Evading the Transparency Tragedy: The Legal Enforcement of Corporate Sustainability Reporting

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I. INTRODUCTION

There is a growing awareness that corporate social responsibility (“CSR”) is crucial to the economic landscape of transnational corporations. CSR generally refers to an “ongoing commitment by businesses to behave ethically and to contribute to economic development while demonstrating respect for people, communities, society at large, and the environment.”¹ Many corporations are adopting CSR measures as part of their mission statements and general company practices. Most of the world’s largest corporations choose to adopt codes of conduct, and several volunteer annual reports on their social practices.²

Why do companies care about behaving ethically? The case for CSR initiatives is that they are beneficial from both a moral and economic standpoint and are increasingly necessary for a corporation’s long term success.³ The morality rationale is that “behaving as a good global citizen seems sensible, and even

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² Id at 735.
³ Id at 736.
instinctive." Corporations have come to recognize that “part of being a good corporate citizen includes respecting the human rights of those who come into contact with the corporation in some way,” whether it is directly (employees or customers) or indirectly (workers of suppliers, or people living in areas affected by a corporation’s activities). In fact, human rights are relevant to the economic, social, and environmental aspects of corporate activities. The *Economist* notes the “striking” trend of “how often activists, big firm[s] and governments are in agreement about the importance of human rights, and are working together to advance them.” Further, stakeholders and consumers are increasingly expecting corporations to act in a socially responsible manner. In addition to the complex human rights impact of economic globalization, transnational corporations tend to have immense amounts of wealth and power, giving corporations “at least a moral obligation to discover and consider the social consequences of their actions.” Thus, corporations are seeking to increase their accountability and behave as good corporate citizens through CSR initiatives. Simply put, corporations feel this is the “right” thing to do.

Fortunately for corporations, the “right” thing to do is often the “profitable” thing to do since there are also economic or self-interested reasons to commit to CSR. Many empirical studies show that corporate social and environmental performance are positively associated with corporate financial performance, especially for reputational purposes. First, CSR is attractive to consumers. Buyers of products believe an honest company will produce better products; some consumers even believe a commitment to CSR is an

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4. Cragg, supra note 1, at 737.
6. Id.
8. Id.
9. See Cragg, supra note 1, at 739.
indicator of a firm’s honesty and reliability.\textsuperscript{11} Company commitment to CSR thus serves as a form of advertisement to establish brand loyalty among consumers, which in turn draws in greater profits for companies.\textsuperscript{12} Second, corporate advocacy of human rights contributes to consumer investment strategy. For example, when founders of Ben & Jerry’s Homemade, Inc. committed their company to donating 7.5% of its pretax profit to social causes,\textsuperscript{13} they were able to sell the company to Unilever for $326 million—a 150 percent premium over the trading price of its stock when the takeover was initiated.\textsuperscript{14} This demonstrates that global companies recognize CSR initiatives as value added to a company.

However, many corporations do not practice what they preach. When profits are the driving goal of corporations, there is a big temptation to evade social responsibility. A study that asked what happens when companies engage in socially responsible behavior concluded that corporations focusing on pursuing a socially responsible agenda are more likely than other businesses to behave in socially irresponsible ways.\textsuperscript{15} The study found that self-licensing, or “moral licensing,” morally frees people to worry less about the consequences of being immoral.\textsuperscript{16} For example, Enron led an extraordinary level of corporate philanthropy branding in the years leading up to one of the greatest acts of corporate fraud in history by the company.\textsuperscript{17} As a result, unconscious self-righteous branding sometimes leads to irresponsible behavior, often leaving human rights abuses and environmental impacts unchecked.\textsuperscript{18}

These abuses are particularly likely to go unchecked in a more globalized economy, where governance gaps create transparency

\begin{thebibliography}{9}
\bibitem{12} Id.
\bibitem{16} Id.
\bibitem{17} Id.
\bibitem{18} Id.
\end{thebibliography}
challenges in global supply chains. The emergence of globalization has created governance gaps, leading to an unbridled system of human rights abuses by corporations. The scope of larger scale economic forces have hindered societal capacity to manage the negative consequences that often come along with economic power. There have been many transformative changes in the global economic landscape during the last two decades. First, the dynamics of economic globalization have shifted the site of manufacturing from developed to developing countries. Second, global companies’ production and supply chains are increasingly transcending national boundaries. However, the legal framework to regulate transnational corporations has not entirely caught up with the complexities of the globalized business landscape, making it difficult to determine which entity is accountable for human rights harms. There is a widely held perception that economic globalization has created an unregulated system of rapidly growing global corporations and markets. Accordingly, transnational corporations are said to carelessly exert their power without any responsibility or accountability. There has been a dramatic increase in both the scale and complexity of human rights abuses as well as the globalized international production methods from which these abuses arise. The fundamental challenge in holding transnational corporations accountable to their human rights and environmental violations is ultimately for narrowing the gaps between all of the actors in global supply chains by increasing transparency in corporations’ activities abroad.

