

# MAKING SENSE OF ESG WITH THE SEC

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I. INTRODUCTION .....	928
II. FROM CSR TO ESG .....	932
a. Defining ESG .....	932
b. A Note on Corporate Purpose .....	934
c. The Strategic CSR Precursor .....	937
d. The Rise and Support of ESG Reporting .....	943
III. THE SEC'S PROPOSAL FOR MANDATORY CLIMATE-RELATED REPORTING IN RELEASE NO. 33-11042 .....	946
a. The ESG Context for SEC Climate-Related Disclosure .....	947
b. TCFD Origins & Limitations .....	948
c. Responses to Three Major Criticisms of the Proposing Release .....	951
i. SEC's Regulatory Purview and Scope .....	951
ii. Principles <i>and</i> Line-Items .....	956
iii. Challenges of GHG Metrics .....	961
IV. ACCOUNTABILITY .....	964
a. The Essential Problem .....	964
b. Materiality and Liability .....	966
i. Materiality in Volitional ESG Reporting Versus Financial Reporting .....	966
ii. Materiality in Securities Law .....	972
iii. Liability with a New Safe Harbor? .....	976
V. CONCLUSION .....	978

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## I. INTRODUCTION

To debate at present whether public corporation<sup>1</sup> Environmental, Social, and Governance (ESG) reporting is important or necessary is to engage with a past to which we cannot return — “we” being those in the United States or anywhere else in the Western developed world. Moreover, to insist that ESG reporting should remain volitional rather than become mandatory is to ignore the demands of present day reality.<sup>2</sup> Our global climate crisis is real and intensifying, and for better or worse, the ESG reporting horses long ago left the gate in response.<sup>3</sup> With the recent United States Securities and Exchange Commission (SEC or Commission) proposal for mandatory climate-related reporting in Release No. 33-11042 (Proposing Release), it appears that some version of mandatory ESG reporting is on the very near horizon in the United States (having already arrived in Europe, the United Kingdom, and Japan, *inter alia*).<sup>4</sup> Even if flawed, for reasons developed in this article, we must support it.

The Commission’s Proposing Release offers regulation on mandatory ESG reporting narrowed to climate-related information and metrics — focused on the environmental E of ESG. Though, certain climate-related measures included in the Release relate to other components of ESG,<sup>5</sup> its primary intention is to require companies registering under the Securities Act of 1933 or reporting under the Securities Exchange Act of 1934 to disclose to the investing public actual and anticipated material effects on business due

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1. For purposes of this article, “public corporation” refers to corporations subject to regulation (including periodic reporting) overseen by the United States Securities and Exchange Commission (SEC) and promulgated pursuant to the Securities Act of 1933 [hereinafter 1933 Act], 15 U.S. Code §77a et seq. and the Securities Exchange Act of 1934, 15 U.S. Code § 78a et seq. [hereinafter 1934 Act].

2. *See generally* Gerlinde Berger-Walliser & Inara Scott, *Redefining Corporate Social Responsibility in an Era of Globalization and Regulatory Hardening*, 55 *AM. BUS. L.J.* 167, 213 (2018) (proposing a new definition of corporate social responsibility (CSR) that accounts for the legalization of CSR notwithstanding the original conception of CSR being volitional). This discussion of volition in defining CSR would seem to be a precursor of the later voluntary versus mandatory ESG reporting debate.

3. *See generally* Lawrence J. Trautman & Neal F. Newman, *The Environmental, Social, Governance (ESG) Debate Emerges from the Soil of Climate Denial*, 53 *UNIV. MEMPHIS L. REV.* 809 (2022).

4. *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 33-11042, 17 CFR §§ 210, 229, 232, 239, and 249, 311-12 (May 11, 2022), <https://www.sec.gov/rules/proposed/2022/33-11042.pdf> [<https://perma.cc/RB66-XJ5T>] [hereinafter SEC Release No. 33-11042 or Proposing Release or the Release].

5. *See infra* Part III.a.

to climate change.<sup>6</sup> This includes required disclosure of certain Green House Gas (GHG) emissions metrics.<sup>7</sup> Imperfect in its scope and coverage, it is, on balance, a reasonable first step toward bringing uniformity and accountability to a marketplace inundated with a chaotic mix of misleading, volitionally reported ESG information.

To appreciate the need for the mandatory approach offered in the Proposing Release, we situate the Proposal not only as an incrementally positive outcome of the volitional versus mandatory ESG debate, which has been extensively addressed in prior research,<sup>8</sup> but in the precursor understandings of Corporate Social Responsibility (CSR), and more particularly in what we call “strategic or instrumental CSR.”<sup>9</sup> In part because of its strategic CSR heritage, volitional ESG disclosure has not always been motivated by altruistic concern for the environment or other stakeholders, but by instrumental attempts to achieve market advantage and by financial risk mitigation strategies appealing to powerful investors.<sup>10</sup> Many companies

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6. See SEC Release No. 33-11042, *supra* note 4, at 52.

7. SEC Release No. 33-11042, *supra* note 4, at 147.

8. See generally Daniel C. Esty & Quentin Karpilow, *Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation*, 36 YALE J. ON REG. 625, 626 (2019); Nicholas P. Mack, *The Covid-19 Pandemic Highlighted the Need for Mandated ESG Disclosures: Now What?*, 30 U. MIAMI BUS. L. REV. 188 (2022); Seth C. Oranburg, *The Unintended Consequences of Mandatory ESG Disclosures*, 77 BUS. LAW. 697 (2022); Bryant Rivera, *Green Bonds: Reforming ESG Regulation in the United States to Meet the Requisite Funding Demand for A Decarbonized Economy*, 28 HASTINGS ENVTL. L.J. 191 (2022); Jake Landreth, *The Materiality of Environmental, Social, and Corporate Governance (“ESG”) Indicators: Is It Time for Mandatory Disclosure?*, 36 NOTRE DAME J.L. ETHICS & PUB. POL’Y ONLINE SUPP. 528 (2022); Virginia Harper Ho, *21<sup>st</sup> Annual Business Law Fall Forum: “Comply or Explain” and the Future of Nonfinancial Reporting*, 21 LEWIS & CLARK L. REV. 317 (2017).

9. See generally Berger-Walliser & Scott, *supra* note 2, at 182 (arguing that “a plethora of scholarly literature in both business and legal journals seeks to prove the economic benefit of CSR policies . . .”).

10. As such, in the fund management context, ESG typically is linked to a desire to reduce systematic risk. See Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821, 1823–25 (2021) (citing e.g., Larry Fink, *Larry Fink’s 2020 Letter to CEOs: A Fundamental Reshaping of Finance*, BLACKROCK, <https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter> [<https://perma.cc/S6JM-YKQW>] (stating that BlackRock’s “investment conviction is that sustainability-and climate-integrated portfolios can provide better risk-adjusted returns to investors”)); John C. Coffee, *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, 2021 COLUM. BUS. L. REV. 602 (2021) (linking interest in ESG disclosure by managers of diversified index funds to a desire to reduce systematic risk); Jeffrey N. Gordon, *Systemic Stewardship*, J. CORP. L. (forthcoming 2022) (arguing that index funds’ approach to ESG matters can serve the interests of their investors by reducing systematic risk) (emphasis omitted).

indeed may be using voluntary ESG disclosure in an instrumental way to enhance shareholder value rather than as a means to reduce their detrimental environmental impact. At worst, they may be using it in greenwashing.<sup>11</sup> Understand greenwashing to mean the difference between the ESG measures a company reports or claims and the ESG measures assessed by a third-party standard verified source.<sup>12</sup> As such, this article recognizes that volitional ESG reporting remains deeply tied to the U.S.-American shareholder value maximization paradigm, rather than to an altruistic stakeholder approach. In part because of the need to mitigate this instrumentalist leaning, and for reasons expanded, *infra*, we generally support the Commission's proposal for mandatory climate-related reporting, though we recognize that the benefits it brings exist very much within a prevailing instrumentalist, investor-oriented paradigm and thus may fall short of its greater potential.

At the same time, we do not seek to over-emphasize the possibly abusively instrumentalist downside to ESG reporting as an argument to dismiss the Proposing Release. Instead, we think it necessary to proceed with mandatory reporting and argue against critics of the Proposing Release's mandatory disclosure in our discussion of the details of the Release. To stymie the Commission's narrow proposal of mandatory climate-related disclosure would be to ignore the perhaps still more detrimental effects that incoherent and diverse, broader volitional ESG reporting practices currently

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11. See, e.g. Jason Czarnezki, Andrew Homan and Meghan Jeans, *Creating Order Amidst Food Eco-Label Chaos*, 25 DUKE ENV'T L. & POL'Y F. 281 (2015) (discussing the problem of sustainability related claims in labeling of food and responses to this as an early example of greenwashing); Silvia Ruiz-Blanco, Silvia Romero, & Belen Fernandez-Feijoo, *Green, blue or black, but washing—What company characteristics determine greenwashing?*, 24 ENVIRONMENT, DEVELOPMENT & SUSTAINABILITY 4042, 4042 (2022) (offering empirical research and concluding that “environmentally sensitive industries greenwash less than their counterparts in other industries, as well as companies following the GRI guidelines. Companies that issue a sustainability report and assure it greenwash less than those that do not.”); John Lewis, *Corporate Social Responsibility/Sustainability Reporting among the Fortune Global 250: Greenwashing or Green Supply Chain?* 1 ENTREPRENEURSHIP, BUS. & ECON. 347 (finding greenwashing among the majority of a sample of the Fortune Global 250 (FG250) primarily due to lacking detail and quantification in reporting). See also Commission Regulation 2020/852, 2020 O.J. (L 198) 11.

12. See Ruiz-Blanco et. al, *supra* note 11, at 4025 (defining greenwashing as “as the difference between what is reported, based on the firms’ discourse, and the company’s commitment to sustainability, determined by an externally established sustainability performance ratio.”). See also Betsy Atkins, *ESG: Environmental, Social, Greenwashing?* FORBES (Jan. 17, 2022), <https://www.forbes.com/sites/betsyatkins/2022/01/17/essg-environmental-social-greenwashing/?sh=6bca2d684e31> [https://perma.cc/C57M-MWEM] (defining greenwashing in more popular parlance as “the practice of using marketing and PR tactics to overamplify your ESG efforts for the purpose of gaining greater favor from consumers, investors, employees, etc.”).

have for reporting companies, investors, shareholders, and broader stakeholders alike.<sup>13</sup>

Therefore, we encourage those working in the field to not only embrace the necessity of mandatory ESG disclosure regulation, but we urge a turn of attention to the details and consequences of implementing the Commission's proposed mandatory reporting. The imperative of mandatory ESG disclosure is not simply to require that corporations report on ESG – as most already do voluntarily and out of self-interest.<sup>14</sup> It is rather, that the essential concerns of ESG reporting uniformity and accountability (with its component parts of materiality and liability) included in the SEC's Proposing Release must be carried through and refined.

Thus, if the Commission's Proposing Release ushers in a regime of as yet imperfect mandatory reporting in the United States (as we believe it will), it most importantly offers a means of bringing uniformity and accountability that is necessary not only to protect investors, but also to counter-balance the negative effects of instrumental volitional CSR and ESG reporting.<sup>15</sup> We note, however, that this means of accountability is itself imperfect in that it brings with it chronic materiality definition issues in need of further refinement, but we must support it nonetheless as a first incremental step toward broader ESG reporting uniformity and accountability so needed in the confusing storm of corporate ESG claims.

To address these and related concerns, this article proceeds as follows. Part II defines and situates ESG reporting, with particular reference to CSR nomenclature as a precursor. We analyze what the shift from CSR to ESG means for the broader corporate purpose debate and the positive effect of mandatory ESG reporting in mitigating negative effects of instrumental CSR. Part III situates the Proposing Release in the ESG reporting milieu, traces its international origins, presents its limitations, and responds to three major criticisms of the Release.<sup>16</sup> Part IV supports the Proposing Release as a much needed means of bringing accountability to ESG reporting through securities anti-fraud actions, yet points out the problems around materiality and liability that this means of accountability brings with it. Part V concludes with slightly qualified support for the Proposing Release and

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13. See SEC Release No. 33-11042, *supra* note 4, at 29.

14. See *infra* Part II.d.

15. See *generally* SEC Release No. 33-11042, *supra* note 4.

16. Note that this article is not addressing Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, SEC Release No. IA-6034; IC-34594 (to be codified at 17 CFR §§ 200, 230, 232, 239, 249, 274, and 279) (2022) (which proposes regulation of ESG disclosures by investment advisors).

recommendations for future research.

## II. FROM CSR TO ESG

### a. *Defining ESG*

Over the past few years, ESG has developed into a buzz word covering a variety of topics spanning from climate change, human rights, cybersecurity, to corporate tax policy.<sup>17</sup> However, despite its recent popularity in political and business circles,<sup>18</sup> ESG, substantively, is nothing new.<sup>19</sup> Many of the issues now raised under the term ESG have been part of the corporate sustainability and CSR debate for a long time.<sup>20</sup> They include the perceived “fuzziness” of the term,<sup>21</sup> the corporate purpose debate,<sup>22</sup> as well as the controversy about voluntary versus mandatory CSR and related disclosure.<sup>23</sup> ESG’s basic premise is that primarily data-driven metrics help investors make better decisions about ESG risks and the value of a particular company.<sup>24</sup> CSR, in contrast, is, though definitions vary, described as the “general principle that companies should be mindful of the public good and not simply be motivated by profit maximization.”<sup>25</sup> As such, ESG is “a subcategory of CSR,”<sup>26</sup> or to be more precise, Corporate Social Performance

17. See Rose, *supra* note 10, at 1822 (describing ESG as “a shorthand for a dizzyingly broad array of “environmental,” “social,” and “governance” topics affecting businesses”).

18. See Witold Henisz, Tim Koller, and Robin Nuttall, *Five Ways that ESG Creates Value*, MCKINSEY QUARTERLY, <https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx> [https://perma.cc/2PP9-S9MC], 1 (Nov. 2019) (referencing the “meteoric rise” of ESG investing). See also Fink, *supra* note 10 (claiming “[t]he next 1,000 unicorns won’t be search engines or social media companies, they’ll be sustainable, scalable innovators – startups that help the world decarbonize and make the energy transition affordable for all consumers”).

19. See Thomas Lee Hazen, *Social Issues in the Spotlight: The Increasing Need to Improve Publicly-Held Companies’ CSR and ESG Disclosures*, 23 U. PA. J. BUS. L. 740, 745 (2021) [hereinafter *Social Issues*] (characterizing ESG as a “subcategory of CSR”).

20. Interestingly, what started off as sustainability became, in an attempt to broaden its reach, CSR. Now ESG seems to narrow down the focus again. In the following, we do not differentiate between sustainability and CSR, but use CSR as it encompasses the narrower term sustainability.

21. See Rose, *supra* note 10, at 1827.

22. See *infra* Part II.b.

23. See *supra* note 8 and accompanying text.

24. See Hazen, *supra* note 19, at 745 (categorizing ESG “as a subcategory of CSR [that] uses a metric-driven format to measure a company’s commitment to social responsibilities”).

25. Hazen, *supra* note 19, at 745.

26. Hazen, *supra* note 19, at 745.

(CSP)—a notion that developed in the 1980’s and early 1990’s management literature and places greater emphasis on outcomes and performance than the earlier mostly definitional CSR research.<sup>27</sup> What is new about ESG is its narrower focus on measurable outcomes addressed to investors rather than a wider range of stakeholders.<sup>28</sup> While CSP models concentrated on identifying corporate principles, processes, and policies that increase CSP,<sup>29</sup> ESG disclosure, more narrowly, was born out of investors’ craving for easily accessible, comparable, data-driven information on corporate sustainability or CSR efforts that affect a company’s bottom line.<sup>30</sup> With that comes a need to align ESG reporting with public financial reporting and objectively defined materiality standards that we will discuss in Part IV of this article.<sup>31</sup>

Measuring the impact of CSR has been at the heart of the CSR debate for decades.<sup>32</sup> Presented with a milieu similar to the present-day confusion in ESG measures and reporting, strategy guru Michael Porter and his co-author Kramer addressed the fragmented approaches to CSR back in 2006.<sup>33</sup> They noted how difficult it was then to measure the impact of even the most acclaimed superstar CSR-practicing companies.<sup>34</sup> Ever since, impact

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27. See Archie B. Carroll, *Corporate Social Responsibility, Evolution of a Definitional Construct*, 38 BUS. & SOC’Y 268, 285–89 (1999) (defining CSP as “a more comprehensive theory under which CSR might be classified or subsumed.”).

