Legal Roundtable
ON EMERGING ISSUES RELATED TO SUSTAINABILITY DISCLOSURE
Established in 2011, the Sustainability Accounting Standards Board (SASB) is an independent standards-setting organization dedicated to enhancing the efficiency of the capital markets by fostering high-quality disclosure of financially material sustainability information that meets investor needs. The SASB develops and maintains sustainability accounting standards—for 79 industries in 11 sectors—that help public corporations disclose material information to investors in SEC filings. The SASB’s rigorous process, which includes evidence-based research and broad, balanced stakeholder participation, yields standards that are valued by investors and corporations alike because they are cost-effective and decision-useful. The SASB Standards Board comprises nine members with diverse backgrounds and expertise encompassing capital markets regulation and policy, investing, financial accounting, securities law, corporate finance, and sustainability.
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Preface

On June 19, 2017, at the Harvard Law School in Cambridge, Massachusetts, a group comprising securities law scholars and practitioners participated in a half-day roundtable discussion entitled “Emerging Legal Issues Related to Public Company Sustainability Disclosures.” The 29 participants came from law schools, law and accounting firms, businesses, and nonprofit organizations, and included former senior officials from the U.S. Securities and Exchange Commission (SEC). A full list of the participants is included in Appendix A.

The roundtable was organized by the Sustainability Accounting Standards Board (SASB). Established as a 501(c)(3) nonprofit organization in 2011, the SASB is developing sustainability accounting standards for the disclosure of material, decision-useful information in SEC filings. The SASB has been engaged in this effort since 2011 and, after the completion of a notice and comment period, plans to promulgate codified standards for companies in 77 industries in early 2018.

The adequacy of disclosures made by public companies of sustainability factors—often referred to as environmental, social, and governance (or “ESG”) issues—is an increasingly significant topic among investors and their portfolio companies. For example, in response to a 2016 SEC Concept Release on Regulation S-K seeking public feedback on how to modernize disclosures to make them more useful for today’s investors, two-thirds of non-form letters addressed sustainability matters, with 80 percent of those calling for improved disclosure of this type of information.1, 2

Despite growing interest in the topic among the investor, corporate, and regulatory communities, many important and relevant legal questions relating to sustainability disclosures remain unanswered. The SASB staff has engaged in extensive discussions with issuers in recent years and has been told that legal uncertainties, relating primarily to the materiality of sustainability information and the potential liability risk relating to its disclosure, are a stumbling block to use of SASB standards, particularly if, as the SASB intends, the standards are used to make disclosures in filings with the SEC. The purpose of this discussion was to surface these questions and uncertainties, and capture insights from highly regarded practitioners and academics on possible ways to address them, in the hope of moving the conversation of corporate sustainability disclosures forward.

Roundtable participants engaged in moderated, “off the record” panel sessions under the Chatham House Rule, allowing them to speak freely and candidly about the various topics. They deliberated on approaches to improving the effectiveness of corporate disclosure on sustainability performance, including both top-down regulatory efforts and bottom-up, market-based initiatives, as well as those intended for disclosure both within and outside of regulatory filings.

The session was divided into three topic areas as follows:

- Materiality and the Reasonable Investor in the Context of Sustainability Disclosure: In this opening session, participants explored the role of investors in driving demand for the disclosure of more useful sustainability information, and the extent to which the existing SEC disclosure regime requires disclosure of such information.

- Corporate Implementation of Sustainability Disclosure: In this second session, the roundtable participants concentrated on corporate implementation of sustainability disclosure and, in particular, the liability concerns associated with such disclosure.3

- Involvement of Regulators, Lawyers, Accountants, and Others with Respect to Sustainability Disclosure: In this final session, participants discussed the roles of regulators, lawyers and accountants, academics, and others in the evolution of sustainability reporting.

Participants were provided with a list of questions relevant to each topic; those questions are provided at the beginning of each section of this report. Each discussion session began with an introductory presentation made by the moderator. The moderators for the panels were John Coates, the John F. Cogan, Jr. Professor of Law and Economics at the Harvard Law School; Thomas L. Riesenberg, SASB’s Director of Legal Policy;4 and Elisse B. Walter, a member of the SASB Foundation Board of Directors and a former SEC Chair.

This report is the conveners’ best attempt to present an objective summary of the most important topics discussed at the meeting. Although the meeting was intended to advance discussion and debate—rather than to elicit specific conclusions or recommendations—some participants did make recommendations that market participants may consider as they work toward integrating sustainability factors. It is the conveners’ hope that the report will be the impetus for further discussion and study.

The conveners would like to thank the Harvard Law School for sponsoring the event with financial assistance from the law firm of Cleary Gottlieb Steen & Hamilton LLP.

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3 A detailed memorandum analyzing sustainability-related liability issues was prepared for the roundtable by the law firm of K&L Gates and distributed to participants in advance. A copy of the “Executive Summary” of that memorandum is provided in Appendix B. Full text found here.

4 Mr. Riesenberg’s work for the SASB is conducted through a secondment agreement between the SASB and the professional services firm of Ernst & Young LLP.
**Overview**

Business is an activity characterized by a tireless pursuit of progress, and that progress is plainly evident in each of its elements, from big-picture management to daily bookkeeping. As many key business disciplines continue to evolve—including accounting, finance, law, investor relations, and others—their practitioners have begun to engage with one another to address an increasingly conspicuous point on the horizon at which their diverse interests seem to converge: sustainability.

The ideas covered in these roundtable discussions collectively attempt to illuminate that important intersection from a legal perspective. The need for this discussion stems from ongoing and parallel, but uncoordinated, attempts to move corporate sustainability disclosures forward on several fronts.

- First, investors have begun to develop a more sophisticated understanding of the link between sustainability and finance. That is, they recognize that a company’s performance on one can have important implications for the other, in particular on a company’s long-term prospects for financial success. As these investors seek information on corporate performance with respect to critical sustainability factors, questions arise whether existing U.S. securities laws require the disclosure of such information. If so, how?

- Secondly, companies have made efforts to respond to this growing investor demand, but they continue to grapple with the related difficulties, including costs. It may not be easy to reimagine organizational structures, management and reporting processes, and oversight approaches in order to accommodate new, non-traditional factors. If there are substantial liability risks, should companies even try to overcome these difficulties?

- Finally, regulators have begun to at least consider—to various degrees in different jurisdictions—requiring more such disclosure. Although a variety of voluntary, market-based approaches exist, corporate uptake has been slow. Should regulators do more? If so, how should they approach the standardization of information that, by its very nature, is often industry-specific and difficult to quantify? And what is the role of other market participants, including “gatekeepers” such as attorneys, accountants, securities analysts, and others?

Although many companies have reacted positively to this market shift, significant questions have been raised about legal issues. The SASB recognizes the merit of these questions and seeks to move the conversation forward, examining materiality, liability, and regulation primarily through the lens of the federal securities laws. The following pages capture that conversation as it recently unfolded among practitioners and scholars, and this report concludes with a summary of key takeaways from the dialogue. The views expressed in this document are those of the participants, not the SASB.
Session 1: Materiality and the Reasonable Investor in the Context of Sustainability Disclosure

TOPICS FOR DISCUSSION

The SASB standards are developed using an approach that observes the definition of materiality that is well-established under the federal securities laws. The SASB has published a detailed position paper on how it applies this definition. The roundtable will use this position paper as its starting point for the discussion of several issues, including the following topics and questions, which were contained in the agenda for Session 1.

Materiality

Some advocates of sustainability disclosure have argued that investor interest alone should be sufficient to establish materiality. This view is important to consider in light of the substantial, and growing, number of mainstream investors expressing demand for improved reporting on ESG factors. (See the SASB's comment letter on the SEC's Regulation S-K Concept Release for a more detailed discussion.) What are the merits of this view? How broad is the "total mix of information" standard of TSC Industries v. Northway? Suppose it could be shown that 30 percent, or 50 percent, or 70 percent of investors support disclosure of a particular matter that appears unrelated to financial performance (e.g., conflict minerals, or political contributions)—should that matter be considered "material" simply because of the level of investor interest?

The Reasonable Investor

The federal securities laws are built on the concept of the "reasonable investor." How is this concept changing over time? More specifically, how should this concept be applied in the context of sustainability, given that there currently exists a substantial, and increasing, number of investors interested in ESG issues? Even where there is no clear effect on stock prices, such investors almost certainly view ESG information as "having significantly altered the 'total mix' of information made available." Current case law does not appear to definitively resolve whether the socially responsible investor is a "reasonable investor." However, the growing ranks of such investors would seem to provide some support for an affirmative answer. (Cf. Sec. & Exch. Comm’n v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968): "The speculators and chartists of Wall and Bay Streets are also ‘reasonable’ investors entitled to the same legal protection afforded conservative traders.").

Investor Interest

Recent studies show that "investors respond to the information contained in risk-factor disclosures," consistent with investors benefiting from more specific disclosures and that "the level of specificity in risk disclosures does affect investors’ and analysts’ evaluations." The SASB has determined that 69 percent of companies are already addressing at least three-quarters of the disclosure topics the SASB has identified for their industry, and 38 percent are already providing disclosure on all disclosure topics. However, more than 50 percent of sustainability-related disclosures in SEC filings use boilerplate language. Given the research in this area, would this be a strong argument in favor of the materiality of improved ESG disclosures?

DISCLOSURE, MATERIALITY, AND THE REASONABLE INVESTOR

In the opening session, participants focused primarily on the role of investors in driving demand for the disclosure of more useful sustainability information, and the extent to which the existing disclosure regime—and its underlying body of statutes and case law—requires disclosure of such information.

Materiality Generally

Much of the opening roundtable discussion centered on the question whether sustainability information is generally material information. Materiality is a fundamental principle of mandated disclosure in the U.S. The concept of materiality recognizes that some information is important to investors in making investment decisions, while other information is not. Participants generally agreed that, while some sustainability information may

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9 17 C.F.R. § 229.503(c) (2015).
indeed be considered material in certain circumstances, not all sustainability information will necessarily meet this threshold.

To interrogate the question more fully, participants offered and considered evidence that may—or may not—support the materiality of sustainability disclosure. They did so in the context of the definition of materiality established by the U.S. Supreme Court, which underpins federal securities laws:

“There must be 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 available.”

Based on this definition, one key factor in determining materiality is the view of “the reasonable investor.” In an attempt to apply this concept to the topic of sustainability disclosure, participants discussed the real-world evidence of investor interest in sustainability information.

There is no shortage of evidence to support the claim that investors are interested in sustainability information. One participant noted that in a 2015 survey of 1,325 CFA Institute members (portfolio managers and analysts), 73 percent said they use environmental, social, and governance data in their investment analysis and decisions. As the speaker said, “If 73 percent of sophisticated investors are using the information, we can almost stop right there when asking if this is material information.”

Participants also pointed to shareholder voting on sustainability-related disclosure to shed light on the materiality of such information. For example, one speaker noted that 62 percent of ExxonMobil shareholders recently voted for more disclosure of how the company is handling climate change. Based on this and other examples, some participants were inclined to conclude that sustainability information would appear, at least in these instances, to be material.

What About Earnings Calls?
A securities lawyer challenged this conclusion, citing quarterly earnings calls as one venue in which the mainstream investment community is afforded an opportunity to directly inquire about sustainability factors, but “never” does so. The speaker, who advises companies as they prepare their 10-Q and 10-K filings, as well as the disclosures they make in earnings calls, said that companies “never get any questions” about sustainability disclosure on these calls. He then noted that the audience for such calls typically includes analysts—“the people who are making investment recommendations”—as well as the investors themselves, but none has ever uttered “any expression of interest about sustainability information.” The speaker concluded that investor interest in such information is perhaps overblown.

