \$529 billion between 1995 and 1997. Altogether, it is said that "\$1.185 trillion of the \$13.7 trillion in funds under professional management in the United States (or about 9%) are invested using social 'screens' for either products to be avoided (tobacco, alcohol, and military hardware lead the list) or practices to be encouraged (intelligent environmental stewardship, for instance)."

Id. at 641-42 (citing Cynthia Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, at 1267-68 (1999)). See also Symposium, *Corporate Social Responsibility: Paradigm or Paradox*, 84 CORNELL L. REV. 1282 (1999) [hereinafter *Corporate Social Responsibility Symposium*] (discussing the growing relevance of CSR in corporate America). Tim Smith states that:

Milton Friedman's maxim that the goal of business is profits for shareholders, and at least as it was interpreted over the years—that it was the sole goal and all good things flowed from it—is something that I am not hearing from the top executives, the CEO's of major corporations, any longer. You hear more. Of course you still will hear that profitability is key to the long-term success of the company, for shareholders. But, you also will often hear companies like General Motors talk about how work on environment and leadership on the environment is good for the bottom line. And you will hear other companies talk about how being a socially responsible corporate citizen is not simply a do-good action but it is also good for the shareholders and the bottom line. So I believe that corporate social responsibility commitments are being heard more and more from American corporations.

Id. at 1302 (footnote omitted).

68. Ostas & Loeb, *supra* note 12, at 63.

69. *Id.* at 74.

ways to maximize the wealth of their shareholders while simultaneously conforming to legal rules and the ethical customs of society.⁷⁰ Furthermore, social reporting also serves to increase corporate transparency and accountability.⁷¹ The social reporting approach to CSR proposed in this Article is not merely theoretical—it is a theory currently in action.⁷² Both The Body Shop International (The Body Shop), which is headquartered in the United Kingdom and Ben & Jerry's Homemade, Inc. (Ben & Jerry's), which is headquartered in the United States have received widespread publicity regarding their social reports.⁷³

70. See Hess, *supra* note 15, at 63–64. Hess describes the utility of social reporting as the appropriate gauge by which to measure a corporation's responsiveness to widely held social ethical norms and by which to assess its' long term economic success:

[A social report] provides measures of how well an organization lives up to the shared values [created jointly with its stakeholders] to which it has committed itself. It contributes to a dialogue process where values become integrated into the organization. It provides an extensive picture of the organization's relationships with its stakeholders, and thus of its chances for long-term development and survival. But it encompasses more than just a snapshot at a particular time; its design, development and interpretation contribute to an ongoing dialogue culture where values become vital for the organization's self-reference.

Id. at 64 (quoting Peter Pruzan, *The Ethical Dimensions of Banking: Sbn Bank, Denmark*, in BUILDING CORPORATE ACCOUNTABILITY 12 (Simon Zadek et al. eds., 1997), at 63, 67). Though the details of constructing a social report in the employment context regarding compliance with anti-discrimination laws is discussed later in this Article, Hess notes that social reports generally correspond with both the predominant and progressive viewpoints:

[B]y promoting: (1) improved and informed corporate decisions with full understanding of the implications of any action; (2) accountability to the public through disclosure; (3) an understanding of community and stakeholder expectation of business and of the evolution of those expectations; and (4) a measurement of progress towards meeting those expectations. Overall, such a system will allow corporations to pursue their profit objective, but in a manner that is responsive to the expectations of society.

Id. at 63.

71. See discussion *supra* note 48 (discussing the necessity and utility of social reports being mandated by new legislation); see also discussion *supra* note 49 (discussing the importance of transparency and accountability in stipulating that outside auditors must verify corporate social reports, much like the "auditing of corporate financial statements . . .").

72. See Hess, *supra* note 15, at 72; see generally *id.* at 47–48 (debating whether or not it is time to legislate corporate social report and noting that social reporting, itself, is not a new idea).

73. *Id.* at 72.

The Body Shop is a retailer and franchiser in the health and beauty aids industry. In

The question that remains from the CSR approach adopted in this Article “is whether resources spent to address social issues enhance or detract from the [corporation’s] traditional performance measures such as profitability, market share, and stock price.”⁷⁴ To ask the question from the predominant viewpoint: does this utilization of CSR positively affect the corporation’s bottom line?⁷⁵ “A recent article surveyed the empirical evidence, identifying fifty-one studies that had tested for a correlation between a corporation’s social performance and the [corporation’s] financial performance.”⁷⁶ Although the results of these studies are mixed, the authors of the review report ‘good news’, observing that ‘the largest number of researchers has found a positive relationship.’⁷⁷

Finally,

From a corporate strategy perspective, the costs of creating a social report may not be considered costs at all, but rather an investment with returns paid in several different forms. First, the corporation

1995, The Body Shop had total retail sales of \$800 million from over 1200 stores worldwide. The company employed over 3300 persons in 1995 and its 572 independent franchisees employed several thousand more persons. Beginning in 1992, The Body Shop began publishing independently verified environmental statements. In 1995, The Body Shop published its first social report, entitled *The Values Report 1995*. As a supplement to this internal evaluation, Kirk Hanson, a senior lecturer at the Stanford School of Business, conducted an independent evaluation of the company during 1994 and 1995.

Id. (footnotes omitted).

Ben & Jerry’s is a premium ice cream maker and ice cream parlor chain. It is a public corporation with annual sales around \$165 million. The company employs approximately 700 people and has three plants and 130 parlors, which are primarily in the United States. Ben & Jerry’s has conducted some type of social report since 1988. These social reports began as analyses issued by independent reviewers and then gradually moved to their current form, an externally-verified internal audit. The current approach is not just the assessment of the company from an outsider’s perspective, but an attempt to develop standards against which the company can measure itself.

Id. at 77 (footnotes omitted). For updates on each company, go to <http://www.benjerry.com> and <http://www.thebodyshop.com> (last visited Dec. 29, 2003).

74. Ostas & Loeb, *supra* note 12, at 74.

75. *Id.*

76. Jennifer J. Griffin & John F. Mahon, *The Corporate Social Performance and Corporate Financial Performance Debate: Twenty-Five years of Incomparable Research*, 36 *BUS. & SOC’Y* 5, 6–7 (1997).

77. *Id.* at 6.

will benefit from stronger relationships with critical suppliers, customers, and employees. Second, the corporation will have a better understanding of any potential legal liability it may face, either from failure to comply with government regulations or from civil lawsuits (*e.g.*, sexual harassment). Third, the long-term survival and profitability of the company is dependent upon understanding and meeting the expectations of consumers, as well as other members of the general public.⁷⁸

The viewpoint expressed in this Article does not call for corporate managers to sacrifice the long-term economic interests of the corporation.⁷⁹ “Rather, it suggests that inquiring into and cooperating with the ethical norms [of society] can often enhance those [long term economic] interests . . .”⁸⁰ while simultaneously enhancing corporate transparency and accountability.

II. INFORMATION GATHERING AND REPORTING OF COMPANY FINANCIAL DATA

A. SEC Financial Disclosure Requirements

In the area of securities regulation, Congress has long encouraged companies to develop procedures for information gathering and reporting that promote stable securities markets.⁸¹ Stable securities markets are possible only when shareholders have accurate information available to make decisions about the worth of a particular company, in light of its operations in a variety of areas, especially the area of finance.⁸² Under the Securities Act of 1934,⁸³ Congress delegated authority to regulate securities trading to the Securities and Exchange Commission (SEC).⁸⁴ The SEC (1) administers a process that registers

78. See Hess, *supra* note 15 at 81.

79. Ostas & Loeb, *supra* note 12, at 76.

80. *Id.*

81. See, *e.g.*, Don More, *The Virtues of Glass-Steagall: An Argument Against Legislative Repeal*, 1991 COLUM. BUS. L. REV. 433, 440–44.

82. See JoErin O’Leary, *Recent Decisions*, 33 DUQ. L. REV. 1053, 1060 (1995).

83. 15 U.S.C.A. § 78a (2003).

84. See generally *id.*

actors in the financial services industry, such as brokers and dealers,⁸⁵ (2) collects periodic reports publicly traded companies must file,⁸⁶ and (3) establishes procedures and actions that prevent and respond to fraud and market manipulation.⁸⁷

With regard to periodic reporting, it is important to note that the SEC's overriding goal in requiring publicly traded companies to submit registration statements and periodic reports is to require them to disclose all material facts about their activities so investors can decide for themselves where to invest.⁸⁸ In *TSC Industries v. Northway, Inc.*⁸⁹, the United States Supreme Court defined the materiality standard.⁹⁰ Material information is information which "a reasonable investor would find significant in making an investment decision."⁹¹ Examples of information that meets the materiality standard include:⁹² (1) selected

85. 1 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 9.1 (2d ed. 2002).

86. *Id.* § 9.3.

87. *Id.*

88. *See id.* § 9.2.

89. 426 U.S. 438 (1976), cited in 1 HAZEN, *supra* note 85, § 9.6.

90. 1 HAZEN, *supra* note 85, § 7.5.

91. *Id.* § 7.5. Companies must disclose:

(1) the organization, capitalization and nature of the business; (2) the terms, rights and privileges of all classes of outstanding securities; (3) the terms of any securities offered by the issuer within the preceding three years; (4) the names of all of the issuer's officers, directors, underwriters and holders of more than ten percent of any class of equity security of the issuer; (5) compensation of employees other than officers and directors that exceeds sixty thousand dollars per year in cash; (6) description of employee bonus and profit sharing plans; (7) description of management and service contracts; (8) description of options that exist or are to be created with regard to the issuer's securities; (9) all material contracts made by the issuer in the past two years or which are to be executed in whole or in part after the filing and that are outside of the ordinary course of the issuer's business; (10) balance sheets for not more than the three preceding years to be certified as required by the Commission; (11) profit and loss statements for the same period; (12) such further financial statements as the SEC deems necessary for investor protection; and (13) copies of the articles of incorporation or other organizing documents as well as any material contracts to which the issuer is a party as the Commission may require.

Id. § 9.2.

