

Rise of the Shadow ESG Regulators: Investment Advisers, Sustainability Accounting, and Their Effects on Corporate Social Responsibility

by Paul Rissman and Diana Kearney

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Summary

Actions that fall under the catchall of “corporate social responsibility” have been viewed with skepticism. In the United States, part of the blame lies with lax laws and regulations surrounding social and environmental disclosure. Disclosure may soon be vastly improved with finalization of the Sustainability Accounting Standards Board’s financially material social and environmental reporting standards. While the standards are voluntary, the fact that they have been endorsed as “material” by many of the world’s largest investment advisers will transform them into legally actionable standards.

[D]isclosure has become the most important method to regulate corporate managers. . . .

—Robert B. Thompson & Hillary A. Sale¹

[B]y and large, companies continue to take a minimally compliant approach to sustainability disclosure. . . .

—Sustainability Accounting Standards Board²

Because federal securities law is grounded in the principle of disclosure, one could deduce from the quotes above that the sustainability practices of business might be better regulated if companies reported about them with greater care. Such strengthening would yield important benefits both for environmental protection and the global cause of human rights.³ Corporate social responsibility (CSR)⁴ acquires even more salience in light of the perceived rollback of human rights protections around the world,⁵ setbacks to the environmental movement such as the United States’ rejection of the Paris Agreement on climate,⁶ and the weakening of U.S. Environmental Protection Agency (EPA) regulations domestically.⁷ CSR is growing in importance, both in terms of public awareness⁸

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1. Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 861 (2003).
2. SASB, THE STATE OF DISCLOSURE 2017, at 3 (2017), available at <https://www.sasb.org/wp-content/uploads/2017/12/2017State-of-Disclosure-Report-web.pdf>.
3. MANETTE KAISERSHOT & NICHOLAS CONNOLLY, CORPORATE POWER AND HUMAN RIGHTS 1 (2016) (discussing “[t]he pervasive influence of the corporation and its ever-increasing effects on human rights globally”).
4. Here, CSR broadly refers to business initiatives that promote environmental and social well-being. This is typically done through assessing and accounting for a company’s human rights and environmental impacts to ensure that they are operating in a responsible manner; some actors also view this as encapsulating provision of services to communities likely to be impacted by private-sector operations.
5. Interview by Ari Shapiro, National Public Radio, With Larry Diamond, Senior Fellow, Stanford University (Aug. 3, 2017), <https://www.npr.org/2017/08/03/541432445/decline-in-democracy-spreads-across-the-globe-as-authoritarian-leaders-rise>.
6. Robinson Meyer, *Syria Is Joining the Paris Agreement. Now What?*, ATLANTIC, Nov. 8, 2017, <https://www.theatlantic.com/science/archive/2017/11/syria-is-joining-the-paris-agreement-now-what/545261>.
7. Jennifer Ludden, *Public to EPA on Cutting Regulations: “No!”*, NAT’L PUB. RADIO, May 19, 2017, <https://www.npr.org/sections/thetwo-way/2017/05/19/528993681/public-to-epa-on-cutting-regulations-no>.
8. NIELSEN, THE SUSTAINABILITY IMPERATIVE 2 (2015) (“Sixty-six percent of consumers say they are willing to pay more for sustainable brands—up from 55% in 2014 and 50% in 2013.”), <http://www.nielsen.com/content/dam/corporate/us/en/reports-downloads/2015-reports/global-sustainability-report-oct-2015.pdf>.

and in corporate acknowledgement.⁹ Business managers are aware of the harms of authoritarianism and climate change,¹⁰ and have spoken out and undertaken remedial actions.¹¹ But these actions have been halting and unsatisfactory to many in the fields of human rights and environmental protection; “corporate greed” is a phrase yet alive and well in common parlance,¹² and business attempts to rectify social and environmental damage are often dismissed as “greenwashing.”¹³ This disappointing progress is all the more distressing in light of the aforementioned backsliding by government.

The thesis of this Article, however, is that a measure of pessimism surrounding responsible business practices can soon be ameliorated. We predict that corporations are on the cusp of moving along the spectrum from castigation to approval. This will have nothing to do with a sudden change of heart on the part of a company’s directors and officers. These persons will value what they have always valued: a duty to their investors. Rather, it is the attitude of a critical subset of stockholders and bondholders that has begun to change: the largest professional asset managers.

While more than one cause will foment this change,¹⁴ the factor that will seal the shift in stockholder attitude, and in turn push CSR to the forefront of corporate consciousness, is the finalization of a set of material disclosure standards for sustainability topics.¹⁵ Nonfinancial sustainability reporting, regarding such business impacts as human rights violations or effects upon climate change, has not been considered universally material. The effort to demonstrate material implications for specific firms has been an ongoing project by certain investors and organizations for several decades, yet U.S. corporate issuers seldom face liability if they neglect to report such impacts to shareholders or the public.

The Sustainability Accounting Standards Board (SASB), however, an organization conceived explicitly to formulate standards that comply with the U.S. Supreme Court’s definition of materiality, can soon be instrumentalized to transform these long-standing tenets of corporate practice. Due to the process of consultation and voting utilized by SASB, there will be a clear record of investors publicly endorsing the “materiality” of a range of human rights, environmental, or related standards that they have helped formulate.

Among the investors that have assisted in crafting the standards are a significant group of investment advisers, including six of the 10 largest asset managers globally.¹⁶ Released in November 2018,¹⁷ the standards are purely voluntary and exist apart from the reporting compendium that is enforced by the U.S. Securities and Exchange Commission (SEC). We argue, however, that by endorsing the materiality of the standards, these specific investors will have created for themselves an extension of their fiduciary duty of care to their customers: an implied duty to ask for, and evaluate, reporting that satisfies the standards. Conscientious customers, then, can pressure these asset managers that have publicly supported the materiality of the SASB standards, ensuring that best efforts are made to force disclosure of such human rights and environmental issues.

Finally, the evolving nature of the asset management industry itself provides the catalyst to turn fiduciaries into effective de facto regulators. Small shareholders have largely been replaced by large institutional investors; as the concentration of stock ownership into the hands of a few grows, so too does the power wielded by these large owners. Today, the largest asset managers own staggeringly large amounts of stock on behalf of their clients, spread over thousands of companies around the world.¹⁸ Once these investors find themselves compelled to consider material sustainability disclosure, they will demand such disclosure from vast swaths of the global corporate world. We predict that this will set off a virtuous circle of disclosure impacting behavior change.

The Article will proceed as follows: first, we describe the current situation in which corporations have a deepening financial interest in fighting against authoritarianism and climate change. Despite some admirable efforts, however, most companies still have far to go in strengthening their

9. Susan McPherson, *6 CSR Trends to Watch in 2017*, FORBES, Jan. 19, 2017 (“In the past decade, we’ve witnessed a stunning transition as corporate social responsibility (CSR) evolved from a nice-to-have silo to a fundamental strategic priority for businesses large and small.”), <https://www.forbes.com/sites/susanmcpherson/2017/01/19/6-csr-trends-to-watch-in-2017/#2bcbbc1ab1cc>.

10. See *infra* Part I.

11. *Id.*

12. *End Corporate Greed! Rights Now! A Sign-On Statement to Stop the Poisoning of the People and the Planet*, PAN ASIA PAC., Dec. 3, 2017, <http://panap.net/2017/12/end-corporate-greed-sign-on/>; AFL-CIO, *Corporate Greed* (“It seems that hard work doesn’t matter anymore. This is the corporate attitude.” Mary Willis, laid off Nabisco/Mondeléz International worker), <https://aflcio.org/issues/corporate-greed> (last visited Dec. 1, 2018); Derek Burnett, *Corporate Greed: These Companies Deceived America for Profit—And You Probably Helped Them*, READER’S DIG., <https://www.rd.com/culture/corporate-greed/> (last visited Dec. 1, 2018).

13. Yermi Brenner, *Greenwashing: Consumers Confronted by Dubiously “Conscious” Fashion*, AL JAZEERA, May 19, 2014, <http://america.aljazeera.com/articles/2014/5/19/consumers-greenwashingfashion.html>; Gabe Smalley, *PepsiCo’s Greenwash: All Talk, No Action*, RAINFOREST ACTION NETWORK, Aug. 14, 2017, https://www.ran.org/pepsico_greenwash_all_talk_no_action; Bruce Watson, *The Troubling Evolution of Corporate Greenwashing*, GUARDIAN, Aug. 20, 2016, <https://www.theguardian.com/sustainable-business/2016/aug/20/greenwashing-environmentalism-lies-companies>.

14. See *infra* Part III.

15. Material disclosure refers to information that shareholders would find important when weighing the decision whether or not to invest or vote on a corporate resolution. For a detailed discussion, see *infra* Part II.

16. SASB, *Supporters*, <https://www.sasb.org/investor-use/supporters/> (last visited Dec. 1, 2018). For a list of the largest asset managers, see IPE Reference Hub, *Total Global AUM Table 2018*, <https://hub.ipe.com/top-400/total-global-aum-table-2017/10007066.article> (last visited Dec. 1, 2018).

17. Ken Tysic, *SASB Publishes Industry-Specific Sustainability Accounting Standards*, J. OF ACCOUNTANCY (Nov. 9, 2018), <https://www.journalofaccountancy.com/news/2018/nov/sasb-sustainability-accounting-standard-201820089.html>.

18. Index fund providers are among the largest asset managers. An index fund is a stock mutual fund or separately managed account that is explicitly designed to hold every stock in a given index, such as the Standard & Poor’s (S&P) 500 or the MSCI All Country World Index (comprising approximately 2,500 constituents around the globe). “Closet indexers,” investment advisers that are so large that by virtue of their size they are forced to own diversified portfolios containing a myriad of holdings, are also among the largest asset managers. See *infra* note 138.

CSR records. In Part II, we highlight a significant root of this problem, which stems from the principle of investor protection: the Supreme Court has decreed that investors should be shielded from immaterial disclosure, and the SEC has presumed that investors regard nonfinancial environmental, social, and governance (ESG) disclosure as largely immaterial. Taken together, these two factors severely limit the ESG achievements and embarrassments that companies reveal. Because federal securities statutes have essentially surmounted state law as the primary regulatory mechanism for a broad range of corporate ethical behavior,¹⁹ effective regulation is impaired. Indeed, even when companies actively seek to be “good actors,” they can be thwarted by their duties to short-term investors prioritizing financial optimization.

Parts III and IV then discuss potential solutions to the problem, and identify the shortcomings currently preventing them from taking root. Specifically, structural impediments in the asset management industry discourage many of the largest investors from acting in more than a minimally responsible fashion. We conclude that the finalization of SASB’s material ESG standards can surmount these challenges.