This observation prompted a lot of comment, and several explanations were offered. One participant pointed out that analysts on earnings calls tend to be more oriented toward short-term investing. Another participant concurred, saying that earnings calls are “quarterly by definition” and not usually concerned with long-term issues such as sustainability. This participant also indicated that earnings calls are not the only channel through which analysts may express interest in sustainability information—for instance, such discussion may also take place through board conversations or other engagements. The participant noted that many people, for whatever reason, believe that “if it’s not on the call, then it’s not real.” However, the participant said, earnings calls are highly scripted, and those asking the questions are often pre-selected. “Not anyone can just show up and ask a question on quarterly earnings calls,” the participant said, noting personal experience with investors who wanted to ask questions on such calls but were shut out. “It is a forum that is very controlled, probably for good reasons,” the speaker explained, “but it is not conducive for a full-on conversation of these issues.”

The earlier speaker (the securities lawyer) agreed somewhat, but stated that even investor relations departments—which are more likely to engage with long-term investors—don’t receive sustainability-related questions at the companies with which the lawyer works. In any case, the speaker continued, the analysts and investors involved in earnings calls are the ones who drive the behavior of chief accounting officers, chief financial officers, and financial reporting teams. When these members of corporate management think about writing their MD&A or making other disclosures, the speaker said, they do so specifically to respond to that audience. “Investors may be looking for sustainability information,” the participant said, “but the people in companies who are preparing information for disclosure are not hearing it.”

The Chicken or the Egg?
Further addressing this issue, a few speakers suggested that analysts do not ask questions about ESG issues “because they don’t know how.” Essentially, these speakers described a conundrum: disclosure of sustainability information may not be useful to investors and analysts until they better understand it, but they cannot develop their understanding until the information is being widely disclosed. As an example, one participant cited a recent standalone sustainability report produced by the airline JetBlue, in which it disclosed information following the SASB...
standards for the airline industry.  
Although the report was interesting and well done, the speaker said, it was difficult to know what to do with the information. For instance, JetBlue reported its metric tons of gas usage, but in the absence of similar information on peer companies, there was no meaningful basis for comparison. When presented with the report, the participant said, “it is difficult to know what the next question should be, and that might be why you don’t see analysts asking questions about these sustainability subjects. Maybe it’s just because it’s hard to put a frame around it.”

Another speaker added that the lack of questions from investors is not necessarily correlated with a lack of interest. “Rather,” the participant said, “people don’t understand … the medium- and long-term impacts of some of these sustainability issues.” The speaker said that when sustainability information is reported as standalone data—in a way “where it’s divorced from how the business operates and how it makes money and how costs associate with the business”—it is problematic. “If sustainability issues are continually dumped into a [separate] report on the website,” the speaker suggested, “nobody’s going to ask questions about it, because they don’t know how.”

Another speaker then described this as a definitional issue. The participant observed, “The disconnect revolves a lot around, ‘Oh, well, it’s sustainability, so you must just be talking about climate change, and nobody ever asks about climate change, and therefore it’s all irrelevant.’” Whereas much of the investment community is asking about “ESG,” companies are thinking about—and, in many cases, effectively managing—the same issues but using different terminology. For example, one speaker referenced a handful of disclosures included in JetBlue’s standalone SASB report: environmental footprint of fuel use, labor relations, competitive behavior, and accidents and safety management. “Now, is it really true that on earnings calls, nobody ever wants to know about competitive issues or nobody wants to know about labor relations or nobody wants to know about accidents?” the speaker asked. “It is hard to believe that that’s the case.” So, the speaker concluded, the nomenclature applied to such issues—be it “sustainability” or “ESG” or something else—is an important consideration.

Evidence of Financial Impact
The discussion also centered on the aspect of the Supreme Court TSC Industries v. Northway definition of materiality that focuses on whether a given piece of information would assume significance in light of the “total mix” made available. As one participant put it, it’s not just about “what investors are doing today,” but also “how the market reacts to environmental, social, and governance disclosure.” Thus, participants discussed whether the disclosure of sustainability information can have financial impacts.

Another speaker then pointed to empirical research showing that sustainability performance can impact overall company performance. The speaker cited a meta-study in which the authors found that 90 percent of the 200-plus studies they surveyed showed that companies with sound sustainability practices enjoy a lower cost of capital; 88 percent of reviewed studies showed that companies with strong sustainability practices demonstrate superior operational performance, ultimately translating into cash flows; and 80 percent of reviewed studies demonstrated that stock price performance is positively influenced by robust sustainability practices.  

Such findings, the speaker suggested, further support the materiality of information related to corporate sustainability performance. As another participant pointed out, however, materiality is not a bright-line rule or an easily applied test. This speaker noted that, in practice, different parties seem to take different approaches to thinking about materiality, which might be viewed as input- and output-focused. For example, the U.S. Supreme Court definition, the speaker said, “focuses mainly on input: What is it that people would consider important?” Whereas, often in its interpretation and application, “the SEC focuses on output: Does it have a certain type of impact?” Although discussions of materiality often cite TSC Industries v. Northway as a touchstone, the speaker asked, “What happens if a significant segment of reasonable investors would consider something important to their investment decisions, but it doesn’t have some type of impact?” The participant said a stare decisis determination based on legal precedent would answer that question in one way (i.e., “it’s material because they would consider it important”), but often in the court of public opinion, “we get to this place [where] if we don’t see an impact, we decide that it’s not material.”

Questioning the Assumptions
Given the diversity of perspectives on materiality as it relates to sustainability information, the conversation turned toward a more fundamental question of whether the U.S. Supreme Court definition is, in fact, an appropriate threshold for disclosure. Most participants seemed to agree that a principles-based framework is preferable to one involving mandatory line-item disclosures (at least in the context of ESG data). However, some questioned whether the legal concept of materiality is equipped to provide the foundation for a sustainability disclosure-based regime. As one speaker succinctly put it, “While that definition of materiality is a good standard for civil fraud liability, it may not necessarily be a great standard for deciding what should be disclosed under securities laws.”

Another participant agreed that, when it comes to sustainability, “the litigation concept of proof is problematic.” For example, when long-term impacts are involved—as they often are in the case of sustainability factors—how can the materiality of those impacts be proven? If there’s a known trend or uncertainty...
Another participant pointed out that it is easy to talk about materiality as binary—i.e., is it material or not? However, the speaker suggested, there may be degrees of materiality. Thus, it may be more useful to recognize it as a bell curve of things that may be material, and instead focus on the question of duty: “Should the SEC, and/or the courts, establish a duty to disclose wherever it lies on the materiality spectrum?” The speaker acknowledged that this inevitably becomes a question of costs and benefits, but pointed out that “the stronger the case you can make for materiality, the more you’re going to easily find benefits.” Even so, if one were to ask which drivers are going to affect the value of a company in five years and then ask how many of those drivers are required disclosures, the speaker said, “the answer is ‘Not many.’” That’s not because the degree of the company’s investment in intellectual property, innovation, and so forth isn’t material or relevant, but rather it is because it has been decided that it is not cost-effective to mandate that kind of disclosure. “When we realize that [information for which there is a] duty [to disclose] is a subset of that which we reasonably concluded is material, we move the discussion forward,” the participant concluded.

Who Decides?
As the discussion unfolded and produced a laundry list of questions, some participants observed that a primary point of ambiguity seemed to be who does—or who should—settle matters such as whether the information is material, when is there a duty to disclose, what is the channel of disclosure, and so on. Should it be a top-down, regulatory process or a bottom-up, market-based one?

In considering this question, many speakers agreed on one point: “We don’t want the decider to be Congress.” One participant cited past U.S. Congressional policymaking to make the point, referencing the 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act, which required disclosure related to conflict minerals—gold, tin, tungsten, and tantalum whose purchase funded armed groups in conflict zones near the Democratic Republic of the Congo. In this case, Congress appeared to decide that disclosure could advance an important national policy, but, the speaker said it was “divorced from what the SEC has traditionally done.”

Another speaker agreed, pointing out that the SEC may be in the best position, with regard to sustainability information, “to weigh the costs and benefits and raise the policy questions and really focus on trying to figure out who the reasonable investor is in this era in the 21st century.” A different participant noted that this is in stark contrast to the 1970s, when the SEC addressed this issue after being sued by the Natural Resources Defense Council (NRDC). At that time, the speaker observed, the NRDC’s “argument was that protecting the environment is an important national policy, and therefore the SEC should require disclosure on that subject. There wasn’t much argument then about investors using this information to make decisions because there wasn’t much evidence—in those days—that investors would use that kind of information in making decisions.” That is no longer the case. Nevertheless, in promoting sustainability disclosure, there is a risk of losing sight of why the SEC and the federal securities laws exist. The answer, the speaker said, is to require disclosure of information that would be significant to an economically motivated investor in making investment decisions. “If you get away from that proposition, then you will have a lot of irrelevant noise in disclosure.”

In contrast to support for SEC oversight, other participants suggested alternatives. For example, as one participant pointed out, when the 1933 Act was passed, most large companies were publicly traded—it was simply the best, cheapest way to amass financial capital. Today, however, many large and hugely influential companies are part of the private equity market, raising money through channels that fall outside the scope of the federal securities laws. The participant suggested considering a different, non-SEC regime for certain kinds of disclosure—cit- ing Europe as a model—in which the requirement is not linked to public registration. “Why link it to public company status when you can have a privately-owned … company with exactly the same impact who’s not going to be subject to disclosure?”

Other participants suggested the better option is to “let the market decide.” By putting it in the hands of companies and their investors to work out amongst themselves, they argued, any efforts are more likely to reflect the needs of stakeholders and less likely to get bogged down in bureaucracy. However, as another pointed out, this approach is likely to be slow and, occasionally, painful. “Are we fated to continue to watch the market speak and fall prey to the evolutionary process where you see a BlackRock or a Vanguard or even a Fidelity basically say, ‘We think it’s important. We’re going to use the shareholder proposal process as a tool for negotiation’?”

Considerations for Corporate Uptake
A primary reason that the “evolutionary process” is likely to move at a glacial pace, according to participants, is that sustainability initiatives—at both companies and among their investors—originated and have “grown up” outside of core operations. At corporations, for example, sustainability departments exist in silos, separate from finance, accounting, risk management, investor relations, compliance, and other departments or functions potentially relevant to rigorous sustainability disclosure. Adapting to a new reality, in which sus- tainability is wholly integrated into a firm’s strategy, operations,
and reporting processes—not to mention its organizational structure—necessarily involves a certain amount of time, effort, and expense, according to speakers. Furthermore, because of potential liability risks, companies’ progress down this path is even more likely to be cautious and deliberate. (This subject will be discussed further in Session 2: Corporate Implementation of Sustainability Disclosure.)

Under existing regulation, the question of "who decides?" is straightforward: Companies do. Materiality is "an inherently fact-specific finding," an inquiry that requires consideration of the source, content, and context of a piece of information. However, as one participant pointed out, although questions about sustainability—including from large investors—are being put to corporations, "they’re not being put to the financial people who [prepare] the securities reports" because of the traditional “silos” that separate sustainability and other functions.

Instead, another speaker noted, corporations are “spending tens of millions of dollars completing very extensive data filings” with Global Reporting Initiative (GRI) and other sustainability reporting frameworks in an attempt to meet the demand of large investors. Because many of these initiatives appeal to a broad group of stakeholders (including NGOs, employees, customers, communities, and others), they lack the focus of mandatory public filings, which are guided by an investor-centric conception of materiality. As a result, such reports cast a very wide net, capturing dozens or, in many cases, hundreds of data points covering a wide swath of subjects, many of which may not be relevant to a company’s business or to its investors. “If the CFO or lawyers realized some of the information that is going through the Chief Sustainability Officer [or] COO or Chief Marketing Officer,” the speaker said, “then there might be more of a sense that these other parts of the company are dealing with [sensitive] things, and they’re putting out public information, using terms like ‘material’ or ‘absolutely imperative’ or ‘billions of dollars,’ and making commitments on changing operations that are not finding their way into the securities filing.” So, the participant said, it’s not that investors are not interested—it’s that they’re already getting information through alternative channels that lack the safeguards of financial reporting. “It’s a very dangerous position for corporations to be in,” the speaker concluded.