92. *E.g.*, Progress Software Corporation, Form 10K, Commission File Number: 0-19417, For the Fiscal Year Ending November 30, 2002 (mandatory 10K filing includes material disclosures), available at

<http://www.sec.gov/Archives/edgar/data/876167/000095013503001256/b45503pse10vk.htm> (last visited Oct. 26, 2003).

financial data, such as information about revenue, worth of investments, and long-term debt; (2) information about pending legal action that could affect a company's financial position; (3) analysis of strategic decisions, such as changes in product development investments; (4) disclosures about market risk, such as information about competitors; (5) information about who owns company securities; and (6) financial statements, such as balance sheets and statements about cash flow.⁹³

Two sections of the 1934 Securities Exchange Act are especially relevant to the Diversity Report Card we advocate in Section III of this Article.⁹⁴ Both sections relate to information gathering and reporting—Sections 13(a) and Section 14(a).⁹⁵ Section 13(a) of the 1934 Exchange Act is the provision that requires companies to engage in periodic disclosure and reporting.⁹⁶ Companies must file annual (form 10K) and quarterly (form 10Q) reports to provide information that will give investors the updated information they need to make informed investment decisions.⁹⁷ It is especially important that investors are aware of a corporation's true financial conditions.⁹⁸ Knowledgeable investors can devote resources to what they perceive to be the most meritorious companies.⁹⁹ Periodic reporting requirements have the added benefit of alerting a company's directors and senior managers to problems they must address.¹⁰⁰ In theory, the reports allow companies to monitor themselves.¹⁰¹ Companies that present themselves to outsiders in a forthright manner¹⁰² also experience long-term benefits, in that they see their operations in an accurate light, then have the opportunity to

93. *Id.*

94. 15 U.S.C.A. § 78 (2003); *see also* 1 HAZEN, *supra* note 85, § 9.3.

95. 15 U.S.C.A. §§ 78m, 78n (2003); *see also* 1 HAZEN, *supra* note 85, § 9.2.

96. 15 U.S.C.A. §§ 78m (2003); *see also* 1 HAZEN, *supra* note 85, § 9.3..

97. 17 C.F.R. §§ 249.10-K, 249.10-Q (2004); *see also* 1 HAZEN, *supra* note 85, § 9.3.

98. Darin Bartholomew, *Is Silence Golden When it Comes to Auditing?* 36 J. MARSHALL L. REV. 57, 106 (2002).

99. *Id.*

100. *Id.* at 101.

101. *Id.* at 63.

102. *Id.* at 107. Bartholomew proposes that the SEC should authorize exchanges to employ public auditors for listed corporations to better regulation of post-Sarbanes-Oxley audit committees, arguing this will lead to more honest accounting. *Id.*; *see also* 15 U.S.C.A. § 78a (2003).

engage in proactive rather than defensive actions to correct problems internally.¹⁰³

Section 14 of the Securities Exchange Act of 1934 is also relevant to the proposal we present in Section III.¹⁰⁴ When Congress passed Section 14, its intent was to end corporate fraud that occurred when management solicited proxies without letting shareholders know the nature of matters investors would vote on at shareholder meetings.¹⁰⁵ Section 14 outlines how voting will take place on issues such as election of directors, and whether to pass particular shareholder proposals.¹⁰⁶ Section 14(a) of the Securities Exchange Act outlines proxy rules that aim to “provide full disclosure of to investors of matters likely to be considered at shareholder meetings.”¹⁰⁷

The concept of materiality under the proxy rules is the same as it is for periodic reporting, *e.g.*, the test is whether reasonable investors would consider a fact significant when making an investment decision.¹⁰⁸ It is important to note that the concept of materiality is woven through many sections of securities laws.¹⁰⁹ It is also important to point out that the SEC generally interprets the concept to mean “matters that have affected, or will affect, a company’s profitability and financial outlook.”¹¹⁰

103. Bartholomew, *supra* note 98, at 104.

104. Compare generally 1 HAZEN, *supra* note 85, § 11.1 (discussing how the Securities Exchange Act of 1934 and proxy rules are intended to assure full disclosure) with *infra* Part III. See also 15 U.S.C.A. § 78a (2003).

105. 1 HAZEN, *supra* note 85, § 11.2.

106. See *id.* § 11.6; *cf. id.* § 11.2 (discussing Securities and Exchange Commission’s argument that Section 14 of the Securities Exchange Act of 1934 is to ensure “fair shareholder suffrage.”).

107. *Id.* § 11.1. This section “empowers the SEC to require proxy disclosure as necessary or appropriate in the public interest or for the protection of investors.” 15 U.S.C.A. § 78n(a) 2000.

108. See *id.* § 11.4; see also *id.* § 7.5 (discussing materiality and disclosure with regard to Securities Act of 1933 registration statements and Securities Act of 1934 filings).

109. *Id.* at 133; see Securities Act of 1933, 15 U.S.C.A. § 77a (2003). Securities Act of 1934, 15 U.S.C.A. § 78a (1934).

110. *Nonfinancial Disclosure*, *supra* note 11, at 1433–34.

B. The Sarbanes-Oxley Act of 2002

We now know that SEC requirements under a number of provisions, including those outlined above regarding periodic reporting and proxy rules, have not always yielded the kind of behavior society hopes for corporations to live up to.¹¹¹ Given the SEC's focus on ensuring that investors have access to accurate financial information, it is not surprising that many of Congress's post-Enron reforms relate directly to ensuring that investors have access to accurate financial data.¹¹² On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (hereinafter the "Act") on July 30, 2002.¹¹³ The Act, which is the most comprehensive legislation affecting securities laws and their administration since the Great Depression, strives to prevent future scandals and restore investor confidence.¹¹⁴ The Act attempts to actualize these goals by: (1) establishing oversight of the accounting profession; (2) enhancing the independence of accounting firms; (3) fostering greater independence of the audit committee of a company's board of directors and, likewise, (4) of the auditors themselves; (5) ensuring greater accountability among corporate directors and (6) calls for specific regulations as a response to the particular ethical lapses evidenced by recent corporate scandals.¹¹⁵

To address the virtual non-existence of outside and independent regulation of accounting firms, the Act establishes the Oversight Board (hereinafter, "Board"), which will "oversee the audit of public companies,"¹¹⁶ "establish standards for auditors, . . . conduct inspections of public accounting firms"¹¹⁷ and can "impose sanctions . . . such as suspension from accounting activities on an accountant or accounting firm for non-compliance with the Act."¹¹⁸ The Board will consist of five individuals, two of which are required to be or have been certified public

111. Brian Kim, *Recent Development: Sarbanes-Oxley Act*, 40 HARV. J. LEGIS. 235, 238 (2003) (discussing how Enron's compliance with the then-existing SEC provisions still led to its collapse and deceit of the public).

112. *Id.*

113. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

114. *See generally* Kim *supra* note 111.

115. *Id.* at 235 (listing some of the changes initiated by the Sarbanes-Oxley Act).

116. Sarbanes-Oxley Act § 101(a).

117. *Id.* § 104(a).

118. Kim, *supra* note 111, at 241.

accountants.¹¹⁹ These Board members are obliged to have a “demonstrated commitment to the interests of investors and the public.”¹²⁰

The Securities and Exchange Commission (SEC) is responsible for the organization and oversight of the Board.¹²¹ The SEC is required to approve all Board-proposed rules, may “censure or impose limitations upon the . . . operations of the Board,”¹²² “if it finds that the Oversight Board has violated the Sarbanes-Oxley Act or the securities laws, or if the Oversight Board has failed to ensure the compliance of accounting firms without reasonable justification or excuse.”¹²³ Furthermore, the SEC may remove any member from or censure any member of the Board for failing to enforce the Act and/or the securities laws.¹²⁴ “The SEC can also enhance or reduce the Oversight Board’s sanctions if the [SEC] finds them inadequate or excessive.”¹²⁵ Through such unprecedented legislation, the Board promises to have progressive and far-reaching effects on the transparency and accountability of the accounting profession.¹²⁶ All of these measures designed to improve information gathering and reporting demonstrates legislators’ desire to protect the workings of financial markets, which rely on honesty in reporting.¹²⁷

The Act also seeks to augment the quality and independence of an audit by imbuing the audit committee of a company’s board of directors with more authority regarding and responsibility for the audit.¹²⁸ The Act makes it clear that it seeks to untangle the conflicts of interests that had become defining features of recent corporate scandals by “break[ing] the traditional ties between the company’s outside accountants and company management by making the audit committee responsible for the

119. Sarbanes-Oxley Act § 101(e)(2).

120. *Id.* § 101(e)(1).

121. *Id.* § 107(a).

122. *Id.* § 107(d)(2).

123. Kim, *supra* note 111, at 241–42.

124. *Id.* at 242.

125. *Id.*

126. *Id.* at 236.

127. *Id.*

128. *Id.* at 242–43.

company's relationship with outside accountants."¹²⁹ Under the Act, the audit committee is responsible for hiring and receiving reports from the company's outside accounting firm, and it will be responsible for the work-product and payment of the firm.¹³⁰ Furthermore, the Act provides that each audit committee member "must be 'independent,' which under the Act means that he or she cannot, other than in his or her capacity as a member of the audit committee, the board or any other board committee, (1) accept any consulting, advisory or other compensatory fees from the company or (2) be an 'affiliated person of the issuer' or any of its subsidiaries."¹³¹ To further disentangle conflicts of interests, the Act mandates "that if a company's CEO, Controller, CFO, or Chief Accounting Officer was employed by the company's outside accounting firm during a one-year period preceding the audit, that auditing firm has a conflict and is not independent."¹³² Such measures are hoped to prevent the ties between the executive officers of corporations and their accounting firms from leading to "biased audits overlooking ethically questionable or outright illegal activities."¹³³

The Act's prohibition of public accounting firms from providing non-audit functions conjointly with any audit is another way in which the Act strengthens the independence of accountants.¹³⁴ "Non-audit services not explicitly prohibited – such as tax services – must be approved by the audit committee in advance. . . Any preapproval of non-audit services must be disclosed in periodic reports filed with the [SEC]."¹³⁵ Auditors are also required to "report to the audit committee with respect to critical accounting policies, alternative treatments of financial information under generally accepted accounting principles ("GAAP") that have been discussed with management and any other material written communications with management. In addition, the Act requires that filings include all material adjustments that have been

129. John J. Huber & Thomas J. Kim, *The Response to Enron: The Sarbanes-Oxley Act of 2002 and Commission Rulemaking*, 1343 PRAC. L. INST. CORP. L. & PRAC. HANDBOOK SERIES 61, 102 (Nov. 7–9, 2002). Huber & Kim analyze the Act from the perspective of providing counsel to corporate clients. *Id.*

130. Kim *supra* note 111, at 2433.

131. Huber & Kim, *supra* note 129, at 103.

132. See Kim, *supra* note 111, at 243.

133. *Id.*

134. *Id.*

135. Huber & Kim, *supra* note 129, at 113.

identified by an accounting firm.”¹³⁶ The Act also mandates the rotation of the audit partner every five years.¹³⁷ Essentially, the strengthening of auditor independence is meant to preempt the occurrence of a corporation “buying off” its auditor through lucrative “bribes” through the guise of consulting fees, which prevents a transparent and accountable financial image of the corporation from emerging.¹³⁸

To further enhance corporate accountability, the Act requires the SEC to implement rules providing for corporate executive certifications on a quarterly and annual basis.¹³⁹ In addition, the Act imposes criminal liability, which takes the form of a fine of up to \$5 million and/or imprisonment for up to 20 years “for CEOs and CFOs who knowingly or willfully furnish inaccurate certifications.”¹⁴⁰ Furthermore, “if an audit firm has to prepare a restatement because of material noncompliance with any financial reporting requirement, the CEO and CFO must forfeit any bonus received in the twelve months following the first public issuance of the financial statement.”¹⁴¹

As an accompaniment to the aforementioned certifications requirement, the Act also mandates an internal control report, which forces “CEOs not only to certify that they know of no wrongdoing, but also to take steps to guarantee that if there were any wrongdoing, they would be likely to know about it.”¹⁴² The report is to also “contain an assessment, as of the end of the most recent fiscal year, of the effectiveness of such structure and procedures.”¹⁴³ Moreover, “[t]he [corporation’s] outside auditor is required to attest to, and report on, the internal control assessment made by the management of the [corporation] in accordance with the standards for attestation engagements adopted by the [Board] established under the Act.”¹⁴⁴ As a matter of fact, “without accurate internal controls to gather and sort a

136. Cleary, Gottlieb, Steen & Hamilton, *SARBANES-OXLEY ACT OF 2002 USHERS SWEEPING CHANGES FOR PUBLIC COMPANIES IN THE UNITED STATES* (2002) at 4 [hereinafter *SWEEPING CHANGES*] (citations omitted).