28. See Hazen, *Social Issues*, *supra* note 19, at 745. (categorizing ESG “as a subcategory of CSR [that] uses a metric-driven format to measure a company’s commitment to social responsibilities”).

29. See generally Archie B. Carroll, *supra* note 27 at 694–99 (discussing CSP models and principles).

30. See Antea Group, *Environmental, Social, and Governance (ESG), What You Need to Know and Why It Matters*, [https://f.hubspotusercontent40.net/hubfs/5091640/Environmental%20Social%20and%20Governance%20\(ESG\)%20eBook%20Antea%20Group.pdf](https://f.hubspotusercontent40.net/hubfs/5091640/Environmental%20Social%20and%20Governance%20(ESG)%20eBook%20Antea%20Group.pdf) [https://perma.cc/6TBN-Q4YJ] (last visited Aug. 6, 2022) (stating “[c]orporate culture has never been more transparent[.]”).

31. See Virginia Harper Ho, *Modernizing ESG Disclosure*, 2022 U. ILL. L. REV., 277, 289 [hereinafter *Modernizing*] (comparing materiality definitions in various ESG reporting frameworks); *infra*, Part IV.b.

32. See Gerlinde Berger-Walliser, Paul Shrivastava, & Adam Sulkowski, *Using Proactive Legal Strategies for Corporate Environmental Sustainability*, 6 MICH. J. ENV’T. & ADMIN. L. 1, 6 (2016) (tracing the development of corporate sustainability).

33. See Michael E. Porter & Mark R. Kramer, *Strategy & Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, 84 HARV. BUS. REV. 78, 81–83 (2006) (analyzing and critiquing the four prevailing approaches to CSR).

34. See *id.* at 83 (claiming that the lack of measurable impact puts “CSR programs on shaky ground”).

measuring has influenced corporate sustainability and CSR strategies.<sup>35</sup> Hence, one would assume that ESG's increased focus on and progress in achieving measurable outcomes advances CSR goals.<sup>36</sup> On the other hand, one could argue that ESG shifts the focus on investors while losing sight of other stakeholder interests.<sup>37</sup> Some scholars, on the contrary, are arguing that ESG reporting, climate-related information reporting, or sustainability reporting<sup>38</sup> will actually serve to harm progress toward mitigating climate damage because it is not shareholder oriented enough, which raises the question of shareholder versus stakeholder governance and the purpose of the corporation addressed in the following section.<sup>39</sup>

*b. A Note on Corporate Purpose*

The concerns of CSR and ESG involve fundamental questions of how and for what purpose a corporation should be managed. Thus, our discussion of the development of CSR and ESG necessarily involves some address of the legal conception of corporate purpose. These legal or structural parameters of corporate purpose establish a baseline constraint on the demands of CSR and ESG strategy and the related discussion about the effectiveness of ESG reporting. Corporate purpose has long been in debate

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35. Evidenced by the proliferation of environmental or CSR performance indexes. *See, e.g.,* Valerio Baselli, *Mapping ESG Practices and Carbon Risk in 48 Countries' Stock Markets*, MORNINGSTAR (Apr. 12, 2022), <https://www.morningstar.com/articles/1095901/mapping-esg-practices-and-carbon-risk-in-48-countries-stock-markets> [https://perma.cc/D9BL-JGZE].

36. *But see generally* Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1926 (2020) (conducting a case study of ESG investment practices and describing “the consequences of opaque ESG”).

37. *See* Ann M. Lipton, *Not Everything is for Investors: The Case of Mandatory Stakeholder Disclosure*, 34 YALE J. ON REG. 499, 519 (2020).

38. *See* Rose, *supra* note 10, at 1825 (noting the nomenclature problem with ESG reporting).

39. *See* Lucian A. Bebchuck & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 108–24 (2020) (arguing that “stakeholderism” whether motivated by normative or instrumental concerns is leading us to additional costs and not actually serving stakeholder interests, that management and directors really are driven by shareholder value interests). *See also* Matteo Gatti & Chrystin Ondersma, *Can a Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera*, 46 J. CORP. L. 1 (2020) (focusing more on inequality resulting from shareholder primacy and claiming that stakeholderism will not correct it, that regulation is the way to go); Rose, *supra* note 10, at 1840 (urging a refocusing of attention on, *inter alia*, conceptual problems of interjurisdictional conflict and the role of management as a threshold matter preceding the SEC regulating mandatory ESG reporting).



in the United States. Current arguments about shareholder primacy versus stakeholder management or CSR or now ESG generally reference the origin of the ongoing discussion in the Dodd-Berle interchange about corporate purpose.<sup>40</sup> It is not the project of this article to repeat the history of that debate, which others have expertly done elsewhere.<sup>41</sup> For the instant discussion, know that corporate purpose may be shaped by a number of legal sources, chiefly state law sources, as corporations (and other legal fictions facilitating business) are creatures of state law. First, corporate purpose is shaped by states' corporation statutes via which some corporations choose to state specific purposes in the articles of incorporation filed to form their corporate entity.<sup>42</sup> Second, by state constituency statutes expressly permitting or requiring management to consider other stakeholder interests in management decision-making and therefor offering related legal protection for decision-makers.<sup>43</sup> Third, by state B corporation statutes

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40. See E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932); A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931); ADOLF A. BERLE, JR., *THE 20TH CENTURY CAPITALIST REVOLUTION* 169 (1954) (asserting that corporations have a social service component rather than serving shareholders alone).

41. See Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2612 (2021) (discussing the CSR to ESG transformation as part of the general phenomenon shifting from normative to instrumental corporate governance bringing corporate governance in a as function of shareholder primacy); Thomas Lee Hazen, *Corporate and Securities Law Impact on Social Responsibility and Corporate Purpose*, 62 B.C. L. REV. 851, 862 (2021) [hereinafter *Corporate Purpose*]. See generally C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century*, 51 U. KAN. L. REV. 77, 84–87 (2002); Katharine V. Jackson, *Toward a Stakeholder-Shareholder Theory of Corporate Governance: A Comparative Analysis*, 7 HASTINGS BUS. L. J. 309, 313–14 (2011); Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 713–14 (2002).

42. See e.g., Del. Code Ann. tit. 8, § 102(a)(3) (1953) (“The nature of the business or purposes to be conducted or promoted. It shall be sufficient to state, either alone or with other businesses or purposes, that the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware, and by such statement all lawful acts and activities shall be within the purposes of the corporation, except for express limitations, if any”).

43. See e.g., CONN. GEN. STAT. § 33-756(g) (2020) (“[A] director of a corporation that has a class of voting stock registered pursuant to Section 12 of the Securities Exchange Act of 1934, as the same has been or hereafter may be amended from time to time, in addition to complying with the provisions of subsections (a) to (c), inclusive, of this section, may consider, in determining what the director reasonably believes to be in the best interests of the corporation, (1) the long-term as well as the short-term interests of the corporation, (2) the interests of the shareholders, long-term as well as short-term, including the possibility that

created to embody consideration of other stakeholder interests explicitly in the very purpose of the corporation's formation.<sup>44</sup> Fourth, by state court case law typically interpreting state statutes.<sup>45</sup> Fifth, by securities law and the notion of fiduciary duty which is integral to the discussion of

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those interests may be best served by the continued independence of the corporation, (3) the interests of the corporation's employees, customers, creditors and suppliers, and (4) community and societal considerations, including those of any community in which any office or other facility of the corporation is located. A director may also consider, in the discretion of such director, any other factors the director reasonably considers appropriate in determining what the director reasonably believes to be in the best interests of the corporation.”) (emphasis added). This is an example of a permissible, not mandatory, version of a constituency statute.

44. See e.g., CONN. GEN. STAT. § 33-1358 (2020)

Standards of conduct for director:

(a) In discharging the duties of their respective positions and considering the best interests of the benefit corporation, the board of directors, any committee of the board and the individual directors of the benefit corporation:

(1) Shall consider the effects of any corporate action or inaction upon:

(A) The shareholders of the benefit corporation;

(B) The employees and workforce of the benefit corporation, its subsidiaries and its suppliers;

(C) The interests of the customers of the benefit corporation as beneficiaries of the general public benefit purpose and any specific public benefit purpose of the benefit corporation;

(D) Community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries or its suppliers are located;

(E) The local and global environment;

(F) The short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from such corporation's long-term plans and the possibility that such interests may be best served by the continued independence of the benefit corporation; and

(G) The ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose;

(2) . . .

(3) Need not give priority to the interests of a particular person or group referred to in subdivision (1) or (2) . . .

(b) The consideration of interests and factors in the manner required by subsection (a) of this section

(1) shall not constitute a violation of section 33-756, . . .

45. See, e.g., Hazen, *Corporate Purpose*, *supra* note 41 at 867 (discussing *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010)).

accountability.<sup>46</sup>

Legal address of corporate purpose can determine not only what a corporation's managers *must* do, but what they *may* do. For instance, if state statutory law requires corporations to act in the best interest of their shareholders and either the statute or state courts' interpretation of those statutes define best interest as maximizing shareholder value, then managers *must* maximize shareholder value or be exposed to liability for not doing so. If state statutes allow corporate purpose to be elected and named as meeting certain stakeholder interests other than shareholders, then managers *may* elect and name and so manage a corporation to address interests of stakeholders other than just shareholders. . . . and so on. Though scholars today dispute a legally enforceable duty on the part of corporate managers to put shareholder interests first, it is important to recognize that "there exists a *cultural norm* within the United States--and to a certain degree also in the UK market economy--that the responsibility of business is to increase the profits of shareholders, and that the interests of any other stakeholder groups must be subordinate to this goal."<sup>47</sup>

The current debate about ESG reporting can only be fully understood against the background of this corporate purpose debate, which has shaped our understanding of CSR for decades. We must be mindful of these legal and structural constraints in framing the demands of CSR and designing ESG reporting requirements. It is to the CSR precursor of ESG that we turn in the following section to support our argument that neither shareholder, nor stakeholder concerns conflict with the demands of mandatory ESG reporting, even on the narrower climate-related framework of the Commission's Proposing Release.

*c. The Strategic CSR Precursor*

How deeply entrenched shareholder primacy is in the understanding of CSR can be traced back to the 1980s when a cohort of highly influential strategy scholars began to link CSR and profitability.<sup>48</sup> Not only did profitability become part of the CSR definition,<sup>49</sup> some went as far as to claim that "business ought to "convert" its social responsibilities into

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46. See *infra* Part IV.

47. Berger-Walliser & Scott, *supra* note 2, at 176 (emphasis added).

48. See generally Carroll, *supra* note 27 (tracing the historical development of CSR).

49. See Archie B. Carroll, *Corporate Social Responsibility: Will Industry Respond to Cutbacks in Social Program Funding?*, Speech Delivered at Kent State University (Feb. 28, 1983), in VITAL SPEECHES OF THE DAY 604 ("CSR involves the conduct of a business so that it is economically profitable, law abiding, ethical and socially supportive").

business opportunities.”<sup>50</sup> While this view does not ignore the positive effects of CSR on society, it does reflect a shareholder primacy lens rather than a stakeholder approach that supports CSR expenditures on their own.<sup>51</sup>

In the early 2000’s, an even more instrumental approach to CSR emerged. Michael Porter has been a leading proponent of what is now commonly known as strategic CSR, i.e. the instrumental use of CSR by firms to create economic value.<sup>52</sup> Porter and his co-author Kramer’s claim was that the inter-relationship and interdependence of business and society are so foundational as to make the logic of companies embracing CSR a win-win.<sup>53</sup> We can read Porter and Kramer’s take on CSR as promoting the instrumental project of companies very intentionally and knowingly aligning their social responsibility initiatives with the competitive success and profit-making interests of their businesses at various points along the value chain.<sup>54</sup> While stakeholder-oriented definitions of CSR focus on the moral or ethical duty that business owes to society,<sup>55</sup> Porter and Kramer unabashedly tell us that “[n]ot every company can build its entire value proposition around social issues . . . but adding a social dimension to the value proposition can offer a new frontier to competitive positioning.”<sup>56</sup> So on our reading of Porter and

50. Carroll, *supra* note 27 (“But the proper ‘social responsibility’ of business is to tame the dragon, that is to turn a social problem into economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth,” citing Peter F. Drucker, *The New Meaning of Corporate Social Responsibility*, 26 CAL. MGMT. REV. 53, 62 (1984)).

51. See Berger-Walliser & Scott, *supra* note 2, at 182 (discussing the literature that makes the “business case for CSR” and comparing it to “stakeholder oriented approaches and the European doctrine of enlightened shareholder value”).

52. See Berger-Walliser & Scott, *supra* note 2, at 182.

53. See Porter & Kramer, *supra* note 33, at 84 (claiming [t]he mutual dependence of corporations and society implies that both business decisions and social policies must follow the principle of *shared value*”).

54. See *id.* at 88 (“Many opportunities to pioneer innovation to benefit both society and companies’ own competitiveness can arise in the product offering and the value chain.”). See also Lund & Pollman, *supra* note 41, at 2569 (discussing the CSR to ESG transformation as part of the general phenomenon shifting from normative to instrumental corporate governance brining corporate governance in a as function of shareholder primacy).

55. Berger-Walliser & Scott, *supra* note 2, at 173 (citing Jonathan P. Doh & Terrence R. Guay, *Corporate Social Responsibility, Public Policy, and NGO Activism in Europe and the United States: An Institutional-Stakeholder Perspective*, 43 J. MGMT. STUD. 47, 54 (2006) (“CSR is the notion that companies are responsible not just to the shareholders, but also to other stakeholders (workers, suppliers, environmentalists, communities, etc.)”) and N. Leila Trapp, *Stakeholder Involvement in CSR Strategy-Making? Clues from Sixteen Danish Companies*, 40 PUB. REL. REV. 42, 43 (2013) (“CSR essentially involves navigating and addressing stakeholder concerns.”)).

56. Porter & Kramer, *supra* note 33, at 90.

Kramer, strategic CS can legitimately be a full-on instrumental undertaking in the interest of achieving competitive advantage over rivals.<sup>57</sup> To muddy the nomenclature further, in their treatment of CSR, Porter and Kramer seem to leave stakeholder terminology by the wayside.<sup>58</sup> They demote if not discard stakeholder terminology and related considerations while harkening back to shareholder primacy concerns in their claim that “[t]he most important thing a corporation can do is contribute to a prosperous economy.”<sup>59</sup> As taught by Porter and Kramer or other proponents of strategic CSR,<sup>60</sup> CSR, or now ESG, can really be understood to be all about corporate performance and competitive advantage. Under this paradigm, ESG reporting becomes nothing but a risk management and communication tool to maximize corporate profits. Stakeholder interests (or ESG concerns) are simply a means to that end.

This is not to diminish Porter and Kramer’s development of the shared value concept and approach.<sup>61</sup> “Shared value can be defined as the policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the

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57. See generally Thomas M. Madden, *Law and Strategy and Ethics?*, 32 GEO. J. L. ETHICS 181 (2019) (discussing law together with ethical implications as bound resources in the strategic project of achieving competitive advantage over rivals). See also Stephen Kim Park, *Legal Strategy Disrupted: Managing Climate Change and Regulatory Transformation*, 58 AM. BUS. L.J. 710, 740 (2021) (calling for resiliency as a strategic resource business must acquire to respond to the current disruption of the changing climate-related disclosure regulation).

58. See Porter & Kramer, *supra* note 33, at 91 (stating that “[t] current preoccupation with measuring stakeholder satisfaction has it backwards. What needs to be measured is social impact.”).

59. See Porter & Kramer, *supra* note 33, at 91.

60. See Rose Schreiber, *Corporate Social Responsibility Is an Essential Strategy in Today’s Marketplace*, in CORP. SOC. RESPONSIBILITY 22, 24 (Margaret Haerens & Lynn M. Zott eds., 2014) (“[T]he entire premise on which CSR stands has been overtaken by the argument on whether or not it can be linked to financial value and a return on investment”). See generally Archie B. Carroll & Kareem M. Shabana, *The Business Case for Corporate Social Responsibility: A Review of Concepts, Research and Practice*, 12 INT’L J. MGMT. REV. 85 (2010); Dimosthenis T. Mousiolis & Apostolos D. Zaridis, *The Effects in the Structure of an Organization Through the Implementation of Policies from Corporate Social Responsibility (CSR)*, 148 PROCEDIA SOC.&BEHAV. SCI. 634, 634 (2014) (summarizing evidence from a variety of studies indicating financial benefits related to CSR); Brittany T. Cragg, Comment, *Home Is Where the Halt Is: Mandating Corporate Social Responsibility Through Home State Regulation and Social Disclosure*, 24 EMORY INT’L L. REV. 735, 740–44 (2010) (providing a variety of economic arguments for adopting CSR).