In Part V we describe SASB’s mandate, how it operates, and why its focus on financial materiality is unique compared to the multitude of other disclosure regimes whose effectiveness has been limited. Fortunately, the pressures that these emerging principles generate will be felt most acutely by the world’s largest (and most influential) investment advisers who have formulated and endorsed the materiality of the standards; this will extend their fiduciary duty of care to cover ESG criteria, as will be discussed below, and will transform them into “shadow regulators” of companies’ human rights and environmental performance.

Part VI then explores the implications of this new regulatory role that large asset managers have unwittingly assumed. By publicly affirming the materiality of human rights and environmental criteria, these managers have changed what information their customers should expect them to demand from their corporate holdings. Finally, we turn to the role of the customer, and explain how he or she will galvanize this shift in asset managers’ duties. In order for investment advisers to become effective shadow regulators, customers may need to litigate to prod their asset managers to recognize their ESG obligations and develop tactics to ensure that the companies they own disclose these practices. Nongovernmental organizations (NGOs) can facilitate the process by allying with investment advisers to this end.

Through this process, the SASB principles are poised to set off a chain reaction that could end in virtually all public companies disclosing—and, in turn, improving—environmental and human rights practices.

I. Multinational Corporations’ Hesitant Embrace of CSR

In many respects, one would expect that the private sector would be a natural ally for social causes. Corporations typically thrive when the rules under which they operate are transparent and predictable, for example²⁰; they should, therefore, all things being equal, support strengthening the rule of law in their jurisdictions. Corporations also thrive when their access to critical information is unimpeded.²¹ Thus, they should similarly encourage the free flow of data, including data disseminated by the press. Finally, corporations thrive when they are able to efficiently allocate capital resources, human and otherwise, across their geographies. That is why corporations oppose boundaries that limit capital flows.

In light of these corporate needs, it is striking that governments across the globe, in turning toward authoritarianism and nationalism,²² are actively harming the business climate for multinational companies. The weakening rule of law,²³ attacks on the press,²⁴ and attempts to restrict

20. Transparent rules usually benefit businesses, allowing them to make the most efficient investment and operational decisions. See generally Michael Ewing-Chow et al., *The Facilitation of Trade by the Rule of Law: The Cases of Singapore and ASEAN*, in *CONNECTING TO GLOBAL MARKETS* 129 (Marion Jansen et al. eds., World Trade Organization 2014) (quantifying the positive impact that stable rule of law has upon trade); JAMES SCOTT, *SEEING LIKE A STATE* (1999) (detailing the benefits of operating in a “legible society” that has clear rules); IBRAHIM SHIHATA, *THE WORLD BANK IN A CHANGING WORLD* 54-56 (1991) (declaring that a prerequisite for development is that rules must be widely known in advance). This holds particularly true in stable societies.

However, corporations can also benefit financially when the rules under which they operate are transparent and predictable as applied to the company itself, but are hidden to business competitors or the general public; companies can then exploit this asymmetry of information or ability to navigate the legal framework. See, e.g., James Holston, *The Misrule of Law: Land and Usurpation in Brazil*, 33 *COMP. STUD. SOC’Y & HIST.* 695 (1991) (observing that irresolution in Brazilian property laws can be a strategy that the elite may use to secure their own rights, while lower-income groups may be unable to do the same); HERNANDO DE SOTO, *THE OTHER PATH* 132 (2002) (arguing that companies benefit when they are able to take advantage of laws that are too confusing for members of the general public to navigate).

21. See, e.g., NIGEL CORY, *INFORMATION TECHNOLOGY & INNOVATION FOUNDATION, CROSS-BORDER DATA FLOWS: WHERE ARE THE BARRIERS, AND WHAT DO THEY COST?* (2017) (stating that “data localization and other barriers to data flows impose significant costs”), <http://www2.itif.org/2017-cross-border-data-flows.pdf>; Douglass North, *The New Institutional Economics and Third World Development*, in *THE NEW INSTITUTIONAL ECONOMICS AND THIRD WORLD DEVELOPMENT* 17 (John Harris et al. eds., Routledge 1995) (pointing out that lack of access to information hinders growth). Though unimpeded access to information generally benefits corporations, it is also possible that there are situations in which companies may not benefit from unimpeded access for all—rather, they may benefit most when their own access to information is unimpeded, but competitors or the general public do not have free access. In those cases, lobbying for the free flow of data would not necessarily be advantageous.

22. Interview by Ari Shapiro, *supra* note 5.

23. Sean Illing, *20 of America’s Top Political Scientists Gathered to Discuss Our Democracy. They’re Scared.*, *Vox*, Oct. 13, 2017 (interviewing the nation’s preeminent political scientists about the erosion of the rule of law across the United States), <https://www.vox.com/2017/10/13/16431502/america-democracy-decline-liberalism>.

24. Michael Grynbaum, *Trump’s Attacks on the Press: Telling Escalation From Empty Threats*, *N.Y. TIMES*, Oct. 12, 2017, <https://www.nytimes.com/2017/10/12/business/media/trump-news-media-attacks.html>.

19. See *infra* Part II.

human capital allocation²⁵ and trade²⁶ are also acutely evident in our own nation. The United States has dealt a further blow to the ability of firms to plan for the future by rejecting the Paris Agreement, drawing us closer to the precipice of catastrophic climate change, a prospect that could prove devastating to business interests.²⁷

Corporations are not powerless to resist these trends. Governments appreciate that the corporate sector provides jobs, investment and taxes, and partnerships that enrich local elites. These benefits give corporations a formidable voice in shaping policies that can mutually benefit themselves and society at large.²⁸ In addition to lobbying for openness and environmental protection, companies can ensure that they themselves are not exacerbating authoritarianism, nationalism, and environmental damage through their own actions. Moreover, businesses can bolster NGOs, the private nonprofits that work to promote human rights and ecological health.

Multinational corporations have spoken out with increasing frequency to oppose the harms of authoritarianism, nationalism, and climate change, and it is instructive to examine some of their efforts to combat regressive social agendas. First, companies have taken a stand on government policies that they perceive as harming their ability to cultivate a strong work force. In March 2017, for example, Apple, IBM Corporation, Microsoft, and 50 other companies filed an amicus curiae brief in the case of *Gloucester County School Board v. G.G.* in the U.S. Court of Appeals for the Fourth Circuit.²⁹ The brief was intended “to address the rights of transgender students under Title IX of the Education Amendments of 1972.”³⁰ Its 53 signatories affirmed that “[d]iversity and inclusion are essential features of amici’s businesses, and recruiting and retaining the best employees—including those in or allied with the

transgender community—is a critical component of their diversity missions.”³¹

This came on the heels of another corporate-led effort to support a social justice cause in which 97 businesses, including Apple, Google, Intel, and Microsoft, filed an amicus brief in the U.S. Court of Appeals for the Ninth Circuit in *Washington v. Trump*.³² The brief opposed the Donald Trump Administration’s immigration order temporarily barring nationals from seven countries from entering the United States, arguing that the order “hinders the ability of American companies to attract great talent; increases costs imposed on business; makes it more difficult for American firms to compete in the international marketplace; and gives global enterprises a new, significant incentive to build operations—and hire new employees—outside the United States.”³³ More recently, the chief executive officers (CEOs) of JPMorgan Chase, Pepsi, Apple, and other Fortune 500 companies reflected this concern in a letter to the White House, writing that such harsh immigration policies cause “considerable anxiety” for their employees, discourage talented job candidates from moving to the United States, risk upsetting company operations, and present additional “costs and complications for American businesses.”³⁴ When corporate profit and social justice causes align, companies have proven themselves willing allies.

Attempts to restrict information flow have also generated comment from business interests. After China passed a 2016 cybersecurity law clamping down on access to uncensored information and slashing privacy protections for Internet users,³⁵ the private sector responded with concern. The American Chamber of Commerce in China complained:

[S]ome of the requirements for national security reviews and data sharing will unnecessarily weaken security and potentially expose personal information . . . some of the measures seem to emphasize protectionism rather than security. But one thing is for sure: the more difficult it is for data to travel across the Chinese border,

25. Ben White, *Trump’s Early Moves Trigger Business Backlash*, POLITICO, Jan. 30, 2017, <https://www.politico.com/story/2017/01/trump-executive-order-immigration-business-backlash-234377>.

26. See, e.g., Daniel Pearson, *Protectionism Won’t Make America Great Again*, CNBC, Sept. 1, 2017 (discussing the Donald Trump Administration’s move toward trade restrictions), <https://www.cnbc.com/2017/09/01/trump-protectionism-wont-make-america-great-commentary.html>; David Francis, *Trump’s Trade Restrictions Could Miss China and Slam Everybody Else*, FOREIGN POL’Y, June 12, 2017 (same), <http://foreignpolicy.com/2017/06/12/trumps-trade-restrictions-could-miss-china-and-slam-everybody-else/>.

27. Richard Gledhill et al., *Business-Not-as-Usual: Tackling the Impact of Climate Change on Supply Chain Risk*, RESILIENCE, 2003, at 15, https://www.pwc.com/gx/en/governance-risk-compliance consulting-services/resilience/publications/pdfs/issue3/business_not_as_usual.pdf.

28. Daphne Chen, *Apparel Groups Including H&M and Gap Urge Cambodia Garment Industry Reform, Seek Meeting With Hun Sen*, PHNOM PENH POST, Mar. 21, 2018; see also Letter from American Apparel and Footwear Association, to Myanmar State Counselor Daw Aung San Suu Kyi (Mar. 6, 2018) (supporting labor law reform), [https://www.aafaglobal.org/AAFA/AAFA_News/2018_Letters_and_Comments/AAFA_Raises_Concerns_with_Burma_\(Myanmar\)_Labor_Law_Reform_Process.aspx](https://www.aafaglobal.org/AAFA/AAFA_News/2018_Letters_and_Comments/AAFA_Raises_Concerns_with_Burma_(Myanmar)_Labor_Law_Reform_Process.aspx); Comment From Nordic Food Companies on the Court Decision 26th March 2018 Regarding Defamation Case Against Human Rights Advocate Andy Hall, to Ministry of Foreign Affairs in Thailand et al. (Apr. 11, 2018), <https://www.business-humanrights.org/sites/default/files/documents/Nordic%20comment%20on%20the%20Thai%20Court%20decision%20%28002%29.pdf>.