One way to hold multinational corporations more accountable for their social and environmental performance is increasing company

21. Id.
22. See Ruggie, supra note 19.
23. See THE POLITICS OF GLOBAL REGULATION, supra note 20, at 160.
transparency through practices like sustainability reporting.\textsuperscript{26} Corporations use sustainability reporting to “disclose the processes they use to manage CSR issues and their performance on these matters.”\textsuperscript{27} This provides stakeholders (such as customers, shareholders, and NGOs) with information to “hold corporations accountable and pressure them to improve performance if needed.”\textsuperscript{28}

To date, most sustainability reporting has been entirely voluntary: companies may choose whether to report or not, have significant discretion about the scope and substance of what they report, and are not subject to legal consequences for failing to report or misreporting their activities. Voluntary reporting is a key feature of current sustainability guidelines, which has led to what some have called a “transparency tragedy.”\textsuperscript{29} Many stakeholders complain about the incomplete information in the reports, the lack of consistency from year to year, the inability to compare social report data between companies, among other problems.\textsuperscript{30} Not only is the lack of information an issue for stakeholders, but so is the high volume and low quality of information that render assessing the truth or falsity of corporate communications increasingly difficult.\textsuperscript{31} The quality of these reports creates a vicious cycle: as a result of the poor quality of information in these reports, stakeholders are not likely to use them and thus apply less pressure on corporations to adopt better social reporting practices.\textsuperscript{32} The fact that corporations often use sustainability reports for branding purposes also causes stakeholders to further reduce their demand of quality social reporting.\textsuperscript{33}

\textsuperscript{26} \textit{See}, e.g., Dominque Bessire, \textit{Corporate Social Responsibility: From Transparency to “Constructive Conflict”}, in THE ASHIGATE RESEARCH COMPANION TO CORPORATE SOCIAL RESPONSIBILITY 65, 65 (David Crowther & Nicholas Capaldi eds., 2008) (“In the domains of CSR and corporate governance] the necessity for transparency is taken for granted and is very seldom question.”).


\textsuperscript{28} \textit{Id.}

\textsuperscript{29} \textit{Id.} at 55.

\textsuperscript{30} \textit{Id.}


\textsuperscript{32} \textit{See} Hess, \textit{supra} note 27, at 55.

\textsuperscript{33} \textit{Id.}
Thus, although sustainability reporting is a mechanism for improving labor and human rights practices in global supply chains, it has had limited effects to date because of its voluntary nature. Embracing a uniform reporting standard and making companies legally accountable for the veracity and completeness of their disclosures could enhance the efficacy of sustainability reporting. Generally, this Note explores how such a system could be structured.

Part II of this note describes the Global Reporting Initiative ("GRI") as a case study of sustainability reporting and some of its shortcomings. Specifically, Part II will address how the voluntary nature of GRI's Reporting Guidelines is preventing the complete realization of increased transparency and stakeholder trust in organizations. To solve the shortcomings of voluntary reporting guidelines, Part III of this note will introduce the comply-or-explain mechanism, which is a possible mandatory reporting structure. Part III will describe comply-or-explain policies generally, discuss arguments supporting and critiquing them, and analyze GRI's attempt to adapt them for its own reporting standards. Because comply-or-explain alone does not hold companies accountable to the degree of accuracy in their disclosures, Part IV discusses how there must exist an enforcement structure to find companies liable for misrepresentation. More specifically, Part IV also describes the framework of the 1934 Securities Exchange Act and how "materiality" should be interpreted to include non-financial disclosures since a company's social and environmental information is material information to investors.

II. THE GLOBAL REPORTING INITIATIVE ("GRI") AS A CASE STUDY OF GLOBAL SUSTAINABILITY REPORTING

The Global Reporting Initiative ("GRI") is a private non-profit, transnational regulatory body that has produced the leading standard for corporate sustainability reporting. GRI is an organization that promotes the use of sustainability reporting as a way for companies to

contribute to sustainable development. Companies and organizations use GRI’s developed Sustainability Reporting Guidelines to report their economic, environmental, and social impacts caused by their everyday activities. GRI has contributed to a significant growth in corporations’ adoption of social reporting practices.