61. See generally Michael E. Porter & Mark R. Kramer, *The Big Idea: Creating Shared Value*, HARV. BUS. REV. ONLINE (Jan/Feb 2011) (reprint).

communities in which it operates.”<sup>62</sup> So a counterpoint to our reading of Porter & Kramer’s instrumentality, may be their broader, later emphasis on business taking on social problem solving. However, this again, can be viewed without normative judgement as instrumental. Perhaps more to the point is that Porter and Kramer go further in their discussion of business’ involvement in social problem solving to recognize that government regulation is an important means motivating and enhancing shared value.<sup>63</sup> This recognition of government regulation’s role in helping business solve social problems offers connection to the support for mandatory ESG reporting. In a mandatory reporting framework such as that described in the Proposing Release, the normative - instrumental tension in business’ approach to ESG reporting should be diminished. With regulated standard measures subject to SEC means of accountability, we should find less room for spin and manipulation of reported facts and more cooperation toward joint business-government problem solving.<sup>64</sup>

Sixteen years after the advent of strategic or instrumental CSR, we are now quite thoroughly immersed in a world of instrumental ESG. Strategic use of CSR or the present day ESG is the not-so-new normal. Bebchuk and Tallarita have gone so far as to claim that both normative and instrumental “stakeholderism” is “illusory,” and is taking us down the wrong path, and that owning up to the reality of shareholder primacy is necessary and inescapable.<sup>65</sup> To contend that strategic CSR is a novelty still in debate, or a concept somehow divorced from or antithetical to management on the shareholder primacy model, is to delude ourselves.<sup>66</sup> Even policy-makers in

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62. *Id.* at 6.

63. *Id.* at 14.

64. *See generally* Stephen Kim Park & Gerlinde Berger-Walliser, *A Firm-Driven Approach to Global Governance and Sustainability*, 52 AM. BUS. L.J. 255 (2015) (advocating for corporate-government cooperation through a model of corporate regulatory feedback loops to enhance corporate sustainability).

65. *See* Bebchuk & Tallarita, *supra* note 39, at 155 (claiming that “no . . . link exists between CEO interests and stakeholder interests”).

66. *See* Lund & Pollman, *supra* note 41, at 2612–18 (2021) (tracing the folding of CSR through ESG into “shareholderism” from the Dodd-Berle debate through B corporations to the present and presenting these developments as incorporated into a regulatory system that accommodates management driven by shareholder primacy). *See also* Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose*, 99 TEX. L. REV. 1309, 1332–45 (2021) (challenging the conception that law requires shareholder primacy and constructing an instrumentalist version of managing for alternative corporate purpose through structural and governance mechanisms and not law); Hazen, *Corporate Purpose*, *supra* note 41, at 871–85 (discussing state constituency statutes, the ultra vires doctrine and benefit corporations in the range of legal options addressing corporate purpose and management for social responsibility beyond shareholder interests).

regions like the European Union or Asia that historically are known for their stakeholder approach, have endorsed what the European regulator has called “enlightened shareholder value.”<sup>67</sup> Revealing for the present discussion is the fact that with the endorsement of instrumental CSR, which is at least partially divorced from the moral obligation business owes to society, has come an increase in CSR regulation including but not limited to mandatory ESG reporting in these regions. With its mandatory ESG reporting proposal, the SEC is following this global trend of “CSR legalization.”<sup>68</sup>

If management scholars’ conceptions of CSR and legal theories of shareholder primacy laid the foundation, the ensuing practice of strategic CSR went on to pave the way for the current day ESG milieu.<sup>69</sup> Hence, it comes as no surprise that shareholder primacy, as we will further discuss in Part III. b., both sets the stage for and permeates the SEC’s Proposing Release. We might also note that the de facto emphasis on shareholder primacy we trace from strategic CSR to volitional ESG reporting practices and see in the Commission’s Proposing Release is real despite the seemingly opposite claim made in the recent and much-publicized stakeholder management endorsement from the Business Roundtable.<sup>70</sup>

Certainly, logically, intuitively, and anecdotally, in today’s market, just about any management team seeking to enhance shareholder value is talking some ESG.<sup>71</sup> It is, however, more than doubtful that all the talk is accurate,

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67. EUROPEAN COMM’N, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: A Renewed EU Strategy 2011-14 for Corporate Social Responsibility* (Oct. 25, 2011), <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52011DC0681> [<https://perma.cc/J9AP-SVM7>]. See also Berger-Walliser & Scott, *supra* note 2 at 181 (stating the “European doctrine of “enlightened shareholder value” (citation omitted) imports Anglo-American concepts of shareholder primacy into formerly stakeholder-oriented EU member states (citation omitted)”).

68. By “legalizing CSR” we do not mean legalizing an activity that used to be illegal, but the regulatory hardening of formerly voluntary CSR measures. See generally Berger-Walliser & Scott, *supra* note 2 (tracing the trend of regulatory hardening of CSR in various countries and regions and discussing the impact of these new realities on current concepts of CSR and the role of the firm in society).

69. See generally Lund & Pollman, *supra* note 41, at 2603. We should note that, notwithstanding the instrumental call for, and resultant practice of, strategic CSR or strategic ESG, the alternative normative motivation for either remains openly available. Doing good for competitive advantage in no way precludes doing good for goodness’ sake.

70. *Business Roundtable Redefines the Purpose of a Corporation to Promote ‘An Economy That Serves All Americans’*, BUS. ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans> [<https://perma.cc/3B7C-ZGVJ>].

71. See Atkins, *supra* note 12.

wholly truthful, and issued in a consistent, comparable, and verifiable format. This is further evidence that the volitional versus mandatory CSR or ESG reporting debate must yield to mandatory ESG reporting. Without it, such practices may be not only diminished, but subsumed by instrumentalized volitional reporting.

Real questions about what defines CSR lie in the concept's own origins as a volitional, normative undertaking. Many definitions of CSR imply that it is comprised of "actions companies take beyond what is required by law."<sup>72</sup> Yet, in light of the increased regulatory hardening of CSR, a proposed revised definition of CSR would apply independent from whether socially responsible undertakings are done voluntarily or in compliance with regulation.<sup>73</sup> On this proposal, the core of CSR lies in the considerations addressed in making businesses decisions.<sup>74</sup> Accordingly, CSR exists where in the business decision-making process, decision-makers consider the effect of the externalities of their decisions on external stakeholders.<sup>75</sup> What matters is the consideration of the business decision's impact on the external stakeholders itself, not why or how that impact is considered. On this notion, CSR can hold whether the motivation for that consideration is normative or instrumental or simply in compliance with regulation.<sup>76</sup> So too, mandatory ESG reporting can hold open the door to normative CSR.

Consistent with the proposed definition of CSR, this article makes the pragmatic claim that today, we need not dwell on the motivation for ESG reporting and we must move past the clinging to volitional ESG reporting.

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72. Berger-Walliser & Scott, *supra* note 2, at 187 (citing Virginia Harper Ho, *Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility and the Law in China*, 46 VAND. J. TRANSNAT'L L. 375, 383 (2013) (describing voluntary compliance as the way CSR "is typically understood" and discussing the volitional nature of CSR generally).

73. Berger-Walliser & Scott, *supra* note 2, at 217 (proposing a new definition of CSR that "explicitly remove[s] . . . any reference to whether actions are voluntary or involuntary"). See also Berger-Walliser & Scott, *supra* note 2, at 202–06 (analyzing the international trend towards increasing government-mandated CSR policies and regulations).

74. Berger-Walliser & Scott, *supra* note 2, at 214–15 (defining CSR "as undertaken by a corporation or directed by a state, includes activities that internalize costs for externalities resulting directly or indirectly from corporate actions, or processes and actions to consider and address the impact of corporate actions on affected stakeholders, which are undertaken at least in part because of a recognized moral or ethical duty to society and stakeholders beyond the corporation's owner/shareholders").

75. Berger-Walliser & Scott, *supra* note 2, at 216 (differentiating CSR from charity).

76. See Berger-Walliser & Scott, *supra* note 2, at 215 ("Corporations should not be discouraged from seeking 'win-win' actions that increase profits and serve social ends. But CSR activities should not be defined by reference to their ability to increase value to the corporation").



Mandatory reporting has become a necessity. As with strategic CSR, we can undoubtedly assume that at least a good portion of companies talking ESG are doing so for its instrumental effect. We must recognize the pressure toward greenwashing that exists in our instrumentalist market culture and turn our concern toward the pending reality of mandatory U.S., and already existing mandatory international, ESG reporting. The issue today centers on the transformation of the widespread though disparate existing practices of volitional ESG reporting into SEC regulated, mandatory ESG reporting and how that mandatory reporting should be shaped. We must support the benefit of uniformity and accountability that a mandatory reporting regime based on an international model and overseen by the SEC can achieve. The volitional ESG reporting regime is fraught with instrumentalist propensity and a mandatory framework can bring uniformity and accountability to that confusing mix

*d. The Rise and Support of ESG Reporting*

It may well be that increasing concern with ESG in the investment world is a natural consequence of (i) teaching CSR and its strategic version in business schools over the past few decades, as well as (ii) a general and seemingly inescapable growing public awareness and experience of climate change in the now commonplace witness of, for example, more frequent and extreme storms, extreme temperatures, and forest fires.<sup>77</sup> ESG claims are routinely, strategically deployed in the most extreme cases by greenwashing, but otherwise as well-established, strategic means of seeking to achieve competitive advantage over rivals.<sup>78</sup> This really is not surprising, given the strategic CSR heritage, and knowing that broad support for addressing ESG is well established both among corporate management (91% in favor) and among consumers (86%).<sup>79</sup>

Some attribute the push for and popularization of ESG reporting to leading institutional investors with political or issue-based agendas, such as Larry Fink of BlackRock.<sup>80</sup> Who can dispute that Fink and others in positions

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77. See generally Trautman & Newman, *supra* note 3.

78. See generally Atkins, *supra* note 12.

79. *Beyond Compliance: Consumers and Employees Want Business to Do More on ESG*, PwC, <https://www.pwc.com/us/en/services/consulting/library/consumer-intelligence-series/consumer-and-employee-esg-expectations.html> [<https://perma.cc/PWQ6-BCDM>] (last visited Aug. 26, 2022).

80. Larry Fink, *A Fundamental Reshaping of Finance, 2020 Letter to CEOs*, (last visited

similar to his wield tremendous market influence? Much has rightfully been made of such fund managers' arguably distorted power in voting shares that are ultimately beneficially owned by disparate fund investors.<sup>81</sup> Others have looked askance at the international organizations which have been advancing climate-related awareness and working on the standardization of ESG reporting for a number of years.<sup>82</sup>

Even if the claimed disproportional influence of these constituents were true, it does not mean that individual investors do not support mandatory ESG reporting, would not benefit from it, and/or would not be better protected as investors in knowing the information such reporting would make available and possibly accountable to them. A March 2022 Financial Industry Regulatory Authority (FINRA) survey of retail investors found that 57% to 77% of such investors favored making investment decisions or investing in funds that seek to change the world for the better.<sup>83</sup> Over one third of these investors were unaware of whether their present investments were in ESG stocks.<sup>84</sup> While most retail investors (approximately 75%) expressed a lack of familiarity with ESG, younger and non-white investors

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Aug. 26, 2022), <https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter> [<https://perma.cc/C5LC-YF47>]. Fink is a founder of BlackRock, the world's largest investment manager with approximately \$10 trillion in assets under management. This letter is cited in *SEC Release No. 33-11042 in note 23 at 14*. See generally Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 104 GEO. L. J. 924 (2019) (explaining components necessary to make effective sustainability disclosures).

81. Investor Democracy is Expected (INDEX) Act, S.4241, 117th Cong. (2021–2022) (requiring pass through proxy voting by investment advisors). See generally Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2021 COLUM. BUS. L. REV. 840 (2021) (explaining that the SEC needs to proceed with caution as it addresses ESG disclosure mandates because the mandates may not be aligned to the SEC's goal of protecting efficient markets).

82. See Lawrence A. Cunningham et. al., *Comment Letter on Climate-Related Disclosures for Investors*, at 3 (Apr. 22, 2022), <https://www.sec.gov/comments/s7-10-22/s71022-20126528-287180.pdf> [<https://perma.cc/7YR9-QJPT>] [hereinafter Cunningham Letter] (criticizing the United Nations among others as one of the “Most Vocal Institutions” but “lack[ing] any relevant expertise”).

83. Gary Motolda, Olivia Valdez, Robert Ganem, Angela Fontes & Mark Lush, *Investors Say They Can Change the World, If They Only Knew How: Six Things to Know About ESG and Retail Investors*, FINRA INVESTOR EDUCATION FOUNDATION, at 2 (Mar. 2022), <https://www.finrafoundation.org/sites/finrafoundation/files/Consumer-Insights-Money-and-Investing.pdf> [<https://perma.cc/M5DW-DX6M>] [hereinafter FINRA Survey]. See also Lauren Foster, *Investors Know Little About ESG, a New Study Finds*, BARRON'S (Apr. 12, 2022), <https://www.barrons.com/articles/esg-meaning-sustainable-investing-study-51649719876> [<https://perma.cc/5JBT-K6AE>].

84. FINRA Survey, *supra* note 83 at 3.

showed greater and increasing interest in it.<sup>85</sup> Investors who own ESG stocks self-reported that their investment decisions are motivated roughly evenly by environmental concerns and by profitability concerns.<sup>86</sup> If anything, this survey data indicates a growing trend of increasing awareness and concern about ESG reporting and climate-related investment decision-making and describes a rising investing audience ripe for further education on the topic.

For those not yet attuned to ESG concerns, it may be difficult to appreciate the scale of existing volitional ESG reporting.<sup>87</sup> That scale is already enormous. One recent survey found that 90% of the S&P 500 companies are reporting.<sup>88</sup> Bloomberg asserts that it “tracks climate-related reporting for over 13,000 international companies representing over 88% of global market capitalization.”<sup>89</sup> Yet, Bloomberg tellingly notes, “few companies are disclosing comparable and consistent information with the level of detail needed by financial organizations to assess climate impact fairly and accurately.”<sup>90</sup> This, again, is the nub of the problem that SEC regulation is necessary to address.

Volitional standards issued by the International Stability Standards Board (ISSB) of the International Financial Reporting Standards (IFRS) Foundation are one existing guidepost.<sup>91</sup> The Global Reporting Initiative (GRI) is another.<sup>92</sup> The Sustainability Accounting Standards Board (SASB) further adds to the list.<sup>93</sup> Large numbers of U.S. corporations are volitionally

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85. FINRA Survey, *supra* note 83 at 2.

86. FINRA Survey, *supra* note 83 at 5.

87. See generally Lucy Pérez, Dame Vivian Hunt, Hamid Samandari, Robin Nuttall, & Krysta Biniek, *Does ESG Really Matter and Why*, MCKINSEY QUARTERLY (Aug. 10, 2022), <https://www.mckinsey.com/capabilities/sustainability/our-insights/does-esg-really-matter-and-why> [<https://perma.cc/T6MH-KS2E>].

88. *Flash Reports: 90% of S&P Index Companies Publish Corporate Sustainability/Responsibility Reports in 2019*, GOV. & ACCOUNTABILITY INST. (July 16, 2020), <https://www.ga-institute.com/research/ga-research-collection/flash-reports/2020-sp-500-flash-report.html> [<https://perma.cc/83PX-FAEH>].

89. *Comment Letter on The Enhancement and Standardization of Climate-Related Disclosures for Investors*, BLOOMBERG, at 2 (Jun. 22, 2022), <https://www.sec.gov/comments/s7-10-22/s71022-20132643-303160.pdf> [<https://perma.cc/6JPU-B3EZ>].

90. *Id.*

91. See *IFRS S1 General Requirement for Disclosure of Sustainability-related Financial Information*, INT'L SUSTAINABILITY STANDARDS BD. (Mar. 2022), <https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf> [<https://perma.cc/LJZ6-28ST>].

92. GLOBAL REPORTING INITIATIVE, <https://www.globalreporting.org/standards/> [<https://perma.cc/2KG9-74S7>] (last visited Aug. 29, 2022).

93. SASB STANDARDS, <https://www.sasb.org/about/sasb-and-other-esg-frameworks/> [<https://perma.cc/XD2F-KQAQ>] (last visited Aug. 29, 2022).

reporting under these disparate guidelines.<sup>94</sup> Indeed, a recent survey found that 52% of responding companies are engaged in some version of ESG reporting.<sup>95</sup> It is noteworthy that this level of engagement is not limited to massive multinational corporations with the most extensive resources. Rather, of the corporations responding to the survey, 67% were under \$5 billion in capitalization and 32% were below \$700 million in capitalization.<sup>96</sup> Providing and assessing climate-related corporate information is now inescapable in the Western world. It is already a global norm deeply bound up with existing international frameworks of financial reporting.