Other speakers agreed that the status quo poses problems for both companies and their investors. One pointed out that under the current proliferation of voluntary sustainability reporting frameworks, "If companies have a good story to tell on their sustainability, they will of course tell it. But if they have a bad story, one might surmise that they will not tell it." This doesn’t help investors, or anyone else for that matter, the speaker said. Another suggested that, while there may be few questions about the information contained in sustainability reports during quarterly earnings calls, they may instead go to the investor relations office and be routed improperly. “There may be topics in that report that are appropriate for [the sustainability officer], but there are lots of topics that should be focused at the CFO level, and the finance level, and the strategic and risk officers, as well.”

However, these obstacles can be overcome, another participant suggested. The speaker mentioned General Electric as an example of a company that produces an integrated report (incorporating both financial and sustainability information). GE will “pull together their different silos and get people from different parts of the corporation more sensitive to different issues.” The introduction to GE’s 2016 report states that it “shows investors GE through the lens of management,” consistent with the SEC’s guidance for Item 303 of Regulation S-K (MD&A); it includes as one of its three principal objectives: “to provide a narrative explanation of a company’s financial statements that enables investors to see the company through the eyes of management.”

Another participant pointed out that these issues are already being addressed in SEC filings, but “they’re disclosed at a much higher level, they’re disclosed as strategic issues, disclosed as a risk." The real push-back, according to the speaker, is that companies aren’t convinced of the value in reporting specific pieces of data or in using highly granular metrics such as those proposed by the SASB. The speaker suggested that “most companies would fully concede [the issues] are material,” but disagree on how to best measure performance. Based on feedback from clients, the participant said, many companies would say they are “more than happy to talk about it with investors who are interested,” and to “tie it to what we think it means for the financial business of the company,” but would not find detailed performance metrics to be relevant.

Another participant countered that although sustainability accounting efforts may not have identified the best performance measures yet, they’re “on the road to operationalizing” these issues. Specifically, the speaker pointed out that the SASB has made a conscious decision to be conservative and to work through the lens of financial materiality. The speaker said, although the metrics may not be perfect, they at least represent an attempt to ask the right questions—such as, “Of those issues you’re worried about for the future, which ones are going to hit your bottom line? Which ones are going to trip your cost of goods sold? Which ones are going to radically change your revenue up or down in a very consciously economic sense?” The speaker suggested there’s a lot of value in having identified the issues, even if the way performance is measured may need to be refined. As the participant said, “Maybe that’s not the end of the discussion, but it’s a pretty good place to start.” If, in fact, these issues are material to companies—and their vague, often boilerplate disclosures indicate that they are—companies should be interested in moving that conversation forward, the speaker


said. It’s important, then, to “break down the communications barriers so that instead of raving for 20 minutes, your client would say, that’s the wrong metric, but the right metric is this one that I’m using right here.”

Considerations for Investor Uptake
As many roundtable participants observed, investors—even those who are strong proponents of improved sustainability disclosure—face challenges of their own. For example, the way large investment organizations—such as asset owners and managers—approach sustainability often mirrors that of corporations, with core strategy in one silo and ESG in another. One participant noted that some companies are beginning to put sustainability information in their Schedule 14A proxy statements, 19 which are issued prior to shareholder meetings, and pointed out that this illustrates an important disconnect: Although sustainability information might be immaterial for analysts participating in the quarterly earnings call, it may be highly material for investors’ governance teams. “So here we have a piece of information, like executive compensation, that might be material for proxy voting purposes, but not material for pure financial investment purposes. Is there a difference?”

The speaker said that if something is material for a proxy voting decision, one can argue that this is an economic decision. But when investors have “two silos, making different decisions, often at odds with each other, often without talking to each other,” the question of materiality becomes complicated. Essentially the question becomes, are both silos reflecting the concerns of “reasonable investors”? This may be especially true when the investor—for example, an asset manager such as BlackRock—is also a public company, another participant said. When these investors make a shareholder vote or engage with a company, “to what extent is it grounded in a desire to make a buy/sell decision on the one hand, or to what extent are they managing their own reputational risk as a publicly held company?” As the speaker pointed out, these two interests may not always be aligned, creating a mismatch between the materiality threshold and the “reputational pain threshold” of a company.

Another participant observed that in its 2016 Concept Release on Regulation S-K, 20 the SEC discussed to whom disclosure should be directed. For example, the release mentioned that the Securities Act of 1933 and the Exchange Act of 1934 require the disclosure of information necessary or appropriate in the public interest or for the protection of investors. 21 It also pointed out that subsequent studies initiated by the Commission have suggested a need to strike a “pragmatic balance ... between the needs of unsophisticated investors and those of the knowledgeable student of finance,” without expecting filings “to be readily understandable in total by uninformed investors.” 22 As the speaker pointed out, “the concept of a reasonable investor varies,” thus it may be better defined as “a range of reasonableness—just like in fair value [accounting], it will not be a point, but a range.”

As another speaker suggested, “if there’s something called a reasonable investor, there’s also something called an unreasonable investor.” When it is left undefined, the speaker said, markets may face a situation where a significant majority of investors want some information or believe it is important, but “if we decide they’re unreasonable, then we don’t care if they want that information.” When individuals decide for themselves which investors are reasonable (for example, those participating in earnings calls) and which are not (for example, everyone else), it allows them to ignore portions of the investor community, the speaker said. Therefore, based on their own assumptions, they can “block out whatever noise” they have decided represents the unreasonable perspective, even if it may have great value. The concept needs to be further developed, the speaker concluded, given the wide diversity of investors in the market today.

On the subject of the “reasonable investor,” another participant observed that the concept evolves over time—in other words, what is reasonable today may not have been yesterday, and what is reasonable tomorrow may not be now. For example, the speaker said, “the thinking that Schedule A [of the 1933 Act] 23 was the end all and be all was the originalist view of disclosure.” However, since then, the SEC has used its rulemaking authority to prescribe additional information—as well as to omit unnecessary information—to result in a set of disclosure requirements that, with a few notable exceptions, most people would consider essential today. This ability of the disclosure regime to evolve alongside the reasonable investor is crucial in today’s market, where broad macroeconomic trends such as population growth, globalization, and technological innovation have contributed to environmental and social impacts such as climate change, resource scarcity, and rising economic inequality. As the speaker put it, “Things change. Investors have different things that they’re interested in.”

In a related comment, another participant tied this exploration of the reasonable investor back into the question of whether materiality—as defined by the U.S. Supreme Court—is an appropriate standard for the disclosure of sustainability information. As an alternative way of considering the issue, the speaker suggested the mosaic theory, a commonly used approach to securities analysis that involves piecing together bits of information from various sources to be considered together as a whole. As the speaker said, “no particular tile may be material to a mosaic, but eliminate it and you do not see the whole picture.” Another speaker pointed out that such an

Bridging the Divide

Ultimately, sustainability disclosure may be considered in terms of supply and demand. On the demand side, an increasing number of mainstream investors are seeking out better data on corporate sustainability performance. On the supply side, issuers are disclosing more information on ESG factors largely outside of the SEC reporting regime. At the end of the day, neither seems particularly satisfied.

In order to overcome this disconnect, participants generally agreed that both sides—companies and their investors—need to focus on sustainability in fundamentally economic terms. Many special interests “want these disclosures because of some broader public policy interests that [they] have,” one speaker mentioned, but such a perspective is not helpful to either corporate leaders or to investors, who—as the users and providers of financial capital—are the stakeholders in the best position to effect meaningful change. Another participant wondered how securities lawyers could conceivably advise their corporate clients without an economic grounding because a lawyer cannot reasonably advise without some neutral, analytic foundation. As the speaker said, “The sustainability umbrella obviously could be of economic significance. Right now, for some companies, they are not trivial topics, they’re serious topics. But the demand for disclosure is too much unhinged from this economic approach.”

Another participant cited conflict minerals as an example of sustainability disclosure that is rooted in social—rather than financial—impact; although the issue is important, it is unlikely to have relevance for economic decisions impacting a company or its securities. Thus, the speaker said, it is worth thinking about whether there are aspects of sustainability that may be of general concern, but would be better addressed in their own light and on their own terms, “as opposed to this constant arm wrestling” about how they fit into the materiality-based, SEC disclosure system.

Another speaker agreed that for sustainability disclosure to be useful to investors, “there needs to be an anchor to economic value.” The participant said that because sustainability matters generally involve medium- to long-term impacts, they are often “unobservable” and leave users “grappling with the uncertainty.” As a result, “a lot of sustainability exists in the realm of ‘beta’—it’s kind of out there in the ether.” However, by grounding it financially and identifying metrics with which it can be operationalized, the speaker said the issues can move from being vague areas of uncertainty to being quantifiable financial risks. If the link exists, it should be possible—albeit not necessarily easy—and at that point “people begin to become more comfortable with it.”

For those investors who are already comfortable with sustainability information, most participants stressed that the need for an economic lens extends to how they express their demand to portfolio companies. However, as one speaker noted, it may be enough to simply open lines of communication with the right parties. When companies provide disclosure, the speaker said, they do it in response to what they think economic investors want—and they will do it whether it is required or not. Indeed, the speaker continued, they will provide information voluntarily as long as they think the investor base wants it. If those investors want information, including sustainability information, “the companies generally will provide it voluntarily, because they have to in order to compete in the marketplace.”

Communication Disconnect

Many speakers noted that a key reason investors and companies struggle to see eye-to-eye on sustainability is that, in many cases, they are speaking different languages. Because, as noted above, the term “sustainability” can be applied to a wide variety of different issues—from environmental impacts to social concerns to employee relations—it gives rise to much confusion. One speaker said that no matter how you define “sustainability,” corporate audiences will always think of it in narrow terms related to the environment and climate change—and their disclosures are likely to reflect that. Another speaker agreed, questioning whether the umbrella term “sustainability” advances the discussion or just shuts it down. “Environmental, social, and governance—those topics are all so different,” the speaker said. “It can be hard to get your head around the topics.”

Another participant found it simple to conceptualize as, “What are the issues that are important … to having this company be sustainable in the future?” After all, the speaker pointed out, companies provide investors with copious information about what happened yesterday and what’s true today, but “what investors really want to know, like all of us, is, ‘What’s going to happen tomorrow?’” Another participant agreed, adding that sustainability is “really not that different than the forward-looking aspect of [Item] 303 [disclosure].” Although they use different terminology, another speaker agreed, companies are actively thinking about and managing sustainability issues. In many cases, the participant suggested, they can’t afford not to. “They’re sitting in the C-suite thinking, ‘If I continue to do the things the same way, in three years I’m going to run out of X.’ Or ‘I’m going to be at the top of the heap, and isn’t that a great thing?’ And ‘Maybe I’ll put some more money into why that is, because it’s really going to distinguish me from the crowd.’” In other words, the speaker said, company leadership is thinking
about sustainability issues as business issues—some of which also happen to be environmental issues, or labor issues. What they’re not doing, the speaker continued, is a good job of telling their investors and their potential investors about how they’re managing these factors—“and they’re not even doing that when it’s an opportunity rather than a risk.”

One proposed solution would be to describe sustainability factors in industry-specific terms. To frame ESG factors in a way that is actionable and can be operationalized, one participant suggested, “they must be very specific in terms of language, whether it’s exposure to counterfeit drugs in the pharmaceutical industry, whether it’s data security issues, or whether it’s how competitive a company is in doing R&D to get their emissions down in new automotive markets.” Several others agreed, with one saying that the core of sustainability is asking what strategy a company is pursuing to deal with long-term trends specific to its circumstances, and another suggesting that the key questions are: “What are the long-term trends that are at risk for companies in the particular industry in which they operate? And is this company, in this industry, being proactive in the face of those trends?”