GRI’s mission is to make sustainability reporting a standard practice for all companies and organizations, and to enable greater organizational transparency and accountability. Through transparent reporting, GRI’s goal is to build stakeholders’ trust in organizations and to develop long-term sustainable and socially responsible practices among companies and organizations. GRI recommends that disclosures and quantitative indicators in company reports must reflect impacts and enable stakeholders to make decisions. Hence, by making corporate sustainability more mainstream, GRI claims that it is “operationalizing emerging norms on corporate responsibility for human rights, among other issues.”

By systemizing disclosures about CSR practices, this institution is making abstract human rights norms more concrete, measurable, and routine, making it easier for corporations to integrate social reporting into their practices.

GRI’s goals are accomplished through complete disclosure of information on topics and indicators required to reflect impacts that enable stakeholders to make decisions. First, GRI determines the topics and indicators on which the organizations should report.
Second, GRI ensures the quality and appropriate presentation of the information. In the most recent version of the GRI Reporting Guidelines, guidance is provided on how corporations should develop the content of their reports and the information that must be included in the reports. The main body of the report consists of disclosures addressed toward a corporation’s general management approach and performance regarding various specified categories of economic, environmental, and social issues. GRI’s Reporting Guidelines have a section on “defining report content” where each organization and company must generally meet GRI’s standards on materiality, stakeholder inclusiveness, sustainability context, and completeness. Additionally, GRI has a section on ensuring quality and appropriate presentation of reported information where disclosures must be balanced (i.e., reflect positive and negative aspects of an organization’s performance), comparable, accurate, timely, clear, and reliable. Both sections include a detailed checklist that disclosing companies should meet in their reports.

GRI contends its sustainability reporting structure will achieve company transparency for a number of reasons. First, GRI believes that this sustainability reporting process is expected to improve organizational credibility and reputation with investors, customers, and community members. Companies will realize that they need to obtain a kind of “social license to operate” from stakeholders and society in general (in addition to meeting governmental regulation requirements); therefore, the ability of a company to speak transparently about its economic, environmental, and social aspects of its business operations in a trustworthy way is extremely valuable to company-stakeholder relationships. Second, the GRI reporting process can help companies consider realistic and feasible steps

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44. See GRI G3.1, supra note 40.
45. Id.
46. See Hess, supra note 27, at 58.
47. See GRI G3.1, supra note 40.
48. Id.
49. Id.
51. Id at 10.
toward building a sustainable future. Additionally, transparency and dialogue with stakeholders ensure that companies are living up to their stated social commitments and making socially responsible decisions in their business practices.

Despite the lofty goals and some successes that GRI can claim for sustainability reporting, a major shortcoming of GRI’s Reporting Guidelines is that it is completely voluntary and does not have an enforcement mechanism in place to meet GRI’s policy goals. Because of the reporting guidelines’ voluntary structure, it is not clear that all relevant information is being disclosed or that the information disclosed is accurate. Although GRI encourages both positive and negative reporting, the actual company reports include mostly positive information about company improvements and their contribution to sustainability, human rights, and social performance. The reports include minimal negative information, if any.

For example, Dell has a link on its report that directs readers to some clarifying questions and responses related to the accuracy of reports that stakeholders raised regarding Dell’s drafted report. There is not much evidence to show that other companies do the same (or at least this information is not available to the public). Dell has a single section found on the second to the last page of their report, dedicated to showing auditor findings on labor, health and safety, environment, management system, ethical shortcomings, and the actions that Dell took to correct them. The report thus includes very minimal negative data and is displayed toward the tail end of the report, which stakeholders and other readers may easily brush over. Dell’s report illustrates how the voluntary and unenforceable character of GRI’s Reporting guidelines makes company transparency a difficult goal to achieve. Thus, the existence of many exceedingly “positive” company reports illustrates the need for an enforcement mechanism for voluntary sustainability reporting.

52. GLOBAL REPORTING INITIATIVE, supra note 30, at 40.
53. Id.
55. Id.
III. COMPLY-OR-EXPLAIN APPROACH

One of the ways in which voluntary sustainability reporting structures can evade the transparency tragedy is if they embrace a uniform reporting standard that holds companies accountable to the completeness of the disclosures they make. The comply-or-explain approach is a flexible corporate governance regime that provides uniform reporting principles rather than strict regulations. The comply-or-explain approach goes one incremental step beyond voluntary reporting policies like the GRI: Although comply-or-explain makes standards somewhat voluntary, it selects a uniform set of standards that requires an explanation for the deviation from those standards. In fact, GRI has adapted a model similar to comply-or-explain in order to advocate for regulation in sustainability reporting. This section will describe comply-or-explain policies generally, discuss arguments supporting and critiquing them, and analyze GRI’s attempt to adapt them for its purposes.