29. Brief for IBM Corp., Microsoft, and 50 Others as Amici Curiae Supporting Respondents, *Gloucester County Sch. Bd. v. G.G.*, 137 S. Ct. 1239 (2017) (No. 16-273), available at 2017 WL 894895.

30. *Id.* at 1.

31. *Id.* at 2.

32. Brief for Technology Companies and Other Business as Amici Curiae Supporting Appellees, *Washington v. Trump*, 847 F.3d 1151 (9th Cir. 2017) (No. 17-35105), available at 2017 WL 626517.

33. *Id.* at 3.

34. Natasha Bach, *Business Leaders Warn of Immigration Policy’s “Substantial Harm on U.S. Competitiveness,”* FORTUNE, Aug. 23, 2018, <http://fortune.com/2018/08/23/business-roundtable-letter-immigration-policy/>.

35. Among other actions, these new rules require instant messaging subscribers to register with their real names and personal information; demand Internet companies censor “prohibited” content; force “citizens’ personal information and important business data” to be stored on Chinese servers; and restrict transfers of data offshore without a “security assessment.” *China Passes New Cybersecurity Law*, COVINGTON & BURLING LLP, Nov. 8, 2016, <https://www.cov.com/en/news-and-insights/insights/2016/11/china-passes-new-cybersecurity-law>; Data Privacy and Cybersecurity Communication, Covington & Burling LLP, China Releases Second Draft of Cybersecurity Law (July 12, 2016), https://www.cov.com/-/media/files/corporate/publications/2016/07/china_release_second_draft_of_cybersecurity_law.pdf; Kate Conger, *China’s New Cybersecurity Law Is Bad News for Business*, TECH CRUNCH, Nov. 6, 2016, <https://techcrunch.com/2016/11/06/chinas-new-cybersecurity-law-is-bad-news-for-business/>.

the more difficult it will be for companies inside those borders to innovate . . .³⁶

Censorship can be bad for business.

Along similar lines, businesses have also touted the importance of transparency and an honest appraisal of the costs of climate change when they stood to benefit. Apple's vice president of environment, policy, and social initiatives, Lisa Jackson, observed:

Certainty is what business needs . . . relying on science is something that we do every single day. So now if we're going to question science, I think it has an impact on more than just some federal rules, or some law, it has a huge impact on human health, the environment, and our economy.³⁷

An April 2017 letter that 16 influential companies³⁸ delivered to President Trump in support of the Paris Agreement echoed this sentiment, arguing that “[b]y setting clearer long-term objectives, and by improving transparency, the agreement provides greater clarity on policy direction, enabling better long-term planning and investment.”³⁹ Yet again, corporate interests aligned with an initiative designed to benefit society at large.

These examples illustrate that company leaders recognize that supporting the rule of law, the free flow of human capital, and access to reliable information, and, conversely, opposing authoritarianism, nationalism, and catastrophic environmental harm, are critical to the success of their operations. It is then odd that their efforts to pursue these aims are not terribly significant, as judged by a series of human rights and sustainability auditors. The 2017 Corporate Human Rights Benchmark Pilot Study, for example, ranked 98 public companies from the agribusiness, apparel, and extractives industries on 100 publicly disclosed indicators.⁴⁰ The average company met 29% of the benchmark's hurdles; only three companies met more than 60% of them.⁴¹

Along similar lines, the KnowTheChain initiative ranked 120 apparel, food and beverage, and information technology companies on their attempts to combat forced

labor. Of 22 indicators, the average apparel company scored a weighted 46 out of 100, the average food and beverage company scored a 30, and the average information technology company scored a 32.⁴² The 2018 Ranking Digital Rights Index evaluated 22 technology and telecommunications firms on policies affecting users' freedom of expression and privacy, with the average company scoring 34%.⁴³ The 2016 Access to Nutrition Index ranked 22 food and beverage companies on their approaches to responsible nutrition and efforts to mitigate undernutrition. A single company scored higher than 6 out of 10.⁴⁴ The 2016 Access to Medicine Index ranked 20 pharmaceutical companies on efforts to improve access to medicines. Only one company scored higher than 3 out of 5.⁴⁵ While these auditing groups naturally encourage a high bar in order to be able to measure progress over time, the majority of companies across a variety of industries cannot meet even half the levels of disclosure and human rights standards sought by civil society.

Even when companies are required by law to report on human rights performance, compliance remains imperfect. In 2016, Development International found that 1,300 companies complied with an average of only 60% of the disclosure requirements found in the 2010 California Transparency in Supply Chains Act, while their affirmative conduct score was 31%.⁴⁶ These failures are not unique to the United States: the CORE Coalition analyzed 2,108 submissions to the United Kingdom (U.K.) Modern Slavery Act of 2015 and found only 14% to be compliant.⁴⁷

Of course, many of these efforts are new, and companies can be expected to improve their scores as they become more familiar with disclosure demands and begin to understand effective approaches to addressing these human rights issues. Indeed, companies subject to public ranking have already improved: the Oxfam Behind the Brands Index began in 2013, and a 2016 update highlighted significant progress that the world's 10 largest food and beverage companies made in their social and environmental practices. Nine of the 10 companies improved their scores by at

36. James Zimmerman, *AmCham China Statement on Cybersecurity Law*, AM CHAM CHINA, Nov. 7, 2016, <https://www.amchamchina.org/about/press-center/amcham-statement/amcham-china-statement-on-cybersecurity-law>.

37. Chris Mooney & Brady Dennis, *On Climate Change, Scott Pruitt Causes an Uproar—And Contradicts the EPA's Own Website*, WASH. POST, Mar. 9, 2017, <https://www.washingtonpost.com/news/energy-environment/wp/2017/03/09/on-climate-change-scott-pruitt-contradicts-the-epas-own-website>.

38. Signatories included the usual suspects, like Apple, Intel, and Microsoft, as well as more surprising parties from the extractive and energy industries, such as BP, Shell, National Grid, PG&E, BHP Billiton, and Rio Tinto.

39. Letter from Apple et al., to President Donald Trump (Apr. 26, 2017), <https://c2es.org/site/assets/uploads/2017/04/business-letter-white-house-paris-agreement-final-04-26-2017-1.pdf>.

40. Corporate Human Rights Benchmark, *2017 Results*, <https://www.corporatebenchmark.org/2017-results> (last visited Dec. 1, 2018).

41. CORPORATE HUMAN RIGHTS BENCHMARK, KEY FINDINGS 2017, at 10 (2017), <https://www.corporatebenchmark.org/sites/default/files/styles/thumbnail/public/2017-03/Key%20Findings%20Report/CHRB%20Key%20Findings%20report%20-%20May%202017.pdf>.

42. KnowTheChain, *KnowTheChain Benchmarks*, <https://knowthechain.org/benchmarks> (last visited Dec. 1, 2018).

43. RANKING DIGITAL RIGHTS, 2018 CORPORATE ACCOUNTABILITY INDEX 19 (2018), <https://rankingdigitalrights.org/index2018/assets/static/download/RDRIndex2018report.pdf>.

44. Access to Nutrition, *Ranking 2016*, <https://www.accessnutrition.org/index/2016> (last visited Dec. 1, 2018).

45. Access to Medicine Foundation, *Access to Medicine Index 2018 Ranking*, <https://accessmedicineindex.org/overall-ranking> (last visited Dec. 1, 2018).

46. CHRIS N. BAYER & JESSE H. HUDSON, DEVELOPMENT INTERNATIONAL, CORPORATE COMPLIANCE WITH THE CALIFORNIA TRANSPARENCY IN SUPPLY CHAINS ACT: ANTI-SLAVERY PERFORMANCE IN 2016 (2017), https://static1.squarespace.com/static/5862e332414fb56e15dd20b9/t/58bf06e346c3c478cf76d619/1488914152831/CA-TISCA.v.24_secured.pdf. An affirmative conduct score refers to the proactive steps that companies take to combat human trafficking in their supply chains. Press Release, Development International, Majority of Companies Not Legally Compliant With California Trafficking/Slavery Disclosure Law (Nov. 20, 2015), http://www.csrwire.com/press_releases/38493-Majority-of-Companies-Not-Legally-Compliant-With-California-Trafficking-Slavery-Disclosure-Law.

47. CORE, *New Short Guides on Modern Slavery Reporting*, <http://corporate-responsibility.org/mini-briefings-modern-slavery/> (last visited Dec. 1, 2018).

least 10% over the three-year period.⁴⁸ This good news was not easily achieved; it was partly a response to more than 700,000 individual actions by consumers.

Despite glimmers of hope, these surveys by and large point to the inadequacy of corporate social performance relative to NGO expectations, at least insofar as the ability to transform the corporate human rights footprint as rapidly as we may hope to see. We posit that one significant reason that businesses, and specifically U.S. public companies, have unsatisfactorily embraced socially responsible behaviors is the fact that under U.S. securities law, they are considered to be immaterial, leading to ineffective regulation of social and environmental externalities.

II. Promoting the Shareholder's "Best Interest": Disclosure and Materiality

A. Disclosure of Material Information as the North Star of U.S. Securities Law

Securities law regulates corporate conduct via requirements that a company disclose information about its operations to the investing public, under the assumption that forced disclosure would decrease the likelihood that a company will behave in unethical ways. This principle is grounded in Justice Louis Brandeis' famous doctrine that "[p]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."⁴⁹ Indeed, disclosure has long been the primary lever for the U.S. government to influence corporate ethics.

The legislative debate leading up to the creation of the 1934 Securities Exchange Act underscores this focus, framing the doctrine in this way: "There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy."⁵⁰ The U.S. House of Representatives Committee Report chronicling the Act's passage reveals congressional intent to instrumentalize disclosure not only to check illicit corporate behavior, but to prevent even those practices that were "legal but unseemly."⁵¹ A corporation exposing itself to shareholders was perceived as "the antidote not only to outright fraud, but also to problems of corporate ethics, such as corporate insiders' failing to appreciate their public responsibilities."⁵² The Supreme Court continued

to embrace this rationale in more modern times, observing that "[t]his Court repeatedly has described the "fundamental purpose" of the [1934] Act as implementing a "philosophy of full disclosure."⁵³

Managements try not to disclose information to the public that would be looked upon unfavorably by their stakeholders. Disclosure can make bad behavior an expensive prospect: potential investors, lenders, or insurers might be frightened away; customers could boycott; politicians could endeavor to pass unfavorable laws; and attorneys could create legal headaches. This holds true not only for information that would embarrass a company in absolute terms (e.g., X Corp's sneakers are produced in sweatshops), but particularly when that embarrassment is high relative to other companies in the same industry (e.g., X Corp's sneakers are produced in sweatshops, whereas other apparel companies source their sneakers from factories that pay workers a living wage). When disclosures are required, the natural tendency of management is to try to mitigate unfavorable impressions through promised improvements, for which they can be held accountable.