The problems brought on by corporations reporting according to disparate versions of ESG guidance are recognized even among the providers of volitional ESG reporting guidelines.<sup>97</sup> So much so, that GRI and SASB have been working together to align their guidance.<sup>98</sup> These organizations, in turn, have informed the international Task Force on Climate-Related Disclosure (TCFD) that has strongly influenced the current SEC Proposing Release and that we will discuss in detail in the following part.<sup>99</sup>

### III. THE SEC’S PROPOSAL FOR MANDATORY CLIMATE-RELATED REPORTING IN RELEASE NO. 33-11042

Against the background of the previously described corporate and political climate, the SEC, on May 11, 2022, released its Proposal, “The Enhancement and Standardization of Climate-Related Disclosures for Investors.”<sup>100</sup> In this Section III, we first situate the Release in the broader ESG disclosure context. Second, we call attention to the Commission’s basis of the Proposing Release in the work of the TCFD. Third, we address the three major criticisms of the Proposing Release; (i) that is outside the Commission’s regulatory purview, (ii) that it should require principles-based

94. See SEC Release No. 33-11042, *supra* note 4, at 49.

95. Climate Change & ESG Reporting from the Public Company Perspective, CENTER FOR CAPITAL MARKETS, at 8 (2021), [https://www.centerforcapitalmarkets.com/wp-content/uploads/2021/08/CCMC\\_ESG\\_Report\\_v4.pdf](https://www.centerforcapitalmarkets.com/wp-content/uploads/2021/08/CCMC_ESG_Report_v4.pdf) [<https://perma.cc/V9PW-GUL3>] (last visited Aug. 29, 2022).

96. *Id.* at 3.

97. See generally *GRI and SASB Reporting Standards: Working Together*, SUSTAINABILITY KNOWLEDGE GROUP (May 5, 2021), <https://sustainabilityknowledgegroup.com/gri-and-sasb-reporting-standards-working-together/> [<https://perma.cc/7STV-SV8Z>] (last visited Aug. 29, 2022).

98. *Id.*

99. See SEC Release No. 33-11042, *supra* note 4 at 46 (“We have modeled the proposed disclosure rules in part on the TCFD disclosure framework.”).

100. SEC Release No. 33-11042, *supra* note 4.

disclosure only, and (iii) that the required GHG metrics disclosures are overly burdensome.

*a. The ESG Context for SEC Climate-Related Disclosure*

Generally, disclosure requirements of public corporations in the United States are the purview of the SEC.<sup>101</sup> Though in other jurisdictions corporate disclosures may be overseen by more than just financial regulatory bodies, in the United States, the SEC is the near-exclusive regulatory powerhouse.<sup>102</sup> This is not surprising, given the de-facto dominance of the shareholder primacy model in the United States discussed above.<sup>103</sup> The basic notion of securities regulation in the United States is to require public companies (that generally have broad market capitalization and liquid trading) to disclose information to the investing public so that investors can make fully informed decisions on buying and selling those securities and in exercising the voting rights associated with them, if so entitled.<sup>104</sup> This information disclosure is required both in registration statements first offering the securities for sale under the 1933 Act and in the ongoing reporting required of public companies under the 1934 Act.<sup>105</sup> Reg. S-K and Reg. S-X govern the detailed information, including financial metrics, that must be included in such disclosure.<sup>106</sup> The Proposing Release would add climate-related information and metrics to that currently required financial disclosure framework.<sup>107</sup>

With the Commission's Proposal, climate-related disclosure is now placed at the forefront of ESG reporting.<sup>108</sup> As we discussed earlier, it is no simple task to distinguish the meaning of climate-related disclosure from the meaning of the closely related terms of sustainability reporting or non-

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101. Securities Exchange Act of 1934, 15 U.S. Code § 78a et seq.

102. See Lipton, *supra* note 37, at 502 (citing Directive 2014/95/EU, of the European Parliament and of the Council of 22 October 2014 Amending Directive 2013/34/EU as Regards Disclosure of Non-financial and Diversity Information by Certain Large Undertakings and Groups 2014 O.J. (L 330) [hereinafter Directive 2014]); Harper Ho & Park, *ESG Disclosure in Comparative Perspective: Optimizing Private Ordering in Public Reporting*, 41 U. PA. J. INT'L L. 249, 295 (noting private ordering of ESG reporting in the U.S. and various other approaches in dozens of additional jurisdictions internationally).

103. See *supra* part II.b.

104. See generally JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 39–40 (3d ed. 2003).

105. *Id.*

106. See 17 CFR § 229.

107. SEC Release No. 33-11042, *supra* note 4, at 153.

108. SEC Release No. 33-11042, *supra* note 4, at 153.

financial reporting or from CSR or ESG more generally.<sup>109</sup> It is further difficult to distinguish a definite scope of each term. The scope of the Release is focused on what is perhaps best known as “climate-related” and “environmental sustainability” reporting – both concentrated on the business implications of climate change and environmental risk within the broader ESG framework. All of the above referenced terms concern at least in part the past, present, and future implications of rising global temperatures and increasingly erratic weather patterns, storms, and other effects.<sup>110</sup>

It is no accident that the SEC’s Proposing Release is titled “The Enhancement and Standardization of Climate-Related Disclosures for Investors.”<sup>111</sup> Though we understand the meaning and impact of ESG to go well beyond climate-related considerations alone, given the extent and urgency of the problem, we recognize the necessary step of instituting mandatory reporting more directly connected to the ramifications of climate-change. With the Commission’s Proposing Release, we must recognize “climate-related” matters to stand at the forefront of, though not in place of, broader considerations of ESG.

Certainly, the E for environmental on which the Release focuses is a major component of the scope of ESG as a whole. Also, though, the G for governance in ESG has much to do with management’s address of the climate-related E. The S for social in ESG is perhaps the least directly connected to climate-related disclosure, but does still connect via, for example, social responsibility projects that address employees’ commuting becoming impaired by flooding or by rising fuel costs. We understand “climate-related” as used in the Proposing Release and as referred to in this article to refer principally to measures within the E of ESG but recognize that these measures also to touch upon the S and G of ESG, albeit in a more limited scope.<sup>112</sup> We also recognize that conflating some of the previously referenced overlapping terms in this discussion is probably unavoidable.

*b. TCFD Origins & Limitations*

As SEC Release No. 33-11042 makes very clear, the Commission looked chiefly to the TCFD as the current paradigm in climate-related

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109. *See supra*, Part II.

110. *See* Park, *supra* note 57, at 723 (analyzing the sources of climate change disruption).

111. SEC Release No. 33-11042, *supra* note 4.

112. *See* Harper Ho, *supra* note 31, at 312 (pointing towards the impreciseness of the term ESG).

disclosure standards.<sup>113</sup> The TCFD was established by the Financial Stability Board (FSB) in 2009 which was created by the Group of Twenty (G20) in response to the 2008 global financial crisis.<sup>114</sup> The TCFD was an international project, that perhaps more than GRI, SASB, and any other independent ESG reporting guidance, has set a coordinated international standard for the Western developed world for climate-related issuer reporting.<sup>115</sup> The TCFD describes its mission as follows:

To help identify the information needed by investors, lenders, and insurance underwriters to appropriately assess and price climate-related risks and opportunities, the Financial Stability Board established an industry-led task force: the Task Force on Climate-related Financial Disclosures (Task Force). The Task Force was asked to develop voluntary, consistent climate-related financial disclosures that would be useful to investors, lenders, and insurance underwriters in understanding material risks. The 32-member Task Force is global; its members were selected by the Financial Stability Board and come from various organizations, including large banks, insurance companies, asset managers, pension funds, large non-financial companies, accounting and consulting firms, and credit rating agencies. In its work, the Task Force drew on member expertise, stakeholder engagement, and existing climate-related disclosure regimes to develop a singular, accessible framework for climate-related financial disclosure.<sup>116</sup>

In its 2021 update, the TCFD reiterated, “The central objective of the Task Force’s recommendations is to encourage organizations to evaluate and disclose, as part of their financial filing preparation and reporting processes, the material climate-related risks and opportunities that are most pertinent to

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113. SEC Release No. 33-11042 *supra* note 4 at 49 (“We have modeled the proposed disclosure rules in part on the TCFD disclosure framework.”).

114. See Task Force on Climate-Related Disclosure (last visited Aug. 26, 2022), <https://www.fsb.org/about/history-of-the-fsb/> [https://perma.cc/P2F2-BVX6].

115. SEC Release No. 33-11042 *supra* note 4, at 38 (“In recognition of the widespread adoption by companies of TCFD reporting, a number of countries, including the United Kingdom, New Zealand, and Switzerland, and the European Union that have proposed mandatory climate-risk disclosure requirements have indicated an intention to base disclosure requirements on the TCFD framework.”).

116. See *Task Force on Climate-Related Financial Disclosures, Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures*, at iii (June 15, 2017), <https://www.fsb-tcfid.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf> [https://perma.cc/7CTQ-PNLY] [hereinafter “TCFD Final Report”].

their business activities.”<sup>117</sup> This obviously and explicitly names a climate-related, investor-driven, financial focus not attuned to stakeholders and not attuned to broader ESG considerations. The Commission’s Proposing Release recognizes and continues these themes,

. . . the proposed rules may reduce information asymmetry both among investors, which can reduce adverse selection problems and improve stock liquidity, and between investors and firms, which can reduce investors’ uncertainty about estimated future cash flows, thus lowering the risk premium they demand and therefore registrant’s cost of capital. The proposed rules could also mitigate certain agency problems between the firm’s shareholders and management, thus strengthening investor protection.”<sup>118</sup>

Indeed, the Proposing Release points to its intended redress of the central problem of present-day unregulated, volitional ESG reporting in part as a means of investor protection;

We anticipate the proposed rules will give rise to several benefits *by strengthening investor protection*, improving market efficiency, and facilitating capital formation. The primary benefit is that investors would have access to more consistent, comparable, and reliable disclosures with respect to registrants’ climate-related risks, which is expected to enable investors to make more informed investment or voting decisions.<sup>119</sup>

Part of that investor protection may be to counter substantial underreporting resulting if all domestic ESG reporting is left volitional. Scholars have called attention to the likely problem of underreporting when that reporting is not mandatory and subject to regulatory oversight.<sup>120</sup> Failing to require reporting and to regulate it may well have the consequence of leaving our aggregate body of public corporations and the capital markets that finance them with dangerous systemic risk in the face of climate change and its effects.<sup>121</sup>

Another part of that investor protection is to bring uniformity and accountability to the myriad and disparate volitional ESG reports in the

117. See Task Force on Climate-related Financial Disclosures: Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures October TCFD Update, at 74 (Oct. 2021) [https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing\\_Guidance.pdf](https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing_Guidance.pdf) [<https://perma.cc/75C6-TVEM>] [hereinafter TCFD Update].

118. SEC Release No. 33-11042, *supra* note 4, at 304.

119. SEC Release No. 33-11042, *supra* note 4, at 304 (emphasis added).

120. See, e.g., Ho, *supra* note 31, at 293–95 (explaining the reasons for systemic underreporting).

121. *Id.*



marketplace. Clearly, the overriding motivation for the TCFD's work from which the SEC's mandatory climate-related reporting proposal is derived is to convert the morass of reporting inconsistent in format, measures, and substance, into meaningful and useful uniformly presented information for investor decision-making on purchases, sales, and votes.<sup>122</sup> This motivation is not only true with regard to the domestic scope of SEC regulation, but aligns with other jurisdictions internationally looking chiefly to the TCFD model in their regulatory approaches thereby making meeting such regulations less burdensome to international reporting corporations.<sup>123</sup>

*c. Responses to Three Major Criticisms of the Proposing Release*

*i. SEC's Regulatory Purview and Scope*

Knowing the international TCFD origins of the Commission's Proposing Release, we are mindful that the domestic embrace of such regulation, and ESG reporting more generally, has not been without contest. Indeed, critics have argued that the scope of the Proposing Release requiring climate-related reporting is beyond the purview of the SEC's regulatory scope.<sup>124</sup> Some allege the SEC is stepping into the territory of the EPA.<sup>125</sup> A group of past SEC Commissioners has argued that the Proposing Release runs counter to the SEC's directive of requiring disclosure only of material information, claiming that climate-related information is not material.<sup>126</sup> It is noteworthy that the signatories advocating this position all went on to private corporate and finance interested endeavors after leaving the Commission.

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122. SEC Release No. 33-11042, *supra* note 4, at 21.

123. SEC Release No. 33-11042, *supra* note 4, at 33.

124. See Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1201, 1238–45, 1273–98 (1999) (offering a history of SEC regulatory scope on reporting that emphasizes broad public interest and ushering an argument for SEC “social disclosure” that would include climate-related disclosure). See also Cunningham, *supra* note 82, at 14 (suggesting the SEC overstepped its mission); Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, COLUM. BUS. L. REV., 840, 873 (2021) (calling the SEC Proposal a “symbolic regulatory mandate adopted for reasons unrelated to [the] agency’s normal mission”); Letter from Richard C. Breeden, Former Chairman, SEC, et al., to Vanessa A. Countryman, Sec’y, SEC (June 17, 2022) at 4–5, <https://www.sec.gov/comments/s7-10-22/s71022-20132519-303005.pdf> [<https://perma.cc/5VVU-M9GM>] [hereinafter Past Commissioners’ Letter] (arguing that the SEC has overstepped its bounds with the Proposing Release, in part because the Release would require disclosure of “volumes of immaterial information.”).

125. See, e.g., Cunningham, *supra* note 82, at 13.

126. See Past Commissioners’ Letter, *supra* note 124.

Past Chair Breeden, the lead author of the group is now a hedge fund manager.<sup>127</sup> Past Commissioner Lochner became Chief Administrative Officer of Time Warner after leaving the Commission.<sup>128</sup> Past Chairman Pitt is now a global consultant to large businesses.<sup>129</sup> Past Commissioner Atkins is now a consultant to financial sector businesses.<sup>130</sup> Past Commissioner Roberts is now a lobbyist with the investment bank Goldman Sachs as a client.<sup>131</sup>

These and other criticisms of the Proposing Release levied by Lawrence Cunningham and other professors of law or business, must be taken seriously as they constitute the views of a cohort of informed experts in the field who may themselves be viewed as political activists of an anti-regulatory sort.<sup>132</sup> Counter to their assertions, we are not convinced that a cabal of U.N.-inspired environmental activists are responsible for championing “contentious topics” recast into SEC Release No. 33-11042.<sup>133</sup> However, we must take seriously their view that the most powerful institutional investment managers are driving the ESG regulation bus for their own competitive advantage in an investment marketplace increasingly targeting growing numbers of younger investors known to be more concerned with ESG than profitability.<sup>134</sup> We must consider whether these interests have pushed the SEC beyond its regulatory purview. In so doing, we must recognize that it is a simple fact that the very organizations first constructing ESG reporting guidelines (and the people involved in them) were and are from and of the

127. See S’HOLDER RTS. PROJECT, *Richard C. Breeden*, [http://www.srp.law.harvard.edu/breeden\\_bio.shtml](http://www.srp.law.harvard.edu/breeden_bio.shtml) [<https://perma.cc/ASZ6-7VGB>] (last visited Apr. 14, 2023).

128. See DIRECTORS & BOARDS, *Mr. Philip R. Lochner Jr.*, <https://www.directorsandboards.com/roster/individual/philip-lochner-jr> [<https://perma.cc/A5LS-5XML>] (last visited Apr. 14, 2023).

129. See KALORAMA PARTNERS, *Harvey L. Pitt*, <https://www.kaloramapartners.com/harvey-l-pitt> [<https://perma.cc/C42H-XVGZ>] (last visited Apr. 14, 2023).

130. See PATOMAK GLOB. PARTNERS, *Paul Atkins*, <https://patomak.com/paulatkins/> [<https://perma.cc/E9PT-H967>] (last visited Apr. 14, 2023).

131. See OPENSECRETS, *Lobbying Firm Profile: RR&G LLC*, <https://www.opensecrets.org/federal-lobbying/firms/summary?cycle=2018&id=D000044467> [<https://perma.cc/JCD8-DPVN>] (last visited Apr. 14, 2023); *Goldman Rolls Out the Big Guns in Lobbying Blitz*, INVESTMENTNEWS, <https://www.investmentnews.com/goldman-rolls-out-the-big-guns-in-lobbying-blitz-28700> [<https://perma.cc/D37W-8VKE>] (last visited May 10, 2023).