A. THE GENERAL FRAMEWORK OF COMPLY-OR-EXPLAIN

In 2000, the U.K. introduced the comply-or-explain approach for corporate governance. The U.K.’s governance regime is rooted in the Corporate Governance Code (“Governance Code”), which establishes a set of governance principles for companies to adhere to while producing annual financial reports for shareholders. Many other countries use a similar comply-or-explain approach as well, including Australia, Austria, Belgium, Canada, China, Germany, Hong Kong, Indonesia, Ireland, Italy, Korea, Malaysia, Mexico, Poland, Portugal, Singapore, Spain, and Sweden. Each country adopts its own comply-or-explain model, which is mirrored very similarly to the U.K.’s Governance Code.

In the U.K., the comply-or-explain approach simply requires companies to report whether or not they comply with the Governance Code.

56. See Sarah Jane Leake, Is Comply or Explain Here to Stay?, BLOOMBERG LAW (AUG. 12, 2011), http://about.bloomberglaw.com/law-reports/comply-or-explain/.
57. Id.
Code designed by the U.K. government. If a company fails to comply, it must provide reasons to its shareholders for its deviation. Companies that do not meet the code’s provisions have to explain their reasons for doing so and have the freedom to adapt and develop best practices for their company.

Deviations are perfectly acceptable if well explained and good explanations do not necessarily have to be long. Companies may give a “short, but convincing reason why following a particular recommendation of the code has not been considered to be in the interest of the company as seen by its board.” Under these conditions, deviations seem to be well received by investors. Explanations are “key to the success of the comply-or-explain mechanism,” even though there is room for improvement in this area.

The use of codes for regulating corporate governance is “widely accepted in practice and in economic and legal theory because of its well known advantages over legal rules.” These advantages include “flexibility, motivation to cooperate and to live up to best practice, adaptability to the challenges and needs of the national and international markets and possibility to try out new solutions and to change them easily if they do not prove successful.” The comply-or-explain system is said to possess flexibility because companies are free to tailor their corporate governance policies to their individual needs and evolving circumstances. Some deviation from the Governance Code’s provisions is permissible, so long as the reasons for doing so are clearly explained and the underlying principle of the Code is met. Drafters of the code realized that “in view of a company’s

59. Afshar & Rose, supra note 58, at 461.
60. Id.
61. Id.
63. Id. at 7–8.
64. Id. at 3.
65. Id.
66. Id.
67. Id.
68. See Afshar & Rose, supra note 58, at 462.
69. Id.
varying size, activities, shareholder structure, and culture, departure from the provisions may be justified in particular circumstances." 70 Smaller or newer companies may determine that some provisions of the code are disproportionate or less relevant to their company practices. 71 For example, in Germany, it has been reported that larger companies more often comply, and smaller companies generally take greater advantage of the ability to explain. 72 Therefore, as compared with mandatory disclosure structures, the comply-or-explain model is particularly attractive to companies because it allows for consideration of the complexity of corporate practices. 73 Justified non-compliance “encourages directors to modify their governance strategies and approaches in light of evolving circumstances.” 74 Additionally, the flow and quality of information provided in the explanation can assist shareholders in assessing the accuracy of managerial decisions and pressing for change if they are not satisfied with what is reported. 75 The general hope of the comply-or-explain implementation is that a constant flow of information regarding corporate practices is assured, providing a foundation for better corporate governance practice in the European Union (“EU”). 76

B. SHORTCOMINGS OF THE COMPLY-OR-EXPLAIN APPROACH

One critique of comply-or-explain is that mandatory disclosure for non-compliance is costly and unnecessary. 77 Compelling management to give an explanation is “unnecessary since managers having a reasonable explanation for non-compliance will naturally have an incentive to provide that explanation.” 78 Further, compulsory compliance may cause investors to be suspicious and “sanction

71. Id.
72. See Leake, supra note 56.
74. Id.
75. Id.
76. See id. at 72.
77. See Steeno, supra note 70, at 404.
78. Id.
companies that fail to give an explanation for their non-compliance. 79 It may also impose additional costs on companies to provide this information. 80

