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Text of Remarks on Panel: Codes of Conduct and Transparency

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Text of Remarks on Panel: "Codes of Conduct and Transparency"

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Hello, I am Cynthia Williams and I'm here today to talk about a strategy to promote greater corporate accountability using the federal securities laws. The U.S. capital markets are noted for their financial transparency. That financial transparency is the result of the mandatory public disclosure of financial information on a quarterly and annual basis by the 14,000 publicly listed companies in the United States. The premise of my academic work is that there should be corporate social transparency in the capital markets comparable to the financial transparency that now exists, and that the means to achieve corporate social transparency is to require public reporting companies to disclose more information about the social, political, environmental and human rights implications of their actions, here in the United States and around the world.

What I am going to do today is define the types of expanded disclosure that could create corporate social transparency, and then talk about the statutory basis for suggesting that the Securities and Exchange Commission ("SEC") could promote this type of transparency under the federal securities laws. I will then talk about

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what I think some of the potential benefits could be of expanded corporate social transparency as a mechanism of corporate accountability. I will conclude by discussing some of the political benefits of a strategy that focuses on the SEC. I will leave for others any discussion of the problems with this approach.

The concept of corporate social transparency is based on the idea that investors and members of society should have consistent, high quality, accurate information available about the social, political and environmental effects of corporate action, both here and around the world. Expanded social disclosure to create such transparency would generally include specific information on the products companies produce and where that production takes place; on the companies' law compliance structures; on their labor relationships, both directly and through subcontractors; on their domestic and global environmental effects; and on corporate charitable and political contributions. In essence, the goal is to create a format for social auditing that would permit the dissemination of an accurate synopsis of a company's social, political and environmental actions.

The statutory basis for suggesting that the SEC has the legal authority to act to require the dissemination of this type of information is Section 14(a) of the Securities Exchange Act of 1934, which regulates proxy disclosure. Shareholders in large, public companies vote on such issues as electing the board of directors on an annual basis, or approving fundamental transactions such as a merger or acquisition, through the proxy process. Prior to seeking shareholders' votes, that is, their proxies, public companies must provide full and accurate disclosure of facts relevant to the particular decision at issue. The SEC defines which facts must be disclosed, and it is a violation of Section 14(a) for a company or person to seek shareholders' proxies without complying with the regulations, including the disclosure regulations, that the SEC has promulgated.

Section 14 contains a very broad grant of authority to the SEC to regulate the proxy process, including proxy disclosure. Specifically, the SEC has been given the authority to develop regulations "as necessary or appropriate in the public interest *or* for the protection of investors."[1] This is clearly a broad grant of statutory authority. One thing that is clear from the language of Section 14(a) is that the SEC has the authority to develop proxy regulations to promote the "public

1. Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n (1994) (emphasis added).

interest," and that the SEC's "public interest" authority is separate from its authority to protect investors, given Congress's use of the disjunctive "or." The public interest that the SEC has the authority to promote, however, has to be related to its general power to regulate the capital markets.

So, looking at how one might construe the Section 14 public interest power, you would look to the legislative history of this section. And the legislative history of Section 14 makes it clear that the goal Congress sought to achieve was for shareholders to know how managers were managing the companies in which they invested. Congress wanted shareholders to have more information about the way their companies were being run and what management policies their directors would seek to implement in the future, if elected, and it enacted Section 14 as the statutory basis for providing shareholders with this sort of information. Other sections of the 1934 Act were enacted to ensure that shareholders were provided with accurate financial information on a regular basis. Section 14, in contrast, had as its primary goal providing non-financial information.

So, that legislative history informs how one would construe the SEC's regulatory power pursuant to Section 14(a). And, I would suggest, in 2001, "how companies are being managed" includes how the company is dealing with important issues around the world and in the United States concerning labor relationships, environmental relationships, and others of the global human rights issues about which we are concerned in today's meeting. So, to advance the "public interest," the SEC should require public reporting companies to disclose more of this kind of social, political and environmental information in companies' annual proxy disclosures.