137. *Id.* at 5.

138. Kim, *supra* note 111, at 244.

139. *SWEEPING CHANGES*, *supra* note 136, at 2.

140. *Id.*

141. Kim, *supra* note 111, at 245.

142. *Id.* at 247.

143. Huber & Kim, *supra* note 129, at 98.

144. *Id.*

corporation's financial data, no amount of vigilance by outside accountants can completely correct numbers tainted at the source."¹⁴⁵ The internal control provision of the Act highlights the unavoidable centrality of the fiduciary duty of trust in corporate disclosures and the heavy obligations placed on corporate managers to attest to the veracity of these disclosures.

As a direct response to the Enron fiasco, several other reforms were mandated by the Act. During "blackout"¹⁴⁶ periods, many Enron employees, by policy, were not allowed to sell company stock, while no similar rule prevented the corporate executives from doing so.¹⁴⁷ The Act prohibits "any director or executive officer of [a corporation] or any equity security to purchase, sell or otherwise acquire or transfer any equity security of the [corporation] during any blackout period with respect to that security if the director or executive officer acquired the equity security in connection with the service to or employment by the [corporation]."¹⁴⁸

Another ethical lapse at Enron was off-balance sheet accounts that were used to hide millions of dollars in losses, thereby creating a false financial picture of the company that encouraged investors to purchase Enron stock.¹⁴⁹ The Act calls for "the disclosure of all 'off-balance sheet transactions . . . that may have a material current or future effect on financial condition . . .'"¹⁵⁰ This provision seeks to prevent corporations from misleading potential investors by not reporting losses on their balance sheets.¹⁵¹ An additional reform that is a response to a specific unethical corporate behavior is the Act's prohibition of personal loans from the corporation to its' executives.¹⁵² "According to media reports, former Tyco [CEO] Dennis Kozlowski received a \$19 million no-

145. Kim, *supra* note 111, at 247.

146. *Id.* at 248. Kim defines a "blackout period" as "the time when employers change pension plan rules or administrators, during which employees cannot access or sell their retirement accounts." *Id.*

147. *Id.*

148. SWEEPING CHANGES, *supra* note 136, at 15 (citations omitted).

149. Kim, *supra* note 111, at 248.

150. *Id.*

151. *Id.*

152. *Id.* at 249.

interest loan from the company that was later forgiven.¹⁵³ “The Act’s prohibition on personal loans will help prevent the abuse of corporate funds for personal purposes.”¹⁵⁴ Expansive in scope, the Act seeks to provide a permanent legislative solution to the problems of recent corporate scandals and to regain the public trust that is requisite for greater investment in corporations.¹⁵⁵

C. Social Disclosure

Although the Sarbanes-Oxley Act is expansive in scope, it does not resolve all key issues related to improved public trust.¹⁵⁶ One issue Congress and/or the SEC¹⁵⁷ has yet to address is whether the SEC should demand additional disclosure on social issues, such as environmental,

153. *Id.* Kim also notes that “Kozlowski received an additional \$13 million from Tyco to pay the income taxes on that loan.” *Id.* Kim goes on to state that such loans to corporate executives “figured prominently in several other recent corporate scandals.” *Id.*

154. *Id.* Kim quotes Senator Schumer discussing the new provision: “CEOs will have to go to the bank, just like everyone else, to acquire a loan; which, [sic] will reduce the risk of CEOs ability to use company funds for personal purposes.” *Id.*

155. Huber & Kim, *supra* note 129, at 1.

156. An additional issue the SEC is just starting to consider is the process by which members of corporate boards are nominated and selected. Recently, the Securities and Exchange Commission has proposed a rule designed “to enhance the transparency of the operation of boards of directors.” Disclosure Regarding Nominating Committee Functions and Communications between Security Holders and Boards of Directors, 17 C.F.R. pt. 240 (amendments to Items 7 and 22 of schedule 14A under the Securities Exchange Act of 1934) (proposed Aug. 8, 2003), *available at* <http://www.sec.gov/rules/proposed/34-48301.htm> (last visited Dec. 15, 2003). Generally, the proposed rules provide greater shareholder access to proxies and foster greater shareholder participation in important matters of corporate governance. *See id.* The proposed rules include a provision that requires disclosure of “the nominating committee’s process for identifying and evaluating nominees for director.” *Id.* We believe this rule does not go far enough. In particular, we believe the rule should require disclosures regarding actions taken to establish greater board diversity. Shareholders are likely to be interested in knowing what policies and procedures a corporation has enacted to promote race and gender diversity in boards of directors.

157. The SEC’s rulemaking power is limited by (1) the original legislation’s statutory mandate and (2) the requirement that any rule the SEC passes bear a “reasonable relationship” to the purposes underlying this statutory mandate. In addition to rulemaking power, the SEC makes law by using its prosecutorial power to bring cases to court. *See HAZEN, supra* note 85, at 410–11.

human rights, workplace and consumer safety, and equal employment opportunity issues.¹⁵⁸ “[S]ocial information bears primarily on *how* a company generates profits, while financial information bears primarily on *whether and to what extent* a company generates profit.”¹⁵⁹ In theory, the question whether the government should insist on disclosure of information related to social issues draws on many of the themes this Article addressed in Section I.¹⁶⁰ Scholars who write in favor of what they call “social disclosure”¹⁶¹ agree that, with regard to increased transparency and accountability, the interests of shareholders and other stakeholders can be convergent.¹⁶²

In the late 1990’s, Cynthia A. Williams wrote a groundbreaking argument in favor of mandatory social disclosure.¹⁶³ Williams compared information gathering and reporting with regard to financial data, with gathering and reporting data related to social issues. She concentrated on reforming Section 14(a) of the 1934 Act, interpreting this section to empower the SEC to “require proxy disclosure ‘as necessary or appropriate in the public interest or for the protection of investors.’”¹⁶⁴ Williams asserted that “[t]he rise of social activism by investors brought purely social concerns within the realm of ‘materiality’ under TSC and so also within the realm of potentially mandatory proxy disclosure.”¹⁶⁵ She argued that “corporate social behavior can affect profitability,” hence social disclosure should be mandatory.¹⁶⁶

158. See *Nonfinancial Disclosure*, *supra* note 11, at 1435.

159. *Id.* at 1449 (emphasis added). Of course, when a company violates the law in a way one might call a “social issue,” it can incur costs (e.g., criminal fines, civil settlements) that relate directly to the company’s bottom line.

160. See *supra* notes 12–80 and accompanying text. Discussions of the topic also raise the same kinds of questions we considered earlier in the piece, e.g., the rights and roles of outsiders in finding out what is going on within a particular company, whether improved information gathering and reporting should be voluntary or mandated on behalf of the public, and whether the costs of increased transparency and accountability outweigh the benefits.

161. See generally *Nonfinancial Disclosure*, *supra* note 11, at 1435.

162. See *id.* at 1440 (“The most obvious reason for an investor to desire social disclosure is that social performance may correlate with profit.”).

163. See Williams, *supra* note 21.

164. *Nonfinancial Disclosure*, *supra* note 11, at 1435.

165. *Id.* at 1436.

166. *Id.*

Recently, the student staff of the Harvard Law Review¹⁶⁷ expanded upon Williams' seminal work by agreeing with most of her argument in favor of mandatory social disclosure,¹⁶⁸ first making a general case for mandatory rather than voluntary disclosure, then outlining a framework for deciding the circumstances under which the SEC should require social disclosure. They made a case for mandatory disclosure by pointing out that "information is a public good."¹⁶⁹ The students made an analogy to a lighthouse as a public good, e.g., "the social benefit. . . exceeds [its] social cost but no private actor has an incentive to provide [it]."¹⁷⁰ Similarly, "information may have a net social benefit, yet individuals may lack the personal incentive to generate it."¹⁷¹ They also explained that there is sometimes a conflict between managers and shareholders. Managers may not give information voluntarily when doing so complicates their lives by adding to the list of outcomes they are accountable for.¹⁷² Finally, the student authors pointed out that "third-party effects may lead to a sub-optimal disclosure levels."¹⁷³ Individual firms may have no incentive to provide certain kinds of information, even though investors may want it.¹⁷⁴ For instance, makers of sport utility vehicles (SUVs) are unlikely to compete with other makers by highlighting safety features because doing so may highlight the dangerous nature of all SUVs, even the "safer" ones.¹⁷⁵ Similarly, if one company points out that it is doing particularly well in an area of

167. At Harvard, student notes are written collaboratively, so no one student's name appears on the notes. In this Article, we refer to the Harvard law review staff as the Harvard students, the students, and the student authors. Our Article evaluates the Harvard students' work because it considers disclosure of social information related to our own work in the field of employment discrimination. Williams, by contrast, applies her theories to social issues related to globalization. See *Era of Economic Globalization*, *supra* note 16.

168. See *Nonfinancial Disclosure*, *supra* note 11, at 1435. The students took issue with Williams' "free-floating" mandate for corporate disclosure and instead advocated a "mandate bounded by considerations of investor welfare and underpinned by the same economic logic that supports mandatory financial disclosure. *Id.*

169. *Id.* at 1446.

170. *Id.*

171. *Id.* at 1447

172. See *id.* at 1449.

173. *Id.* at 1448.

174. See *id.*

175. See *id.* at 1450.

concern to social activists (*e.g.*, whether companies are complying with environmental laws), this disclosure may call attention to an industry's generally weak record in this area.