Looking Ahead
In assessing the situation overall, many participants identified areas of dysfunction in the existing reporting ecosystem. In terms of mandatory disclosure, one speaker remarked that the SEC’s guidance thus far on sustainability matters—such as its releases on climate change24 and cybersecurity25—has gone “to great effort” to give companies what they want, which is a principles-based disclosure framework in lieu of promulgating prescriptive line-item requirements. As the speaker pointed out, this guidance has addressed how existing requirements, including those related to risk factor and MD&A disclosure, may be applied to sustainability information. Nevertheless, the speaker said, many companies have not done so, or have done so poorly, and SEC enforcement has been lacking. For example, the Commission issued 38 comment letters addressing the adequacy of registrants’ climate change disclosure in 2010, but that number trailed off to zero by 2013, despite the fact that nearly half of all registrants failed to address climate change in their filings and, among those that did so, disclosure consisted mostly of non-specific, boilerplate language.26 The participant admitted not knowing the solution, but believed the questions raised are important. For example, should disclosure be prescriptive or principles-based? And, if it is principles-based, how do you get companies to follow through?

Another speaker agreed, saying, “Shouldn’t we ask why voluntary disclosure isn’t working, particularly in an era where something like SEC Rule 14a-8 [which governs the inclusion of shareholder proposals in proxy statements] is more functional than it was before?” The speaker suggested that litigation risk must be what is silencing companies, and if that is so, then MD&A is probably “not a good vehicle for promoting this sort of disclosure.” Going back to the earlier discussion of employing a fraud standard to guide disclosure, the participant noted irony in the fact that it may be doing more harm than good by raising the specter of litigation risk. The private civil liability system, which “many if not most academics think does little to advance investor interest” in its own right, is also significantly inhibiting companies’ willingness to make more robust sustainability-related disclosures, according to the speaker.

The moderator agreed that the challenge is manifold, citing the different mechanisms for different aspects of sustainability disclosure: “Governance is distinct from traditional, good-old-fashioned thinking about Wall Street-relevant disclosure items. Liability is out there as a third rail.” Although lawyers are accustomed to thinking about liability versus corporate finance, they’re not as used to thinking about corporate governance and corporate finance collectively. The moderator pointed out that, going forward, this kind of thinking will likely have to evolve. For example, BlackRock and other large, global asset managers are not going to own less stock 10 years down the road than they do today—and neither will their reputational risks be lower. Therefore, they’re going to have multiple needs: first, proxy-style information on longer-term issues to credibly say the current board is doing the right thing; and, second, performance information for analysts who need to decide whether to overweight or underweight in the next quarter.

As the moderator pointed out, this is part of the predicament the SEC—or whoever promulgates usable sustainability standards—will have to face in the coming years. Today’s investors are as diverse as the number of securities available to them: retail or institutional, growth or value, long-term or short-term, active or passive, public or private. Once again, striking a “pragmatic balance” will be as essential as it is challenging.

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26 Ceres, “Cool Response: The SEC and Corporate Climate Change Reporting” (February 2014).
KEY TAKEAWAYS FROM SESSION 1

There is considerable evidence that investors are interested in certain sustainability information and that such information is “material” under the federal securities laws.

There is a perception among some corporate leaders and their advisers that this is not the case, based on a view that sustainability questions are not asked during earnings calls. However, this conclusion may be a result of the nature of earnings calls, the persons who participate, and an unnecessarily narrow view of what “sustainability” encompasses.

The “reasonable investor” has evolved. Today’s investors are increasingly diverse and there may be a “range of reasonableness.”

Traditional walls that exist within corporations (e.g., between sustainability and finance) and within institutional investor organizations (e.g., between investment and governance) may hinder their ability to effectively move forward with sustainability reporting and analysis.

SASB has sought to identify the best performance metrics, and companies should be interested in assisting in that process.

To break down walls and bridge the divide—between departments, as well as between companies and investors—sustainability initiatives may need to take a fundamentally economic approach, and issues may need to be discussed in terms of traditional financial drivers.
Session 2: Corporate Implementation of Sustainability Disclosure

TOPICS FOR DISCUSSION

The SASB is engaged in discussions with dozens of public companies and expects that some of these companies may begin incorporating the SASB standards into their SEC filings after they are ratified in early 2018. A number of issues are relevant to companies’ adoption of the standards, including the following topics and questions, which were contained in the agenda for Session 2:

- **Litigation Risk**

  Companies are often concerned about liability from private litigation. The following are some aspects of this concern:

  - The principal sources of potential liability relating to ESG disclosures are the federal securities laws. Because “[s]ilence, absent a duty to disclose, is not misleading,” companies sometimes can avoid liability under these laws by declining to speak at all on a particular subject. Additionally, companies generally do not face liability for immaterial statements or omissions, and the application of the materiality concept to ESG issues is often uncertain. These factors, coupled with the potentially severe consequences of acknowledging that a company is experiencing ESG-related difficulties, may provide incentives against meaningful ESG disclosure.

  - On the other hand, in at least some circumstances, current federal law clearly obliges companies to make ESG-related disclosures. Federal and state law impose a limited number of specific ESG disclosure requirements on issuers. In addition, a number of general SEC disclosure requirements, such as Item 303 in the SEC’s Regulation S-K, require meaningful ESG disclosures in some contexts. Private civil liability under Item 303 is far from absolute, however. There is a division among the courts as to whether Item 303 creates any privately enforceable duty to disclose, and Item 303 often effectively endows management with significant discretion regarding whether disclosure must be made. The issue is now pending before the U.S. Supreme Court. How might the outcome of that case impact sustainability disclosures?

  - The securities laws generally also require that, when companies do elect to speak on a subject, they must provide enough information to avoid misleading investors. This rule is not limited to SEC filings. It extends to statements in less formal contexts, such as press releases and/or sustainability reports. Most courts recognize an important exception that likely eliminates liability for many vague corporate “green” slogans. They hold that so-called soft, “puffing” statements are not actionable under the securities laws. Nonetheless, the prohibition against half-truths—along with the statutory and common law safe harbors applicable to forward-looking statements that are accompanied by meaningful cautionary language—provide companies the opportunity to reduce their liability exposure by making more detailed and substantive ESG disclosures. As with compliance with GAAP, the SASB believes it likely that adherence to standards such as those promulgated by the SASB should assist companies in warding off lawsuits in these circumstances. Is this position correct?

  - How real is the liability risk? It would seem that “fraud on the market” class actions predicated on ESG misrepresentations or omissions often are likely to fail due to plaintiffs’ inability to demonstrate loss causation or cognizable damages. But due in part to the increasing prevalence of socially conscious investors and activists, more unconventional remedies may be used to enforce disclosure requirements. These include actions for injunctive relief and state law “blue sky” remedies. Further, more fulsome ESG disclosure may reduce the likelihood of litigation under the proxy rules, which allow companies to exclude shareholder proxy proposals that have been substantially implemented. Thoughts?

  - As noted above, many companies use boilerplate disclosures to address sustainability issues, typically in the risk factor portion of their SEC filing. From a liability standpoint, are issuers better off making more specific disclosures as opposed to boilerplate disclosures? Does the fact that companies include vague references to sustainability concerns in their risk factor disclosures form the basis of a compelling argument that companies should make more detailed disclosures (for example, using SASB standards), or are the risk factor disclosures

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29. *Leidos, Inc. v. Ind. Pub. Ret. Sys.*, 137 S. Ct. 1395 (Mar. 27, 2017) (No. 16-581). Subsequent to the holding of the roundtable the parties reached a settlement agreement and, the case was removed from the Court’s argument calendar.


31. 15 U.S. Code § 78u-4 - Private Securities Litigation Reform Act

32. See, for example, *Geffon v. Micron Corp.*, 249 F.3d 29, 36–37 (1st Cir. 2001): “optimistic statements are not actionable when tempered with warnings of potential risks.”
simply seen as a form of liability protection with no real bearing on a company's broader disclosure obligations?

ESG disclosures also may result in liability under theories other than the securities laws. False, misleading, or inadequate ESG disclosures may give rise to claims under states’ unfair and deceptive acts and practices (UDAP) statutes and other similar causes of action. The plaintiffs in such actions may include consumers, competitors, or even a company's labor unions. Recently, some shareholders dissatisfied with the extent of a company's ESG disclosures also have filed lawsuits demanding books and records pursuant to state corporation law. As with proxy proposals, companies may be able to fend off some such lawsuits more easily to the extent they have already made meaningful ESG disclosures. Finally, while state corporate law does not include specific ESG disclosure requirements, it may provide additional avenues, including breach of fiduciary lawsuits and demands on the board of directors, for activist shareholders desiring additional disclosures. How significant should these potential causes of action be to a company's consideration of ESG disclosures?

**Selective Disclosure**

Investor questionnaires might also raise issues under the SEC’s Regulation FD (Fair Disclosure), which generally forbids selective disclosures of material nonpublic information, and instead requires broad public dissemination. While Regulation FD is not enforceable in private lawsuits, it has been the basis for a number of SEC enforcement actions. Is this an additional factor weighing in favor of the SASB standards?

**Voluntary Disclosure**

Even in the absence of a legal duty to disclose, companies may decide to make voluntary disclosures of information that is useful to investors in assessing the company's future prospects. There is considerable theoretical and empirical literature showing that, in the absence of disclosure costs, companies will disclose private information in order to avoid agency costs and adverse selection. The theory is that investors infer the quality of the company from its disclosure behavior. How strong is this argument in favor of using the SASB standards? Also relevant in this regard are the reputational benefits to a company that likely accrue from an enhanced status as a responsible social and environmental steward.

**Enforcement Actions**

In addition to private liability concerns, the SEC could, of course, bring enforcement actions under the federal securities laws. Also, state attorneys general have begun to bring ESG-related actions (a trend that is likely to grow if federal enforcement of the securities and environmental laws decreases under the Trump Administration). How significant should this concern be to companies?

**Risks Related to Non-SEC Disclosure**

One of the most significant aspects of this field is that many companies publish standalone sustainability reports that contain more ESG-related information than does their SEC filing. The question arises, when do selective statements about corporate ESG issues trigger a duty to make more additional, more detailed disclosures? Further, is there a liability risk when companies make more specific disclosures in their standalone report than in their SEC filing?

**Questionnaire Fatigue**

In addition to standalone sustainability reports, companies often respond to investor questionnaires seeking information about ESG matters. These are time-consuming for companies to answer. Using the SASB standards in SEC filings may enable companies to avoid responding to many of these questionnaires. Would this be a significant incentive for companies to use the SASB standards?

**Costs of Implementation**

Companies with whom the SASB staff has had conversations generally express a reluctance to make SASB-aligned disclosures in their SEC filings because of costs, primarily relating to a need for improved internal controls in order to ensure the accuracy of the disclosed information and possible need for third-party attestation. From a legal perspective, how significant are these concerns?

**Appropriate Channel(s) for Disclosure**

Companies often state that they already make extensive ESG disclosures in their standalone sustainability reports and there is therefore no need to make additional disclosures in their SEC filings. Or, companies state they might use the SASB standards in their standalone reports rather than in their SEC filings. What is the merit in this alternative? In other words, if companies start using the SASB standards in documents other than their SEC filings, will investors’ interests be served?

**What Does the Future Hold?**

Professor Donald C. Langevoort wrote in the recently published book *Selling Hope, Selling Risk* that “an increasing number of influential people think that required corporate disclosure should
move beyond backward-looking financial performance data to a more diverse set of metrics that are associated with long-term value, like human capital, innovation, and sustainability (environmental or otherwise). Auditors would be happy to oblige in assessing compliance, for an extra fee. One of the big questions for the future of securities regulation is whether this project will take hold, creating a truly public form of accounting, over which managers, investors, and political actors would fight endlessly given the lack of solid data about costs, investor benefits, and societal benefits. “34 Is Professor Langevoort correct in his view that “endless fighting” will likely result as this project moves forward?