I'd like to turn now to the topic of what some of the benefits of this type of disclosure might be. In my academic writing to date, I have focused on benefits to investors. And I've looked very crudely at investors as comprised of two types: (1) economic investors, and (2) socially responsible investors. Obviously there is a significant overlap between these categories of investors. But to economic investors, people primarily concerned with the economic returns of their investments, I would suggest (and I would suggest to the SEC) that there is growing empirical evidence that the way companies treat these important social issues has material financial implications.

One example of this financial materiality can be gleaned from a recent study by the World Resources Institute ("WRI"), which studied the financial implications of newly promulgated environmental regulations on thirteen companies in the paper and pulp mill industry. The WRI study found that for those companies, there was a wide variation in how those environmental regulations could potentially affect the companies' financial results, depending on where companies had their mills (whether they were on burdened rivers or not), what kinds of investments they had previously made in environmental abatement and modern technology, and what approach the company had taken to managing environmental issues generally. WRI estimated that some companies would show a net positive impact on their value from these regulations, up to a positive 5% increase in their stock market value. Others would show a negative impact on their stock market value, down to a negative 20% in one case. Thus, WRI found real differences in how these companies were going to be affected, financially, by these environmental regulations. A securities lawyer would say this is material, that is important, information. When WRI looked at these companies' securities disclosure, however, each of these companies either said they do not anticipate any material, financial effects from the implementation of these regulations, or they said they anticipate that there might be some financial effects but that those effects will be the same for companies across the industry, which the WRI study shows not to be the case. This is just one example among many other empirical studies showing material financial effects from how a company manages its environmental risks; other studies show material financial effects from how companies manage their labor relationships, or how they manage global human rights issues generally. Thus this is economically material information that would be of interest to an economic investor.

Second, I have argued that social, political and environmental information is material *per se* to socially responsible investors ("SRIs"), since SRIs are using this information, to the extent it is available, to make investment decisions. As you probably know, a growing number of investors screen their investments for the social practices of the companies in which they invest, as well as for the financial outcomes that they can expect from those companies. In fact, socially screened funds and investments generally are some of the fastest growing sectors of money under management (of course, that relative growth rate is in part due to the fact that SRI funds represented a smaller amount of money to begin with, which is why you see a higher relative growth rate). Some studies show that close to 15% of money under professional management is being invested with some sort of social screen. And I would say in this regard that the California Public Employees Retirement Fund ("CALPERS"), which is the country's largest public pension fund, investing $160 billion, recently decided to screen all of their international investments for the human rights records of the company in which they were being asked to invest. I think that is a very important development, and it shows that social and environmental information is becoming increasingly important to investors as they make investments. So that is the structure of the argument that I have made in my academic writing: expanded social disclosure is necessary to meet the informational requirements of SRIs, and it is useful to economic investors because of the financial implications from how companies manage important social relationships.

But I suggest that there are other benefits from an expanded disclosure mandate as well. First, there are benefits to consumers. Consumers are becoming increasingly concerned about the human rights practices of companies that produce their goods, and in particular do not want to support production in sweatshop conditions, using child labor, or paying wages that do not meet basic human needs. Expanded social disclosure would provide consistent, high quality information to consumers on which they could base their purchasing decisions with respect to these issues. Moreover, political activists and NGOs could benefit from having high-quality social information provided by companies, in a consistent, comparable format. That information could inform further regulation, as necessary, and possibly help to create the political conditions necessary to enact such further regulations (I am assuming that the potential of securities fraud liability for inaccurate or misleading information or non-disclosure would help to assure that this information being disclosed would be "high-quality" information).

I think that there are also benefits to the public generally from requiring this disclosure, given the potential effects on managers from acting with the knowledge that the results of their actions are going to be made public. In this regard, I would point to another example from California, which is Proposition 65. Probably many of you know about Proposition 65, but I would like to read a bit from an article by Professor Mary Graham in *The Economist* about Proposition 65. Since 1986, Proposition 65 has required companies selling their products in California to give reasonably clear warnings whenever they expose people to cancer-causing chemicals and certain other toxic substances. Contrary to what you might expect, Proposition 65 did not inspire a flurry of warnings. Rather, it did inspire a flurry of efforts by nationally known companies to reduce the extent to which they were exposing the public to lead and other dangerous chemicals. Now, notice that Proposition 65 is not a regulation that establishes standards for permissible levels of identified chemicals within manufactured goods. It simply says to companies "disclose what you are doing." But look what companies did, and I quote from *The Economist*: "ten china companies agreed to cut the levels of lead in their glazes in half; fourteen major plumbing supply manufacturers agreed to produce brass faucets that are virtually lead free; ten producers of calcium supplements agreed to reduce the amount of lead in their tablets to almost nothing, all of the major food processors sped up the elimination of lead solder from cans of chili, and numerous other large companies removed carcinogens in formulated car wax, carburetor cleaners, etc., etc., etc." Because California is 15% of the national market, these companies made reforms nationwide—not just for the products that they sell in California. I cite this as one example of the power of disclosure as a regulatory strategy.