After making a case for mandatory disclosure in general, The Harvard students outlined four factors they believe the SEC should consider when deciding whether disclosure should be mandatory: (1) whether and how important the information is to investors;¹⁷⁶ (2) whether the direct costs of disclosure would be low, *e.g.*, costs are lower if the company is already collecting the relevant information;¹⁷⁷ (3) whether, there are indirect costs associated with disclosure levels, *e.g.*, costs as "effects on activity levels;"¹⁷⁸ and (4) whether there are third-party effects associated with the information.¹⁷⁹

The Harvard students applied their four criteria to one social issue, equal employment opportunity.¹⁸⁰ First, the students provided evidence that investors care about equal employment opportunity and want information about a firm's performance in this area.¹⁸¹ They explained social trends toward "vibrant social activism on social issues."¹⁸² The students then highlighted the number of shareholder proposals seeking corporate disclosure of information related to equal opportunity performance.¹⁸³ They also offered information about the number of mutual funds that screen companies for equal employment opportunity performance.¹⁸⁴ With regard to the second criterion that focuses on

176. The students reminded the reader of the SEC's goals of "protecting and empowering investors." *Id.* at 1450.

177. *Id.* at 1451 (stating that "mandatory social disclosure would be quite cheap if the data to be disclosed were already regularly collected.").

178. *Id.* at 1451. A firm may alter profitable behavior (*e.g.*, violating environmental laws), which had been beneficial to the company but a social cost to investors. *See id.* at 1452 (stating that "[n]et indirect costs of disclosure will be low if the behavior curtailed does not contribute greatly to costs and if investors derive significant disutility from such behavior.").

179. *Id.* at 1452 (stating that "indirect costs will be lowest in situations in which the information has significant, secrecy-inducing third-party benefits, for it is precisely in these situations that firms will find it rational to hoard information despite the collective contrary interests of their investors.").

180. *Id.*

181. *Id.* at 1452.

182. *Id.* at 1443.

183. *Id.* at 1452-53.

184. *Id.* at 1453.

direct costs, the students observed that companies are already collecting information about equal employment opportunity, so “an SEC-administered mandatory disclosure requirement would have little direct cost.”¹⁸⁵

The students then turned to their third criterion, which focuses on indirect costs associated with social disclosures.¹⁸⁶ The relevant questions are whether companies benefit from discriminating and whether investors suffer a social cost from this discrimination.¹⁸⁷ The students had proposed earlier in their argument that “the net indirect costs of disclosure will be low if the behavior curtailed does not contribute greatly to costs and if investors derive significant disutility from such behavior.”¹⁸⁸ In applying this proposition to equal opportunity information, the students considered two theories of discrimination.¹⁸⁹ The reader can infer that their first theory relates to intentional discrimination.¹⁹⁰ The students explained that some employers discriminate because they are acting on investors’ “taste” for discrimination,¹⁹¹ e.g., that may be what investors want. The students

185. *Id.*

186. *Id.* at 1451.

187. *Id.*

188. *See* discussion, *supra* note 178.

189. *See Nonfinancial Disclosure, supra* note 11, at 1453.

190. *See id.* The students’ theories include first, a taste for discrimination by investors, where failure to meet these tastes result in costs. *See id.* Second, statistical discrimination may occur. *Id.* This happens because the employer may be using membership in a group “as a proxy for characteristics that are legitimate employment qualifications.” *Id.*

191. *Id.* at 1452.

It is likely that students described discrimination using terms such as taste and statistical discrimination because their analysis is based upon economic theory and conservative economists describe discrimination using these terms. *See, e.g.,* GARY S. BECKER, ACCOUNTING FOR TASTES (1996). Becker, a Nobel prize-winning conservative economist, bases much of his economic analysis on the assumption that “[p]references or tastes play a crucial part in virtually all fields of study in economics and other social sciences. . .” *Id.* at 3. He presents his economic way of looking at life, covering a wide range of topics, from marriage, to crime, to discrimination. *Id.* at 233 (marriage), 143 (crime), 140 (discrimination). When he describes discrimination, he writes about it using terms the Harvard students used, e.g., tastes and statistical discrimination. *Id.* at 141. For example, he writes that, “[p]resumably, the amount of observable discrimination against minorities in wages and employment depends not only on tastes for discrimination, but also on other variables, such as the degree of competition and

then wrote that the average investor presumably has *distaste* for discrimination.¹⁹² Thus, “the benefit to the egalitarians would likely swamp the cost to the discriminators, and investors as a whole would benefit.”¹⁹³

The students also considered a second theory of discrimination, “statistical discrimination.”¹⁹⁴ This concept apparently relates to discrimination that is neutral in intent.¹⁹⁵ The students then described employers who sometimes discriminate by using group membership (e.g., race) as a proxy for considering characteristics that are related to

civil rights legislation.” *Id.* at 141. Later, in describing discrimination, he uses the phrase “statistical discrimination,” which refers to stereotyped reasoning of employers that minorities are less productive. *Id.* at 142. Becker says that these beliefs can be self-fulfilling, causing minorities to invest less in their human capital, hence making them less productive. *Id.*

We believe the students’ analysis of discrimination would have been stronger if they had considered alternative perspectives on discrimination. *See, e.g.,* RANDY ALBELDA ET AL., UNLEVEL PLAYING FIELDS: UNDERSTANDING WAGE INEQUALITY AND DISCRIMINATION (2001) [hereinafter UNLEVEL PLAYING FIELDS]. Albelda contrasts neoclassical economic theories about discrimination with theories developed by political economists. *See id.* at 4-8. Becker’s emphasis on individual “tastes” for discrimination is consistent with neoclassical economic theory. Albelda points out that neoclassical economic theory assumes individuals are rational, self-interest calculators who always determine the costs and benefits associated with a decision. *See* UNLEVEL PLAYING FIELDS, at 121. Additionally, neoclassical economic theory assumes that individuals have perfect information; an individual’s tastes and preferences are based upon this information. *Id.* at 6, 43. By contrast, when political economists look at wage disparities, they ask questions about unequal economic power. *See* UNLEVEL PLAYING FIELDS, at 121. In particular, they consider a person’s membership in a particular group and how this group will affect a person’s ability to “get a fair shot in the labor market or elsewhere the economy.” *See id.* at 121. Political economists assume that when we are born we are not born into a world that is fair, rather, our economy is “an unlevel playing field.” *See id.* at 121. No matter how much we invest in our human capital through experience, education and training, we will have unequal outcomes because “the teams do not have equal resources and the rules of the game favor some over others.” *Id.*

192. *Nonfinancial Disclosure*, *supra* note 11, at 1453.

193. *Id.*

194. *Id.* at 1454.

195. *Id.* (“Statistical discrimination can occur in the absence of any antipathy toward a . . . group.”) (quoting David A. Strauss, *The Law and Economics of Racial Discrimination in Employment: The Case for Numerical Standard*, 79 GEO. L. J. 1619, 1621 (1991)).

employment qualifications.¹⁹⁶ The students then discussed employers' desire to reduce employee search costs.¹⁹⁷ Part of this analysis of the third criterion was difficult to understand. It helps to read the analysis in the context of an earlier passage, where the students wrote that, with regard to social issues, investors may see a social problem (e.g., discrimination) as a cost, even if the company sees it as a benefit (e.g., the company may save money by violating the law).¹⁹⁸ Investors are likely to want to sacrifice some amount of profits if the profits are derived from behavior they find objectionable.¹⁹⁹

Finally, the students considered their last criterion, which focuses on third-party effects.²⁰⁰ The students argued that disclosure should be mandatory in situations in which a particular company could benefit from keeping its own data secret, despite investors' collective interests.²⁰¹ They asserted that firms are unlikely to collect and disclose equal employment opportunity data voluntarily because "of the fear that disclosure will lead to a competitive disadvantage."²⁰² The students explained that even those companies with the best performance are unlikely to volunteer the information because the slogan "We Discriminate Less" is not good marketing.²⁰³

The students concluded their analysis of the four criteria by writing, "equal employment opportunity data are a plausible candidate for mandatory disclosure under a regime that is designed to serve the overall interests of investors, not merely their financial interests."²⁰⁴

We agree with the students' general approach for outlining the circumstances under which the SEC should require mandatory social disclosure. Although we are advocating mandatory social disclosure under Section 13(a) of the 1934 Act, we believe the SEC could use the

196. *Id.* at 1454.

197. Although this part of the students' analysis was intuitively correct, it was incomplete.

198. *Nonfinancial Disclosure*, *supra* note 11, at 1451.

199. *Id.* ("[I]t is a fair guess that most investors would consider the sacrifice of a profit earned on the backs of an enslaved workforce to be a net profit.").

200. *Id.* at 1448 (describing third-party effects).

201. *Id.* at 1452.

202. *Id.* at 1454.

203. *Id.*

204. *Id.*

same set of criteria as those outlined for Section 14(a).²⁰⁵ Using the same criteria is consistent with the fact that materiality is interpreted the same way under more than one provision of the Act. Although we agree with the students' general approach, we question some of the students' analysis. Although we ultimately agree with the students' conclusion—that the SEC should require social disclosure of equal employment opportunity data—our analysis is somewhat different, especially with regard to the students' third and fourth criteria, which focus on indirect costs associated with social disclosure and third-party effects of disclosure. Before we comment on the students' analysis, though, we must present more detailed information about the precise nature of equal employment opportunity data as a social issue.

Many lawyers are using their skills to work toward increased racial and gender equality.²⁰⁶ In the next section we highlight four specific

205. HAZEN, *supra* note 85, at 440–45 (describing disclosure requirements and their application under § 14(a)).

206. See, e.g., Chuck Salter, *The Next Big (Legal) Thing*, FAST CO., Apr. 2003, at 112. Salter describes in detail the work of Brad Seligman, an attorney who led the charge against Wal-Mart based upon Wal-Mart's allegedly discriminatory treatment of women. See *id.* In particular, the class action lawsuit Seligman has filed against the company alleges discrimination in pay and promotions. *Id.* The suit, *Dukes v. Wal-Mart Stores*, is the largest employment discrimination case ever filed. *Id.* at 114. Seligman seeks to represent over 700,000 current and former female employees. *Id.* Salter also describes Cyrus Mehri's work. See Chuck Salter, *A Reformer Who Means Business*, FAST CO., Apr. 2003, at 102.