132. See generally Lawrence A. Cunningham, *A Prescription to Retire the Rhetoric of “Principles-Based Systems” in Corporate Law, Securities Regulation, and Accounting*, 60 V. L. REV. 1409 (2007).

133. *Contra* Cunningham, *supra* note 82, at 3.

134. See Cunningham, *supra* note 82, at 4 (citing Michal Barzuza et al., *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1244 (2020)).

world of established financial reporting and regulation.<sup>135</sup> They are not the toadies of environmental extremists. Rather, they are financial professionals and regulators who realize the direct material impact of climate change on corporate performance and investment decisions. As previously discussed, it is the shift from CSR to ESG that has brought investors' interests into a narrower ESG focus. In this respect, ESG is all the more in the purview of SEC regulation.

The greater travesty of the Cunningham-cohort critique is that at the same time that the group recognizes that more than half of SEC reporting companies privately report ESG measures (specifically noting well-established reporting by carbon-intensive sector companies like energy companies), it ignores the reality that this widespread, unregulated, unaccountable ESG reporting itself justifies the SEC's regulation of that reporting.<sup>136</sup> This fact of now commonplace volitional ESG reporting is itself further evidence that ESG information is being disclosed to meet investor interest. It is, again the very essence of SEC regulation to oversee that disclosure of information to insure fairly and fully informed market decision-making.

Some scholars have proposed that we should expand the investor-driven focus of SEC regulation to include disclosure regulation promulgated more directly in the interest of the general public and various identified stakeholders in addition to investors alone.<sup>137</sup> Some criticize precisely this shift as "illusionary promise."<sup>138</sup> We recognize that the instant Proposing Release's more limited focus on climate-related reporting primarily for the benefit of the investing public indeed does not address broader ESG stakeholder interests. While this may be unsatisfactory from a stakeholder perspective, the Release reflects what is politically feasible at a time where climate-related concerns are of immediate concern to policy makers and the general public, and climate risk is directly impacting corporations' profitability. As such, the Proposing Release's narrow focus is consistent with the persistent broader adherence to a shareholder primacy model discussed in Part II.b.<sup>139</sup> Expanding the Proposal's scope to include other

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135. See TCFD Final Report, *supra* note 116, at 3.

136. See Cunningham, *supra* note 82, at 9; CENTER FOR CAPITAL MARKETS, *supra* note 95, at 8.

137. Lipton, *supra* note 37, at 519.

138. See, e.g., Bechuk & Tallarita, *supra* note 39, at 176.

139. See Berger-Walliser & Scott, *supra* note 2, at 190 (arguing that our current understanding of CSR "implies adherence to a shareholder primacy model of corporate

stakeholders would require a general shift towards a more stakeholder-oriented conception of ESG in the United States, which at this stage remains illusory.

However, that its approach is targeted toward investors and does not expressively include broader stakeholder concerns does not negate the Proposal's benefit. Similar to the voluntary versus involuntary CSR debate mentioned above, what matters is the consideration of the business decision's impact on the external stakeholders itself, not why or how that impact is considered.<sup>140</sup> Notwithstanding the narrower scope, we can assume that the audience to digest the information made available via mandatory SEC climate-related disclosure will be quite broad. It will include shareholders, would-be investors, and the general public. The paramount regulatory concern is that the information made available to *any* audience via mandatory disclosure and considered in and relied upon in making decisions in the marketplace be accurate and that those responsible for making such disclosure be held accountable for its accuracy such that the audience is not misled via material misstatements or omissions. We more fully consider the implications of this broad-based purview and audience for ESG-disclosure in light of the accountability mechanics of materiality and liability associated with SEC disclosure, *infra*.<sup>141</sup>

In the face of criticism that the Proposing Release is an overstepping of the Commission's bounds, the narrow climate-related subset of broader ESG issues is all the more clearly within SEC regulatory purview as it is directly about climate change impact on financial performance. We must also recognize that the scope of SEC regulation has developed over time. Earlier SEC proposals for expanded disclosure have been met with broad public support.<sup>142</sup> Scholars have offered ample evidence finding broad-based support for mandatory disclosure.<sup>143</sup> The inclusion of ESG reporting within SEC regulated reporting has been deemed a necessity to reduce what otherwise will be a grand scale embedding of systemic risk in our largest

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conduct"); Jennifer O'Hare, *Don't Forget the "G" in ESG: The SEC and Corporate Governance Disclosure*, 64 ARIZ. L. REV. 217, 431–33 (2022) (analyzing the relationship between corporate governance, environmental, and social risk).

140. See *supra* Part II.c.

141. See Lipton, *supra* note 37, at 526 (pointing out that ESG reporting information is likely to appeal to a much broader audience than investors).

142. TCFD Final Report *supra* note 116, at iv.

143. See, e.g., Harper Ho, *Modernizing*, *supra* note 31, at 286–88 (describing growing demand for mandatory disclosure from investors and shareholders).

corporate structures with the largest market capitalizations.<sup>144</sup> Moreover, support for more uniform disclosure is clear from government studies at the General Accounting Office (GOA) and in a 2020 report from the Commodity Futures Trading Commission (CFTC).<sup>145</sup>

The TCFD's and Commission's shared goals of bringing uniformity of climate-related reporting to the investing public come in their recognition of the unacceptable situation of a marketplace confused, and likely misled, by commonplace, instrumental corporate ESG reporting at best based on disparate third-party guidance. That the Proposing Release's climate-related focus, like the TCFD's, is targeted to investors lays in the nature of the instrumental approach to CSR that, as previously discussed, has its origin in U.S. shareholder primacy doctrine, which is still prevalent in the United States despite the practical and definitional development of CSR and ESG.<sup>146</sup> We cannot continue to wait for the adoption of a true stakeholder approach along the European model before we adopt climate-related disclosure rules because the negative impacts of climate change are already here and too much is at stake to wait any longer. That the Proposing Release may address only a portion of the broader scope of ESG, does not justify opposing it. Nor does it preclude the possibility of more complete mandatory ESG reporting in greater recognition of varied stakeholders in the future. Other countries, especially the European Union, now have a long-lasting practice of non-financial disclosure regulation that even if not entirely satisfactory nor fully transposable to the U.S. context, can serve as an example.<sup>147</sup>

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144. See Harper Ho, *Modernizing*, *supra* note 31, at 296–99 (arguing “the systemic risk to financial markets from climate change and information gaps...provide further justification for mandating ESG disclosure”).

145. See *Id.* at 291 (citing U.S. Gov. Accountability Off., GAO-20-530, Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them, at 25 (July 2020) [hereinafter 2020 GAO Report], <https://www.gao.gov/assets/gao-20-530.pdf> [<https://perma.cc/L88V-7WF2>] and U.S. Gov. Accountability Off., GAO-18-398, Retirement Plan Investing: Clearer Information on Consideration of Environmental, Social, and Governance Factors Would Be Helpful, at 16 (May 2018), <https://www.gao.gov/assets/gao-18-398.pdf> [<https://perma.cc/XM7W-HFUB>] and Commodity Futures Trading Comm'n, *Managing Climate Risk in the U.S. Financial System* 88–99, <https://www.cftc.gov/> [<https://perma.cc/U6L6-57WL>] (last visited Aug. 26, 2022).

146. See *supra* Part II.

147. See Adam Sulkowski and Ruth Jebe, *Evolving ESG Reporting Governance, Regime Theory, and Proactive Law: Predictions and Strategies*, 59 AM. BUS. L.J. 449, 462–63 (2022) (describing the general dissatisfaction with implementation of the EU non-financial disclosure directive and the subsequent development of recommendations for future mandatory ESG reporting in the European Union).

ii. Principles *and* Line-Items

In modeling its Proposing Release on the TCFD's framework, the SEC essentially parroted the Task Force's four-part approach. "The Task Force structured its recommendations around four thematic areas that represent core elements of how organizations operate: governance, strategy, risk management, and metrics and targets."<sup>148</sup> These four categories, or themes, have been carried through in the Commission's Proposing Release.<sup>149</sup> We should conceive of these four elements as all residing within the E of ESG. They all address climate-related concerns. Though an individual covered element may relate to governance (G) more broadly understood or to more extensive aspects of social issues (S), all four parts are largely driven by, and certainly altered by, climate change; its effects, actual responses to climate-change, as well as planned responses to climate change. While the Commission's Proposing Release addresses all four elements via principles-based disclosure requirements, it also would require enhanced line-item reporting to quantify certain principles-based concepts, including disclosure of fairly robust disaggregated greenhouse gas (GHG) emissions metrics.<sup>150</sup> This two-part approach is a necessity to insure disclosed information is adequately assessed and able to be held accountable.

Under the SEC's Proposing Release, principles-based discussion of all of the four general TCFD derived parts will be required pursuant to an expanded Reg. S-K (on a model similar to the existing management's discussion and analysis of financial condition and results of operations (MD&A) requirement).<sup>151</sup> The Proposing Release would further mandate additional climate-related line-item financial disclosure under an expanded Reg. S-X.<sup>152</sup> This enhanced financial disclosure would include calculations of climate-related matters on both income statement and balance sheet impacts.<sup>153</sup> Thus, the new climate-related disclosure would be addressed first via principles-based discussion in a new section titled "Climate-Related

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148. TCFD Final Report, *supra* note 116, at iv.

149. SEC Release No. 33-11042 *supra* note 4, at 37–38.

150. SEC Release No. 33-11042 *supra* note 4, at 23.

151. See SEC Release No. 33-11042, 84 Fed. Reg. 67,782, 67,840 (Dec. 18, 2019) (to be codified at 17 C.F.R. pt. 229) (proposing amendments to disclose requirements related to ESG issues, particularly application of regulation S-K) (quoting proposed 17 C.F.R. § 229.1501-06 at 49).

152. See Release No. 33-11042, 84 Fed. Reg. 67,792, 67,841 (Dec. 18, 2019) (to be codified at 17 C.F.R. pt. 229) (proposing amendments to disclosure requirements related to ESG issues) (quoting proposed 17 C.F.R. §§ 229.14-01-14.02 at 52).

153. *Id.*

Disclosure” to be made part of both 1933 Act registration statements and 1934 Act on-going reporting filings; *and second*, in specified financial metrics added into financial statements (potentially incorporated by reference).<sup>154</sup>

Generally, scholars have offered a good deal of support for the principles-based approach to the Commission adding ESG reporting modeled on the existing MD&A reporting requirement.<sup>155</sup> There has been markedly less enthusiasm for line-item disclosure, perhaps most particularly, for financial-based Scope 3 GHG disclosures (for which Smaller Reporting Companies (SRCs)<sup>156</sup> are exempt).<sup>157</sup>

No doubt, the proposed regulations present no simplistic task. We must realize, however, that many versions of this task are already well underway. The proposed line-item financial calculations in the Proposing Release, like reporting under existing volitional guidance, involve significant margins of error.<sup>158</sup> Existing disparate, voluntary reporting of such metrics is difficult to authenticate and verify. With the Proposing Release, required line-item disclosure can eliminate much of this confusion and will lend itself to accountability by providing easier determination of materiality in disclosure.<sup>159</sup> Principles-only discussion cannot. Principles-only discussion will leave us with far too much subjectivity and ambiguity, hampering any hope of holding reporters accountable for their claims.

In recognition of the challenges of line-item disclosure, the Commission can slightly revise its proposal to make such reporting more palatable. One valid concern from critics of the Release is that the Commission’s proposed one percent financial metrics reporting threshold

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154. *Id.* at 54.

155. See Fisch, *supra* note 80, at 954 (explaining the importance of MD&A disclosure for narrative disclosure, citing John W. Bagby, Paula C. Murray & Eric T. Andrews, *How Green Was My Balance Sheet?: Corporate Liability and Environmental Disclosure*, 14 VA. ENV’T. L.J. 225, 299 (1995) and Henry T.C. Hu, *Disclosure Universes and Modes of Information: Banks, Innovation, and Divergent Regulatory Quests*, 31 YALE J. ON REGUL. 565, 594 (2014)).

156. 17 C.F.R. § 229.10 (Item 10) (2022) (defining “smaller reporting company” as an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that had a public float of less than \$250 million, or had annual revenues of less than \$100 million and either: (A) no public float; or (B) a public float of less than \$700 million).

157. SEC Release No. 33-11042, *supra* note 4, at 368 (noting also that SRCs are required to provide less historical information than other issuers for scope 1 and 2 GHG emissions); *Supra* note 4, at 192 (the proposed GHG metrics and related criticism are discussed, *infra* at Part III).

158. SEC Release No. 33-11042, *supra* note 4, at 123.

159. See, *infra*, Section IV.

may be too demanding.<sup>160</sup> In proposed C.F.R. 210.14-02(c), for example, reporting companies would be required to disclose greater than a one percent effect of climate change on existing financial line-item disclosures.<sup>161</sup> This margin may be too slim in light of the developing understanding of these effects. Indeed, in the Release, the Commission requests comment on whether the one percent threshold is appropriate.<sup>162</sup> Though the Commission refers to its past practices requiring one percent impact financial reporting thresholds in other mandatory reporting, given the developing nature of the climate-related field and the vital accountability issue, it may be more prudent and engender less fervent opposition to relax the threshold to five

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160. See, e.g., SEC Release No. 33-11042, *supra* note 4, at 467 (proposing C.F.R. 210.14-02):

Climate-related metrics. . . .

(b) *Disclosure thresholds.*

(1) Disclosure of the financial impact on a line item in the registrant's consolidated financial statements pursuant to paragraphs (c) and (d) of this section (including any impacts included pursuant to paragraphs (i) and (j) of this section) is not required if the sum of the absolute values of all the impacts on the line item is less than one percent of the total line item for the relevant fiscal year.

161. See, e.g., SEC Release No. 33-11042, *supra* note 4, at 467:

Climate-related metrics. . . .

(c) *Financial impacts of severe weather events and other natural conditions.* Disclose the impact of severe weather events and other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented. Disclosure must be presented, at a minimum, on an aggregated line-by-line basis for all negative impacts and, separately, at a minimum, on an aggregated line-by-line basis for all positive impacts. Impacts may include, for example:

(1) Changes to revenues or costs from disruptions to business operations or supply chains;

(2) Impairment charges and changes to the carrying amount of assets (such as inventory, intangibles, and property, plant and equipment) due to the assets being exposed to severe weather, flooding, drought, wildfires, extreme temperatures, and sea level rise;

(3) Changes to loss contingencies or reserves (such as environmental reserves or loan loss allowances) due to impact from severe weather events; and

(4) Changes to total expected insured losses due to flooding or wildfire patterns.

162. SEC Release No. 33-11042, *supra* note 4, at 136.



percent.<sup>163</sup> A five percent measure would be more workable in defining materiality while still providing the anti-fraud means of holding this reporting accountable.<sup>164</sup> Comment letters have been particularly pointed at the compliance risk involved in a lower than five percent measure.<sup>165</sup> At either level, it is reassuring, and necessary, that the proposed rules require that the new climate-related financial metrics, like the rest of financial data reported under Reg. S-X, be subject to auditing.<sup>166</sup> As irksome as this requirement and other more nuanced aspects of the Proposing Release may be, auditors are well-versed in this sort of undertaking and will likely find only a marginal learning curve necessary to meet the proposed regulations. That learning curve would be particularly shallow for those auditors already engaged in voluntary climate-related metric reporting, which many are.<sup>167</sup>

Generally, the financial metrics reporting requirements to be added to Reg. S-X pursuant to the Proposing Release are commensurately most burdensome on the issuers most able to meet the new regulations and to bear the associated cost, accelerated and large accelerated filers.<sup>168</sup> Reporting requirements would be less burdensome on SRCs<sup>169</sup> and any registration statement-filing small businesses (generally defined as those having under \$5 million in assets).<sup>170</sup>

Cost of compliance with the new regulations, of course a legitimate concern of reporting companies, is estimated in the Release to total less than an initial annual amount of \$700,000 for the largest issuers who currently have no ongoing related reporting.<sup>171</sup> It is expected that cost would be much less for those already reporting on volitional frameworks and that cost will decrease significantly once a company has established the systems to accommodate the additional disclosures.<sup>172</sup> These cost estimates have been severely criticized and doubted in comments to the Release.<sup>173</sup> Perhaps time

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163. *Id.* at 360 n.869. *See also* Letter from Shearman & Sterling LLP to Vanessa A. Countryman, Secretary, SEC (June 20, 2021); Letter from ABA, Business Law Section, to Vanessa A. Countryman, Secretary, SEC (June 23, 2022) (each referencing the 5% materiality standard of Staff Accounting Bulletin No. 99 and criticizing impact of less than 5% of a given line item to be immaterial) [hereinafter ABA Comment Letter].