Further, the main challenge to a comply-or-explain approach is the lack of enforcement. 81 Self-regulation of codes alone is not enough, because even if many of the companies comply, there are always some black sheep that do not cooperate and, even worse, profit from “free-riding.” 82 In other words, since there is no enforcement mechanism in place for disclosures, those free-riding companies may be able to get away with not complying with the code. This is unacceptable because it produces unjust practices and also “erodes the cooperativeness of the majority and in the end leads to the full breakdown of the code.” 83 To meet this challenge, “it is now general international practice to require disclosure of compliance or non-compliance, whether by non-legal or legal means.” 84 This disclosure is needed in order to “inform the fellow-addresses, the competitors, the financial press and the general public and on this basis to allow them to react by valuating the compliance or the noncompliance.” 85 The information provided must be meaningful. Mere “box-ticking and boiler plate language are not enough to activate the reaction mechanism at the market and in the public.” 86 Yet, the question of how this type of enforcement must occur remains open-ended.

79. See Steeno, supra note 70, at 404.
81. See Höckli et al., supra note 62, at 4.
82. Id.
83. Id.
84. Id.
85. Id.
86. Id.
C. GRI SHOULD DRIVE STATE GOVERNMENTS TO ADOPT THE COMPLY-OR-EXPLAIN APPROACH

GRI is currently pushing for the Report or Explain Campaign Forum, which is very similar to comply-or-explain.87 The Campaign Forum involves a group of people (generally, any individuals and/or non-profit organizations who believe that sustainability reporting is necessary and beneficial) who aim to increase organizational transparency worldwide.88 This group urges companies to reveal their performance through sustainability reporting or the reasons why they do not report.89 The Campaign Forum claims to advance the sustainability reporting agenda in a number of ways, including encouraging organizations and individuals to join the Campaign Forum to share information on developments and initiatives on the disclosure of sustainability information. The Campaign Forum also calls on companies and regulators to make a substantial change on disclosure and transparency, and encourages governments to initiate minimum sustainability disclosure regulation.90 The Campaign Forum advocates for regulation in sustainability reporting; however, they do not necessarily call for mandatory reporting.91 Their rationale is that such an approach could persuade more companies to report while still being free to choose what information to disclose. Since the Campaign Forum creates a norm for reporting, companies are conveying information about their activities even when they decline to make disclosures because nondisclosure deviates from the reporting norm, raising doubts among stakeholders regarding a company's social practices; in turn, markets and society have information from these companies to judge their choices.92 This in turn affects shareholder decisions to invest in companies while companies are put on greater notice about their public image.93

88. Id.
89. Id.
90. Id.
91. Id.
92. Id.
93. Id.
GRI should drive state governments to adopt domestic regulations in order to require companies to issue sustainability reports that “comply” with GRI reporting standards or “explain” why they do not. A country must first mandate sustainability reporting since most countries do not currently have such a mandate. This step will push companies to report. Second, the country will then have to require that these company reports “comply” with GRI guidelines or “explain” why they do not. Thus, the state law will not only mandate sustainability reporting, but will also mandate companies to report in compliance with uniform GRI guidelines or explain why they do not comply. Under this regime, comply-or-explain will increase company transparency and stakeholder trust by requiring both mandatory sustainability reporting and compliance with the reporting guidelines.

Because companies are not required to completely disclose all of their information, GRI’s transparency goals are seldom met. With the authority of a state, comply-or-explain can help alleviate some of these issues. First, comply-or-explain makes it mandatory for all companies to report based on the Governance Code. Similarly, state regulation can make it mandatory for all companies to report based on GRI’s Reporting Guidelines. In this sense, the mandatory reporting will compel all companies to be more transparent about their practices. Second, the fact that companies must explain why they deviate from the Reporting Guidelines with this approach will hold them accountable for their corporate practices. Since these companies are conveying information about their activities even when they decline to make disclosures, shareholders will scrutinize these companies and judge them based on the type of information they convey. Shareholders will thus have greater leverage over company deviations, which will in turn drive companies to be more transparent and socially responsible. Since GRI’s Report or Explain Campaign Forum is already modeled after the similar comply-or-explain mechanism, GRI should work to convince state governments to mandate the comply-or-explain approach. This mandate will allow GRI to use its reporting principles to increase organizational transparency and corporate social responsibility.

There must be a stronger enforcement mechanism in place to hold companies accountable to accurate reporting and socially responsible practices. Neither GRI’s Campaign Forum nor the
comply-or-explain approaches have legal enforcement over the absence of disclosures or misrepresentation of company information. Though there are benefits to the flexibility of these approaches, stakeholders will never know whether or not a company is completely truthful and will be unable to make informed investment decisions.\textsuperscript{94} Each country will mandate the implementation of code compliance, yet will fail to cater to the complementary need for proper monitoring and disciplining mechanisms for both the “complying” and “explaining” components of the mechanism.\textsuperscript{95} Therefore, the comply-or-explain approach alone is insufficient.