Disclosure not only forms the bedrock of securities regulation, it has taken on even more importance as a result of what scholars describe as a creeping preemption by the federal securities regime of state-based corporation law. State governments have traditionally served as the primary regulators of corporate behavior.⁵⁴ Given that companies incorporate themselves by registering with states, such governance was logical; as the Supreme Court observed in 1987's *CTS Corp. v. Dynamics Corp.*, "[s]tate regulation of corporate governance is regulation of entities whose very existence and attributes are the products of state law."⁵⁵ As such, "no principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations."⁵⁶

Systemic shocks, however—including the collapse of Enron, WorldCom, and unfolding fraud scandals in corporate governance—spurred a renewed interest in turning to federal regulators to curb corporate excess.⁵⁷ With the passage of federal regulations like Sarbanes-Oxley and Dodd-Frank, the U.S. Congress sought to reassert itself as an arbiter of corporate behavior in the place of state corporate law, with an eye toward protecting investors.⁵⁸ In sum, "[f]ederal securities law, not state corporate law, plays the most important role in corporate governance in America

53. *Basic*, 485 U.S. at 230.

54. Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REGULATION, Spring 2003, at 26 ("For over 200 years, corporate governance has been a matter for state law."), available at <https://www.sec.gov/comments/4-537/smbainbridge1431.pdf>.

55. 481 U.S. 69, 89 (1987).

56. *Id.* (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §304 (1971)).

57. Bainbridge, *supra* note 54, at 26.

58. James J. Park, *Reassessing the Distinctions Between Corporate and Securities Law*, 64 UCLA L. REV. 116, 119 (2017); see also Bainbridge, *supra* note 54, at 28-29 (discussing the motivations behind the Sarbanes-Oxley Act); Donald Langevoort, *Federalism in Corporate/Securities Law: Reflections on Delaware, California, and State Regulation of Insider Trading*, 40 U.S.F. L. REV. 879, 879 (2006) ("By all accounts, the Sarbanes-Oxley Act has federalized more of what Congress used to leave to state corporate law.").

48. OXFAM INTERNATIONAL, BRIEFING PAPER: THE JOURNEY TO SUSTAINABLE FOOD: A THREE-YEAR UPDATE ON THE BEHIND THE BRANDS CAMPAIGN (2016), https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bp-journey-to-sustainable-food-btb-190416-en.pdf.

49. Louis D. Brandeis, *What Publicity Can Do*, HARPER'S WKLY., Dec. 20, 1913, available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1910/1913_12_20_What_Publicity_Ca.pdf.

50. *Basic v. Levinson*, 485 U.S. 224, 230 (1988) (citing H.R. REP. NO. 1383, at 11 (1934)).

51. Cynthia Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1227, 1235 (1999).

52. *Id.* at 1235.

today, primarily because ‘disclosure has become the most important method to regulate corporate managers and disclosure has been predominantly a federal, rather than a state, methodology.’⁵⁹

Because federal law centers on disclosure as the primary lever for influencing corporate ethics, and federal law has surpassed state law in many aspects of corporate governance, the saliency of disclosure is clear.⁶⁰ Thus has it evolved that the foremost method of controlling corporate ethics in the United States centers on the responsibilities that businesses have in communicating with their investors.

Despite the overarching importance that disclosure has acquired, not all of it is desirable.⁶¹ Disclosure can be costly, misleading, uninteresting, or may reveal competitive information. Too much disclosure can even create liability under the “buried facts” doctrine.⁶² The most salient aspect in considering whether disclosures are helpful to investors is related to materiality, a concept that has been considered “the cornerstone of the federal securities laws since Congress incorporated this principle in the first of these laws in the 1930s.”⁶³ Rule 10b-5 of the Securities Exchange Act makes it unlawful to “make any untrue statement of a *material* fact or to omit to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .”⁶⁴ What exactly made a fact “material,” however, remained a matter of dispute.

59. Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 806 (2006) (quoting Thompson & Sale, *supra* note 1, at 861).

60. The usurpation of state corporate governance prerogatives by Congress and the SEC seems neither inevitable nor irreversible, but is the result of a dynamic tension. See Roberta S. Karmel, *Realizing the Dream of William O. Douglas: The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 81 (2005) (stating that prior to the passage of the Sarbanes-Oxley Act in 2002, “[w]here statutory mandates were ambiguous, however, the courts frequently halted the SEC’s reach for jurisdiction to regulate corporate governance, even though the judicially-constructed demarcation between federal and state law was little more than a line in the sand,” and describing Sarbanes-Oxley as “the latest maneuver in a long running battle between federal and state authorities over the regulation of public corporations”).

61. CHRISTIAN LEUZ & PETER D. WYSOCKI, ECONOMIC CONSEQUENCES OF FINANCIAL REPORTING AND DISCLOSURE REGULATION: A REVIEW AND SUGGESTIONS FOR FUTURE RESEARCH (Working Paper, 2008) (detailing some drawbacks of the disclosure regime), available at <http://ssrn.com/abstract=1105398>; see also Étienne Farvaque et al., *Corporate Disclosure: A Review of Its (Direct and Indirect) Benefits and Costs*, 128 INT’L ECON. 5 (2011) (same).

62. *Werner v. Werner*, 267 F.3d 288, 297 (3d Cir. 2001) (“Under the ‘buried facts’ doctrine, a disclosure is deemed inadequate if it is presented in a way that conceals or obscures the information sought to be disclosed. The doctrine applies when the fact in question is hidden in a voluminous document . . .”). For an opposing view, cf. MOHINI SINGH & SANDRA J. PETERS, CFA INSTITUTE, FINANCIAL REPORTING DISCLOSURES: INVESTOR PERSPECTIVES ON TRANSPARENCY, TRUST, AND VOLUME (2013) (“Sophisticated investors who are capable of analyzing high volumes of data are not concerned with volume. Furthermore, we contend that investors cannot be overloaded with too much information *if it is useful information.*”) (emphasis added), <https://www.cfainstitute.org/-/media/documents/article/position-paper/financial-reporting-disclosures-investor-perspectives-on-transparency-trust-volume.ashx>.

63. BUSINESS ROUNDTABLE, THE MATERIALITY STANDARD FOR PUBLIC COMPANY DISCLOSURE: MAINTAIN WHAT WORKS 3 (2015), <http://businessroundtable.org/sites/default/files/reports/Materiality%20White%20Paper%20FINAL%2009-29-15.pdf>.

64. 17 C.F.R. §240.10b-5 (2003) (emphasis added).

The Supreme Court took up the issue in 1976’s *TSC Industries v. Northway*.⁶⁵ In rejecting an earlier formulation of the materiality test as “all facts which a reasonable shareholder *might* consider important,”⁶⁶ the majority determined that prior application of the standard had at times been unacceptably loose. The Court noted:

Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good . . . if the standard of materiality is unnecessarily low . . . management’s fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decision-making.⁶⁷

Part of the Court’s effort, then, was to protect investors from overly dense disclosure.

Despite the recognition of the need to tighten what constitutes “material” information, however, the Court’s definition remains ambiguous:

What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, 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 made available.⁶⁸

More recent cases have attempted to flesh out some of the details of this definition. The “reasonable investor” is not a dictator who can demand whatever pleases her or him: as the U.S. Court of Appeals for the Second Circuit observes, “a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact.”⁶⁹ Nonetheless, facts that truly have a bearing on an investment or voting decision fit the conception of materiality. Like obscenity, materiality is difficult to define, but “reasonable shareholders” know it when they see it.⁷⁰ This refusal to specify materiality, except in terms of disclosures that reasonable investors happen to think are relevant to their decisions, is a unique aspect of U.S. securities law⁷¹ and a critical distinction for any potential sea change in corporate responsibility trends.

65. 426 U.S. 438 (1976).

66. *Id.* at 445.

67. *Id.* at 448.

68. *Id.* at 449; see also *Basic v. Levinson*, 485 U.S. 224, 232 (1988) (“We now expressly adopt the *TSC Industries* standard of materiality for the §10(b) and Rule 10b-5 context.”); *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2413 (2014) (reaffirming this standard of materiality).

69. *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1999).

70. The definition and scope of “reasonable investor” is problematic in its own right. See, e.g., Margaret V. Sachs, *Materiality and Social Change: The Case for Replacing “the Reasonable Investor” With “the Least Sophisticated Investor” in Inefficient Markets*, 81 TUL. L. REV. 473 (2006/2007); Tom C.W. Lin, *Reasonable Investor(s)*, 95 B.U. L. REV. 461 (2015) (both discussing the definitional challenges of characterizing a reasonable investor).

71. Yvonne Ching Ling Lee, *The Elusive Concept of Materiality Under U.S. Federal Securities Laws*, 40 WILLAMETTE L. REV. 661, 677 (2004) (“Instead of the TSC standard, which accentuates the ‘importance’ of information to

The concept of materiality is further complicated by the notion that while the “reasonable investor,” whomever it may be, sets the standard for materiality, it is up to corporate management to decide whether each particular fact satisfies the standard, and, as a result, whether to disclose it.⁷² In essence, it is the responsibility of management to place itself in the investor’s shoes and to ask itself whether the “reasonable investor” would view a fact as material and, therefore, its omission as misleading. If management guesses the wrong way, it may expose the corporation to accusations of fraud. The Supreme Court recognized the quandary that managements might face in this assessment, but concluded that each instance of determination was situation-specific, and that management was the only entity that was capable of making such a choice: “The determination requires delicate assessments of the inferences a ‘reasonable shareholder’ would draw from a given set of facts and the significance of those inferences to him . . .”⁷³

The SEC has echoed the Supreme Court’s observation on the ambiguity of “materiality,”⁷⁴ and has provided additional guidance to issuers of securities as to what items should be considered material.⁷⁵ For example, the determination of materiality involves “a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.”⁷⁶ In addition, the SEC has suggested that issuers “eliminate” disclosure of any topic “that does not promote understanding of registrants’ financial condition, liquidity and capital resources, changes in financial condition and results of operations.”⁷⁷ Here, the SEC has gone beyond the Supreme Court in favoring a restricted version of disclosure based solely on financial, short-term considerations of materiality.

‘the mythical reasonable investor in making his investment decision,’ other jurisdictions such as Australia, European Community, and Hong Kong have adopted securities laws and regulations whose emphasis appears to be on the information’s impact on market prices.”)