164. *See, infra*, Section IV.

165. SEC Release No. 33-11042, *supra* note 4, at 360 n.869.

166. SEC Release No. 33-11042, *supra* note 4, at 363.

167. SEC Release No. 33-11042, *supra* note 4, at 363.

168. SEC Release No. 33-11042, *supra* note 4, at 459–60.

169. SEC Release No. 33-11042, *supra* note 4, at 459–60.

170. SEC Release No. 33-11042, *supra* note 4, at 459–60.

171. SEC Release No. 33-11042, *supra* note 4, at 386.

172. SEC Release No. 33-11042, *supra* note 4, at 386–92.

173. ABA Comment Letter *supra* note 163, at 14–15.

will tell how accurate they are.

Certainly, assessing all physical, acute, chronic, and transition risks manifested by climate change sounds daunting.<sup>174</sup> So too does a corporate board's undertaking of scenario analyses – the project of simulating climate-related scenarios to determine effects and to then plan prevention, mitigation, and other responses.<sup>175</sup> Yet, the possible novelty and the challenge of doing so does not negate the utility or importance of these undertakings.<sup>176</sup> These concepts require no small measure of informed speculation subject to causal climate-related events beyond reporting companies' control. However, again, most reporting companies are already attempting this risk-assessment in disparate, unaccountable ways. As a consequence, the current marketplace is awash in confusing, unchecked ESG claims. The market impact of these claims is likely open to both intentional and unintentional inaccuracies that are quite likely misleading would-be investors, voting shareholders, and the public. This is especially so given the aforementioned instrumental or strategic use of ESG reporting. The SEC is duty-bound to address this problem and the current Proposing Release offers a predominantly reasonable, if still imperfect, approach to do so. It is a logical updating of existing disclosure regulations such as risk factors,<sup>177</sup> legal proceedings,<sup>178</sup> and MD&A<sup>179</sup>—each long-accepted as mandatory SEC reporting.<sup>180</sup> Its incorporation of line-item reporting together with principles-based discussion is a necessity both for clear assessment and accountability.

Perhaps the concept of the Proposing Release's required transition plan disclosure best embodies the urgent reality.<sup>181</sup> Beyond better informing the investing public, the Proposing Release would effectively require any board of a reporting company to get up to speed on climate-related issues effecting its operations.<sup>182</sup> Requirements to discuss the afore-mentioned risks are arguably already incumbent upon reporting companies under existing risk factor discussion requirements.<sup>183</sup> Corporate management's measuring,

174. SEC Release No. 33-11042, *supra* note 4, at 472–73.

175. SEC Release No. 33-11042, *supra* note 4, at 475 (note that the Commission's proposal does not mandate scenario analysis, but rather mandates disclosing such analysis only if the reporting company voluntarily undertakes such analysis, *Id.* at 87).

176. *Contra* ABA Comment Letter *supra* note 163, at 22–23.

177. Item 1A of Form 10-K, 17 C.F.R. § 229.105 (2016).

178. Item 3 of Form 10-K, 17 C.F.R. § 229.103 (2016).

179. Item 7 of Form 10-K, 17 C.F.R. § 229.303 (2016).

180. *See generally* Hazen, *Social Issues*, *supra* note 19 at 752–55 (reviewing standard reporting requirements “that potentially implicate ESG-related disclosures”).

181. SEC Release No. 33-11042, *supra* note 4, at 477.

182. SEC Release No. 33-11042, *supra* note 4, at 477.

183. SEC Release No. 33-11042, *supra* note 4, 478–84.

assessing, and responding to climate-change is simply a necessity for business survival, let alone success, in today's world. Including line-item measures will make this exercise far more accurate and valuable than the often generality-prone principles-only discussion. The more opportunity for more identifiable accountability that can come with line-item disclosure regulation of such work is too great and too obvious to forgo.<sup>184</sup>

### iii. Challenges of GHG Metrics

Another resonant criticism of the SEC's Proposing Release is its requirement that reporting companies not only assess, but quantify uncertain risks and effects.<sup>185</sup> While the Commission expressly looked to the well-known and frequently relied-upon voluntary framework and metric calculations established by the Greenhouse Gas (GHG) Protocol, some have offered legitimate criticism of this portion of the proposal.<sup>186</sup> Much of the to-be-required judgement-making is centered on GHG emissions data to be calculated and disclosed—including at its most comprehensive application—disaggregated current and historical data in Scopes 1-3.<sup>187</sup> Scope 3 presents a real challenge, as it includes indirect emissions which may be substantially upstream or downstream of a reporting company's actual operations and substantially beyond its direct control and ability to accurately measure.<sup>188</sup> So it may be that uncertainties and discretion are at their most extreme in reporting the proposed GHG metrics.

We recognize the importance of GHG disclosure as the production of greenhouse gasses are at the causal heart of climate-change. Moreover, we recognize that, similar to our reasoning in support of line-item disclosure,<sup>189</sup>

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184. See *infra*, Part IV.

185. SEC Release No. 33-11042, *supra* note 4, § 229.1504 at 484–90.

186. See, e.g., ABA Comment Letter, *supra* note 163 at 24–32. See also *About Us*, GREENHOUSE GAS PROTOCOL, available at <https://ghgprotocol.org/about-us> [<https://perma.cc/699W-K5DP>].

187. See SEC Release No. 33-11042, *supra* note 4, at 476–77.

188. See *Corporate Value Chain (Scope 3) Accounting and Reporting Standard*, GREENHOUSE GAS PROTOCOL (2011), [https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporting-Standard\\_041613\\_2.pdf](https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporting-Standard_041613_2.pdf) [<https://perma.cc/U56Q-EEAJ>]. This standard identified eight upstream and seven downstream emission categories potentially within Scope 3 emissions. The GHG Protocol is further developing related guidance. See *Update on Greenhouse Gas Protocol Carbon Removals and Land Sector Initiative*, GREENHOUSE GAS PROTOCOL (2021), <https://ghgprotocol.org/blog/update-greenhouse-gas-protocol-carbon-removals-and-land-sector-initiative> [<https://perma.cc/U3VR-6GCC>].

189. See *supra* Part IV(b).

GHG metrics must be quantified to be accurately assessed and accountable. Yet, in light of the aforementioned challenges, we would support eliminating Scope 3 reporting for SRCs and adding an additional year phase in for other reporting companies.

Moreover, we support the Commission's own general position that "[t]he proposed financial statement metrics disclosures would involve estimation uncertainties that are driven by the application of judgments and assumptions, similar to other financial statement disclosures (*e.g.*, estimated loss contingencies, fair value measurement of certain assets, etc.).<sup>190</sup> This is simply to recognize that if the challenge on climate-related disclosure is open to some discretion and difficult judgment, that is not off-putting to the Commission. The Commission is realistic to embrace these "uncertainties" as an unavoidable reality in metrics reporting.<sup>191</sup> Of course, these uncertainties would be anything but new to the many issuers already voluntarily reporting climate-related metrics on TCFD, GRI, SASB or other guidance frameworks (or to the investors or public reading them).<sup>192</sup> By requiring the disclosure of "contextual information" to make clear how a reporting company arrived at its reported metrics, the Commission affords an opportunity to make such uncertainties more palatable for management to disclose.<sup>193</sup>

Still, the challenges of adding GHG emissions metrics to existing Generally Accepted Accounting Principles (GAAP) standard financial statements under proposed § 229.1504 are real.<sup>194</sup> The Commission's means of addressing these challenges is chiefly by way of requiring expert attestation of the required GHG emissions reporting. The Proposing Release's attestation requirement can be seen simply as additionally burdensome to reporting companies, or as a solution and possible risk mitigation strategy to an increasingly obvious and severe existential threat.<sup>195</sup>

"[R]equiring a third party's attestation over these disclosures would provide investors with an additional degree of reliability regarding not only the figures that are disclosed, but also the key assumptions, methodologies, and data sources the registrant used to arrive at those figures."<sup>196</sup> In addition, the Commission proposes a two-year transition period to phase in the requirement and to progress from the lower-level limited to the higher-level

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190. SEC Release No. 33-11042, *supra* note 4, at 110.

191. SEC Release No. 33-11042, *supra* note 4, at 110.

192. *See supra* notes 70–73.

193. SEC Release No. 33-11042, *supra* note 4, at 110–16.

194. SEC Release No. 33-11042, *supra* note 4, at 484.

195. SEC Release No. 33-11042, *supra* note 4, at 477–79.

196. SEC Release No. 33-11042, *supra* note 4, at 229.

reasonable standard of reporting GHG metrics.<sup>197</sup>

The Proposing Release would require accelerated and large accelerated filers to provide attestation of Scope 1 and 2 GHG emissions data within certain reported timeframes.<sup>198</sup> Attestation of this reporting would be phased in and progress from the limited assurance to reasonable assurance levels.<sup>199</sup> The same concern for inconsistencies and lack of verification over ESG reporting is generally proposed again with assurance.<sup>200</sup> In the voluntary ESG reporting world, assurance via attestation is common, yet standards are inconsistent and metrics difficult to verify. The Commission's proposal seeks to rectify this.<sup>201</sup> The Commission's approach would establish minimum standards to be met by those eligible to provide such attestation.<sup>202</sup> The attestation requirements are prudent and lend themselves well toward accuracy and accountability.

Together with the expressed general discomfort with GHG metrics, critics have raised as a concern the role of non-governmental accounting oversight bodies in the Proposing Release's changes to Reg. S-X.<sup>203</sup> Yet, as the Commission noted in the Proposing Release, the Financial Accounting Standards Board (FASB)<sup>204</sup> which sets the GAAP<sup>205</sup> standards relied upon in U.S. corporate financial reporting (including that in SEC reporting) has already addressed ESG reporting and ways of aligning that reporting with existing FASB guidance.<sup>206</sup> One might understand FASB to have the position that the SEC's proposed mandatory climate-related reporting is, like existing

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197. SEC Release No. 33-11042, *supra* note 4, at 174, 216, 225, 227.

198. SEC Release No. 33-11042, *supra* note 4, at 225.

199. SEC Release No. 33-11042, *supra* note 4, at 225.

200. SEC Release No. 33-11042, *supra* note 4, at 233.

201. SEC Release No. 33-11042, *supra* note 4, at 236.

202. SEC Release No. 33-11042, *supra* note 4, at 475–76.

203. ABA Comment Letter, *supra* note 163 at 12–13 (“If the Proposed S-X Rules are adopted, then the Commission will have effectively created a new set of accounting standards for climate impacts for which substantial guidance to auditors about how to audit such information likely will be necessary. At a minimum, such guidance is necessary to provide consistency in application of the audit requirement across accounting firms. Therefore, an audit requirement should only be imposed after the PCAOB considers whether new auditing standards or guidance are possible and necessary and, if so, adopts such standards or issues such guidance.”).

204. FASB Staff Education Paper, FIN. ACCT. STANDARDS BD., (Mar. 2021) [https://www.fasb.org/Page/ShowPdf?path=FASB\\_Staff\\_ESG\\_Educational\\_Paper\\_FINAL.pdf&title=FASB%20Staff%20Educational%20Paper-Intersection%20of%20Environmental](https://www.fasb.org/Page/ShowPdf?path=FASB_Staff_ESG_Educational_Paper_FINAL.pdf&title=FASB%20Staff%20Educational%20Paper-Intersection%20of%20Environmental) [<https://perma.cc/33JJ-4QHM>]; FIN. ACCT. STANDARDS BD. <https://www.fasb.org/about> [<https://perma.cc/4PKB-SJS3>].; See SEC Release No. 33-11042, *supra* note 4, at 115.

205. *See Id.*

206. *See Id.*; SEC Release No. 33-11042 *supra* note 4, at 225 n.590-91.

volitional ESG reporting, able to be synthesized with existing FASB standards.<sup>207</sup> Similarly, one can argue that existing Public Accounting Oversight Board (PCAOB)<sup>208</sup> (tasked with overseeing outside auditors) auditing standards can address the Proposing Release's mandates on GHG metrics.<sup>209</sup> Full coordination of SRO guidance with the current SEC rulemaking may not be made clearer until FASB and the PCAOB are presented with the Commission's release of final climate-related reporting rules and can fill in the blanks between such a release and its effective date. On the narrower issue of regulating attestation of GHG disclosures, the Commission may be on firmer ground in looking to existing PCAOB guidance.<sup>210</sup>

Finding greater fault in GHG production elsewhere around the globe is another critical response to the SEC's Proposing Release, apparently to stymie more accountable ESG reporting. It is hardly a solution to climate change to blame the broader problem on China.<sup>211</sup> To the contrary, others in support of the proposal have called for a higher standard of uniform GHG metrics reporting in the form of absolute emissions for all three scopes.<sup>212</sup>

Indeed, an added benefit of GHG metrics reporting is to contribute to clearer *ex ante* understanding of materiality that is more difficult to define when applied only to narrative accounts in principles-based reporting. The following part more fully addresses the materiality challenge embedded in the accountability that the Release can bring.

#### IV. ACCOUNTABILITY

##### *a. The Essential Problem*

The general endeavor of holding companies accountable for the veracity and accuracy of claims they make in the marketplace is one that requires ample resources and will to undertake. This is particularly so in our instrumentalist, shareholder primacy-oriented marketplace that produces market pressure toward greenwashing.<sup>213</sup> Often, we rely on attorneys general

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207. See FASB Staff Education Paper, *supra* note 204.

208. See PUB. CO. ACCT. OVERSIGHT BD., <https://pcaobus.org/about> [<https://perma.cc/4JDJ-5B3E>]

209. See SEC Release No. 33-11042 *supra* note 4, at 152, 230 n.598-99, 247.

210. SEC Release No. 33-11042 *supra* note 4, at 152, 230 n.598-99, 247.

211. *Contra* Cunningham Letter, *supra* note 82, at 16 (pointing towards decreased GHG emissions in the United States while “these emissions have *more than tripled* in China”).

212. *E.g.*, BLOOMBERG, *supra* note 89, at 8.

213. See *supra* note 9 and accompanying text.

and their consumer divisions to conduct a watchdog role.<sup>214</sup> We may also look to the Federal Trade Commission to serve this function.<sup>215</sup> Private litigation, at least in the United States, for now, as the following section exemplifies, plays a limited role.<sup>216</sup> Holding companies accountable for ESG reporting may be all the more challenging as the field is still developing and remains open to a range of third-party standards and guidance.

At least in a pre-mandatory ESG reporting context, recent attempted remedies to combat greenwashing seem to have taken the form of consumer fraud suits brought by private parties and organizations over allegedly false or misleading advertised ESG claims. Such suits alleging various versions of consumer fraud for misleading pro-ESG claims include; *Earth Island Institute v. BlueTriton Brands*<sup>217</sup>, *Hanscom v. Reynolds Consumer Products*<sup>218</sup>, *Dwyer v. Allbirds, Inc.*<sup>219</sup>, and *Lee v. Canada Goose*.<sup>220</sup> Each of these suits has met with procedural hurdles in court and has thus far failed to offer a successful model of accountability.<sup>221</sup> Notable climate-related suits brought on other theories of fraud and unfair trade practices include; *Connecticut v. Exxon Mobile Corp.*<sup>222</sup> and *City of New York v. Exxon Mobile*

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214. See, e.g., Deputy Att’y Gen. Lisa O. Monaco, Keynote Address at ABA’s 36<sup>th</sup> National Institute on White Collar Crime (Oct. 28, 2021), (transcript available at <https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-o-monaco-gives-keynote-address-abas-36th-national-institute>) [<https://perma.cc/F4RP-AVLF>].

215. 16 C.F.R. §260 (2012).

216. See generally Network for Greening the Financial System, Climate-related Litigation: Raising Awareness about a Growing Source of Risk 8 (2021), [https://www.ngfs.net/sites/default/files/medias/documents/climate\\_related\\_litigation.pdf](https://www.ngfs.net/sites/default/files/medias/documents/climate_related_litigation.pdf) [<https://perma.cc/8DGV-HM3W>] (Explaining that climate-related litigation, in general, has been more successful in European countries).

217. See e.g., *Earth Island Inst. v. BlueTriton Brands*, 583 F. Supp. 3d 105, 2 (D.D.C. 2022) (alleging that “the company’s representations about its sustainability practices misled and deceived D.C. consumers”).

218. See e.g., *Hanscom v. Reynolds Consumer Prods. LLC*, No. 43, 2022 U.S. Dist. LEXIS 34057 at \*1 (N.D. Cal. 2022) (accusing Hanscom of misleading claims as to the recycled material used in making the bags).