For additional articles about class action lawsuits alleging systemic discrimination, see Kate Darby Rauch, *Lawsuit Plaintiffs 'Wonder Boys' Help fill Needs of Those Who Want*, SAN DIEGO UNION-TRIB., July 21, 2002, at A6. This article describes the lawsuit brought by Angela Alioto against international bakery chain Interstate Brands Corp. for race discrimination. *Id.* A jury awarded plaintiffs \$120 million for discrimination with regard to promotions and jobs. *Id.* The plaintiffs also alleged a racially hostile environment. Ultimately, the case settled out of court for \$20 million. *Id.*; see also Cliff Hocker, *Equality in the Workplace*, BLACK ENTERPRISE, Aug. 1, 2002, at 22. This article describes class action job-bias lawsuits plaintiffs brought against both NASA flight centers in Maryland and Virginia and the Social Security Administration by black employees. *Id.* In 2002, NASA engineers and scientists won a \$3.75 million settlement. In the same year, black male employees at the Social Security Administration won a \$7.75 million settlement after alleging denials of promotions based upon race. *Id.*; see also Janet Wiscombe, *Corporate America's Scariest Opponent*, WORKFORCE, Apr. 1, 2003, at 34, 38 [hereinafter *Scariest Opponent*]. This article describes multi-million dollar discrimination cases, including the Interstate Brands and Social Security Administration race discrimination cases. *Id.*; see also David Aronson, *Managing the*

cases—not because they are the only compelling systemic discrimination cases, but rather because we have direct knowledge of the issues and facts in these cases,²⁰⁷ and this knowledge will ultimately allow us to return to the Harvard students' analysis of indirect costs (criterion three) and third-party effects (criterion four) of social disclosure. First, however, Section III describes legal challenges to human resources policies.

III. INFORMATION GATHERING AND REPORTING OF WORKFORCE DIVERSITY DATA

A. Legal Challenges to Human Resources Policies

The lawsuits against Texaco, The Coca-Cola Company, Johnson & Johnson and BellSouth have brought to the public's attention allegedly illegal corporate behavior—allegations that corporations were or are engaging in widespread race discrimination in the areas of pay, performance evaluations, and promotions. These cases, when considered as a set, provide clear information about (1) areas of weaknesses many companies demonstrate in the employment

Diversity Revolution: Best Practices for 21st Century Business, CIV. RTS. J. (2002), at 46, 50 [hereinafter *Diversity Best Practices*]. This article summarizes a number of lawsuits filed against corporations for race and gender discrimination, including those filed against Shone's, Home Depot, Publix, Denny's, and South Carolina Edison. *Id.* The article also lists the Coca-Cola and Texaco cases. *Id.*

207. Cyrus Mehri represented or currently represents the plaintiffs in the four cases we highlighted in the next section. Class counsel in *Roberts v. Texaco Inc.* were Cyrus Mehri and Michael Hausfeld (Cohen, Milstein, Hausfeld & Toll, P.L.L.C.) and Daniel L. Berger, Max W. Berger and Steven B. Singer (Bernstein Litowitz Berger & Grossmann LLP). Class counsel in *Ingram v. The Coca-Cola Company* were Jeffrey C. Bramlett and Josh Thorpe (Bondurant, Mixson & Elmore, L.L.P.) and Cyrus Mehri and Pamela Coukos (Mehri & Skalet, P.L.L.C.).

Lead Plaintiffs' counsel in *Gutierrez v. Johnson* are Cyrus Mehri and Pamela Coukos (Mehri & Skalet, P.L.L.C.), Johnnie L. Cochran, Jr. (The Cochran Firm), Bennet D. Zurofsky (Reitman Parsonnet, P.C.), and Bruce Ludwig (Sheller, Ludwig & Badey, P.C.). Lead plaintiffs' counsel in *Jenkins v. Bellsouth Corp.* are Joseph M. Sellers and Christine E. Webber (Cohen, Milstein, Hausfeld & Toll, P.L.L.C.), Cyrus Mehri and Gouri Bhat (Mehri & Skalet, P.L.L.C.), Johnnie L. Cochran (Cochran, Cherry, Givens, Smith & Montgomery), and Byron R. Perkins (Wiggins, Childs, Quinn & Pantazis, P.C.).

discrimination/diversity arena, (2) the kinds of information proactive companies should gather and report for the benefit of all stakeholders, and (3) concrete action steps companies can take to remedy problems and avoid the costs of litigation. As the next paragraphs describe the four class action lawsuits, notice the overlapping themes of widespread, institutionalized²⁰⁸ discrimination that either went unnoticed by key decision makers, or was noticed, but ignored.²⁰⁹ All four cases highlight the need for improved information gathering and reporting.

*Roberts vs. Texaco Inc.*²¹⁰ was one of the first glass ceiling²¹¹ cases alleging systemic race discrimination at a Fortune 500 company. In this case, the plaintiffs brought to light several problems with the company's human resources policies and procedures. For instance, they uncovered a secret high-potential list, which served as the basis for promotion decisions.²¹² Furthermore, plaintiffs hired a statistician, who gathered

208. M. Neil Browne & Andrea Giampetro-Meyer, *Many Paths to Justice: The Glass Ceiling, The Looking Glass, and Strategies for Getting to the Other Side*, HOFSTRA LAB. & EMP. L.J. (forthcoming) [hereinafter *Many Paths to Justice*]. The authors explain that when discrimination is institutionalized, it is both historical and ongoing. Unlike individual discrimination, which involves intent and inappropriate behavior by specific people, institutionalized discrimination is difficult to see in everyday practices. *See id.*

209. *See* Complaint, Gutierrez v. Johnson & Johnson, at 6–7, available at <http://www.findjustice.com/ms/cases/j-and-j/complaint/11-15-2001.PDF> (claiming the company demonstrated reckless indifference to allegations of race discrimination) (last visited Dec. 30, 2003) [hereinafter *Gutierrez Complaint*]; *see* Complaint, Jenkins v. Bell South Adver. & Publ'g Co., at 2–3 (claiming that the company knowingly administered discriminatory employee testing), available at <http://www.findjustice.com/ms/cases/bellsouth/complaint-final.PDF> (last visited Dec. 29, 2003) [hereinafter *Jenkins Complaint*].

210. This case settled in 1996 for \$176.1 million. Thomas Mulligan & Chris Kraul, *Texaco Settles Race Bias Suit for \$176 Million*, L.A. TIMES, Nov. 16, 1996, at A-1.

211. A glass ceiling is a metaphor that describes hidden barriers that prevent individuals or groups from advancing upward in their organizations into high-level managerial positions. *See Many Paths to Justice, supra* note 208. Recently, the United States Supreme Court affirmed the importance of eliminating glass ceilings. *See Grutter v. Bollinger*, 123 S. Ct. 2325, 2341 (2003) (reasoning that “[i]n order to cultivate a set of leaders with legitimacy in the eyes of its citizenry, it is necessary that the path to leadership be visibly open to talented and qualified individuals of every race and ethnicity.”).

212. *See* BARI-ELLEN ROBERTS & JACK E. WHITE, *ROBERTS VS. TEXACO: A TRUE STORY OF RACE & CORPORATE AMERICA* 145 (1998) [hereinafter *ROBERTS VS. TEXACO*].

and reported to plaintiffs evidence of systemic race discrimination in the company's compensation system.²¹³ Another significant problem plaintiffs discovered was that the company's performance appraisal system gave managers too much discretion, and too often managers did not use this discretion in a legally sound way.²¹⁴

Two additional facts are worth highlighting. One is that Texaco's culture condoned even blatant racist slurs.²¹⁵ A second, related concern is that the company lacked a fair process that allowed employees to offer complaints and suggestions internally. For instance, when a team of managers engaged in benchmarking and offered suggestions to the company about how it might manage diversity more effectively,²¹⁶ the

213. See generally *id.* at 209, 212, 215, 230 (noting that plaintiffs hired a statistician who analyzed data that plaintiffs were able to gather during the discovery process).

214. See *id.* at 162–63 (describing how Robert's performance evaluation rating was lowered at the request of management on the basis that she had been "uppity").

215. After filing a class complaint, attorneys seeking to represent the class use formal discovery procedures to collect evidence in support of an eventual motion for class certification. See FED. R. CIV. P. 23 & 26. As part of the discovery process, attorneys obtain documents and computerized human resources data from the defendant. See FED. R. CIV. P. 26. They also deposed key company representatives in an effort to show that the company's employment practices are class wide in scope and discriminatory in effect. *Id.* Additionally, attorneys gather evidence from potential class members. *Id.* Potential class members provide anecdotal evidence of discrimination by sharing their stories with attorneys. In *Texaco*, attorneys gathered a significant amount of evidence about discrimination, including anecdotes that support plaintiffs' assertion that the company condoned blatant racist slurs. *ROBERTS VS. TEXACO*, *supra* note 212, at 243. Potential class members recounted stories in which white employees threatened, taunted, and harassed black employees. *Id.* at 243–44. A company vice president came to a company-sponsored Halloween party dressed as a black Sambo. *Id.* at 242. A Texaco manager advised another manager to "fire [the] black ass" of an African-American employee who had filed a charge of employment discrimination with the Equal Employment Opportunity Commission (EEOC). *Id.* at 243. A white man referred to a black man as "an orangutan." *Id.* A black employee had "KKK" painted on the side of his car. *Id.* at 244. An African-American employee was called "a nigger, nothing but a nigger." *Id.* For additional examples, see *id.* at 206–08, 242–44; see also Kurt Eichenwald, *The Two Faces Of Texaco*, N.Y. TIMES, Nov. 10, 1996, § 3, at 1 (documenting chronically racist incidents at Texaco) [hereinafter *The Two Faces of Texaco*].

216. In 1992, Texaco started a new initiative, Texaco Award for Excellence teams, known as TAFE teams. *ROBERTS VS. TEXACO*, *supra* note 212, at 143. These teams were supposed to promote innovative ideas within the company. *Id.* A company director of human resources invited a small group of employees to provide input about

human resources executive who listened to the suggestions retaliated against the managers working to promote change.²¹⁷ He responded to the team's somewhat traditional proposals for promoting diversity by suggesting the proposals were radical.²¹⁸ Then he had a temper tantrum in response to the proposals, and yelled at the team that that they were "Black Panthers."²¹⁹

It is important to note that, in this case, plaintiffs' attorneys engaged in more information gathering and reporting than the company had ever imagined or planned for themselves. Lawyers for the company knew the evidence that was mounting against the company, but upper-level managers and the Board of Directors had no apparent knowledge of the complete picture of company human resources policies and practices until the parties were on the verge of settling the lawsuit.²²⁰ Additionally, shareholders had no idea that they had invested in a company with massive problems in its diversity management system

how the company could succeed with regard to diversity. *Id.* This small group included Bari-Ellen Roberts and Sil Chambers, two individuals who eventually became class representatives in *Texaco*. *Id.* The director arranged a meeting with this small group and his boss, John Ambler. *Id.* When Roberts and Chambers presented their ideas about how the company might succeed with regard to diversity, Ambler exploded:

You people must have lost your minds. I think you're a bunch of militants! I've been here for thirty-three years and I can tell you right now that Texaco will not even consider any of these proposals! We'll never do any of these things! The next thing you know we'll have Black Panthers running down the halls, or around the circle in front of the building! We're not having that here!

Id. at 147–48.

217. See generally ROBERTS VS. TEXACO, *supra* note 212, at 159–60

218. *Id.* at 148.