IV. NEXT STEPS: HOLDING CORPORATIONS LIABLE FOR INCOMPLETE REPORTS

Even if countries were to adopt a comply-or-explain approach to mandate companies to report under the GRI guidelines, there would be no enforcement mechanism to police the veracity of disclosures or explanations. The primary weakness of comply-or-explain is that the accuracy of reports is not legally enforced. This Note has therefore demonstrated that both voluntary reporting (i.e., under GRI) and voluntary reports combined with a comply-or-explain regime are inadequate. Neither is adequate to resolve the transparency tragedy. Consequently, in this section, I propose an enforcement structure to hold companies accountable for the accuracy and completeness of their reports. In order to really solve the problem of poor transparency standards in global supply chains, a source of legal accountability must be introduced. The Securities Exchange Act of 1934 (“the 1934 Act”) provides a model for doing just that.

The 1934 Act is a set of laws that form the legal foundation for the corporate disclosure requirements enforced by the U.S. Securities and Exchange Commission (“SEC”).\textsuperscript{96} The overarching purpose of securities laws are to protect investors from fraudulent or manipulative practices, to ensure the efficient functioning of

\textsuperscript{94} See GRI website, supra note 35.
\textsuperscript{95} Id.
\textsuperscript{96} See David Monsma & Timothy Olson, Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information, 26 STAN. ENVTL. L.J. 137, 145 (2007).
securities markets, and arguably to promote in corporate management a greater sense of public accountability.\textsuperscript{97} Rule 10b-5 of the 1934 Act prohibits the use of any means or instrumentality to employ any “device, scheme, or artifice to defraud,” and creates liability for any misstatement or omission of a material fact—i.e., a fact that investors would think was important to their decision to buy or sell the stock.\textsuperscript{98}

A. DEFINITION OF “MATERIALITY” UNDER THE CURRENT FRAMEWORK

Materiality is the “legal benchmark for determining the significance of information for disclosure purposes.”\textsuperscript{99} “Full and fair disclosure of all material information” is said to protect investors.\textsuperscript{100} \textit{TSC Industries, Inc. v. Northway, Inc.} defined a material fact as “one to which there is a substantial likelihood that a reasonable investor would attach importance in making a decision because the fact would significantly alter the ‘total mix’ of available information.”\textsuperscript{101} Liability under the 1934 Act is limited to material nondisclosure or misrepresentation.\textsuperscript{102} However, this is a subjective legal standard since there is no bright line rule for what is precisely material.\textsuperscript{103}

Most economic disclosures ensure a level of transparency necessary to promote investor confidence in the truth and accuracy of issuing companies’ financial statements.\textsuperscript{104} The antifraud theory underlying disclosure rules is that transparency prevents “low-quality

\textsuperscript{97} Monsma & Olson, \textit{supra} note 96.

\textsuperscript{98} 17 C.F.R. § 240.10b-5 (2015).


\textsuperscript{100} See Monsma & Olson, \textit{supra} note 96, at 141.


firms from making misrepresentations that cause investors to mistakenly believe that they are high-quality firms.”

105 This emphasis on transparency from an economic perspective turns on the term “materiality.”

Although SEC regulations in defining materiality “do not explicitly adopt an economic standard, the SEC implicitly defines material information as information that bears on the economic value of an investment.”

107 Rule 405, promulgated under the Securities Act of 1933, defines material information to be those “matters [as] to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.”

108 This view of materiality “assumes a ‘reasonable investor’ [is someone] who is interested in the direct and quantitative economic effect of the contested information.”

Therefore, the analysis of the scope of the SEC disclosure rules thus far has focused on “a concept of materiality that emphasizes the quantitative economic effects of the withheld information on the financial condition and prospects of a company.”

The dominant view of material disclosures is that a company is “not obligated to disclose so-called social and environmental information because such information is not . . . relevant or material to the financial condition of the company.”

111 In the absence of a specific duty to disclose the social and environmental information about a corporation, “traditional antifraud rules do not affirmatively require firms to make [such] disclosures.”