219. See e.g., *Dwyer v. Allbirds, Inc.*, 598 F. Supp. 3d 137, 145 (S.D.N.Y. 2022) (accusing Allbirds of inaccurate claims regarding the treatment of the sheep from which it sources its wool for athletic shoes).

220. See e.g., *Lee v. Can. Goose US, Inc.*, Nos. 20 Civ. 9809, 2021 U.S. Dist. LEXIS 121084, at \*2 (S.D.N.Y. 2021) (accusing Canada Goose of issuing misleading information regarding the use of coyote fur in its jackets).

221. *Supra* note 217–220.

222. See e.g., *Connecticut v. Exxon Mobil Corp.*, Nos. 3:20-cv-1555, 2021 U.S. Dist. LEXIS 111334 at \*1 (D. Conn. 2021) (describing a suit brought on unfair trade practices).

*Corp.*<sup>223</sup> Still other approaches include a demand for divestiture of fossil fuel companies in *Harvard Climate Justice Coal. v. President & Fellows of Harvard Coll.*<sup>224</sup> Each of these suits has also met with procedural challenges and has yet to succeed at bringing accountability for deficient ESG claims.<sup>225</sup>

While the essential problem of ESG reporting accountability appears to be rather complex, a shift from claims made by way of attempted stakeholder intervention in a volitional ESG reporting world toward a future of claims made under an investor-focused mandatory financial reporting framework, as proposed by the Commission is an improvement over weak, common law fraud claims. We believe the Proposing Release will usher in a greater means of accountability by bringing with it causes of action in securities fraud over misleading mandatory reporting, largely under Section 10(b) of the 1934 Act.<sup>226</sup> The challenge with this means of greater accountability is that successful securities anti-fraud actions (whether public or private) often turn on a determination of what is material.<sup>227</sup>

#### *b. Materiality and Liability*

##### *i. Materiality in Volitional ESG Reporting Versus Financial Reporting*

As discussed, *supra*, the Commission explicitly looked to the TCFD to inform its drafting of Release No. 33-11042. Though the Commission's understanding and conveyance of the vital meaning of materiality in the Proposing Release was surely not limited to prior TCFD address of the concept, the Commission did look again to the TCFD to inform its own address of materiality:

The Task Force believes climate-related issues are or could be *material* for many organizations, and its recommendations should be useful to organizations in complying more effectively with existing disclosure obligations. In addition, disclosure in mainstream financial filings should foster shareholder engagement

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223. See *e.g.*, *The City of New York v. Exxon Mobil Corp.*, No. 21-CV-4807 (VEC) (S.D.N.Y. Nov. 12, 2021).

224. See *e.g.*, *Harvard Climate Just. Coal. v. President & Fellows of Harvard Coll.*, 90 Mass. App. Ct. 444, 60 (2016) (dismissing case for lack of standing).

225. *Id.*

226. 15 U.S.C. §18j(b).

227. See Thomas M. Madden, *Significance and the Materiality Tautology*, 10 J. BUS. & TECH. L. 217, 220–24 (2015) (Discussing the problem of defining materiality tautologically as *ex post*, fact-based significance originating with *Basic*, *TSC*, and *Mills*).



and broader use of climate-related financial disclosures, thus promoting a more informed understanding of climate-related risks and opportunities by investors and others. The Task Force also believes that publication of climate-related financial information in mainstream annual financial filings will help ensure that appropriate controls govern the production and disclosure of the required information. More specifically, the Task Force expects the governance processes for these disclosures would be similar to those used for existing public financial disclosures and would likely involve review by the chief financial officer and audit committee, as appropriate.<sup>228</sup>

One key aspect of the problem appears to be that *material* in a general market context, where the audience is very broad and comprised of many ESG concerned stakeholders in addition to shareholders and the general investing public, does not have the same meaning as *material* in a formal context of disclosure under federal securities laws.<sup>229</sup> To understand the current volitional ESG reporting milieu is to realize that GRI, IIRC, and CDP all have differing definitions of materiality in their competing standards for volitional ESG reporting.<sup>230</sup> Most of these meanings are distinguished from the meaning of materiality in financial reporting.<sup>231</sup> Indeed, “GRI’s materiality definition presents major challenges as it tries to be all things to all stakeholders.”<sup>232</sup> Though, in contrast, SASB, in its standards, has looked to the SEC and formal securities law to define the term.<sup>233</sup> In her in-depth

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228. TCFD Update, *supra* note 117, at iv.

229. See Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 56 AM. BUS. L.J. 645, 647 (2019) (internal citations omitted):

The separation of financial and ESG reporting can be pegged to different facets of materiality. The SEC represents the compliance aspect of materiality, wherein the government uses the concept to define specific legal obligations. The SEC’s adherence to the traditional definition of materiality as encompassing solely financial information purports to reflect the investor protection focus of U.S. securities law and sets the threshold for complying with the legal duty to provide information to investors. Investors, on the other hand, represent the market aspect of materiality. Although ostensibly intended to protect them, investors show dissatisfaction with the traditional definition of materiality.

230. *Id.* at 662–63.

231. *Id.* at 664.

232. *Id.* at 665.

233. *Id.* at 647; See also Sustainability Accounting Standards Board, SASB Conceptual Framework, 2–3, 11 (2017), <https://www.sasb.org/wp-content/uploads/2017/02/SASB-Conceptual-Framework.pdf> [<https://perma.cc/76Y5-5YA2>] (looking to securities law definitions of materiality to employ in SASB’s standards).

examination of the materiality challenge in ESG reporting, Ruth Jebe references prior scholarly work dating back to 2005, which called for generally enhanced volitional environmental disclosures and defined the notion of “cumulative materiality” to determine what to report as a lesser standard than that of materiality defined under securities law.<sup>234</sup>

As long ago as 2010 in SEC Release No. 33-9106 titled “Commission Guidance Regarding Disclosure Related to Climate Change,” the Commission gave close attention to climate-related disclosure, noting that at that time, more than ten years ago now, many companies were reporting on ESG measures and doing their best to assess the effect of climate change on their operations and profitability.<sup>235</sup> In the 2010 Guidance, the Commission recounted the then developing volitional standards available to public companies and the increasing interest in such disclosure beyond certain requirements separately imposed by the U.S. Environmental Protection Agency (EPA).<sup>236</sup> The 2010 Guidance very clearly referenced the standard securities law definition of materiality, citing to *TSC* and *Basic*, “a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information.”<sup>237</sup>

This clear and long-standing securities law-based materiality definition stood in distinction to confused and conflicting definitions of materiality in the then developing volitional standards. In 2019, the SEC of the Philippines created a useful chart comparing the volitional reporting schemes’ materiality definitions.<sup>238</sup> GRI’s definition is included as, “[m]aterial aspects” are those that reflect the organization’s significant economic, environmental and social impacts, or that substantively influence the assessments and decisions of shareholders.<sup>239</sup> IR’s definition is included as

234. Jebe, *supra* note 229, at 664–65; *See also* Mitchell F. Crusto, *Endangered Green Reports: ‘Cumulative Materiality’ in Corporate Environmental Disclosure after Sarbanes-Oxley*, 42 HARV. J. ON LEGIS. 483, 493–97 (2005) (arguing that investors want environmental disclosure).

235. *See* SEC, 17 C.F.R. § 211, 231, & 241, Commission Guidance Regarding Disclosures Related to Climate Change, at 2 (Feb. 8, 2010) <https://www.sec.gov/rules/interp/2010/33-9106.pdf> [<https://perma.cc/AM62-4KL6>] [hereinafter 2010 Climate Guidance] (“Many companies are providing information to their peers and to the public about their carbon footprints and efforts to reduce them.”).

236. *Id.* at 7–10.

237. *Id.* at 11.

238. *See* SEC Philippines, SEC Memorandum Circular No. 4, Sustainability Reporting Guidelines for Publicly Held Companies, at 5 (Feb. 21, 2019), <https://www.sec.gov.ph/wp-content/uploads/2020/09/2019MCNo4.pdf> [<https://perma.cc/8SZX-YYPC>].

239. *Id.*

“[a] matter is material if it could substantively affect the organization’s ability to create value in the short, medium or long term.”<sup>240</sup> SASB’s definition is included as “[f]inancially material issues that are reasonably likely to impact the financial condition or operating performance of the typical company within an industry and therefore are most important to investors.”<sup>241</sup> Finally, the Philippine’s SEC chart included the TCFD’s unhelpful definition as “[p]ublic companies’ legal obligation to disclose material information in their financial filings—including material climate-related information.”<sup>242</sup>

In its 2010 Guidance, the Commission specifically addressed disclosure in the existing Reg S-K sections of description of business,<sup>243</sup> legal proceedings,<sup>244</sup> risk factors,<sup>245</sup> and MD&A<sup>246</sup>; as well as the companion details of Reg. S-X.<sup>247</sup> The Commission tipped its hand toward future climate-related considerations in its section of the 2010 Guidance titled “Indirect consequences of regulation or business trends” advising topics to be addressed primarily in the existing MD&A category of Reg. S-K.<sup>248</sup> Here, the Commission called for, for example, consideration and assessment of changes in competition and demand for emission reducing products and services.<sup>249</sup> All of this, the Commission cautioned, was required under existing regulation back in 2010.<sup>250</sup> To now make this assessment more robust with the Proposing Release is certainly consistent with the long-standing instrumentalist, investor-oriented conception of climate-related reporting, and ESG reporting more generally, so ingrained in the U.S. conception of CSR and ESG and long embedded in SEC regulation.<sup>251</sup>

More recently, in 2020, a subcommittee of the SEC Investor Advisory Committee made recommendations which were apparently mindful of broad ESG impact yet were phrased more explicitly in the interest of investors.<sup>252</sup>

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240. *Id.*

241. *Id.*

242. *Id.*

243. 17 C.F.R. § 229.101 (2020).

244. 17 C.F.R. § 229.103 (2020).

245. 17 C.F.R. § 229.503(c) (2019).

246. 17 C.F.R. § 229.303 (2021).

247. *Id.* at 12.

248. *Id.* at 24.

249. *Id.*

250. *Id.* at 27.

251. *See supra* Part II.

252. SEC, Recommendation from the Investor-as-Owner Subcommittee of the SEC

By the time of the Proposing Release in 2021, the Commission appears to have focused its attention on ESG to the narrower conception limited to climate-related disclosures that are wholly shareholder and investor driven. So, the Commission's consideration of ESG reporting is not new and has in some ways only become narrower and more clearly investor focused. This has implications for the role of materiality in corporate reporting prior to or even without the Proposing Release ushering in U.S. mandatory reporting.

As Thomas Hazen has noted, "aspirational" statements associated more with CSR are generally not likely to be legally considered material.<sup>253</sup> However, "the extension of CSR generally to ESG metrics may move the needle towards or past materiality."<sup>254</sup> That is, when claims are more than generally aspirational and become specific, targeted, or clearly tied to financial performance, existing materiality standards may give rise to liability.<sup>255</sup> Certainly, the Proposing Release's required metrics disclosures to be added to Reg. S-X will yield material specifics.

The materiality challenge in the broader ESG context is itself long-standing and derives from ESG's roots in CSR that have been addressed in Part II, *supra*. Indeed, "[t]he evolution of the CSR movement to include ESG has materiality-based implications. General discussions of CSR are qualitative in nature. On the other hand, ESG is premised on use of metrics."<sup>256</sup> The Proposing release includes both qualitative and quantitative reporting requirements, the latter focused again on GHG metrics incorporated into Reg. S-X.<sup>257</sup>

This shift in the scope of materiality may be a reflection of the social constructionist model that Jebe discusses.<sup>258</sup> The social constructionist framework holds that the meaning of materiality can be understood differently among different groups even in the same reported instance.<sup>259</sup> To build out this notion with materiality and sustainability, is to argue that stakeholder-based groups calling for environmental sustainability reporting

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Investor Advisory Committee Relating to ESG Disclosure, at 1 (May 14, 2020), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf> [<https://perma.cc/8AES-T8WS>].

253. Hazen, *Social Issues*, *supra* note 19, at 759.

254. Hazen, *Social Issues*, *supra* note 19, at 759.

255. Hazen, *Social Issues*, *supra* note 19, at 759.

256. *Id.* at 760.

257. SEC Release No. 33-11042, *supra* note 4, at 153.

258. See Jebe, *supra* note 229, at 674 ("Social constructionist scholarship focuses on the social processes used to change and shape social meaning around specific conditions (such as financial collapse or homelessness).").

259. Jebe, *supra* note 229, at 674.

have simultaneously had multiple understandings of materiality.<sup>260</sup> This movement, one can interpret, took the meaning of materiality out of the financial world and reinterpreted it into an environmentally interested, broader, social world.<sup>261</sup> We believe the Commission is adhering to a long-standing investor oriented, instrumentalist version of ESG, narrowed to climate-related measures in the Proposing Release. As unsatisfying as this may be to external stakeholders beyond investors, it is a positive step in bringing uniformity and accountability to ESG reporting. Unfortunately, it brings with it the challenges of defining materiality in securities anti-fraud regulation.

Still another challenging aspect of defining materiality in a volitional ESG reporting context is reporter judgement.<sup>262</sup> For some, defining the concept of materiality begs for quantitative information.<sup>263</sup> It would seem easier to set quantitative thresholds to define materiality than to define the term in a solely qualitative disclosure context. “Most critically, because sustainability reporting is generally directed at a wide range of stakeholders identified by the company, it is subject to self-defined materiality standards that are not aligned with the financial definition of materiality that applies to public reporting.”<sup>264</sup> Embedded in any of the volitional frameworks is the problem of self-judgement of what is either qualitatively or quantitatively material.<sup>265</sup>

Sulkowski and Jebe have recently discussed the notion of dynamic materiality – a conception that the differing financial and stakeholder-oriented understandings of what is material might change or converge over

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260. Jebe, *supra* note 229, at 680.

261. Jebe, *supra* note 229, at 681.

262. See Harper Ho, *Modernizing*, *supra* note 31, at **Error! Bookmark not defined.** (citing CERES, DISCLOSE WHAT MATTERS: BRIDGING THE GAP BETWEEN INVESTOR NEEDS AND COMPANY DISCLOSURES ON SUSTAINABILITY 20-24 (2018), [https://www.ceres.org/sites/default/files/reports/2018-08/Ceres\\_DiscloseWhatMatters\\_Final.pdf](https://www.ceres.org/sites/default/files/reports/2018-08/Ceres_DiscloseWhatMatters_Final.pdf) [<https://perma.cc/PFU8-BG5W>] (reporting that nearly 60% of “large global companies do not externally assure their sustainability disclosures, and the quality of the assurance provided is low”) and Jon Lukomnik, *State of Integrated and Sustainability Reporting 2018*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 3, 2018), [https://www.ceres.org/sites/default/files/reports/2018-08/Ceres\\_DiscloseWhatMatters\\_Final.pdf](https://www.ceres.org/sites/default/files/reports/2018-08/Ceres_DiscloseWhatMatters_Final.pdf) [<https://perma.cc/XN8D-3UB5>] (reporting that over 60% of sustainability reports by S&P 500 companies lacked external assurance).

263. See BLOOMBERG, *supra* note 89, at 5 (“To assess the materiality of an asset of a company in a given location, a metric of the economic value of that asset is needed.”).

264. *Id.*

265. See Harper Ho, *Modernizing*, *supra* note 31, at 293 (linking self-judgment to underreporting).

time.<sup>266</sup> This dynamic model is not likely to constitute a realistic solution to the materiality challenge.<sup>267</sup> We believe the SEC's anti-fraud securities law-based understanding of materiality, however flawed, is the best we can get at the moment. To alter it involves a much larger and long-standing challenge embedded in the federal case law applying anti-fraud provisions in securities law litigation.

So what does or should materiality mean? Turning to the meaning of materiality in the securities law context and applying it to mandatory ESG disclosure we believe will bring more accountability to ESG reporting. However, with that accountability comes the long troublesome problem of defining materiality within the securities law-based definition on which the Proposing Release's investor focused reform continues to rely.

## ii. Materiality in Securities Law

Thus, as far back as 2010, long before the Proposing Release and the look to the TCFD Report, the Commission issued guidance on the materiality concerns tied to corporate discussions and disclosure relating to climate change in SEC filings.<sup>268</sup> This guidance in turn looked back to the Commission's first explicit discussion of disclosure of environmental matters back in the 1970s.<sup>269</sup> The now long-established guidance applied to disclosures made chiefly in risk factors and MD&A.<sup>270</sup> Additional areas where materiality entered into existing disclosure requirements include the peripheral disclosure requirements specific to conflict minerals,<sup>271</sup> oil and natural gas,<sup>272</sup> and dealings with Iran<sup>273</sup> promulgated pursuant to the Dodd-Frank Act.<sup>274</sup>) The 1971 guidance defined materiality as has the Commission

266. Adam Sulkowski & Ruth Jebe, *Evolving ESG Reporting Governance, Regime Theory, and Proactive Law: Predictions and Strategies*, 59 AM. BUS. L. J. 449, 482 (2022) (concluding that the time needed for dynamic materiality to align or improve is too great in face of the current crisis).