72. *In re Lions Gate Entm’t Corp. Sec. Litig.*, No. 14-cv-5197 (JGK), 2016 WL 297722, at *17 (S.D.N.Y. Jan. 22, 2016) (“[A]n omission is actionable under federal securities laws only when the [defendant] is subject to a duty to disclose the omitted facts.’ Even though Rule 10b-5 imposes no duty to disclose all material, nonpublic information, once a party chooses to speak, it has a ‘duty to be both accurate and complete.’” (citations omitted)).

73. *TSC Indus., Inc.*, 426 U.S. at 450.

74. The SEC remarked:

In the articulation of the materiality standards, it was recognized that doubts as to materiality of information would be commonplace, but that, particularly in view of the prophylactic purpose of the securities laws and the fact that disclosure is within management’s control, “it is appropriate that these doubts be resolved in favor of those the statute is designed to protect.”

(citation omitted). Commission Guidance Regarding Disclosure Related to Climate Change, Security Act Release No. 33-9106, 75 Fed. Reg. 6290, 6293 (Feb. 8, 2010). While this statement and the guidance that follows were issued in the context of reporting about the materiality of climate change, they are generalizable to the materiality of any topic. For a specific discussion of the 2010 climate guidance, see *infra* note 91 and accompanying text.

75. Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 74, at 6293.

76. *Id.* at 6294 (citation omitted).

77. *Id.*

B. Attitudes Toward the Materiality of ESG Disclosure

The law has never disputed that social and environmental factors that “promote understanding of registrants’ financial condition, liquidity and capital resources, changes in financial condition and results of operations” are appropriate topics for disclosure.⁷⁸ But the SEC has traditionally declined to go farther than this in its approach to any reporting that bears upon corporate ethics.⁷⁹ While the SEC might argue that there is no need to move beyond a principles-based regime, critics counter that it “does little to encourage either affirmative disclosures or issuer attention to determining whether sustainability issues are economically significant.”⁸⁰ Many firms voluntarily disclose sustainability information despite the lack of obligation to do so, but it is thought to be of poor quality by investors.⁸¹ For these reasons, socially responsible shareholders

78. Corporations are required to discuss social and environmental topics that they deem material primarily in three fora: First, issuers must disclose whether they are in compliance with certain statutes, such as the mine safety rules of §1503 of Dodd-Frank. Second, all U.S. issuers are required to “[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations” in the “[m]anagement’s discussion and analysis of financial condition and results of operations” as part of their annual filings. 17 C.F.R. §229.303(a) (3)(ii). Registrants may disclose material social and environmental impacts here, as well as under the “Description of Business” and “Legal Proceedings” headings of their annual filing.

Third, all U.S. issuers are required to disclose risk factors in the same annual filings. 17 C.F.R. §229.503(c) (“Where appropriate, provide under the caption ‘Risk Factors’ a discussion of the most significant factors that make the offering speculative or risky.”). Some legal experts have advised using a broad interpretation of materiality in these filings, because

risk factors, and risk disclosure generally, often satisfy the dual purpose of serving as cautionary language for purposes of the Private Securities Litigation Reform Act of 1995 safe harbor and the “be-speaks caution” doctrine as well as compliance with Item 503(c) of Regulation S-K [aforementioned “Risk Factors”]. As a result, additional disclosure of risks can play an important role in staving off antifraud liability and regulatory action for non-compliance.

STUART GELFOND ET AL., FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP, LEXIS PRACTICE ADVISOR, TOP 10 PRACTICE TIPS BY EXPERTS: RISK FACTORS 2 (2017), <http://www.friedfrank.com/siteFiles/Publications/LPA-Top%2010%20Tips-RISK%20FACTORS-final.pdf>.

79. An exception to this statement is the SEC staff’s assertion that “[a]mong the considerations that may well render material a quantitatively small [otherwise immaterial] misstatement of a financial statement item are . . . whether the misstatement involves concealment of an unlawful transaction.” SEC Staff Accounting Bulletin: No. 99—Materiality (1999), available at <https://www.sec.gov/interps/account/sab99.htm>. The assertion is grounded in the question of whether small examples of illegal behavior, such as commercial bribes, cause the reasonable investor to doubt the integrity of management.

80. Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. (forthcoming 2019) (p. 34 in draft, available at <https://ssrn.com/abstract=3233053>).

81. Most large companies voluntarily issue sustainability information, usually in the form of sustainability reports. Many of these follow the Global Reporting Initiative (GRI) standards. See, e.g., KPMG INTERNATIONAL, THE KPMG SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2013 (2013), <https://assets.kpmg.com/content/dam/kpmg/pdf/2015/08/kpmg-survey-of-corporate-responsibility-reporting-2013.pdf>. Under U.S. securities law, voluntary sustainability reporting must not be materially misleading. Nancy S. Cleveland et al., *Sustainability Reporting: The Lawyer’s Response*, BUS. L. TODAY, Jan. 2015, at 1 (“All reporting standards require that a company’s sustainability disclosures—even where there is no duty to disclose under the U.S. federal securities laws—be both accurate and complete.”), <https://>

and their supporters have on several occasions requested the SEC to compile mandatory ESG disclosure standards.

The SEC has periodically examined what kinds of environmental and social information ought to be mandatorily disclosed. Following the first social shareholder proposals submitted to Dow Chemical in 1968 (relating to the sale of napalm)⁸² and General Motors in 1970 (requesting investigations into the company's policies regarding pollution, safety, mass transit, and minority hiring)⁸³; and in response to a 1971 rulemaking petition by the Natural Resources Defense Council,⁸⁴ in 1975, the SEC undertook a consideration of environmental and social reporting matters.⁸⁵ This was followed by a 1977 congressional advisory committee report on corporate disclosure.⁸⁶ The SEC concluded in 1975 that mandatory reporting of these topics would be burdensome for issuers and of little interest to investors.⁸⁷

The SEC's findings were endorsed by the subsequent advisory committee, which recommended the SEC "require disclosure of matters of social and environmental significance only when the information in question is material to informed investment or corporate suffrage decision-making."⁸⁸ The advisory committee also "expressed the view that the Commission should classify social and environmental information as material 'only when it reflects significantly on the economic and financial performance of

the company."⁸⁹ In other words, absent a clear impact on financial performance, social and environmental damage is not worth the trouble of reporting.

This attitude has persisted. The aforementioned explication of the nuances of materiality⁹⁰ was derived from an SEC guidance document produced in response to a series of rulemaking petitions, filed from 2007 to 2009, that bemoaned the adequacy of climate change disclosure.⁹¹ The SEC advised that material impacts stemming from climate change could flow to financial statements through legislation and regulation, international accords (e.g., the Kyoto Protocol), indirect consequences of regulation or business trends, and physical impacts. The intent of the document was to clarify disclosure under existing rules, however.

In doing so, the SEC did not satisfy the degree of detail requested by petitioners.⁹² In 2016, the SEC published a concept release to "seek public comment on modernizing certain business and financial disclosure requirements."⁹³ In asking for the public's opinion about ESG reporting, the SEC noted that "[t]he current statutory framework for adopting disclosure requirements remains generally consistent with the framework that the Commission considered in 1975."⁹⁴

Views regarding ESG disclosure have been shifting for some time. In 2016, the SEC observed that the "role of sustainability and public policy information in investors' voting and investment decisions may be evolving as some investors are increasingly engaging on certain ESG matters."⁹⁵ Despite this acknowledgment, nonfinancial

www.americanbar.org/content/dam/aba/publications/blt/2015/01/sustainability-reporting-201501.pdf.

Nevertheless, all of these disclosures are chock-full of boilerplate language and, in the case of sustainability reports, rosy depictions. Sustainability reports specifically should be viewed as public relations documents (which cannot be materially misleading either) rather than rigorous disclosure. In reviewing all of these sources, experts continue to opine that, "by and large, companies continue to take a minimally compliant approach to sustainability disclosure." SASB, *supra* note 2.

82. Medical Comm. for Human Rights v. Securities & Exch. Comm'n, 432 F.2d 659 (D.C. Cir. 1970).

83. *Campaign GM*, HARV. CRIMSON, Sept. 20, 1971, available at <https://www.thecrimson.com/article/1971/9/20/campaign-gm-pin-1970-a-group/>; see also SEC Commissioner James C. Treadway Jr., Shareholder Activism and Corporate Ethics: The Government as Referee, Remarks at the Leroy Jeffers Memorial Lectures on Theology and Law (Oct. 17, 1983), <https://www.sec.gov/news/speech/1983/101783treadway.pdf>.

84. Natural Res. Def. Council v. Securities & Exch. Comm'n, 389 F. Supp. 689, 5 ELR 20074 (D.C. Cir. 1974); Fair Empl. Prac. Cas., 167 E.R.C. (BNA) 1199.

85. Notice of Commission Conclusions and Rulemaking Proposals in the Public Proceeding Announced in the Securities Act Release No. 5569, Securities Act Release No. 5672, Exchange Act Release No. 11733, 8 SEC Docket 41 (Oct. 14, 1975).

86. ADVISORY COMMITTEE ON CORPORATE DISCLOSURE, REPORT TO THE SECURITIES AND EXCHANGE COMMISSION, 95TH CONGRESS, COMMITTEE PRINT 95-29 (1977), available at <https://babel.hathitrust.org/cgi/pt?id=pst.000012956586;view=1up;seq=4>.

87. As the SEC explains:

The proposed disclosures would be extremely voluminous, subjective and costly to all concerned. They also would not lend themselves to comparisons of different companies, which is of great importance to investors since investment decisions essentially involve a choice between competing investment alternatives . . . Moreover, there appears to be virtually no direct investor interest in voluminous information of this type.

40 Fed. Reg. 51662 (Nov. 6, 1975).

88. ADVISORY COMMITTEE ON CORPORATE DISCLOSURE, *supra* note 86, at D-21.

89. Business and Financial Disclosure Required by Regulation S-K, SEC Release No. 33-10064, 81 Fed. Reg. 23916 n.687 (Apr. 22, 2016), available at <http://www.legalexecutiveinstitute.com/wp-content/uploads/2016/09/46-Excerpts-from-SEC-S-K-Concept-Release.pdf>.

90. See *supra* notes 74-77 and accompanying text.

91. Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 74.

92. California Public Employees' Retirement System et al., Petition for Interpretive Guidance on Climate Risk Disclosure, File No. 4-547, §6a (Sept. 19, 2007), available at <http://www.sec.gov/rules/petitions/2007/petn4-547.pdf>.

93. Business and Financial Disclosure Required by Regulation S-K, *supra* note 89.

94. *Id.* at 210.