Another example is TRI, which stands for the toxic release inventory. TRI is a federal statute that since 1986 has required manufacturing companies to report annually on the levels of toxic chemicals that they've released, facility by facility, and chemical by chemical. Again, reading from *The Economist*, "TRI is now credited with enormous success, reducing releases of chemicals subject to the law by more than 40%." This regulation did not say, "You must reduce toxic releases." It just says to companies "tell the public what levels of the following toxins you are releasing." I would point to this potential to affect corporate actions as one of the most important benefits of disclosure. Indeed, the fundamental premise of the securities laws is that there is a "shrinking quality" to harmful actions people will take if they are required to expose those actions to the "disinfectant" of full public disclosure.

And finally, I submit that there are benefits to the companies themselves from engaging in the reflective process necessary to collect social and environmental information systematically, evaluate it and make it public. Clearly some companies are already engaged in such "social accounting" or "stakeholder disclosure," and these companies have recognized internal benefits from engaging in the underlying process of self-reflection. That is what I hear from companies who adopt or try to adopt such social responsibility disclosure initiatives. One initiative of which you may be aware is the Global Reporting Initiative ("GRI"), which is a voluntary initiative under which certain companies have agreed to disclose specified social and environmental information. The Ford Motor Company is a member of the Global Reporting Initiative, and the General Counsel of Ford has talked publicly of the benefits of GRI. He suggested that the process of evaluating everything Ford did, from start to finish, in order to report on it under the GRI, has helped Ford identify numerous ways both to save money and to reduce their environmental impact. Ford's General Counsel has also said that the process of participating in GRI has opened up new channels of communication in the company, and has helped to promote a greater willingness to be self-critical within the company. He credits their participation in the GRI process with helping the company respond non-defensively and fully last summer, when there were Congressional hearings about the Ford Voyager. If it is true that "you manage what you measure," then requiring companies' social, political and environmental impacts to be more precisely measured will help them to be more intelligently managed, as we've seen with Proposition 65 and the TRI. In some cases this will even enhance profitability. Thus, we ought not underestimate the benefits to companies themselves from these types of disclosure initiatives.

I see I have only one more minute. In one minute, I would say that the political reason I think of this as a potentially important and beneficial strategy is that it has the value of being a national approach, given the necessity of convincing the Securities and Exchange Commission, a federal agency in the United States, that this is an important policy initiative that it should promulgate. That it is a national approach is important, given the problems we have been discussing of an international "sovereignty gap." And yet, it would reach international corporate behavior, because any disclosure schedule that would be responsive to the realities of economic globalization would have to include disclosure on the social, political, and environmental consequences of companies' international actions. If one believes that the possibility of liability is an important motivator, for some companies, to comply with the law, it is also potentially useful that there could be liability consequences under the federal securities laws for misleading disclosure, or misleading non-disclosure.

My final sentence is that there is a coalition of organizations in Washington, D.C., which is starting to lay the groundwork for this approach to the SEC. The coalition includes SRI investors and money managers, the AFL-CIO Office of Investment, a number of environmental groups, including the World Resources Institute, and some academics. The coalition is organized by Michelle Chan-Fischel, at Friends of the Earth. Voluntary initiatives such as the GRI are extremely important self-regulatory mechanisms that lead the way and demonstrate the feasibility of these social accounting techniques. Yet, ultimately, I am still persuaded that mandatory approaches will be necessary to address concerns of corporate accountability under conditions of economic globalization. And one such mandatory approach is for the SEC to require companies to disclose specific information about their social, political and environmental actions. Such disclosure could constrain harmful corporate action, and would promote greater corporate accountability. Thank you.