267. *Id.*

268. SEC, 17 C.F.R. § 211, 231, & 241, Commission Guidance Regarding Disclosures Related to Climate Change, at 2 (Feb. 8, 2010) <https://www.sec.gov/rules/interp/2010/33-9106.pdf> [<https://perma.cc/AM62-4KL6>] [hereinafter 2010 Climate Guidance].

269. See SEC Release No. 33-5170 (July 19, 1971) [36 FR 13989]; SEC Release No. 33-6130 (Sept. 27, 1979) [44 FR 56924].

270. See SEC, 17 C.F.R. § 229.601 & 302.

271. See 15 U.S.C. § 78m(p)(1).

272. See 15 U.S.C. § 78m(q).

273. See 15 U.S.C. § 78m(r).

274. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502(a), 124 Stat. 1376, 2213 (2010).

in the instant Proposing Release.<sup>275</sup> That is, by looking to *Basic* and *TSC*.<sup>276</sup>

In the Proposing Release, as with the 2010 Guidance, the Commission's discussion of materiality looks explicitly to existing understandings of the concept derived from *Basic* and *TSC* and associated with presently required MD&A disclosure in SEC reporting.<sup>277</sup> The Proposing Release goes on to emphasize that reporting companies will define for themselves short, medium, and long term time frames in which to assess whether a matter is material.<sup>278</sup> Again, the working definition of material employed in the Release is a "substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote," again referencing *TSC* and *Basic*.<sup>279</sup>

Unfortunately, securities anti-fraud case law is replete with confusion over the meaning and usage of the all-important concept of materiality. Hence, the varieties of meaning of materiality in the volitional ESG reporting world is not likely to be instantly resolved by the Commission's Proposing Release. Any dramatic clarification is still more unlikely if we realize just how broad and longstanding is the problem with any precise definition of materiality under existing securities law and its interpretation by a series of widely critiqued U.S. Supreme Court decisions.<sup>280</sup> Indeed, the lack of clarity with the securities law-based definition of material is notorious.<sup>281</sup>

Notwithstanding the Commission's claim that materiality vis a vis new climate-related reporting mandates would align with established treatment of materiality in other long-standing areas of securities law, the concept remains a lightning rod. Indeed, Cynthia Williams and Donna Nagy have criticized what they call the "SEC's materiality blind spot" among other

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275. See SEC Release No. 33-5170 (July 19, 1971) [36 FR 13989], at 11.

276. SEC Release No. 33-11042 *supra* note 4, at 67–69 (citing 17 C.F.R. § 240.12b-2 (definition of "material")); *Basic Inc. v. Levinson*, 485 U.S. 224, 231, 232, & 240 (1988) (holding that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision); *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1977) (an omitted fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available").

277. SEC Release No. 33-11042 *supra* note 4, at 67–69.

278. SEC Release No. 33-11042 *supra* note 4, at 68.

279. *Id.* at 64.

280. *Id.*

281. See *Id.*; see also Kurt S. Schulzke & Gerlinde Berger-Walliser, *Toward a Unified Theory of Materiality in Securities Law*, 56 COLUM. J. TRANSNAT'L. L., 6, 16–27 (2017) (discussing judicial extension, observance, and sometimes breach of the TSC-Basic materiality rubric in U.S. case law and suggesting a Bayesian framework to harmonize the substantive evaluation of materiality).

blind spots.<sup>282</sup> They find that the SEC’s financial disclosure-based definition in the ESG context misses the mark.<sup>283</sup>

Thus, a repeated and resounding concern with the Proposing Release in both scholarly evaluation and professional commentary centers on the meaning and implication of materiality embedded in mandatory climate-related reporting.<sup>284</sup> This is a constraint on the accountability benefit we see the Proposing Release offering. Of course, materiality has been a concern in the mix of volitional ESG reporting that continues to the present day. It is also broadly recognized that materiality is a vital and inadequately clear concept at the heart of securities law reporting, accountability, and redress of fraud.<sup>285</sup>

The Commission has very explicitly adopted the most appropriate legal definition of the term . . . “[a]s defined by the Commission and consistent with Supreme Court precedent, a matter is material if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote.”<sup>286</sup> Yet, that definition is hardly crystal clear and is most often subject to *ex post* fact-based determination.<sup>287</sup> Thus, notwithstanding some explicit address of materiality in SEC Release No. 33-11042, concern around this vital concept has rightfully been voiced.<sup>288</sup> It remains a real challenge.

Hazen’s conclusion on the state of ESG materiality under securities law is hard to disagree with, “[t]he SEC’s analysis of materiality in the ESG context reinforces the amorphous fact-based determination of what is material and what is not. Thus, the existing SEC guidance fails to provide specifically referenced instructions on how to make materiality determinations.”<sup>289</sup>

282. See Cynthia M. Williams & Donna A. Nagy, *ESG and Climate Change Blind Spots: Turning the Corner on SEC Disclosure*, 99 TEX. L. REV. 1453, 1475–81 (2021).

283. *Id.* at 1481 (arguing that “the SEC’s well-recognized mission of ‘protecting investors’ should be construed to include granting investors access to more easily comparable ESG and climate data”).

284. See, e.g., SEC Past Chairmen’s Letter *supra* note 124; ABA Comment Letter, *supra* note **Error! Bookmark not defined.**, at 14–15; see also Jebe, *supra* note 229, at 664; Hazen, *Corporate Purpose*, *supra* note 41 at 902; see generally Hazen, *Social Issues*, *supra* note 19; Harper Ho & Park, *supra* note 102.

285. See generally, Madden, *supra* note 227.

286. SEC Release No. 33-11042, *supra* note 4, at 64.

287. See Madden, *supra* note 227, at 220–24 (“In deciding whether and exactly how much to disclose, materiality, and perhaps significance, may be determined *ex ante*, but it can only be verified as correctly made *ex post facto*, and then it is fraught with bias and unfairness.”)

288. See, e.g., Hazen, *Social Issues*, *supra* note 19, at 757.

289. See Hazen, *Social Issues*, *supra* note 19, at 759.



The materiality challenge exists both in principles-based and line-item, metrics-based reporting; however, the Proposing Release's line-item disclosure requirements offer better prospects of clearer definitions of material. Long-standing concepts like 5 percent differentiation provide clearer standards of what is material that can be more easily applied *ex ante*. Indeed, it is likely easier to set clear quantitative definitions of materiality in metrics reporting than to define a clear *ex ante* standard of materiality in narrative discussions like MD&A and CD&A. Still, that does not entirely eliminate the challenges of a materiality determination that so often seems only made *ex post*. The judgement calls seem much more challenging in the more discretionary narratives of principles-based disclosure. Though Hazen's proposal of narrative discussions of CSR and ESG together are certainly well intentioned, such an approach would seem to leave us saddled with an even bigger materiality problem.<sup>290</sup>

Perhaps the greatest frustration with the materiality challenge is that it is nothing new! The inherent problem with a largely fact-based determination of materiality is that it is almost inescapably backward-looking. An *ex post* rather than *ex ante* disclosure assessment is a terrible challenge.<sup>291</sup> How can we escape it or change it? Judgements, expectations, and predictions are the headaches of *ex ante* materiality determinations. When improper, they seem only to be remedied with securities fraud actions in courts that apply *ex post*, fact-based determinations of whether claims made or not made are material.<sup>292</sup>

Quantitative thresholds on line-item metrics reporting can make some of those headaches avoidable. With principles-based narratives, we may only be able to escape the headaches with careful, cautionary language disclosing inherently uncertain considerations.<sup>293</sup> Drafting such disclosure narratives requires a balance among considerations of specificity versus generality, qualification versus boilerplate caution, and the overarching materiality determination. Fleshing this out is called for under the Proposing Release's

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290. See Hazen, *Social Issues*, *supra* note 19, at 777.

291. See Madden, *supra* note 227, at 220–24 (discussing the problem of defining materiality tautologically as *ex post*, fact-based significance originating with *Basic*, *TSC*, and *Mills*).

292. *Id.*

293. See, e.g., *Geffon v. Micrion Corp.*, 249 F.3d 29, 36–37 (1st Cir. 2001) (optimistic statements are not actionable when tempered with warnings of potential risks); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 364 (3d Cir. 1993) (bespeaks caution doctrine relating to forward-looking statements).

provision for “contextual information.”<sup>294</sup> However unsatisfying this is, we may have no better alternative to address an existential problem that is both concerning and confusing shareholders, investors, the general public, and, yes, myriad stakeholders.

### iii. Liability with a New Safe Harbor?

Liability in the mandatory reporting context that would exist under the Proposing Release would be brought to bear (i) by SEC enforcement and (ii) by civil claims brought under a private right of action. Such actions would be brought under Section 11 of the 1933 Act or Section 10(b) and Rule 10b-5 under the 1934 Act.<sup>295</sup> Section 11 applies to false or misleading statements or omissions in registration statements. Section 10(b) and Rule 10b-5 apply more broadly to statements made in connection with the purchase and sale of a security. Rule 10b-5 actions require a showing of: (1) a material misrepresentation or omission, (2) scienter (intent to deceive), (3) made in connection with the purchase or sale of a security; (4) which is relied upon, (5) and results in economic loss (6) with demonstrated loss causation.<sup>296</sup>

The possibility of both the SEC and private parties bringing Section 11 and Rule 10b-5 actions arising from mandatory climate-related disclosure is needed to improve the lack of accountability and liability in the volitional ESG reporting world. At least, the Proposal would give us such accountability over climate-related matters. Without SEC regulation making disclosure mandatory and hence making materiality-based legal challenges in fraud more likely, a mandatory disclosure regime would bring little to no more accountability than that in the volitional ESG present. This is so even though the materiality problem remains central in both Section 11 and Rule 10b-5 actions. It is the reason why defining materiality and including quantifiable line-item disclosure in the ESG reporting context has such large repercussions. Bringing the real threat of SEC and private investor anti-fraud causes of action on the veracity of this reporting to a marketplace characterized by a chaotic mix of ESG claims is an improvement that we simply cannot forego.

Even if Section 11 and Rule 10b-5 actions remain subject to the definitional challenges of materiality, without the enhanced threat of those

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294. See SEC Release No. 33-11042, *supra* note 4, at 346 (laying out several contextual considerations).

295. See *supra* note 3.

296. See, e.g., *Matrixx Initiatives, Inc. v. Siracusano*, 131 S.Ct. 1309, 1317 (2011) (stating six elements under Rule 10b-5); see generally *Madden*, *supra* note 227, at 219.

actions, we would be left in a sea of largely unaccountable claims with unpromisingly weak consumer and common law fraud actions or otherwise nonexistent redress. Reliance on state law claims based on state corporation statutes, constituency statutes, or even benefit corporation statutes are not at all promising.<sup>297</sup>

A chief benefit of SEC regulation of climate-related disclosure is the combination of SEC and private oversight of that disclosure. Exposing reporters and assurers to potential liability for what they do and do not report on ESG is needed to bring about more accountable reporting. Adding new or expanded safe harbors to mandatory SEC regulated climate-related disclosure would stymie what redress can come with the enhanced threat of securities fraud actions.<sup>298</sup>

We would not support a new safe harbor even if limited specifically to Scope 3 reporting, but would point to the existing forward-looking statements safe harbor under the Private Securities Litigation Reform Act (PSLRA).<sup>299</sup> The latter, we believe, offers enough protection for reporters'

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297. See *supra* notes 51–53 and accompanying text; see also, Hazen, *Corporate Purpose*, *supra* note 41, at 871 (tracing the history of corporate charters from English law and arguing that even under contemporary corporation law corporate acts beyond the corporate purpose are “*ultra vires* and thus invalid”).

298. *Contra* Hazen, *Social Issues*, *supra* note 19, at 787. See also *supra* Part III d.

299. For the application of safe harbor for forward-looking statements, see Private Securities Litigation Reform Act, 15 U.S.C. § 78u–5 (1995):

(c) Safe harbor

(1) In general, Except as provided in subsection (b), in any private action arising under this chapter that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a *person* referred to in subsection (a) shall not be liable with respect to any *forward-looking statement*, whether written or oral, if and to the extent that—

(A) the *forward-looking statement* is—

(i) identified as a *forward-looking statement*, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the *forward-looking statement*; or

(ii) immaterial; or

(B) the plaintiff fails to prove that the forward-looking statement—

(i) if made by a natural *person*, was made with actual knowledge by that *person* that the statement was false or misleading; or

(ii) if made by a business entity; was—

added disclosures relating to the uncertain conditions, consequences, and expected outcomes of climate change.<sup>300</sup> To carve out new or expanded safe harbors in the process is to coddle reporters and assurers and to fail to calm the seas of disparate, unaccountable ESG claims.

## V. CONCLUSION

We assert in this article that the present-day, paramount issue with ESG reporting is not *whether* corporations should be required to report on ESG. Most already do. The paramount issue is rather that we need uniformity and accountability for this reporting. Accountability in turn requires clarity in its component parts of materiality and liability. The Proposing Release gives us an opportunity to make headway on this need via mandatory climate-related reporting and the real threat of anti-fraud suits brought by both the SEC and investors with private rights of action under Section 11 and Rule 10b-5. Unfortunately, the Release does not extricate us from the frustrations of *ex ante* materiality determination, though, importantly, it gives us some more quantifiable measures which can make the task of defining materiality more plausible than can qualitative disclosure alone. We must embrace this opportunity and carry through and refine these vital concepts so that the mandatory climate-related reporting project is worthwhile.<sup>301</sup>

At present, it does not appear that we have a better means of improving the ESG uniformity and accountability problems than to support the Commission's adoption of the Proposing Release, perhaps with the elimination of GHG Scope 3 emissions reporting for SRCs and an additional year phase-in for others (though not with a related new safe harbor), as well as a 5% instead of a 1% threshold on metrics. Any new safe harbor to be added to the Proposal beyond the existing protection of forward-looking statements would unnecessarily weaken the prospects of improved accountability so gravely needed with ESG claims generally.

The problem of unaccountable reporting of ESG in the marketplace, effecting myriad stakeholders and the general public, will, of course, not be

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- (I) made by or with the approval of an executive officer of that entity; and
  - (II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading

300. See SEC Release No. 33-11042, *supra* note 4, at 218 (discussing the efficacy of assurances in the ESG context).

301. See SEC Release No. 33-11042 *supra* note 4, at 297 (providing quantifiable measures for examining ESG success).

entirely resolved by SEC Release 33-11042. However, uniformity of reporting (and therefore comparability) and accountability for climate-related disclosures will be enhanced with the Proposal's added mandatory reporting, particularly added metrics under Reg. S-K and Reg. S-X.

Even if the Commission's approach in the Proposing Release may leave by the wayside important components and broader stakeholder interests of ESG, it is better to regulate climate-related aspects within the purview of SEC regulation than to leave the entire field of ESG reporting to disparate volitional guidance and inadequate or non-existent accountability. We know that the climate-related reach of the Proposing Release would encompass aspects of governance (G) and social (S) ESG measures, even while clearly focusing on environmental (E) measures and impacts. The benefit of mandatory climate-related disclosures surely outweighs the detriment of not making mandatory additional ESG disclosures and metrics.

If anything, the apparently widespread instrumental corporate engagement with ESG reporting that we suggest may derive from earlier teaching and scholarship on strategic and instrumental CSR, requires greater oversight. Without the Commission's enforcement and the private actions that SEC regulation will bring, where would adequate accountability be found?<sup>302</sup> The Proposal further empowers the investing public and may lead the Commission to further consideration of broader ESG reporting in the interest of additional stakeholders later. Once mandatory climate-related disclosure becomes effective and is lived with for a time, revision or further reform may ensue.

In conclusion, we must support the Release as an incremental improvement over utterly lacking redress in a world of instrumental ESG claims made on disparate guidance. Moreover, we must continue to work on the all-important *ex ante* determination of what is material both generally, and in a climate-related context. This challenge begs for further analysis. Better solutions to it may only come after the Proposing Release's reform becomes effective and some experience of reporting under it and finding liability under it is acquired.

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302. See generally Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look ahead at the Next Decade*, 7 YALE J. ON REG. 149, 278–86 (1990) (discussing the general role of enforcement in SEC regulation and suggesting the connection of increased enforcement with greater penalties when regulation is weakened, albeit in a substantially earlier time frame than the present).