**CORPORATIONS AND SUSTAINABILITY DISCLOSURE**

In this second session, the roundtable participants concentrated on corporate implementation of sustainability disclosure and, in particular, the liability concerns associated with such disclosure. The participants also discussed when a duty of disclosure arises; what forms the disclosure can or should take; who should control the process; whether the disclosures should be part of mainstream financial filings, such as those mandated by the SEC; and how the costs related to improved disclosure impacts the decision to disclose.

**How Significant Is the Liability Risk?**

The discussion of liability risk was informed by a memorandum prepared for the roundtable by the law firm of K&L Gates. The memorandum surveyed the relevant case law and, while not reaching definitive conclusions, noted that most lawsuits involving traditional ESG factors have failed. Another memorandum, a client advisory memorandum issued in March 2017 by the law firm of Gibson, Dunn & Crutcher LLP, was also provided to participants in advance of the roundtable. This memorandum took a more negative approach to sustainability disclosure initiatives, such as the SASB’s; it cited uncertainty about liability risk in this area and urged caution. It concluded, among other things, that “[w]hile [corporate social responsibility] statements may foster public goodwill and inform customers and investors about positive company initiatives, they can also create real litigation and liability risks.” It also noted that although lawsuits in this area are generally unsuccessful, disclosures made in an SEC filing “may increase the risk of litigation, as courts may presume that the statements are material or that investors and consumers relied on them.”35

With those commentaries as a backdrop, a securities law professor began the discussion by noting that, as a general matter, silence can be an attractive course for companies concerned about liability because it is harder to be sued for not disclosing information than it is when a company discloses something that turns out to be inaccurate or misleading. As the Supreme Court has put it, “silence, absent a duty to disclose, is not misleading.”36 Silence may be particularly attractive to issuers because the duty to disclose sustainability information is frequently uncertain and companies do not typically face liability for immaterial misstatements or omissions. The K&L Gates memorandum also considered this view: “These factors, coupled with the potentially severe consequences of acknowledging that a company is experiencing ESG-related difficulties, may provide incentives against meaningful ESG disclosure.”

Notwithstanding these legal issues, the securities law professor stated his view that the likelihood of a successful private legal challenge under the federal securities laws based on an allegation of false or misleading sustainability disclosure is “tiny.” Nevertheless, the professor added, telling a corporate client that the likelihood of losing at trial is remote may not be enough to support improved sustainability disclosure. This is because a securities lawsuit arising out of a sustainability disclosure could result in significant legal costs, negative publicity, and distraction from core business responsibilities. The Gibson Dunn memorandum noted in this regard: “Claims challenging [corporate social responsibility] statements have also survived the pleading stage in at least a few instances, subjecting companies to costly discovery.”

The professor went on to say that what most troubles many companies is the fear of a major incident or accident that can be traced back to a sustainability disclosure that failed to properly or correctly address an underlying issue—and thus could open a company to real and substantial legal liability. Here, the speaker referenced the BP Deepwater Horizon disaster. The professor described a BP-like scenario in which a company issues years of upbeat sustainability disclosures during which nothing untoward occurs, but then one day “something explodes, or there is a cybersecurity breach, or some other disaster befalls the company.” In such a case, the speaker suggested, “suddenly the past sustainability reports are scrutinized for legal liability, either for failing to disclose a problem or for disclosing a problem that was not corrected.” In fact, the participant said, some hedge funds are now using machine learning algorithms to scan corporate disclosures for “happy adverbs,” which might be the source of future disclosure-related liability. So, the speaker concluded, there will always be risks—including sustainability-related risks—that companies recognize as having BP-like disaster potential, and they will be reluctant to issue statements around these risks for fear the statements might, at some future date, become the source of legal liability.

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Another speaker noted that even if one were to conclude that the liability risk under Rule 10b-5 is negligible, there remains a concern about liability under Section 11 of the Securities Act. This lawyer said that from his standpoint this is “a very simple reason” why a seasoned issuer should not make sustainability disclosures in Form 10-K, where it would be incorporated by reference into a registration statement.

Many Reasons Why Better Disclosure May Actually Reduce Liability Risk

These comments prompted a vigorous discussion. A number of participants described reasons why, in their view, liability concerns in this area are misplaced or overstated or, at the very least, in need of more context.

First, there is the general principle under the federal securities laws that silence is not an option if there is a duty to disclose. Thus, disclosure may be required if the information is material and is mandated by, for instance, Item 303 (MD&A) because it constitutes a “known trend or uncertainty” that is “reasonably likely” to impact a company’s operating performance or financial condition. A company can be sued for nondisclosure of material information, particularly if it makes more fulsome disclosure outside an SEC filing. Of course, whether sustainability information is material as a general matter is a matter of some debate, as discussed in Session 1 above.

Second, several participants observed that liability under the federal securities laws can arise no matter where a false or misleading statement is made, as long as it is material and the plaintiff can show causation, reliance, or scienter on the part of the defendants, and damages. They discussed the fact that much sustainability information is currently disclosed outside of SEC filings—in stand-alone sustainability reports, on websites, or elsewhere—and is also disclosed as “boilerplate” in SEC filings. These disclosures were described as “upbeat public relations pieces” containing “general and laudatory commentary” about how companies promote sustainable practices within their operations. When such statements are made in the “loosely controlled” environment of sustainability reports, several speakers noted that they can more easily backfire, particularly after an accident or incident that can be traced back to the sustainability report. The BP case was referenced again as evidence of how positive but unrealistic sustainability disclosures can ultimately lead to legal liability.

A participant also noted that “there is the notion of the half truth,” in which securities fraud liability can arise if an issuer fails to provide all the information necessary to make a statement not misleading. As the K&L Gates memorandum noted, quoting from relevant case law, this legal doctrine provides that “once a company speaks on an issue or topic, there is a duty to tell the whole truth.” The potential for “half-truth” liability is significant since most sustainability-related issues are likely to be addressed as risk factors. Further, more detailed disclosures may enable an issuer to take advantage of statutory or common law safe harbors for forward-looking information. Again, according to the K&L Gates memorandum, citing case law, “providing detailed and thoughtful risk disclosures in areas suggested by SASB standards may enable a company to avoid liability.”

Liability for statements made outside SEC filings was made more concrete by a further discussion of the BP Deepwater Horizon incident. One of the many lawsuits brought against BP and a certain number of its officers was a shareholder securities fraud class action alleging that BP had made a series of misleading statements—mostly in sustainability reports, but also in two SEC filings—that BP had instituted a safety measure (called the “Operating Management System”) at “all” of its offshore oil rigs when, in fact, it had only done so at rigs fully owned by BP and not at leased or contractor-owned rigs. These allegations, the court held, were sufficient to withstand a motion to dismiss filed by the defendants.37

Third, several participants felt the BP episode made a compelling case for putting sustainability information through the rigor of the traditional financial reporting process, which reduces risk by using accounting standards, effective internal controls, sound data governance, well-established regulatory oversight, and external audits or reviews. Such a process, they argued, adds protection. One former regulator wondered why companies are not “petrified” when they release sustainability information in reports or on websites without the benefit of the scrutiny that goes into a 10-K filing.

Many companies take a very calculated approach to disclosing financial performance in their SEC filings but fail to monitor or control sustainability reporting efforts, without sufficient concern for the heightened legal liability risk this approach may produce, this speaker said. Another speaker agreed, stating that boilerplate sustainability reports issued outside the traditional financial reporting process may be more vulnerable to litigation liability.

On the other hand, not all participants were convinced that this was a rationale for the SASB’s efforts. One commenter said, “So companies need to become more disciplined, but that doesn’t necessarily lead to a conclusion that I’ve got to integrate those [sustainability accounting standards] and make those part of an SEC disclosure document with securities law liability in order to get quality.”

Fourth, a participant said that use of the SASB standards might lead to implementation of better sustainability-related procedures, again with the BP incident as a lesson. The commenter pointed out that a more complete conversation about such safety disclosure within BP might have led the company to inspect all the rigs—both owned and contracted—and perhaps improved safety. Discussion of the BP incident prompted another

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37 The Court of Appeals for the Fifth Circuit later denied class action status to the plaintiffs in this lawsuit. Ludlow v. BP PLC, No. 14-20420 (5th Cir. September 8, 2015). According to news reports, a settlement of $175 million was subsequently reached as to the securities law claims.
speaker to suggest that the lesson for others is not only that more rigorous sustainability disclosure standards can help mitigate liability risk for an individual company, but also that an incident at one company that can be tied to a sustainability reporting issue can affect liability risk for other companies in the industry. In other words, the participant explained, when BP was alleged to have made misleading sustainability disclosures, all other oil and gas companies should have been worried about their own reporting and performance on safety issues. Before the incident, the company’s sustainability reports asserted that BP adhered to high safety standards, but the veracity of those disclosures came under attack after the explosion. The speaker said the BP case meant that all companies with oil rigs would find themselves under similar scrutiny regarding how well they handled safety issues and how well they disclosed their performance. In effect, their liability increased even if they did not report on their safety performance, the participant said, suggesting that the same situation could apply across other industries. In fact, as another speaker described, in response to the BP incident at least one investor reviewed a portfolio of holdings in the context of the BP sustainability reports, seeking answers on the effectiveness of safety programs and strategies at other companies.

Fifth, a speaker made a broader point: He said that a company might be better off in a lawsuit involving a sustainability disclosure if it were able to state that it had used the SASB standards. Defendants in financial fraud lawsuits typically argue that they complied with Generally Accepted Accounting Principles (GAAP) in making their financial statement disclosures, and, if they can establish that, a finding of liability is highly unlikely. The K&L Gates memorandum stated in this regard: “As cases involving [GAAP] suggest, compliance with a set of well developed, transparent standards may reduce the risk that disclosures will be found to be misleading or made with fraudulent intent.”

Finally, a securities law professor went outside the federal securities laws and noted the “increasing awareness” that plaintiff lawyers have about books and records lawsuits under Section 220 of the Delaware General Corporation Law, which authorizes shareholders with a proper purpose to demand independent, third-party attestation, but so far this has not report on their safety performance, the participant said, suggesting that the same situation could apply across other industries. In fact, as another speaker described, in response to the BP incident at least one investor reviewed a portfolio of holdings in the context of the BP sustainability reports, seeking answers on the effectiveness of safety programs and strategies at other companies.

**Risks versus Rewards and Disclosure Processes**

Other aspects of sustainability disclosure and associated risks were also discussed. One speaker questioned the cost-benefit ratio of improved sustainability disclosure. Specifically, the participant offered a view that the idea of reducing litigation risk must first be framed within the context of the relative size of the risk. To convince companies to invest in such disclosure, there needs to be sufficient reward. Unless companies perceive that reward to be meaningful, the speaker said, they are not likely to bother.

In this regard, some attention was given to the reputational reward that could result from better sustainability disclosure. A company might show that it is “on the ball” and engaged in “general good behavior” if it were to use the SASB standards, according to one speaker. Another participant noted the existence of studies showing improved stock market performance in response to better sustainability disclosures. Another practitioner noted that issues of strategy and competition and human capital “are not very well addressed in S-K today;” indeed, discussion of human capital “is completely deficient in SEC filings” even though companies “compete on the basis of human capital every day.” Improved disclosures in these areas would clearly benefit investors.

Participants also discussed several elements of the financial reporting process, including the involvement of disclosure committees. One participant cited the Gibson Dunn memo, which recommends that companies carefully consider who signs off on corporate social responsibility statements, including to what extent directors and senior management should participate in the process. Another speaker said his law firm has been advising companies to put all sustainability reporting through their disclosure committees, and is also advising company boards to pay much closer attention and to take a more active role in sustainability disclosure to reduce risk.

A speaker recalled from the earlier session that sustainability reports are often prepared apart from other company business functions, in effect conducted in a silo run by sustainability advocates, while financial reports are conducted in a separate silo overseen by accountants and lawyers. The situation has created friction in some companies between legal offices and sustainability offices, the speaker said, and some clients, according to this person, have taken the view that “we’re not going to let the lawyers get involved because they’ll make us do” more extensive work in connection with sustainability disclosures, including insisting that the disclosure committee get involved.