219. *Id.* Additionally, the company retaliated against Jerry Leaphart, a Texaco lawyer who made the first attempts to organize employees who were victims of discrimination. *Id.* at 176–78. Soon after the company found out Leaphart was gathering information and calling employees and alert them about his efforts to pull victims together, the company fired him. *Id.*

Today's Texaco, now ChevronTexaco, has a much different response to employee complaints. *In re Texaco Task Force on Equality and Fairness*, Dkt. No. M-10-469 (Sept. 20, 2002), available at <http://www.texaco.com/diversity> (last visited Dec. 30, 2003). The company has a problem resolution system that allows employees to voice concerns. *Id.* This system includes a confidential hotline. *Id.* ChevronTexaco attempts to make sure that employees are not afraid of retaliation. *Id.* Additionally, the company has implemented an Ombuds Program, which provides an ombudsperson who hears and resolves employee complaints. *Id.*

220. See *The Two Faces of Texaco*, *supra* note 215.

until news of overt discrimination and a cover-up became public²²¹ and shareholder value plummeted.

The next case added another layer of complexity to the growing realization that American corporations are experiencing failures in the area of employment discrimination/diversity. *Ingram v. The Coca-Cola Company*²²² made it clear that companies with good reputations and excellent diversity rhetoric suffer from problems just like those at Texaco. In *Ingram*, plaintiffs alleged that the company had engaged in systemic race discrimination in its compensation system, that the company's performance appraisal system was fundamentally flawed,

221. Kurt Eichenwald of The New York Times broke stories of both overt discrimination and Texaco's cover-up. See *Texaco Executives, On Tape*, *supra* note 2; see also *The Two Faces of Texaco*, *supra* note 215. After these stories hit the press, the company's relatively new CEO, Peter I. Bijur, faced scrutiny over tapes leaked to the press in which Texaco senior officers made disparaging remarks about African-Americans and Jews. ROBERTS VS. TEXACO, *supra* note 212, at 263. The tapes also made clear the executives were illegally conspiring to destroy evidence subject to discovery in the class action lawsuit Mehri had filed. *Id.* Almost immediately, class representatives in the case received over two hundred requests for media interviews. *Id.* at 264. Ted Koppel of ABC's Nightline interviewed Bijur, pressing him to the point that he agreed to settle Roberts v. Texaco, on live TV, before an audience of millions. *Id.* at 269-70.

222. 200 F.R.D. 685 (N.D. Ga. 2001). This lawsuit settled in 2001 for a total estimated at \$192.5 million. See Summary of Settlement Agreement in *Ingram v. The Coca-Cola Company*, at <http://www.findjustice.com/ms/cases/coke/summary1.htm> (last visited Dec. 15, 2003). As in *Roberts v. Texaco*, the discovery process that served as the basis for an eventual motion for class certification yielded evidence about discrimination at The Coca-Cola Company. The discrimination at the Coca-Cola Company was far more subtle than at Texaco. Executives were never caught on tape making racist comments and plans to shred documents, as they had been at Texaco. The discrimination was more subtle and data driven, which meant that reports about the case included data comparing the way the company treated white and black employees. Henry Unger, a reporter for The Atlanta Journal-Constitution, presented detailed accounts of discrimination at Coke after reviewing the legal complaint filed by plaintiffs. See, e.g., Henry Unger, *Discrimination Lawsuit—Coca-Cola Accused of "Companywide Pattern"*, ATLANTA J.-CONST., Apr. 24, 1999, at H1. Unger's article includes salary data for white and African-American employees, a chart comparing the number of white and black employees in senior management revenue and non-revenue generating divisions of the company and a chart comparing the number of white and black employees in particular pay grades at the company. *Id.* This information came from the plaintiffs' complaint.

allowing unchecked managerial discretion that worked against African-American employees, and, finally, that promotion practices did not assure equal opportunity.²²³ Plaintiffs alleged that a “glass ceiling” prevented African-American employees from climbing to high levels within the company.²²⁴ Another similarity between the Texaco and Coca-Cola cases is that the company failed to listen to high-level employees, who had raised concerns about unfair treatment of African-American employees in 1995, four years before plaintiffs filed the class action lawsuit.²²⁵ Here, however, the employee who raised the concerns was not subjected to racial slurs. Instead, company executives simply ignored the information and failed to act to correct problems.

Ingram v. The Coca-Cola Company added a new theory to the line of cases—the theory known as “glass walls.”²²⁶ Plaintiffs gathered

223. See *Ingram*, 200 F.R.D. at 687.

224. For a description of the glass ceiling in employment for many groups, including African-Americans and women, see *Many Paths to Justice*, *supra* note 208.

225. See Nikhil Deogun, *Coke Was Told In '95 of Need for Diversity*, WALL ST. J., May 20, 1999, at A3 [hereinafter *Coke Was Told*]; see Henry Unger, *Revised Suit Cites Coca-Cola Execs in Motion: Plaintiffs Say Managers Have Known of Companywide Discrimination Since 1995*, ATLANTA J.-CONST., Dec. 21, 1999, at D1; see also Henry Unger, *Facing Suit, Coca-Cola Steps up Diversity Efforts*, ATLANTA J.-CONST., May 27, 1999, at F1 [hereinafter *Facing Suit*]. Carl Ware, the highest ranking African-American at The Coca-Cola Company had met in 1995 with three other high-ranking African-American executives, Juan D. Johnson, Ingrid Saunders Jones, and Thomas A. Peters at the request of then Chairman and Chief Executive M. Douglas Ivester. Henry Unger, *Confidential Coke Documents Released*, ATLANTA J.-CONST., Feb. 10, 2000, at E1 [hereinafter *Documents Released*]. This group met for a day and a half to talk about how the company might improve its efforts to help young African-American executives move up in the company. *Facing Suit*, *supra* note 225. The group's report later became known as The Ware Report. *Documents Released*, *supra* note 225. In the report, Ware pointed out that the company failed to recognize the skills and intelligence of African-American employees and ignored their potential for employment in certain aspects of the business, especially departments related directly to profit and loss. *Id.* Ware also pointed out instances when African American employees felt “humiliated, ignored, overlooked, or unacknowledged.” *Id.* Ware's report urged the company to develop a mentoring program to link high potential African American employees with senior managers. *Id.* Overall, he urged the company to create a “gold standard” for management diversity. *Coke Was Told*, *supra* note 225.

226. See *Coke Was Told*, *supra* note 225. Unger reported the details of the litigation after reviewing the plaintiffs' complaint. This complaint explained that the metaphor of a glass wall refers to company actions “that segregate employees into divisions where African-American leadership is acceptable, and divisions where it is not.” *Id.* Some

evidence that suggested the company made decisions based upon the assumption that African-American leadership was acceptable in only certain, non-revenue generating departments.²²⁷ Positions in non-revenue-generating departments generally pay less and provide fewer opportunities for advancement.

The next case, *Gutierrez v. Johnson & Johnson*,²²⁸ was another company with an excellent reputation²²⁹ to be sued for systemic race discrimination. Like the two cases outlined so far, the case against Johnson & Johnson again alleges that company-wide practices are intertwined with discriminatory impact and intent.²³⁰ The lawsuit's

companies channel black executives into particular kinds of jobs, especially jobs in non-revenue areas, such as human resources, external affairs and community relations. *Id.* These jobs are less likely to lead to promotions than jobs in revenue-generating areas such as marketing and finance. *See generally id.*

227. *See id.*

228. *See Gutierrez v. Johnson & Johnson, Inc.*, No. CIV. A. 01-5302, 2002 U.S. Dist. LEXIS 15418 (D. N.J. Aug. 12, 2002).

229. Johnson & Johnson is well known for its ethics credo, "Our Credo"—which promises to look out for all stakeholders, not just shareholders. With regard to employees, the Credo states:

We are responsible to our employees, the men and women who work with us throughout the world. Everyone must be considered as an individual. We must respect their dignity and recognize their merit. They must have a sense of security in their jobs. Compensation must be fair and adequate, and working conditions clean, orderly and safe. We must be mindful of ways to help our employees fulfill their family responsibilities. Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development and advancement for those qualified. We must provide competent management, and their actions must be just and ethical.

Our Credo at http://www.jnj.com/our_company/our_credo/index.htm (last visited July 15, 2003). The company also states that it values diversity. It states that:

[D]iversity is part of the culture of Johnson & Johnson, where we recognize the value that differences in age, race, gender, nationality, sexual orientation, physical ability, thinking style and background bring a richness to the working environment. Our vision is to be the Employer of Choice in a Dynamic Global Environment.

Diversity at <http://www.jnj.com/community/diversity/index.htm> (last visited Oct. 14, 2003).

230. *See Gutierrez*, 2002 U.S. Dist. LEXIS 15418, at *4 (describing how plaintiffs have filed systemic race discrimination lawsuits based upon Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e (1991)). To prove Title VII claims, plaintiffs rely on disparate treatment and impact theories. *See id.* Most allegations have fallen under the disparate impact theory, which focuses on human resources systems that

allegations are similar in some ways to the Texaco and Coca-Cola allegations.²³¹ First, the Johnson & Johnson case alleges widespread discrimination in promotions.²³² The lawsuit highlights the discriminatory impact and intent in the company's job posting and succession-planning systems.²³³ Like the Texaco and Coca-Cola lawsuits, plaintiffs have evidence of both glass ceilings and glass walls.²³⁴ In essence, the lawsuit points out the informal, behind-the-scenes processes that allows white managers to choose favored white candidates for promotion.²³⁵ Second, like the Texaco and Coca-Cola lawsuits, the Johnson & Johnson case alleges widespread discrimination in the company's compensation system.²³⁶

Gutierrez v. Johnson & Johnson brings new information and allegations to the attention of stakeholders. This lawsuit: (1) highlights discrimination against salaried employees of African *and/or Hispanic* descent; (2) adds a claim of entry level salary bias, a claim that points out that right at the first stage of the employment process, the company overlooks *and/or* undervalues the qualifications of African-American and Hispanic-American employees and offers them only certain kinds of jobs²³⁷ (3) draws attention to new forms of discrimination in the compensation arena, including discrimination in the distribution of stock awards and options²³⁸ (4) highlights the lack of diversity within the company's Board of Directors; (5) points out the failure of the Board of

appear to be racially neutral, but in fact operate to restrict opportunities for employees who are racial minorities. *See id.* at *5.

231. *See* Gutierrez Complaint, *supra* note 209.

232. *Id.* at 14–23.

233. *See id.* at 18–22.

234. *See id.* at 22–23.

235. *See id.* at 14, 20, 22 (claiming that succession planning is a closed-door nomination process during which predominately white management evaluates and picks similar candidates, thus perpetuating the status quo and limiting diversity in the workplace).

236. *See id.* at 23–27 (alleging that managers have too much discretion, resulting in biases in entry level salary, merit increases, and cash bonuses).