95. *Id.* The SEC may one day consider this an understatement in light of the comments received in response to the concept release:

Of the 227 original [comment] letters [responding to the concept release], 66% discussed sustainability disclosures. This is pretty remarkable, considering that only 3.2% of the Concept Release (11 of 341 pages) discussed sustainability disclosure . . . Of the 149 public comment letters that discussed sustainability, more than half were from investors and investor groups with an aggregate AUM of over \$168T. 85% of sustainability-related letters call for improved disclosure of sustainability factors in SEC filings.

Jean Rogers, *Investors Ask SEC for Better Sustainability Disclosure*, SASB, Aug. 17, 2016, available at <https://www.linkedin.com/pulse/investors-ask-sec-better-sustainability-disclosure-jean-rogers>.

Along with changes in views toward ESG disclosure specifically, the SEC has explicitly recognized that the substance of what constitutes material information is subject to change in step with evolving standards of what investors consider important. See Commission Conclusions and Rule Making Proposals, Securities Act Release No. 5627, Exchange Act Release No. 11733, Fed. Sec. L. Rep. (CCH) ¶ 80310, at 85707 (Oct. 14, 1975) (during its explication of its decision not to include social and environmental concerns as "material" in the Natural Resources Defense Council proceedings, the SEC nevertheless acknowledged that securities disclosure rules

ESG disclosure has generally not been considered to be a mandatory need; given the gloss by the Supreme Court and the costs of accurate and complete disclosure, firms are often affirmatively discouraged from shining a cleansing light on social and environmental externalities.⁹⁶ Under existing federal securities disclosure rules, business is currently free to overlook social and environmental issues that it might otherwise feel responsible to correct.⁹⁷

The foregoing discussion begs an important question: despite a statutory lack of interest, if company managements feel strongly about responsible behavior and actually wish to embrace a long-term, sustainable outlook; treat their employees well and ensure that their suppliers do the same; shift their business operations to emphasize renewable resources; and engage in positive fashion with their communities, what is holding them back? Theoretically, nothing. While corporate law traditionally emphasizes the sole responsibility of officers and directors to the shareholder,⁹⁸ the “business judgment rule,” which gives managements the discretion to carry out a wide range of activities—including CSR—in the name (and sometimes in name only) of shareholder value creation

renders any prohibition against serving other stakeholders fairly meaningless.⁹⁹

Nor is there strong evidence that behaving in a responsible fashion undermines financial performance or even shareholder profits; on the contrary, the majority of studies find a (limited) positive relationship between improved CSR performance and a company’s financial returns.¹⁰⁰ Concepts such as “shared value” are now widely understood.¹⁰¹ Why, then, aren’t more businesses “doing well by doing good” to a greater extent than we currently find them to be?

Once again, a significant factor concerns the relationship between a corporation and its investors. The term “activist investor” may be confusing—an “activist investor” is not related to an “active investor,” nor to an activist generally—but has become familiar to company managements and boards of directors. Activist investors are typically hedge funds that accumulate a large enough stake in a public company that they are able to attempt to change the membership of the board, or alter the strategic direction of the company in some other fashion, such that an anticipated improvement in financial performance can repay the investment.¹⁰²

Activist investors tend to target companies affected by a lagging stock price, and when successful, portray themselves as champions of the shareholder. Their impact is such that in the words of one industry participant, “No recent development has influenced firms’ strategic and financial decision-making as profoundly as the surge in shareholder activism following the global financial crisis.”¹⁰³ Indeed, nearly 760 public companies globally were recipients of campaigns in 2016¹⁰⁴; household names General Electric¹⁰⁵

can shift in order to adapt to modern investor concerns and social norms); Statement of the Commission Regarding Disclosure of Year 2000 Issues, Release No. 34-40277, 63 Fed. Reg. 41394, 41398 (Aug. 4, 1998) (“federal securities laws are dynamic and respond to changing circumstances”).

96. As mentioned in note 81, voluntary disclosure must not be materially misleading. In re Lions Gate Entm’t Corp. Sec. Litig., No. 14-cv-5197 (JGK), 2016 WL 297722, at *17 (S.D.N.Y. Jan. 22, 2016) (“Even though Rule 10b-5 imposes no duty to disclose all material, nonpublic information, once a party chooses to speak, it has a ‘duty to be both accurate and complete.’”). Providing verified disclosures incurs cost. See, e.g., Etienne Farvaque et al., *Is Corporate Disclosure Necessarily Desirable? A Survey*, FIN. INT’L MEETING AFFI-EUROFIDAI, Oct. 26, 2009, available at <https://ssrn.com/abstract=1494238>. Even if managements do not care about being parsimonious in their investor communications, they still care about unnecessary spending.

97. It has been recognized for some time that U.S. firms lag international peers in their sustainability reporting. Robert Kropp, *Another Report Shows US Firms Lag Europeans on Sustainability*, GREENBIZ, May 7, 2012, <https://www.greenbiz.com/blog/2012/05/07/another-report-shows-us-firms-lag-europeans-sustainability>. The situation remains unrectified: a 2017 survey of investor relations professionals found that more than one-half of U.S. companies had no ESG-related interactions with investors over the prior year; the corresponding figures for Europe were 24% and Asia-Pacific 35%. *Research Report—Global IR Practice: ESG Communications*, IR MAG., Fall 2017, at vi, available at <https://www.irmagazine.com/download/2286>.

One partial explanation relates to one study’s findings that U.S. institutional investors have comparatively low impact on the CSR practices of business: “U.S. investors do not play a leading role in driving firms’ [environmental and social] E&S performance.” Alexander Dyck et al., *Do Institutional Investors Drive Corporate Social Responsibility? International Evidence*, J. FIN. ECON. at 30 (forthcoming), available at <https://ssrn.com/abstract=2708589>. While Alexander Dyck et al. attributed this to country-level social norms, an alternative explanation is offered here.

98. *Dodge v. Ford* is viewed as the foundational case for the proposition that corporations strive only to maximize shareholder wealth, and is familiar to virtually every student who has taken a course on corporate law . . . [it] is cited almost invariably as evidence that corporate law requires corporations to have a “profit maximizing purpose” and that “managers and directors have a legal duty to put shareholders’ interests above all others and [have] no legal authority to serve any other interests . . .”

Lynn Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 164-65 (2008).

99. As Forest Reinhardt et al. explain:

A Delaware court . . . ruled that the business judgment rule protected the 1989 decision by Occidental Petroleum to spend \$120 million, slightly less than half of the company’s yearly net profit, on an art museum named after its 91 year-old CEO, Armand Hammer . . . So, are firms in the United States prohibited from sacrificing profits in the public interest? And if so, is the prohibition enforceable? The answers to these two questions appear to be “maybe” and “no,” respectively.

FOREST L. REINHARDT ET AL., CORPORATE SOCIAL RESPONSIBILITY THROUGH AN ECONOMIC LENS 9 (National Bureau of Economic Research, Working Paper No. 13989, 2008), available at <http://www.nber.org/papers/w13989>.

100. Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence From More Than 2,000 Empirical Studies*, 5 J. SUSTAINABLE FIN. & INVESTMENT 210 (2015). For an advanced approach, see Mozaffar Khan et al., *Corporate Sustainability: First Evidence on Materiality*, 91 ACCT. REV. 1697 (2016), available at <https://ssrn.com/abstract=2575912>.

101. Michael Porter & Mark Kramer, *Creating Shared Value*, 89 HARV. BUS. REV. 62 (2011).

102. For a summary of the activist investing phenomenon, see J.P. MORGAN, *THE ACTIVIST REVOLUTION: UNDERSTANDING AND NAVIGATING A NEW WORLD OF HEIGHTENED INVESTOR SCRUTINY* (2015), <https://www.jpmorgan.com/jpmpdf/1320693986586.pdf>.

103. *Id.* at 1.

104. ACTIVIST INSIGHT & SCHULTE ROTH & ZABEL, *THE ACTIVIST INVESTING ANNUAL REVIEW 2017*, at 9 (2017), <https://www.activistinsight.com/wp-content/uploads/2017/02/TheActivistInvestingAnnualReview2017AIM.pdf#x83756>.

105. Ed Crooks & Lindsay Fortado, *Activist Investor Triun Wins Seat on GE Board*, FIN. TIMES, Oct. 9, 2017, <https://www.ft.com/content/956eef3e-acf6-11e7-aab9-abaa44b1e130>.

and Procter & Gamble¹⁰⁶ capitulated to such campaign demands in 2017.

Among the many targets of activist investors have been corporations that consider themselves to be long-term, sustainable, and responsible in outlook. Unfortunately, two of the highest-profile of these corporations, Whole Foods Market and Etsy, have been forced to remove directors or officers in response to activist campaigns in the recent past. Any company management planning to burnish its sustainability reputation must carefully consider the implications of these examples:

John Mackey, co-founder and current CEO of Whole Foods Market, literally wrote the book on CSR with the publication of *Conscious Capitalism* in 2013.¹⁰⁷ Whole Foods' core values include supporting team member happiness, serving local and global communities, advancing environmental stewardship, creating ongoing win-win partnerships for suppliers, and promoting customer health through nutritional education.¹⁰⁸ Unfortunately, the company posted declining sales for the seven quarters ending in April 2017.

This prompted activist investor JANA Partners, a group that perceived itself as a champion of shareholders' rights, to accumulate an 8% position in the company, which it leveraged to replace the chairman and add five independent directors to the board. This led to a drastic shift in purchasing practices, as "the company jettisoned its unique purchasing model that wove together a network of autonomous regional production hubs of small farmers and mom-and-pop food startups. It's now prioritizing a centralized, bulk-buying strategy that looks a lot like, well, Walmart."¹⁰⁹ Prioritizing community well-being and partnership with local farmers, a respectable but more costly business model, was buried in favor of profit maximization.