Nonetheless, sustainability disclosures arguably fall under the existing standard for economic “materiality” because companies’ sustainability practices may have economic consequences for businesses. GRI currently asserts that reports on company

105 Macey, supra note 104.
106 See Monsma & Olson, supra note 96, at 142.
110 Id. at 43.
111 See Monsma & Olson, supra note 96, at 161.
112 See Macey, supra note 104, at 413.
sustainability practices affect a company’s profits and financial status, and therefore reveal “material” information. GRI finds nonfinancial information disclosures essential to stakeholder decision-making, stating that such disclosures allow companies to “enhance their value, measure and manage change, and drive improvement and innovation.” 113 Furthermore, companies themselves increasingly view non-economic information as “ultimately having an effect on profitability.” 114 Companies routinely collect and manage nonfinancial information about business functions, such as environmental performance and corporate social responsibility, some of which is arguably material to investors and the financial condition of the company. 115 Under existing GRI values and company practices, disclosures under the GRI Reporting Guidelines contain “material” information that can be monitored under the current structure of the 1934 Act.

In fact, the February 2014 update of the GRI Reporting Guidelines (“G4”) focuses on providing guidance to companies on what disclosures are truly material. 116 By putting a spotlight on materiality, GRI hopes to make abstract sustainability information more tangible and concrete and to help companies “set goals, measure performance, and manage change,” which are “matters directly related to an organization’s core business strategy.” 117 The updated GRI guidelines set “the concept of materiality at the heart of sustainability reporting” by “encouraging reporting organizations to only provide information on the issues that are really critical in order to achieve the organization’s goals for sustainability and manage its impact on environment and society.” 118 GRI says that reports under the G4 guidelines should reflect the company’s significant economic, environmental, and social impacts that will substantively influence the assessments and decisions of stakeholders. 119 Thus, GRI’s guideline

114. See Monsma & Olson, supra note 96, at 142.
115. Id.
116. See AN INTRODUCTION TO G4, supra note 113.
117. Id.
118. Id.
119. Id.
updates reflect the notion that certain sustainability disclosures are “material.” Because GRI is helping companies determine exactly what kinds of material disclosures to include in their reports, it explicitly suggests that these disclosures fit under the existing 1934 Act definition of “material.”

B. THE DEFINITION OF “MATERIAL” SHOULD BE EXPANDED TO INCLUDE NON-ECONOMIC DISCLOSURES

If it is argued that the existing meaning of “material” under the 1934 Act does not include noneconomic disclosures, then “material” should be expanded to include noneconomic disclosures, making it possible to hold corporations liable for misrepresenting non-economic and social information.\textsuperscript{120}

There are several reasons why “materiality” should apply to non-financial information. First, while a general duty to disclose environmental, social, and governance information does not necessarily exist, an “obligation to accurately disclose this information may be inferred from the intents and purposes of the securities disclosure laws.”\textsuperscript{121} For example, Regulation S-K, a comprehensive set of regulatory guidelines under federal securities law, supplements securities laws by requiring disclosure of certain information independent of its strict materiality.\textsuperscript{122} More specifically, Item 303 requires companies to provide in clear narrative form a historical and prospective summary of the status, opportunities, and risks impacting the company’s performance and financial condition.\textsuperscript{123} Though there is no specific requirement, this section has been interpreted to call for the “disclosure of either social or environmental information depending on the circumstances.”\textsuperscript{124} This area has much speculation and uncertainty, but there is evidence that these types of disclosures are highly desirable and encouraged.\textsuperscript{125}

\textsuperscript{120} See Monsma & Olson, \textit{supra} note 96, at 143.
\textsuperscript{121} Id.
\textsuperscript{122} Id. at 147.
\textsuperscript{123} Regulation S-K, 17 C.F.R. § 229.303(a) (2015).
\textsuperscript{125} See Mark A. Stach, \textit{Disclosure of Existing and Contingent Superfund Liability Under
Second, although the dominant view of shareholder responsibility is that a firm does not have an obligation to disclose social and environmental information because such information is not relevant or material to the financial condition of company, courts have recognized that the SEC has the authority to require expanded social and environmental disclosures but has only done so in a limited number of ways. The Court of Appeals for District of Columbia has conceded that the SEC is not required to expand environmental and social disclosure, but “acknowledged the SEC has broad discretionary authority over what disclosure to require.”

For example, during litigation between the Natural Resources Defense Council (“NRDC”) and the SEC in the 1970s, the NRDC sought to expand civil rights and environmental disclosure under federal securities laws. The court established that social and environmental transparency is “within the scope of disclosure authority contemplated by federal securities regulations.” Additionally, the court argued that because corporate social and environmental practices may have economic impacts, the “disclosure of this information is within the public interest and protects investors.” Therefore, although there is no explicit requirement for the SEC to require nonfinancial disclosure, it has the authority to do so.