Another participant asked whether the accounting community is actively working to improve the quality and reliability of sustainability disclosure, and whether such an effort might help lower the liability risk involved. A participant responded that some accounting firms are helping companies develop more reliable data collection and reporting methods and stronger controls in the sustainability disclosure process. The speaker added that the quality of sustainability disclosures could be improved by obtaining independent, third-party attestation, but so far this has

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rarely happened. Another commenter pointed out that several accounting firms offer this service at a cost of “several hundred thousand dollars,” raising skepticism that many companies will see the value in such a practice absent strong countervailing considerations.

An additional contributor to the problem, a participant suggested, may be the different constituencies the two sides believe they are addressing. The audience for sustainability reporting might include a broad swath of stakeholders, including customers, employees, NGOs, communities, and others (although the SASB standards are directed solely at investors). Financial reporting, on the other hand, focuses entirely on the needs of the investment community, which advocates for transparency as a guide to investment decision-making. Speakers questioned how much value the investment community places on sustainability disclosure. “If there was more pressure from the investment side, companies would be more inclined to incorporate sustainability disclosure in financial statements,” one said.

Another participant pointed out that this difference in audiences can sometimes shape the way sustainability disclosure is framed, undermining its usefulness and credibility among traditional financial market participants. For example, this individual pointed out that company boards of directors are interested in three things: strategy, risk, and people. However, sustainability is often defined within the context of environmental and social issues rather than in relation to corporate strategy. This doesn’t mean that rigorous sustainability disclosure couldn’t be very closely tied to corporate strategy and long-term financial performance, the speaker said. It could be, but it typically is not. The commenter pointed to efforts to better manage conflict minerals. Conflict mineral issues are “often dismissed by investment professionals as a political issue,” the participant said. Although this may be fair in certain industries, “for companies in the tech industry, conflict minerals are clearly an important strategic issue.” Many technology companies, including manufacturers of hardware and semiconductors, require these minerals, and if conflicts drive these firms out of a key supplier’s country or restrict access to the minerals, then operations and strategy will be directly impacted. Therefore, the speaker concluded, properly disclosing the risk from conflict minerals is an issue of significance to both sustainability advocates, who are concerned with social issues; and investors, and who are focused on company performance.

Back to the Future
Speaking of company performance, a side issue that came up during the discussion was which type of indicators to use in developing standardized metrics for sustainability disclosure: KPI (key performance indicators) or KRI (key risk indicators). One speaker argued that KPIs are backward-looking data points and so are not as useful as forward-looking performance indicators. KRIs, the participant said, might be more effective as forward-looking indicators, since they disclose potential risks confronting the company. However, others argued that KRIs are too general to be useful in analyzing a situation within a company. These participants said KRIs are primarily risk management statements intended to state the company’s awareness that a risk exists, but don’t provide enough information on how a company is managing those risks.

Several speakers argued in favor of using KPIs to capture past performance and then to use that data to make projections about future performance. They pointed to past data on safety performance by a company as a good indicator of how a company manages that issue and might handle it in the future. Also, because normalized KPI data on safety should be comparable within an industry, the data should give an investor the ability to compare performance across peer companies. Multiple speakers suggested combining risk and performance reporting (i.e., both KRIs and KPIs), so that a stated risk could be better understood and thoroughly analyzed.

The Elephant in the Room: Costs
Several speakers addressed the question of disclosure implementation costs. At least in the short term, costs are likely to be substantial and therefore would run into fierce resistance from financial officers focused on the bottom line.

Participants differed in their assessments of potential cost. One participant said that costs should not be nearly as steep as many companies seem to believe. The speaker pointed out that by viewing sustainability through the lens of financial materiality, the company can focus on the small handful of sustainability issues that are most important. Also, it was suggested that costs would largely be upfront, relating to putting in place adequate systems of internal control. Further, a speaker said, by using common metrics—such as those contained in the SASB standards, which in many cases are already collected by companies—a company can reduce its implementation costs. A participant stated a view that projected costs of new initiatives are often “highly exaggerated;” a different speaker countered that the relevant costs include not only those involved in the preparation of the disclosure, but also in the financial review and approval required for an SEC filing. Once you add in the design, application, and maintenance of internal controls, the involvement of the disclosure committee, the work of compliance and both internal and external audit teams, and so forth, the number can grow quite large. A speaker noted issuers’ experience with Section 404 of the Sarbanes-Oxley Act, where implementation costs were “way underestimated.” But it was also noted that these are not “costs in a vacuum;” they need to be compared to some other costs, for instance, in the case of BP, the costs of not making better disclosures.
KEY TAKEAWAYS FROM SESSION 2

The risk of a successful lawsuit based on an allegedly false or misleading sustainability-related disclosure under Rule 10b-5 (the principal federal securities law anti-fraud provision) is likely very small, but it is not non-existent; although lawsuits in this area would likely be dismissed, like almost all that have been filed thus far, litigation is inherently expensive and disruptive. Also, liability concerns under Section 11 might exist for seasoned issuers if disclosures are made in Form 10-K.

On the other hand, there are likely several significant litigation-avoidance or litigation-reduction benefits that would result from adhering to a market standard such as the SASB standards. Among those that were discussed:

○ Companies are currently at risk because they frequently make extensive sustainability-related disclosures outside SEC filings or make “boilerplate” disclosures within SEC filings. All these types of disclosures can give rise to liability. Issuers using the SASB standards, particularly if disclosures are made in an SEC filing, are more likely to establish internal control and other processes to obtain and disclose higher-quality sustainability information.

○ Companies defending against allegations of insufficient sustainability-related disclosures might benefit from being able to cite their compliance with SASB standards, just as defendants in financial statement-disclosure lawsuits point to compliance with GAAP in defending securities fraud lawsuits.

○ The due diligence relating to sustainability matters, which would likely result where companies use SASB standards, could lead to implementation of improved risk-protection measures.

○ Companies may be better off making improved disclosures as a means of avoiding proxy litigation as well as books and records litigation under Delaware law.

Given the uncertainty over liability risks, issuers need to be convinced that there is some reward to using the standards and that the investment community has substantial interest in these issues.

Use of SASB standards may have other positive outcomes: they could lead to better disclosure of “business performance” issues, such as human capital matters; and by making better sustainability disclosure, management can show it is “on the ball.”

Costs related to making more robust sustainability disclosures are clearly a concern, although some participants thought cost estimates may be exaggerated and, in any event, are likely mostly to be upfront costs (although third-party assurance would presumably be a recurring expense).
Session 3: Involvement of Regulators, Lawyers, Accountants, and Others with Respect to Sustainability Disclosure

TOPICS FOR DISCUSSION

Numerous market participants—including regulators, lawyers, accountants, stock exchanges, and others—have a role to play with respect to sustainability disclosure. Significantly, the SEC’s 2016 Concept Release on Regulation S-K included a discussion of sustainability, resulting in hundreds of comment letters being filed with the Commission in support of improved disclosures. Related to these roles, the following topics and questions were contained in the agenda for Session 3.

Regulators

- Should improved ESG disclosures be mandatory? How would the SEC go about requiring better ESG disclosures? Would the issuance by the staff of the Division of Corporation Finance of comment letters on sustainability disclosures be an effective approach? The SEC staff might compare disclosures made in standalone sustainability reports to disclosures made in SEC filings and question companies on inconsistencies between the two sets of documents. Would this be practical or effective?

- Are changes in the federal securities laws needed to improve sustainability disclosures? If so, what sort of changes?

- What are the arguments for and against integrated disclosure?

- With respect to internal control reporting under Section 404 of SOX, the SEC took the position that use of Committee of Sponsoring Organizations of the Treadway Commission (COSO) guidelines would satisfy the new regulatory requirements. Could the SEC do something similar with respect to SASB standards? What developments would be necessary to encourage that to happen?

Accountants

- The accounting firms, and many consulting firms, look upon sustainability disclosures as a potential new source of business. Is this likely to come to fruition? Are accounting firms in a position to provide assurance with respect to sustainability disclosures? What level of assurance would be provided? What would the liability risk be to the accounting firms in this regard? What should be the role of the Public Company Accounting Oversight Board (PCAOB)?

Lawyers

- What role should the legal profession have with respect to sustainability disclosures? There currently exist various American Bar Association (ABA) committees interested in the topic, and the Association of American Law Schools has had programs addressing the issue. What more might the legal profession do? What would the focus be? Should law schools include the issue in their curriculum?

- There currently exist several organizations other than SASB that develop sustainability or guidelines, including GRI and the International Integrated Reporting Council (IIRC). These other organizations do not use the federal securities laws as their starting point and, hence, do not use materiality as their basis for their standard-setting. But there exists confusion among investors, regulators, and others as to the attributes of these various organizations. How might that be addressed by the legal profession or by others?

Exchanges

- What might the stock exchanges do to encourage better sustainability disclosures?

All Stakeholders

- In Europe and elsewhere outside of the United States, companies are providing much more fulsome sustainability disclosures, largely as a result of regulatory requirements. Presumably as a result, it has appeared to SASB that 20-F filers provide higher quality sustainability disclosures than do 10K filers. Is this disparity significant?

- The SASB standards are largely directed at U.S. registrants. How might that approach be broadened to address non-U.S. corporations?

- The SASB recently structured itself to be aligned with the structure of the Financial Accounting Standards Board (FASB); i.e., with the SASB Foundation responsible for financial and administrative matters, and the SASB consisting of an independent group of persons.
responsible for reviewing and approving the standards. To what extent should this structure ensure that the standard-setting process is objective and consistent with the due process expectations of stakeholders?

**Additional Question Regarding the Need for Further Study**

There are a great many areas where additional research by legal scholars on ESG disclosures would be useful and should assist policymakers going forward. A recent scholar summarized these issues as follows:

“What corporate disclosures beyond financial disclosures do investors view as material? What are the motivations for the disclosure of nonfinancial information and their use in investment decision making? What are the perceived benefits and costs of the disclosure of nonfinancial information? What are the commonalities and discrepancies in the views (of firms and investors) of the materiality of this information? How does a firm choose which ESG information to disclose? What can investors learn about a firm from its nonfinancial disclosures? To what extent, how and why do investors consider ESG information in their investment decision making?”

Answers to many of these questions would be facilitated if companies began making better ESG disclosures. How might SASB engage in the development of research studies and analyses of these issues going forward?

**OTHER ROLES INVOLVED IN SUSTAINABILITY DISCLOSURE**

In this final session, participants concentrated primarily on the roles of regulators and corporate advisers (such as lawyers and accountants, academics, and others) in the evolution of the sustainability reporting ecosystem. The discussion also contained observations on how the SASB might move forward in its efforts.

**Setting the Stage: Why Sustainability? Why Now?**

As discussed previously, corporate sustainability efforts have traditionally been “sliced,” meaning they are planned and managed in isolation from an organization’s broader strategy. Conventional reporting on these efforts—in the form of standalone sustainability or “corporate social responsibility” reports—have presented a clear reflection of this fragmented reality. However, as the links between sustainability performance and value creation become clearer, some companies have begun to integrate mission-critical ESG efforts into their core operations, as well as into their reports filed with the SEC. As a result, sustainability reporting has become relevant to a variety of professionals both inside (finance, accounting, general counsel, investor relations, risk management, etc.) and outside (regulators, auditors, investors, analysts, academics, etc.) the organization.

**Considering Historical Parallels**

Some of the conversation was framed in the context of the historical arc of U.S. financial regulation, from the passage of the Securities Acts and establishment of the SEC in the wake of the Great Depression through the emergence of the Financial Accounting Standards Board (FASB) in the 1970s to the situation today. Specifically, participants noted both similarities and differences between today’s reality and the market dysfunction that precipitated the FASB’s formation.