Online craft marketplace Etsy had been a certified B Corporation, a designation assigned by a nonprofit orga-

nization¹¹⁰ that "measures companies on the treatment of their workers, the benefit they provide to the community and the environment, and their overall governance and transparency."¹¹¹ According to one Bloomberg account, the company features "an elegant Brooklyn headquarters with Manhattan views, art installations, and a 'breathing room,' along with salaries and benefits common at much, much more profitable tech companies."¹¹²

Activist investor black-and-white Capital, after accumulating a 2% position in the company, complained publicly about Etsy's high costs and lower-than-peer growth rate.¹¹³ Its pressure resulted in the removal of the chairman and CEO Chad Dickerson and a layoff of 8% of its work force.¹¹⁴ Etsy has since allowed its B Corporation status to lapse.¹¹⁵ Noting that Etsy was one of only two B Corporations traded on a major public exchange, Bloomberg explained that "[p]ublic-market B Corps are rare because investors hate them."¹¹⁶

Investors that grow weary of what they perceive to be costly forms of socially responsible engagement can sabotage a company's efforts to embrace those principles in their operations. Management's rising fear of activist investors tracks the rising frequency of such campaigns.¹¹⁷ Bloomberg reported that 65 public companies cited "shareholder activism" as a risk factor in their SEC filings in the first six months of 2017; this number increased from 52 in the same period of 2016, 23 in 2015, and 12

106. Siddharth Cavale, *P&G Appoints Peltz to Board Despite Losing Proxy Battle*, REUTERS, Dec. 15, 2017, <https://www.reuters.com/article/us-procter-gamble-trian/pg-appoints-peltz-to-board-despite-losing-proxy-battle-idUSKBN1E92ZA>.

107. Whole Foods Market, *John Mackey: Co-Founder and Chief Executive Officer*, <http://media.wholefoodsmarket.com/experts/executives/john-mackey> (last visited Dec. 5, 2018).

108. Whole Foods Market, *Our Core Values*, <http://www.wholefoodsmarket.com/mission-values/core-values> (last visited Dec. 5, 2018).

109. Nicole Aschoff, *Whole Foods Represents the Failures of "Conscious Capitalism"*, GUARDIAN, May 29, 2017, https://www.theguardian.com/commentisfree/2017/may/29/whole-foods-failures-conscious-capitalism?CMP=Share_iOSApp_Other. As one Whole Foods supplier lamented, "Despite their altruistic philosophy, at the end of the day, Whole Foods is a stock company, and they owe allegiance to shareholders." Lydia DePillis, *As Whole Foods Merges With Amazon, Local Producers Watch and Worry*, CNN MONEY, Feb. 19, 2018, <http://money.cnn.com/2018/02/19/news/economy/amazon-whole-foods/index.html>.

On June 16, 2017, Whole Foods agreed to be acquired by Amazon.com Inc., deepening the commitment to centralized purchasing at the expense of local producers, and challenging the viability of a socially conscientious business model. Nick Turner et al., *Amazon to Acquire Whole Foods for \$13.7 Billion*, BLOOMBERG, June 16, 2017, <https://www.bloomberg.com/news/articles/2017-06-16/amazon-to-acquire-whole-foods-in-13-7-billion-bet-on-groceries>.

110. B Lab, *The B Corp Declaration of Interdependence* ("We envision a global economy that uses business as a force for good. This economy is comprised of a new type of corporation—the B Corporation—Which [sic] is purpose-driven and creates benefit for all stakeholders, not just shareholders."), <https://www.bcorporation.net/what-are-b-corps/the-b-corp-declaration> (last visited Dec. 5, 2018).

111. Etsy, *Mission & Values*, <https://www.etsy.com/mission> (last visited Dec. 5, 2018).

112. Max Chafkin & Jing Cao, *The Barbarians Are at Etsy's Hand-Hewn, Responsibly Sourced Gates*, BLOOMBERG, May 18, 2017, <https://www.bloomberg.com/news/features/2017-05-18/the-barbarians-are-at-etsy-s-hand-hewn-responsibly-sourced-gates>.

113. Press Release, black-and-white Capital, *black-and-white Capital Calls for Change at Etsy* (May 2, 2017), <https://www.businesswire.com/news/home/20170502005999/en/black-and-white-Capital-Calls-Change-Etsy>.

114. Chafkin & Cao, *supra* note 112.

115. David Gelles, *Inside the Revolution at Etsy*, N.Y. TIMES, Nov. 25, 2017, <https://www.nytimes.com/2017/11/25/business/etsy-josh-silverman.html>.

116. Chafkin & Cao, *supra* note 112. The second public company referred to in the Bloomberg article is apparently Rally Software, which was decertified after its acquisition by CA Technologies. Meghan French Dunbar, *How Natura Became the World's Largest B Corp—And How It's Helping*, CONSCIOUS COMPANY MEDIA, Jan. 5, 2016, <https://consciouscompanymedia.com/sustainable-business/how-natura-became-the-worlds-largest-b-corp-and-how-its-helping/>. Of more than 2,200 certified B Corps, only one appears to be currently traded on major U.S. exchanges. See, e.g., B Lab, *B Corp Directory* (providing a search engine for B Corps), <https://www.bcorporation.net/community/find-a-b-corp> (last visited Dec. 5, 2018). Laureate Education was a certified B Corp before it underwent an initial public offering in early 2017. Dennis Price, *Laureate Education Raises \$490 Million in First IPO for a Public Benefit Corp*, IMPACTALPHA, Feb. 7, 2017, <https://impactalpha.com/laureate-education-raises-490-million-in-first-ipo-for-a-public-benefit-corp-6737a2cce896>. In January 2018, its certification was renewed. Press Release, Laureate Education, *Laureate Education, Inc. Announces Renewal of Certified B Corporation® Status* (Jan. 22, 2018), <https://www.laureate.net/NewsRoom/PressReleases/2018/01/Laureate-Announces-Renewal-of-B-Corp-Status>.

117. The number of global activist campaigns increased 45% between 2013 and 2016. ACTIVIST INSIGHT & SCHULTE ROTH & ZABEL, *supra* note 104.

in 2014.¹¹⁸ As Bonnie Roe, a New York-based partner at financial advisory firm Cohen & Gresser LLP observes, “It’s just gotten to be something that everybody has got to be conscious of.”¹¹⁹

The foregoing discussion suggests that much of the disappointment in corporate social and environmental progress can be laid at the door of the investor. The Supreme Court restricts disclosure through its materiality test in the name of investor protection, and the SEC has historically determined that there is insufficient investor interest in nonfinancial social and environmental issues to compel firms to report on them. Given the increasing reliance upon the federal securities statutes in the general field of corporate law, government is unable to sufficiently regulate the social and environmental behavior of business. In addition, profit-maximizing activists have sent powerful signals to managements, forcing high-profile companies that exemplified the long-term advantages of sustainability efforts to place more emphasis on short-term returns.

The desire of both government and the private sector to pursue what they presume to be investors’ financial interests has greatly hobbled the CSR movement.¹²⁰ But a problem that has been (at least indirectly) caused by investors can be solved by investors.

III. Overcoming the Anti-ESG Biases: Potential Solutions and Their Shortcomings

Prevailing attitudes about investors’ needs are driving the corporate sector’s failure to meet the expectations of the human rights and environmental communities. However, the recent explosive growth of the responsible investing movement begs the question of whether change may come as a result of shifting shareholder attitudes. “Responsible investing” can encompass many things, such as the avoidance of bad actors in a portfolio, the provision of capital to firms making a positive social or environmental impact, or working with existing holdings to help improve their behavior.

One illustration of the increasing popularity of these methods is the expansion of financial entities endorsing the United Nations Principles for Responsible Investment

(UN PRI).¹²¹ The six principles, drafted by a group of institutional investors, intergovernmental organizations, and civil society representatives, were launched in April 2006.¹²² The voluntary principles encompass doctrines such as incorporating ESG issues into investment analysis and decisionmaking; seeking appropriate disclosure of ESG issues; and reporting on these efforts.¹²³ Upon launch, 63 funds and fund companies representing \$6.5 trillion under management had signed onto the principles; by 2018, the principles had been endorsed by 1,905 signatories managing more than \$89 trillion in assets.¹²⁴

This underscores that it is difficult, if not impossible, to continue to claim that investors as a group are only interested in short-term financial optimization to the exclusion of longer-term, nonfinancial ESG concerns. It is therefore reasonable to believe that notions of corporate obligation to CSR are evolving alongside investor attitudes, and that regulators and managements will be responsive to this new investor paradigm, causing the CSR problem to resolve itself. But within both the regulatory regime of the United States and the workings of the asset management industry lie obstacles that may prevent rapid and widespread behavior change in the absence of a further catalyst. These will be considered in turn.

A. Potential Changes by the SEC

The most direct way to remediate the lack of corporate ESG regulation is, of course, to regulate. As mentioned above, the SEC issued a 2016 concept release regarding the modernization of disclosure requirements. The response by commenters was striking:

Of the 227 original [comment] letters [responding to the concept release], 66% discussed sustainability disclosures. This is pretty remarkable, considering that only 3.2% of the Concept Release (11 of 341 pages) discussed sustainability disclosure . . . Of the 149 public comment letters that discussed sustainability, more than half were from investors and investor groups with an aggregate AUM¹²⁵ of over \$168T. 85% of sustainability-related letters call for improved disclosure of sustainability factors in SEC filings.¹²⁶

Given that one of the most cogent arguments the SEC cited in 1975 in pronouncing upon the materiality of ESG reporting was that there was little investor interest,¹²⁷ a sig-

118. Shira Stein, *More Companies Cite Activism as a Risk in Financial Disclosures*, BLOOMBERG L., July 6, 2017, <https://www.bna.com/companies-cite-activism-n73014461311>.

119. *Id.*

120. Here, we echo Prof. Ian Lee:

[C]orporate law does not impose upon management an exclusive profit-maximizing duty, but merely links management’s fate to the stockholders’ pleasure. The aggregated choices of participants in the stock market will determine the extent of management’s freedom to pursue goals apart from profit-maximization. In other words, if the critics are right that management pursues stockholder profits to the exclusion of all considerations of ethics, decency and social responsibility, it is not so much because corporate law requires it as because it suits the stockholders.

Ian B. Lee, *Corporate Law, Profit Maximization, and the “Responsible” Shareholder*, 10 STAN. J. L. BUS. & FIN. 31, 38 (2005).

121. UN PRI, *About the PRI*, <https://www.unpri.org/about> (last visited Dec. 5, 2018).

122. *Id.*

123. *Id.*

124. Note that this figure encompasses equities and fixed income assets globally, and not solely assets dedicated to responsible investing. UN PRI, *Annual Report 2018: The PRI in Numbers*, <https://www.unpri.org/annual-report-2018/how-we-work/the-pri-in-numbers> (last visited Dec. 5, 2018).

125. AUM refers to “assets under management.”

126. Rogers, *supra* note 95.

127. Williams explains:

The SEC and the Court of Appeals were on firmer analytic ground when they concluded that there was not enough investor interest in

nificant obstacle in any undertaking of mandatory disclosure has been kicked aside.