237. *Id.*

238. *See* Cyrus Mehri & Steven Berk, *Stock Option Equity: Building Democracy While Building Wealth*, LABOR & CORPORATE GOVERNANCE—THE PVS MONTHLY REVIEW OF MULTI-EMPLOYER PLAN PROXY ISSUES, Nov. 2002, at <http://www.pvsproxy.com/logon.asp> (last visited Dec. 23, 2003) [hereinafter *Stock Option Equity*].

Directors and upper-level management to monitor, report and remedy problems in its human resources operations; and (6) asks for punitive damages against the company for reckless indifference to acts of discrimination it has known about since 1997.²³⁹

The most recent case, *Jenkins v. BellSouth Corporation*,²⁴⁰ presents claims of current and former employees, from 1998 to present. This case adds to the line of cases alleging a pattern and practice of discrimination against African-American employees. The lawsuit highlights problems with promotion processes, compensation disparities brought about primarily by a subjective performance review system, ineffective procedures for resolving discrimination complaints within the company, inadequate monitoring and reporting in the diversity arena, failure to respond to and correct problems highlighted in the company's own diversity reports, an absence of mandatory diversity training for most managers and supervisors, and reckless indifference to legal violations.²⁴¹

The BellSouth complaint asks the court to approve two classes, one for salaried employees, and one for hourly employees.²⁴² This fact is important because, unlike the Texaco, Coca-Cola and Johnson & Johnson cases, the BellSouth case is not only a glass ceiling case. The BellSouth case is especially important because it challenges the way testing procedures are handled for hourly workers. *BellSouth* challenges invalidated tests BellSouth has used with the effect of discriminating against African-American employees.²⁴³ In particular, plaintiffs allege that the company uses tests that are unrelated to skills necessary to perform particular jobs, and that these tests have a disparate impact on minorities.²⁴⁴ The issue matters because some companies, including BellSouth, have used antiquated tests that are unrelated to job

239. See Gutierrez Complaint, *supra* note 209, at 5-7.

240. See Jenkins Complaint, *supra* note 209 (co-counsel included Joseph Sellers of Cohen, Milstein, Hausfeld & Toll, P.L.L.C. and Johnnie L. Cochran, Jr. of The Cochran Firm).

241. See *id.* at 8-13.

242. See *id.* (noting that "Bellsouth has further discriminated against African American hourly . . . employees by . . . requiring them to pass the Access Management testing process while similarly situated Caucasian employees are not required to do so in order to obtain promotions to managerial positions . . .").

243. *Scariest Opponent*, *supra* note 206.

244. *Id.* at 34.

requirements to keep minorities out of certain job categories and training opportunities.²⁴⁵ These tests have a disparate impact on minority employees, effectively preventing them from paths toward increased wages. In essence, the *BellSouth* case includes a battle against certain paper-and-pencil tests. Interestingly, lawyers fought this battle in corporate America decades ago, and won.²⁴⁶ Unfortunately, it appears that employers are capable of reaching back in time to re-create old ways of discriminating. The plaintiffs' allegation in *BellSouth* regarding paper-and-pencil tests highlights the need for companies to monitor and report analyses of requirements for certain jobs, especially jobs that allow some employees to make the transition to management positions.²⁴⁷ Companies need to make sure they are providing equal opportunities for upward advancement, without a preference for white employees.

In all of these cases, from *Texaco* to *BellSouth*, upper-level management and boards of directors would have benefited from having information available to them on a regular basis that would have allowed them to monitor the company's employment practices and reduce litigation exposure. Senior company officials needed information about what was happening in the company with regard to employment discrimination/diversity. Increased knowledge would have set the stage for companies to correct problems. Ideally, companies want to remedy problems internally, before potential plaintiffs have no choice but to seek the assistance of attorneys. We call the tool for information gathering and reporting that we envision a "Diversity Report Card."

245. See, e.g., *Maxey v. Alcoa Apprentice Selection Settlement* (noting an example of a company that has used antiquated tests to keep African-American employees out of apprenticeship programs), available at <http://www.findjustice.com/ms/cases/alcoa/index.html> (last visited Dec. 16, 2003). Although the complaint alleges that *Bellsouth's* tests are antiquated, a court has yet to rule on the matter.

246. See Paulette M. Caldwell, *Reaffirming the Disproportionate Effects Standard of Liability in Title VII Litigation*, 46 U. PITT. L. REV. 555 (1985). Caldwell discusses *Griggs v. Duke Power Co.*, a United States Supreme Court case outlawed "testing requirements that had a disproportionate exclusionary effect on black applicants and employees." *Id.* at 558. She also reviews EEOC issued guidelines that placed restrictions on the use of paper and pencil tests that appear neutral, but have a disproportionate impact on groups protected by Title VII. *Id.* at 593.

247. *Diversity Best Practices*, *supra* note 206, at 60.

Diversity Report Cards are tools that encourage information gathering and reporting for the benefit of all stakeholders.

B. Diversity Report Cards for Employers and Stakeholders

This Article urges the SEC to issue regulations to guide companies as they complete a Diversity Report Card. The SEC should require companies to include report cards in their annual 10K filing. The Diversity Report Card is a model for proper reporting. It presents a yardstick upon which to judge management's performance and ultimately place investors in a better position to make informed decisions about where to place their money.²⁴⁸ When thinking about a Diversity Report Card, readers should keep in mind that the primary idea that underlies the report card is disclosure.²⁴⁹ As Ralph Estes and Martha Burk have commented:

Disclosure requirements are consistent with the basic concept of free market economics and capitalism. Disclosure does not demand intrusive government regulation, nor does it force employers to change their hiring and compensation practices. Rather, it

248. *Stock Option Equity*, *supra* note 238, at 2.

249. It is important to note that some companies will want to go well beyond disclosure. Many companies see the business rationale for increasing diversity in their companies. *See Diversity Best Practices*, *supra* note 206, at 46. They see that increased diversity creates stronger companies and hence makes economic sense. *See generally id.* Companies interested in adopting diversity best practices may need ideas about how to move forward to create and measure programs designed to enhance diversity at all levels of the company. *Id.*

In *Diversity Best Practices*, David Aronson presents an excellent, comprehensive review of best diversity practices for 21st century business. This article offers ideas for employers that fall under a number of categories, including: general principles (*e.g.*, employers should decide what the organization's short- and long-term diversity goals should be); recruitment (*e.g.*, employers should clarify job selection criteria before a selection process begins); promotion and advancement (*e.g.*, employers should make educational and training opportunities widely available); terms and conditions (*e.g.*, employers should conduct periodic "disability friendly" audits of the company's physical work environment); termination and downsizing (*e.g.*, employers should assist terminated employees by providing services such as counseling); alternate dispute resolution (*e.g.*, employers should consider using employee hotlines, ombuds programs, mediation, etc); management commitment and accountability (*e.g.*, the company CEO must provide strong support for diversity initiatives); and other practices (*e.g.*, companies should conduct diversity training). *Id.* at 60-61.

recognizes that the invisible hand of self-interest may go astray
without the invisible arm of accurate and adequate information.²⁵⁰

On the opposite page, we present a sample Diversity Report Card, which gives the reader a picture of what information a Diversity Report Card could include.

250. Ralph Estes & Martha Burk, *Disclosure and Pay Equity: Let the Sunshine In, A Briefing Paper for Lawmakers, Journalists, Candidates, and Citizens*, available at <http://www.stakeholderalliance.org/equity.html> (last visited Nov. 28, 2003) [hereinafter *Disclosure and Pay Equity*].

Sample Diversity Report Card

SUBJECT	DESCRIPTION
Applicants and New Hires	– Breakdown by race, gender, and ethnicity.
Pay Equity	– Range, median and mean salary and starting salary by job title. Breakdown by race, gender, and ethnicity. – List distribution of stock options and stock awards. Breakdown by race, gender, and ethnicity.
Glass Ceiling	–List the 150 highest paid employees. Breakdown by race, gender, and ethnicity.
Reports Describing Diversity Progress and Challenges	EEO-1 reports – List every notice of violation by the U.S. Department of Labor OFCCP. – List discrimination charges filed by the EEOC.
Board of Director Selection	– List candidates interviewed for Board positions. Breakdown by race, gender, and ethnicity.

To fulfill their objective of increasing workplace fairness, though, companies must develop and complete this report card within a particular context. In other words, proper reporting can take a company only so far. For example, a company could implement exacting standards for developing and completing a Diversity Report Card, but the data the report card summarizes will not promote positive change unless the board of directors that reads the report (1) benefits from racial, ethnic, and gender diversity, and (2) has in place a system that ensures that boards of directors play an active role in governing with regard to employment discrimination/workforce diversity.

With regard to board development, it is imperative that corporations take steps to enhance the diversity of their boards.²⁵¹ Subcommittees of

251. On September 12, 2003, Mehri & Skalet submitted comments to the Securities & Exchange Commission (SEC) in response to proposed rule S7-14-03, which requires companies to disclose the nominating procedures for corporate directors. Mehri & Skalet Comment to the SEC (noting that diversity is of material importance because it is valued by shareholders), *available at* <http://www.findjustice.com/ms/pdf/KatzLetter.pdf> (last visited Sept. 12, 2003). Mehri & Skalet's comments urge the SEC to require companies to disclose information that would allow shareholders to see whether a company utilizes diverse candidate slates in the board member selection. *Id.* at 2. The intent of this suggested requirement is to document efforts to obtain a final slate of board candidates that includes minorities and women. *Id.* Mehri & Skalet's comments assert that:

the board responsible for developing the board must actively recruit women and candidates of color who have the skills necessary to help guide the company. These new board members will also serve as assets by virtue of their diversity. Board members with varying backgrounds and experiences may interpret differently the data a Diversity Report Card presents. For instance, an African-American, Hispanic, or female board member may read the Diversity Report Card and see red flags indicating problems in human resources functions, while other board members may read the same data and see business as usual. Companies benefit when boards discover problem areas internally and correct problems immediately.

With regard to systems that promote active governance,²⁵² boards of directors as a whole, or subcommittees of boards, must engage in serious study of equal employment opportunity data on a regular basis. It may help if the company's top leader appoints a senior-level manager to work with the human resources department. This senior-level manager could act as a liaison to the board, making sure the human resources staff provides the kind of macro information the board needs to engage in strategic decision-making.

Proper reporting also promotes workplace fairness in the context of commitment and accountability. The company CEO and high-level managers must support all company efforts to promote equal opportunity. The board of directors must put in place a system that holds the CEO and upper-level managers accountable for performance objectives that relate to workplace fairness. The CEO must direct operating unit presidents to set annual goals, report on progress toward the goals, and link incentives to achievement of the goals. Reward-and-recognition programs should tie bonuses, merit increases, and other forms of compensation to success in achieving EEO/diversity goals.

Just as shareholders have a right to know the mechanism through which their boards of directors are nominated, they have a right to know the extent to which the nominating committee values racial, ethnic and gender diversity when assembling slates of candidates and whether it makes concrete efforts to achieve diversity.