For example, one participant noted that the formation of the FASB was partly a response to the “opinion shopping” that occurred in the 1960s and early ’70s when conglomerates and multinational companies pitted auditors against one another to get the most favorable assessment of their financial statements. The effect of this practice—the erosion of trust among investors, creditors, and the public—mirrors today’s increasingly consensus view of sustainability reporting, where according to one study 90 percent of significant negative events go unreported in stand-alone sustainability reports and such reports are often dismissed as “greenwashing.”

On the other hand, another participant argued that sustainability accounting standards are not as “ready for prime time” today as financial accounting standards were in 1973. The FASB benefited not only from decades of work on financial accounting principles and standards by the American Institute of Accountants (AIA), the Accounting Principles Board (APB), and others, it also enjoyed broad market consensus. Another participant concurred, pointing out that the FASB had a long ramp-up, and that where financial accounting standards were objectively “a necessary thing,” proponents of sustainability accounting standards are in “the very different position” of putting forward something that they must “persuade the world is a necessary thing.” Countering this line of argument, another participant noted that sustainability was the most frequently addressed topic in formal responses to the SEC’s 2016 Concept Release on the modernization of Regulation S-K.

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41 Now known as the American Institute of Certified Public Accountants (AICPA), the AIA engaged in officially sanctioned standard-setting work through its Committee on Accounting Procedure (CAP) from 1939 to 1959.

A Lack of Quality Information

Participants generally agreed that the level of quality is poor in the sustainability-related disclosure that companies currently include in Item 303 or MD&A portion of their SEC filings. Suggested reasons for this deficit varied. One participant observed that existing regulation provides extremely limited guidance for considering “known trends, events, or uncertainties” that play out over a longer time frame, as many sustainability issues do. As a result, companies may simply ignore anything that does not fall within the three-year statute of limitations for Rule 10b-5 claims. Reference was made to Item 303’s two-part “reasonable likelihood” test for determining whether disclosure of forward-looking information is required; and doubt was expressed that companies apply this test appropriately to sustainability factors, particularly those with the potential for longer-term impacts. Another participant submitted a more fundamental concern, citing persistent dissatisfaction among regulators with MD&A disclosure and questioning whether companies can be adept at applying a principles-based disclosure requirement.

Participants also generally agreed that providing markets with comparable information should be a key goal of any effort to improve the effectiveness of sustainability disclosure. However, various points of view were expressed regarding the time frame in which comparability could—or even should—reasonably be expected.

Several participants noted that investors and other market participants currently are not getting comparability from either SEC filings or voluntary sustainability/CSR reports. In the realm of SEC disclosure, views were generally pessimistic that comparability would be achieved through a top-down approach to sustainability disclosure. Participants cited numerous rulemaking precedents they considered unsatisfying, such as disclosure on board leadership structure ("a lot of words that don’t say a thing") and pay ratio ("they gave up on comparability"). As one participant put it, “The SEC is incapable of putting out line-item disclosures in this space,” citing not only the difficulty of establishing standards but the bandwidth required to keep them up to date.

Some participants noted similarities to non-GAAP measures, where comparability is difficult and rarely achieved—or perhaps even desired. However, another pointed out that non-GAAP measures owe their flexibility to the existence of, and their explicit ties to, GAAP. In the world of sustainability disclosure, “we only have non-GAAP.” In other words, everything is non-standardized and non-comparable. The answer to the question of whether investors want comparability among non-GAAP disclosures would surely change if GAAP wasn’t part of the equation.

Ultimately, participants generally agreed that comparable sustainability information is likely to serve all interests. For example, many observed that external decision makers such as investors and creditors need the ability to assess relative performance. Meanwhile, another pointed out that standardization would provide companies with technical specificity that would eliminate the time-consuming guesswork involved in preparing many non-financial disclosures.

Given the increasing demand for and proliferation of sustainability information—and the lack of data quality that characterizes current reporting efforts—participants seemed to be in general agreement that, over the long term, the market is trending in the direction of more rigorous sustainability disclosure. Participants noted that today’s businesses operate in a very different world than they did 40 years ago, 20 years ago, or even 10 years ago. They acknowledged that the pressures compelling the increasing attention to sustainability matters are real and that they are not likely to go away soon, if at all. However, as one participant put it, although the “inevitability” of this evolution is “painfully obvious,” a key question remains: What is the best way to improve the effectiveness of sustainability disclosure?

Mandatory or Market-Based?

Much of the discussion was focused on answering this key question: Should sustainability disclosure be addressed through a top-down, regulatory mechanism (e.g., the SEC), or through a voluntary, bottom-up effort by market participants? Opinions varied.

Noting that companies are focused almost exclusively on near-term earnings, one participant suggested that a mandate is the only way real progress on sustainability disclosure is likely to occur. Another agreed, observing that—a best mandate—it’s difficult to see a first-mover advantage for companies to become leaders in sustainability disclosure.

Other participants suggested that a mandate may be more likely—or more effective—in the form of the SEC delegating its authority, as it has done in certain other cases. As examples, some participants cited officially sanctioned bodies, such as the FASB, which oversees financial accounting standards, and the Public Company Accounting Oversight Board (PCAOB), which oversees auditing standards. Others, meanwhile, referenced organizations that have been more or less endorsed by the SEC, such as the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the Organization for

Economic Cooperation and Development (OECD). Some participants preferred this approach, noting that the SEC is unlikely to have subject-matter expertise when it comes to sustainability-related disclosure.

Other participants felt strongly that a voluntary, market-based approach was preferable to a regulatory mandate, either as a long-term solution or as a more pragmatic starting point. Although several participants expressed skepticism that a campaign could succeed by focusing on convincing corporate issuers of the need, bottom-line benefit of improving their sustainability disclosure, other approaches were afforded more optimism. For example, many participants cited the growing demand among large, institutional investors—including asset owners such as CalSTRS and CalPERS, along with asset managers such as BlackRock and Vanguard—as an important lever to catalyze change in mainstream reporting practices.

One participant mentioned flexibility as one benefit of a voluntary, market-based approach. Unlike SEC rulemaking, which is bureaucratic and time-consuming, a voluntary effort can respond more nimbly to emerging needs, existing shortcomings, or other changes in the reporting ecosystem. This may be especially important as sustainability accounting is a relatively nascent practice with few well-established “best practices.”

Other participants noted that pursuing a market-based disclosure regime does not necessarily rule out the possibility of a future mandate, and, in fact, may make one more likely. As influential investors embrace a market standard for material sustainability disclosure, corporate issuers will be increasingly likely to try to meet their demands, and may eventually prefer regulatory guidance and oversight.

Finally, a few participants recommended a market-based approach simply because it beats the alternative. One pointed out that a mandate would likely “bring a lot of opponents out of the woodwork” who might otherwise remain silent as voluntary sustainability accounting matures under the radar. Another agreed that mandatory sustainability disclosure would drag the practice into a “political quagmire,” creating opportunity for blowback that could temporarily or permanently derail efforts to provide focused, meaningful disclosure.

In any event, participants generally agreed that a regulatory mandate is not likely to be a viable near-term option given the current political environment. Nevertheless, one participant suggested that the political climate is more volatile in the short term than over the long term and should not therefore restrain anyone in their planning.

Moving Forward: Issuers and Investors

The discussion turned toward more constructive approaches to moving forward, mostly focused on establishing broad support for a market standard for sustainability disclosure, such as the SASB standards. Participants generally agreed that it is too early for the SASB to reach for an officially sanctioned role, which would require “an extraordinary act of delegation,” according to one commenter. However, by continuing to work with corporate issuers and their investors, the SASB can more firmly establish its market footprint.

Suggestions for working with corporate issuers varied, but most involved a sharply focused approach to achieve the largest impact. For example, participants suggested working with specific companies, industries, and industry groups.

In terms of specific companies, one participant recommended focusing on sustainability leaders, including those with strong commitments to sustainability performance and/or reporting. Another suggested working with the largest companies by market capitalization to establish best practices for implementation of the standards into both operations and reporting efforts. A third participant opined that it might make more sense to start with those companies having the largest impact, such as the small handful of corporations responsible for the overwhelming majority of greenhouse gas emissions.

Others recommended specific industries or industry groups as a more promising place to establish a “proof of concept.” For example, several participants suggested focusing on highly concentrated industries—such as Telecommunications, Aerospace & Defense, Cable & Satellite, and Non-Alcoholic Beverages—where fewer, larger firms with more manageable competitive pressures may be better positioned to implement a more rigorous reporting framework. Other participants recommended industry groups, such as the Electronic Industry Citizenship Coalition (EICC), with a demonstrated track record for supporting sustainability-related initiatives. Addressing the issue at the industry level is important, one participant said, because of the comparability factor.

Recognizing that the SASB standards could be a “tough sell” to certain corporate issuers, participants backed the SASB’s decision to engage Professor Christian Leuz of the University of Chicago to undertake a rigorous cost-benefit analysis of implementing the SASB standards. They also suggested that the SASB clarify in its messaging to SEC registrants that use of the standards could obviate the need for frequent, numerous, and extensive sustainability-related questionnaires from investors, indices, and ratings organizations. Another participant argued that a corporate-focused effort may


47 Prof. Leuz is expected to issue a report with his findings in 2018.
require a more fundamental approach, focused on developing integrated thinking within the company rather than simply integrated reporting to external parties.

Although one approach would be to convince companies of the cost/benefit advantage of improving their disclosures, many participants recommended an investor-led strategy as a clearer path forward. Commenters cited the rise of “fiduciary capitalism”—the growing influence of long-term-oriented institutional investors on capital markets. One participant recommended working with large asset owners to more effectively and more specifically articulate their demand for a market standard for material sustainability information. Another participant suggested undertaking an effort to ensure that questions about material sustainability issues are regularly raised in analyst calls and with investor relations staff.

**Other Players: Regulators, Advisors, and Academics**

As one participant mentioned, broad market uptake of sustainability accounting would amount to a norms-changing campaign, which would necessarily involve many players, each with their own needs, considerations, and opportunities to contribute. Among those discussed in some detail were regulators, lawyers, and academics.

Even if use of sustainability accounting standards are not explicitly required by the SEC, it may still make sense to facilitate a certain amount of regulatory involvement, participants said. For example, according to a SASB study, in their SEC filings 69 percent of companies are already addressing at least three-quarters of the sustainability topics identified in their relevant SASB industry standard, and 38 percent are already providing disclosure on every SASB topic. However, more than half of these disclosures use boilerplate language, which is nearly useless to investors, while less than 24 percent are disclosed using quantitative metrics. Even in those cases in which metrics are being used, they are non-standardized, and therefore lack comparability across industry peers, hampering their usefulness to decision-makers in advanced analytics and other modeling. Participants noted the SEC’s lack of sustainability-related subject-matter expertise as one reason it is ill-equipped to use its enforcement mechanisms to improve such disclosure. By engaging with the SASB, one participant suggested, or perhaps even by hiring a professional fellow with expertise in sustainability, the Commission could incrementally educate its staff and enhance its ability to improve the effectiveness of sustainability disclosure over the long run.

Participants also discussed the important role of lawyers, including securities lawyers and general counsel at corporations. Participants said the ability to refer to a set of proposed standards for such disclosure can be valuable in “getting lawyers smarter,” and recommended that every lawyer who is reviewing a 10-K or 20-F should refer to the relevant SASB industry standard as one input in their consideration of how disclosure can be improved.

Finally, academic professionals also have a role to play, several participants said. Their efforts can help fill important research gaps and provide guidance for both current practitioners as well as those of the future. By incorporating sustainability-related matters into the curriculum at law schools and business schools, educators can help prepare the next generation of advisers to better understand the risks and opportunities embedded in a company’s performance on—and its transparency around—ESG issues.

**Key Considerations for Looking Ahead**

Participants identified three key considerations for making progress on improving the quality of sustainability-related disclosure: framing, iteration, and alignment.