Third, if “material” is expanded to include nonfinancial information, it will be possible to hold corporations liable for misrepresentation based on the current practice of the word “material”: Rule 10b-5 mandates a duty not to mislead “by means of misstated, untrue, outdated or omitted material information.” The duty to disclose is established by determining whether “in light of

126. See Williams, supra note 107, at 1299.
130. Id.
131. See Monsma & Olson, supra note 96, at 170.
what was omitted, what was said was misleading.\textsuperscript{132} Finding materiality under 10b-5 creates liability for nondisclosure under the "half-truth" doctrine, which includes statements that have some element of truth but are deceptive or omit some \textit{material} fact, thereby making them misleading.\textsuperscript{133} Courts have held that half-truths, or "literally true statements that create a \textit{materially} misleading impression," may support securities fraud claims.\textsuperscript{134} Further, in order for Rule 10b-5 to apply under the "half-truth" doctrine, the withheld information must be material.\textsuperscript{135} Thus, if the noneconomic information that corporations withhold is considered material, then under this framework, it will be possible to hold corporations liable for misrepresenting material information under the "half-truth" doctrine.

In sum, a company’s social and environmental information is material information to investors and must be included under the definition of "materiality" in 10(b)(5). A reasonable investor is not only a profit-seeking investor.\textsuperscript{136} Investors rely on all forms of information found in company reports, statements, and websites.\textsuperscript{137} Additionally, almost all social and environmental information is tangibly related to the economic reality of a firm, but is considered to be nonfinancial.\textsuperscript{138} Corporate social and environmental management actions, which are presumably instituted for long-term sustainability

\textsuperscript{133} See Huang, supra note 127, at 112.
\textsuperscript{134} Id.
\textsuperscript{135} However, the question of whether there is a pre-existing "duty to speak" in non-insider trading situations remains open-ended. See Carol Swanson, \textit{Insider Trading Madness: Rule 10b-5 and the Death of Scienter}, 52 U. KAN. L. REV. 147, 172-75 nn.138-45 (2003) (stating that the only circumstances in which the Supreme Court has explicitly addressed the "when is silence fraudulent?" question has been in insider trading cases, where the Court explicitly said it looked to fiduciary principles in finding 10(b) violations.); Chiarella v. United States, 445 U.S. 222, 235 (1980) (stating in dicta that "when an allegation of fraud is based upon non-disclosure, there can be no fraud absent a duty to speak" and that the duty to speak only arises because, as in insider trading, one party has information "that the other is entitled to know because of a fiduciary or similar relation of trust and confidence between them.").
\textsuperscript{137} Id.
\textsuperscript{138} See Monsma & Olson, supra note 96, at 174.
purposes, are related to both the economic and social reality of the
firm’s business. These types of disclosures may not immediately
enhance shareholder value, but such steps are material to ensure
overall company responsibility to its shareholders and stakeholders.

V. CONCLUSION

Because the current system of corporate sustainability
disclosures is voluntary and lacks an enforcement mechanism, it is not
clear that all relevant information is being disclosed or that the
information being disclosed is accurate. This makes it difficult for
organizations such as GRI to meet their policy goals of increased
company transparency and corporate social responsibility. In order
to solve the issue of inadequate transparency in sustainability reports,
there must be some enforcement mechanism in place.

First, disclosure policies should be driven by a comply-or-explain
approach. Comply-or-explain provides some form of mandated
disclosures while ensuring flexibility among companies and assisting
stakeholders to make decisions. However, this approach does not
hold companies liable for the accuracy and completeness of their
reports. In order to truly solve the issue of inadequate transparency,
a source of legal accountability must be introduced. Perhaps
mandated standards are not currently desirable, but we can at least
make sure that the disclosures companies make in their sustainability
reports are accurate and complete. The 1934 Act provides us with a
legal framework to hold companies accountable to be completely
transparent about their social and environmental impacts. The
cumulative effect of comply-or-explain and 1934 Act enforcement will
thus ensure GRI’s policy goals of transparency and corporate social
responsibility are realized.

Because of the existing value of non-economic company
reporting among investors, stakeholders, and governments, the legal
enforcement of company misrepresentation will likely gain support.

139. See Joseph A. Franco, Why Antitraid Prohibitions Are Not Enough:The Significance
of the Opportunism, Candor, and Signaling in the Economic Case for Mandatory Securities
140. Id.
Companies initially may be uncomfortable with the inflexibility of reporting, mandatory requirements, and the fear of liability for their misrepresentations. However, once factual and transparent reporting becomes the norm, companies will eventually become more socially responsible, in addition to being more profitable.