Id. Disclosure is important because it "makes good business sense, is consonant with the spirit of extant securities regulation, and promotes values important to all those with a stake in effective and responsible corporate governance." *Id.* In essence, investors need data so they can make informed decisions.

252. The information presented in this paragraph comes from communications between Marc Bendick, Jr. and Cyrus Mehri. Marc Bendick is a consultant with Bendick and Egan Economic Consultants, Inc., located in Washington, D.C.

C. Social Disclosure and Diversity Report Cards

Clearly, the Diversity Report Card we envision is consistent with arguments in favor of social disclosure. Advocates of both the predominant and progressive viewpoints are united in their quest to improve information gathering and reporting processes, with the interests of shareholders and other stakeholders in mind.²⁵³ We appreciate some of the general observations the Harvard law review students made when they argued in favor of mandatory disclosure. We agree that information about employment discrimination/workforce diversity may be a public good—something that companies have little incentive to provide voluntarily. We assert, though, that forward-thinking companies will see the value of gathering and reporting information so they can solve problems internally.

We also agree that managers often lack incentives to engage in voluntary, accurate information gathering and reporting. In fact, engaging in reporting often complicates managers' jobs and holds them accountable for an additional area of corporate operations. Managers may be especially uninterested in engaging in this kind of reporting when doing so highlights that they maybe have been using their discretion inappropriately. For example, reports may make clear that a particular company's managers are channeling African-American into non-revenue generating departments, thereby lowering their opportunity for upward advancement. The Board of Directors needs this information so it can monitor and correct problems. Managers may not realize the discriminatory nature of their decisions and if they are, may want to keep this information secret. We also realize that third-party effects may lead to less information gathering and reporting than we desire. We consider this issue below, when we evaluate the students' analysis of their fourth criterion.

With regard to the students' analysis of the four criteria they delineate for when the SEC should mandate social disclosure of equal opportunity data, we agree with the students' analysis of the first two criteria. We wholeheartedly agree with the students' observation that investors want the information. We also agree that it does not cost much for employers to gather and report the kinds of equal employment

253. See *supra* Parts I.A–B.

opportunity data that would help high-level officials monitor the company's human resources operations.

In their third step, the students' analysis of the indirect costs of social disclosure of equal employment opportunity data falls short. Because the students were giving this social issue as a quick example, they did not have the opportunity to explore fully the ways in which discrimination plays out in corporations today. Their intuition that much of the discrimination that exists in corporations today is neutral in intent is on track. Employers are unlikely to be acting on behalf of investors who have a "taste" for discrimination. However, the students needed more information to describe accurately how employers discriminate. Rather than focusing primarily on "statistical discrimination" in employee selection processes, they needed to make clear the many ways in which employers are discriminating. For instance, the analysis needed to highlight systemic discrimination in compensation and performance appraisal systems. This section also needed to highlight issues such as glass ceilings and walls. In spite of this missing information, the students' conclusion with regard to this criterion is correct. Investors are likely to want to sacrifice some profits if the profits are derived from behavior they find objectionable. When investors see information suggesting the company's profits are tied to undervaluing and underpaying employees because of their race, they are likely to want to put a stop to the pattern of illegality even if they lose some money as a consequence.

Finally, with regard to third-party effects, the students argued that disclosure should be mandatory in situations in which a particular company could benefit from keeping its own data secret, despite investors' collective interests.²⁵⁴ Companies will not want to highlight their diversity records if doing so puts them at a disadvantage and makes an entire industry look flawed. We agree with the students that companies are unlikely to engage in voluntary information gathering and reporting of employment discrimination/workforce diversity data if they believe they alone will suffer investor and customer backlash when many other companies with similarly poor records but are successful at hiding information.²⁵⁵ However, we must make two observations that

254. *Nonfinancial Disclosure*, *supra* note 11, at 1452.

255. Writers have urged employers to engage in steps to avoid liability. Unfortunately, some of this work has a negative tone, in that it focuses on preventing

show the complexity of third-party effects. Both observations are based upon our positive impressions of particular companies that have suffered through human resources scandals and failures.

First, our experience in litigating and studying discrimination cases suggests that the Harvard students are incorrect when they assume that corporations typically *know* when they are discriminating and have an incentive to hide the facts from investors and other stakeholders. What we see is that many companies are completely unaware that they are discriminating. They do not realize they are engaging in systemic discrimination based upon race, ethnicity and/or gender. While the students apparently want to mandate disclosure so companies will be forced to own up to their failures, we advocate mandatory disclosure to shake companies out of denial.

Second, we sense that the Harvard students see mandatory disclosure in a somewhat punitive light. We do not, primarily because we have witnessed positive outcomes from mandatory information gathering and reporting. We see competitive advantages for companies that are able to say, "We have enacted best practices to promote diversity."²⁵⁶ For example, it is common knowledge that Texaco completely transformed its corporate culture as a consequence of a court mandate that came about as part of a lawsuit settlement. Although this transformation did not come about voluntarily, in hindsight, it was good for the company and all its stakeholders. Consider the following statement from Mr. Tim Smith of the Interfaith Center on Corporate Responsibility (ICCR).²⁵⁷ ICCR is an association of 275 religious investors, including the Roman Catholic health and hospital chains.²⁵⁸ Speaking for these investors at a panel discussion on corporate social

lawsuits rather than promoting equality. *See, e.g.,* Michael Delikat, *The Texaco Case and Lessons to Learn: How Can Corporations Manage Diversity Effectively?*, in LITIGATION & ADMINISTRATIVE PRACTICE COURSE HANDBOOK SERIES H4-5256, 181 (Practicing Law Institute ed., 1997); *see also* Laura Spatz O'Donnell, *Workplace Advisor: Think Ahead to Thwart Lawsuits Q & A*, SAN ANTONIO EXPRESS-NEWS, Jan. 12, 2003.

256. *Disclosure and Pay Equity, supra* note 250.

257. Currently, Timothy Smith is senior vice president and director of socially responsible investing at Walden Asset Management. Before joining Walden in 2000, he served as Executive Director of the ICCR for 24 years. Smith has a Masters in Divinity from Union Theological Seminary.

258. *See* Interfaith Center on Corporate Responsibility, at <http://iccr.org/about/index.ntm> (last visited Nov. 30, 2003).

responsibility at a Cornell Law Review-sponsored event in 1998, Smith offered these comments about Texaco:

Of course, virtually every company we talk to or you would discuss issues with says they are committed to nondiscrimination in employment. We are talking about equal employment opportunity, shattering the glass ceiling, and diversifying boards of directors. So we need to look beyond the statement, "we are equal opportunity employer, we don't discriminate," and look at what leadership means for a company on the diversity issue.

I think it might be interesting to look at some of the steps that Texaco is taking to illustrate this broader question [of what it means to be socially responsible.] First of all, Texaco, as part of their rigorous present process, is reviewing all levels of its company to ensure it is moving towards true diversity. That is the general theme. It is attempting to break open the glass ceiling. . . .

Texaco is diversifying, and has been diversifying its board. Texaco publishes an annual report on diversity, including the hard numbers—where their EEO numbers stand—and what changes have occurred in the last three years. Texaco tracks these numbers for itself and lets the shareholders and others review those numbers . . . Moreover, I think that Texaco is stressing that this is not simply a do-good program . . . you hear management say again and again that leveraging diversity and the talents of all their people is essential for a profitable future for the company.

Now, I don't mention this as an advertisement for Texaco, but I mention this as sort of a breakdown of what it means to be a leader in equal employment opportunity . . . Diversity is seen as a value in governance that is a value for shareholders.²⁵⁹

Tim Smith's comments remind us that just because a standard is mandatory does not mean it is bad for anyone. In hindsight, a court's mandate that Texaco change simultaneously promoted transparency, accountability, and workplace fairness. When a company stands and discloses the facts, as Texaco has done, this company will enjoy a

259. *Corporate Social Responsibility Symposium*, *supra* note 67, at 1303–04.

competitive advantage because it has adopted diversity best practices. Thus, with regard to third-party effects, we agree with the Harvard students that mandatory disclosure is good in that it makes all companies show the world their practices. However, we add the comment that, when all companies disclose, some will stand out because the information will demonstrate their commitment to equality.

CONCLUSION

At this point, it is important for us to “take stock,” to come full circle, and reconsider the fundamental question that drives our analysis: Why should the SEC mandate social disclosure of workforce diversity data through the use of the Diversity Report Card we outline? This Diversity Report Card stands serves as a model for how companies that embrace corporate social responsibility should proceed in promoting transparency, accountability, and workplace fairness.

Advocates of the predominant view of corporate social responsibility realize that managers who act in the interests of shareholders should welcome improved processes for information gathering and reporting. Managers who shape dynamic corporate cultures prepared to respond to the challenges of operating in a global arena should be pleased to offer information that highlights effective, responsible operations, including legally sound, fair human resources operations. With improved disclosures, individual and institutional investors will have the data they need to make informed investment decisions. They will respond quickly, rewarding managers who provide leadership in creating level playing fields. Over time, many investors will recognize increased shareholder value created by leadership that understands diversity, and will see this shareholder value as a barometer of good management. Consequently, additional investors will offer resources to those well-run companies.

Advocates of the progressive view of corporate social responsibility realize that managers who act in the interest of all stakeholders—shareholders and employees, suppliers and customers—should welcome improved processes for information gathering and reporting. Managers who shape dynamic corporate cultures prepared to attract the best employee talent should be pleased to offer information that assures employees that managers will judge them based their effort, initiative, and merit, rather than upon the color of their skin. With improved

disclosures, employees will have the information they need to make informed decisions about where they want to invest their time and talent. Similarly, suppliers with the best resources will want to establish relationships with companies that provide leadership in creating level playing fields. Additionally, informed customers will “vote with their dollars.” As minority groups grow in size and spending power, they will spend their dollars rewarding companies that demonstrate sensitivity and a keen understanding of what customers need. Over time, employees, suppliers and customers will stand with investors, ready to respond to data that allows them to reward companies that show awareness of, respect for, and responsiveness to innovation, new thinking, and fairness.

As Justice Sandra Day O’Connor reminded us in her majority opinion in *Grutter v. Bollinger*, “[e]ffective participation by members of all racial and ethnic groups in the civic life of our Nation is essential if the dream of one Nation, indivisible, is to be realized.”²⁶⁰ American citizens of all gender, racial and ethnic groups are more likely to participate in society as corporate stakeholders when they have the information they need to assess the extent to which a particular corporation’s human resources system have eliminated conscious and unconscious bias. The model for information gathering and reporting this Article advocates helps eliminate bias. It sits at the nexus of agreement where the pursuit of workplace fairness and corporate success coexist. Our proposed Diversity Report Card is a progressive and productive manifestation of the convergence of legal and ethical custom.

260. 123 S. Ct. at 2340–41.