First, many participants noted that framing may be an important factor for getting buy-in among corporate audiences, including boards of directors. As one commenter put it, “People shut their brain off when they hear the word ‘sustainability.’” Changing the nomenclature may help. For example, it may be more effective, several participants said, to discuss ESG issues in terms of strategy, risk management, traditional financial value drivers, and long-run business performance. Additionally, several commenters suggested focusing sustainability efforts on less controversial issues, such as product safety and human capital, rather than leading with politically charged issues like climate change. At least one participant disagreed with this last point, noting that many corporations strongly support the Paris climate accord.

Secondly, most participants agreed that the establishment and evolution of a market standard for sustainability accounting should be an ongoing, iterative process. The important thing is not to identify the perfect solution, but to get started down the path toward a solution. For example, one participant noted, early financial disclosure was a mess, but not anymore. Another commenter cited Y2K as an example of how a large, looming issue was solved incrementally rather than all at once—by focusing on small, discrete problems rather than a broader doomsday scenario. Likewise, citing the perceived lack of a first-mover advantage for corporations to improve their sustainability disclosure overnight, another participant likened a corporate-led adoption strategy to getting “the first sheep into the slaughterhouse.” Instead, the commenter suggested a need to “incubate” sustainability accounting in a different forum and suggested the possibility of vetting and refining the SASB metrics through use in due diligence audits before moving on to disclosure in SEC filings once their value has been proven. Also stressing the importance of iteration, several participants recommended staying the course and allowing the various voluntary sustainability reporting approaches (including the SASB, the Global Reporting Initiative, and other frameworks) to evolve. One commenter compared this scenario to vehicles

being driven in different lanes but all moving toward the same destination. Several participants counseled patience, with one noting that while progress may not be as fast as investors or other proponents might like, a lot has happened in recent years.

Lastly, several participants noted that any market standard for sustainability accounting needs to be well-aligned with what companies are doing now—or will be expected to do in the near future. Corporate issuers, especially those with a multinational footprint, face a complex and evolving disclosure environment with many potentially conflicting demands. They need to feel confident that any standard they adopt will help them “check all the boxes.” For example, one participant pointed out that a European company that is publicly listed on a U.S. exchange will need to comply with both SEC disclosure requirements as well as those in the EU, including Directive 2014/95/EU of the European Parliament and the Council of the European Union, which requires disclosure of performance on environmental and social matters. Similarly, companies may field additional disclosure demands in the form of exchange listing requirements, industry group standards, mandates from macro- and microprudential regulatory bodies, surveys and questionnaires from stakeholders, and more. Participants suggested that it is best for all parties if the various sustainability reporting organizations harmonize on their own and say, “we figured it out amongst ourselves,” rather than waiting for regulatory intervention. The recommendations of the Financial Stability Board’s Task-Force on Climate-Related Financial Disclosures (TCFD), which were issued in July 2017, may have provided a juncture at which this convergence can take place, as organizations including the SASB, Climate Disclosure Standards Board (CDSB), and others have begun efforts to align with TCFD guidance. Participants agreed that efforts like this to streamline the reporting process and make it more cost-effective would be key to delivering meaningful, useful sustainability information to the capital markets.

**KEY TAKEAWAYS FROM SESSION 3**

- It’s not a question of **whether** improved sustainability disclosure will happen. It’s a question of **how**.
- A voluntary, private-sector, market-informed solution is preferable to a regulatory mandate.
- Corporations need to be convinced of the cost/benefit advantage of improving their disclosures.
- Investors need to clearly and consistently articulate their support for a market standard.
- Advisers such as lawyers and accountants need to get up to speed on sustainability risks and opportunities.
- Proponents of sustainability disclosure should talk less about environmental and social impacts and more about corporate strategy, risk management, financial value drivers, and long-term performance.
- Sustainability reporting organizations must work to achieve greater alignment—not only among themselves, but with other reporting demands.
Conclusion

Asset owners, asset managers, and corporate professionals have increasingly recognized that sustainability factors such as environmental, social, and governance issues can—and often do—have material implications for the risk and return characteristics of their capital allocation decisions. Thus, such factors have also become increasingly relevant considerations for other market actors, such as lawyers, accountants, and regulators, particularly in the context of federal securities laws and their disclosure requirements.

The preceding discussion highlighted many of the legal and other questions that have arisen as issues of sustainability have moved slowly but surely from the fringes of business activity toward its mainstream. The speakers’ ideas, insights, and other intellectual contributions may provide helpful guidance for market participants as they work toward integrating sustainability factors into their own work moving forward.

For proponents of improved sustainability disclosure—primarily investors—the roundtable discussions identified a need to more clearly articulate their demands. To meaningfully influence corporate disclosure practices, roundtable participants generally agreed investors must ensure that their voices are heard in every arena, from proxy voting to private engagement to quarterly earnings calls. Additionally, in communicating this demand, they must address ESG issues in fundamentally economic terms, participants said, viewing them as company-specific value drivers rather than social issues or even broad macroeconomic trends.

Viewing sustainability through the lens of financial materiality can be useful to achieving this end, the roundtable participants generally agreed. Likewise, participants noted, materiality is likely a useful approach for corporations as they attempt to respond to this demand. By aligning the efforts of traditionally separate functions—sustainability, finance, risk management, etc.—around this concept, sustainability efforts can become more focused, better integrated into core strategy and operations, and more cost-beneficial, some participants said. Meanwhile, in terms of disclosure, although liability concerns certainly exist, participants pointed out that the benefits of improved sustainability disclosure—particularly when made in accordance with a market standard—may outweigh the costs in some cases. Such benefits may include improved risk management, potentially enhanced legal protection, and higher-quality data for both internal and external decision-making.

Finally, for all market actors—including lawyers, accountants, regulators, and others—one overarching message resounded: Being prepared and proactive is likely to pay dividends, as investor demand for improved ESG disclosure is expected only to grow, regulators have become increasingly engaged on the matter, and voluntary initiatives continue to build steam. Participants generally agreed that self-regulation is preferable to government mandate, and, as such, companies, investors, and intermediaries are likely to benefit from taking a seat at the table, making their voices heard, and helping ensure the future of sustainability-related is shaped by the market’s own understanding, skill, and expertise.
Appendix A: List of Participants

The following individuals participated in the roundtable discussions documented in this paper. The conveners would like to express gratitude for their time and valuable intellectual contributions to the discussion contained herein.

Tamara Belinfanti • Professor of Law, New York Law School

Robert Buckholz • Partner, Sullivan & Cromwell LLP

Douglas Chia • Executive Director, The Conference Board Governance Center

John Coates • Professor, Harvard Law School

Cathy Dixon • Partner, Weil, Gotshal & Manges LLP

Lisa Fairfax • Professor of Law, George Washington Law School

Sandra Flow • Partner, Cleary Gottlieb

Peggy M. Foran • Chief Governance Officer, Senior Vice President and Corporate Secretary, Prudential Financial, Inc.

Holly Gregory • Partner and Co-Chair of Global Corporate Governance & Executive Compensation Practice, Sidley Austin LLP

Daniel Goelzer • Senior Counsel, Baker & Mckenzie LLP

Keith F. Higgins • Chair, Securities & Governance Practice, Ropes & Gray LLP; Former Director of Division of Corporation Finance, SEC

Chris Holmes • National Director of SEC Matters, Ernst & Young LLP

Beth Ising • Partner, Gibson Dunn

Donald Langevoort • Professor of Law, Georgetown Law

Warren Lavey • Adjunct Professor, University of Illinois

Pamela Marcogliese • Partner, Cleary Gottlieb

Granville Martin • Senior Vice President & General Counsel, Society for Corporate Governance

Lona Nallengara • Partner, Shearman & Sterling LLP

Tom Riesenberg • Director of Legal Policy, SASB

Jean Rogers • SASB Founder & Chair of the SASB

Amanda Rose • Professor of Law, Vanderbilt Law School

Hillary Sale • Professor of Law, Professor of Management, Washington University Law

Anne Sheehan • Director of Corporate Governance, CalSTRS

Jeffrey Smith • Adjunct Professor of Law; Director, Sustainability Initiative - Fordham Law School

Nicholas G. Terris • Partner, K&L Gates

Elisse Walter • Former Chair, SEC; Member, SASB Foundation Board of Directors

John White • Partner, Cravath, Swaine & Moore LLP

Cynthia Williams • Professor, Osgoode Hall Law School
APPENDIX B: EXECUTIVE SUMMARY OF MEMORANDUM, “SOME LIABILITY CONSIDERATIONS RELATING TO ESG DISCLOSURES”

The following is an executive summary of a legal memorandum prepared for the roundtable by the law firm of K&L Gates. The full text is available at: http://www.klgateshub.com/details/?pub=Some-Liability-Considerations-Relating-to-ESG-Disclosures-05-01-2017

EXECUTIVE SUMMARY

This is a general discussion of certain U.S. liability considerations associated with environmental, social, and governance (“ESG”) reporting by public companies.

The federal securities laws are a principal source of potential liability relating to ESG disclosures. Because “silence, absent a duty to disclose, is not misleading,” Basic v. Levinson, 485 U.S. 224, 239 n.17 (1988), companies sometimes can avoid liability under these laws by declining to speak at all on a particular subject. Additionally, companies generally do not face liability for immaterial statements or omissions, and the application of the materiality concept to ESG issues is often uncertain. These factors, coupled with the potentially severe consequences of acknowledging that a company is experiencing ESG-related difficulties, may provide strong incentives against meaningful ESG disclosure.

But there may be countervailing considerations. Federal and state laws impose a limited number of specific ESG disclosure requirements on issuers. In addition, a number of general Securities and Exchange Commission (“SEC”) disclosure requirements, such as Item 303 in the SEC’s Regulation S-K, may require meaningful ESG disclosures in some contexts. Liability under Item 303 is far from absolute, however. The Supreme Court will soon resolve a division among the courts as to whether Item 303 creates any privately enforceable duty to disclose. And management effectively has significant discretion under Item 303 regarding whether disclosure must be made.

The securities laws generally also require that, when companies do elect to speak on a subject, they must provide enough information to avoid misleading investors. This rule is not limited to SEC filings. It often extends to statements in less formal contexts, such as press releases and perhaps even sustainability reports and advertising. But most courts recognize an important exception that likely eliminates liability for many vague corporate “green” slogans. They hold that so-called soft “puffing” statements are not actionable under the securities laws. Nonetheless, the prohibition against half-truths—along with the statutory and common-law safe harbors applicable to forward-looking statements that are accompanied by meaningful cautionary language—may sometimes provide companies the opportunity to reduce their liability exposure by making more detailed and substantive ESG disclosures in lieu of boilerplate.

Paradigmatic “fraud on the market” class actions predicated on ESG misrepresentations or omissions often are likely to fail due to plaintiffs’ inability to demonstrate loss causation or cognizable damages. But due in part to the increasing prevalence of socially conscious investors and activists, more attempts may be made to use less conventional remedies to enforce disclosure requirements. These include actions for injunctive relief and state law “blue sky” remedies. Further, more fulsome ESG disclosure occasionally may reduce the likelihood of litigation under the proxy rules, which allow companies to exclude shareholder proxy proposals that have been substantially implemented.

ESG disclosures also may result in liability under theories other than the securities laws. False, misleading, or inadequate ESG disclosures conceivably may give rise to claims under unfair and deceptive acts and practices (“UDAP”) statutes and other similar causes of action. The plaintiffs in such actions may include consumers and competitors. Recently, some shareholders dissatisfied with the extent of a company’s ESG disclosures have filed lawsuits demanding books and records pursuant to state corporation law. As with proxy proposals, companies sometimes may be able to fend off some such lawsuits more easily to the extent they have already made meaningful ESG disclosures.

Finally, while state corporate law does not include specific ESG disclosure requirements, it may provide additional avenues, including breach of fiduciary lawsuits and demands on the board of directors, for activist shareholders desiring additional disclosures.