A timely rule proposal¹²⁸ by the SEC would be welcomed, but one has cause to be skeptical for several reasons. First, the Trump Administration is virulently antiregulatory, implementing far fewer rules in its first year than did those of previous presidents.¹²⁹ There is reason to believe that this fervor extends to the SEC; in a statement regarding the nomination of SEC Chair Jay Clayton, President Trump pledged to “undo many regulations which have stifled investment in American businesses.”¹³⁰ Clayton himself acknowledged that he favored scaling back regulations during his U.S. Senate confirmation hearing.¹³¹ Finally, Clayton’s failure to mention social or environmental reporting as a priority during a March 8, 2018, speech to the SEC Investor Advisory Committee does not bode well for the potential passage of new rules.¹³²

Moreover, there may be significant opposition from business interests regarding ESG disclosure. Organizations such as the American Bankers Association, American Chemistry Council, American Petroleum Institute, U.S. Chamber of Commerce, National Association of Manufacturers, Business Roundtable, and the National Investor Relations Institute submitted comment letters to the 2016 concept release that indicate as much¹³³: these letters reinforce business concerns that (1) the disclosure burden for corporations is already high; (2) broad-brush disclosure rules for industries as diverse as coal and educational ser-

vices would cause a significant portion of reporting to be rendered irrelevant for investors; and (3) the current principles-based disclosure regime, in which information must be reported if its omission would cause other statements to be materially misleading, works well and does not need mandatory line item enhancements.

While the SEC must consider investors’ heightened interest in ESG as a factor in deciding whether this type of disclosure should be made mandatory, it must consider other factors as well: Congress in the 1933 Securities Act mandated that the SEC consider not only investor protection, but also the promotion of efficiency, competition, and capital formation when engaged in a public interest rulemaking.¹³⁴ This means that even acknowledgement of ESG disclosure as important to the investor does not eventuate the SEC embracing such positions in its rulemaking; in practice,

While the SEC’s definitions of materiality refer only to the significance of information to a reasonable investor, in fact the SEC considers a broader range of issues in determining what is “material,” including the costs to issuers and society in making more information available, and the net benefits to society from expanded disclosure.¹³⁵

There is no guarantee that the SEC would place investor interest above costs to issuers in requiring mandatory ESG disclosure.

Finally, even if the SEC did decide to undertake a rulemaking procedure, there could be no certainty as to timing or outcome. It is best not to rely on the SEC and its disclosure regime to drive any improvement in CSR.

B. Allow the Capital Markets to Work Their Magic Through the Increased Clout of Responsible Investors

As the power of activist investors illustrates, shareholders can have profound influence over corporate behavior if so inclined. But they need not wage war in order to influence management. They can profoundly affect corporate behavior through letters, meetings, and other forms of communicating gentle persuasion (“engagement”), and also by submitting resolutions and voting at every public corporation’s annual general meeting. As the “reasonable investor” grows ever more interested in the long-term financial benefits of sustainable business practices, it is possible that shareholders will impose their own discipline on corporate behavior. This potential solution is considered next.

While it was once true that investors could only confront unacceptable management behavior with virtually

expanded environmental and civil rights disclosure to demonstrate that this information was substantially likely to be significant to a reasonable shareholder—that is, that it was material . . . [a]t the time of the SEC proceedings, four mutual funds had formed for “ethical investors,” one of which was in the process of being disbanded, while another had never accepted funds. The two active funds held, in total, \$18.6 million, or 0.0005% of money under management in mutual funds. Although these statistics do not imply that it would have been unreasonable to have been an “ethical investor” in the 1970s, the statistics undermine the argument that this information was significant to the typical investor of the early 1970s.

Williams, *supra* note 51, at 1267.

128. SEC, *Rulemaking, How It Works* (“When approved by the Commission, a rule proposal is published for public notice and comment for a specified period of time, typically between 30 and 60 days. A rule proposal typically contains the text of the proposed new or amended rule along with a discussion of the issue or problem the proposal is designed to address. The public’s input on the proposal is considered as a final rule is drafted.”), <https://www.sec.gov/fast-answers/answersrulemakinghtm.html> (last modified Apr. 6, 2011).

129. Danny Vinik, *Trump’s War on Regulations Is Real. But Is It Working?*, POLITICO, Jan. 20, 2018, <https://www.politico.com/agenda/story/2018/01/20/trumps-regulatory-experiment-year-one-000620>.

130. Carmen Germaine, *Trump’s Wall Street Ally Pick Signals Enforcement-Light SEC*, LAW360, Jan. 4, 2017, <https://www.law360.com/articles/877381/trump-s-wall-street-ally-pick-signals-enforcement-light-sec>.

131. Dave Michaels & Andrew Ackerman, *SEC Chairman Nominee Jay Clayton Calls for Scaling Back Regulations to Encourage IPOs*, WALL ST. J., Mar. 23, 2017, <https://www.wsj.com/articles/sec-chairman-nominee-jay-clayton-says-past-wall-street-work-is-a-strength-1490281093>.

132. SEC Chairman Jay Clayton, Remarks to the SEC Investor Advisory Committee (Mar. 8, 2018), <https://www.sec.gov/news/public-statement/statement-clayton-2018-3-8>.

133. SEC, *Comments on Concept Release: Business and Financial Disclosure Required by Regulation S-K*, <https://www.sec.gov/comments/s7-06-16/s70616.htm> (last modified Oct. 3, 2018).

134. 15 U.S.C. §77b(b) (“Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”).

135. Williams, *supra* note 51, at 1264.

one tactic—namely, washing their hands of the issue and selling their stock¹³⁶—changes in the structure of shareholding have closed off this option for many. One reason for this is the growth of index funds, which own companies solely by virtue of their inclusion in an index such as the Standard & Poor's (S&P) 500. These funds cannot remove companies from their portfolios unless such issues are removed from the index altogether. Stock index funds have rapidly assumed a significant portion of all equity assets; in the case of mutual funds, the proportion that is indexed grew from 10% in 2001 to 25% in 2016.¹³⁷ Even for investors that are free to buy and sell based on their expectations for financial returns (“active” as opposed to “activist” investors), the largest among them tend to act as “quasi-indexers,” “closet indexers,” or “index huggers.”¹³⁸

Government actions in the early 1990s opened other avenues for investors to influence firms, however. In 1992, the SEC reformed the shareholder voting process¹³⁹ (the “proxy” system) to remove onerous and costly provisions that prevented investors from communicating to the public and each other about voting. This caused one observer to remark, “[O]n October 15, 1992, the SEC approved a package of ‘reforms’ that . . . significantly relaxed proxy filing requirements for shareholders. As a result . . . future corporate change will be effectuated largely through the proxy system: a battle of words among shareholders, management, and dissidents.”¹⁴⁰

In 1994, the U.S. Department of Labor (DOL) reinforced the viability of using proxy voting as an avenue for shareholders to influence management by emphasizing to pension plan sponsors covered by the Employment Retirement Income Security Act (ERISA) that voting their shares was a fiduciary duty¹⁴¹; this rendered such proxy voting an actual obligation. Further, DOL stated:

136. James McRitchie, *Ending the Wall Street Walk: Why Corporate Governance Now?*, CORP. GOVERNANCE (“The reality is that if you don’t like the way the management handles your business, you have traditionally had two choices: hold your nose or sell out.”), <https://corpgo.fatcow.com/forums/commentary/ending.html> (last visited Dec. 5, 2018). This should be distinguished from divestment, in that no signaling is intended.

137. INVESTMENT COMPANY INSTITUTE, 2017 INVESTMENT COMPANY FACT BOOK 45 fig. 2.13 (57th ed. 2017), https://www.ici.org/pdf/2017_fact-book.pdf.

138. GEORGE SERAFAIM, INVESTORS AS STEWARDS OF THE COMMONS? 16 (Harvard Business School Accounting & Management Unit, Working Paper, 2017), available at <https://ssrn.com/abstract=3014952>; PATRICK JAHNKE, VOICE VERSUS EXIT: THE CAUSES AND CONSEQUENCE OF INCREASING SHAREHOLDER CONCENTRATION 11 (2017), available at <https://ssrn.com/abstract=3027058>; MARTIJN CREMERS & ANTTI PETAJISTO, HOW ACTIVE IS YOUR FUND MANAGER? A NEW MEASURE THAT PREDICTS PERFORMANCE (AFA 2007 Chicago Meetings Paper, 2009), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=891719.

139. See generally Joseph Evan Calio & Rafael Xavier Zahralddin, *The Securities and Exchange Commission’s 1992 Proxy Amendments: Questions of Accountability*, 14 PACE L. REV. 459 (1994) (chronicling this shift).

140. *Id.* at 466.

141. 29 C.F.R. §2509.94-1. See also Lori Jones, *DOL Revises Guidance Regarding Exercise of Shareholder Rights by ERISA Fiduciaries*, THOMPSON COBURN LLP, June 2, 2017, <https://www.thompsoncoburn.com/insights/publications/item/2017-06-02/dol-revises-guidance-regarding-exercise-of-shareholder-rights-by-erisa-fiduciaries>. ERISA regulates private employee benefit and pension plans, while public employee plans are regulated under state and local laws. States tend to look to ERISA for guidance on how fiduciaries should behave, however, giving ERISA a wide reach. See David H. Webber,

Active monitoring and communication [in other words, engagement] with corporate management is consistent with a fiduciary’s obligations under ERISA where the responsible fiduciary concludes that there is a reasonable chance that such activities . . . are likely to enhance the value of the plan’s involvement, after taking into account the costs involved.¹⁴²

In this way, voting and engagement became the tools of necessity in any attempt to influence managerial behavior.

The early 2000s presented shareholders with the opportunity to use these tools: the pop of the dot-com bubble in 2000 and the 2001/2002 scandals at Enron, WorldCom, and Tyco seemingly were catalysts for investors to begin to exercise their muscle,¹⁴³ focusing on the “G” in ESG. Shareholders have been strikingly successful since then in breaking down the insular practices of managements and strengthening their own voices. The litany of victories includes, first and most importantly, the widespread adoption of majority-voting schemes for board directors, a move that has bolstered shareholder influence: corporate bylaws or policies can specify board ratification either with a plurality of votes, or by a majority of the shareholder votes cast. Prior to 2004, virtually all directors were elected under the plurality system.¹⁴⁴ Directors nominated by management generally run unopposed.¹⁴⁵ Unopposed candidates in a plurality regime can be elected with even a single “yes” vote, since they have received at least one more vote than their nonexistent opponent, foreclosing an important route to express dissatisfaction with corporate behavior.¹⁴⁶

Shareholders revolted against the perceived lack of fairness via a wave of resolutions calling for majority voting regimes, and as of 2018, approximately 90% of companies in the S&P 500 and 70% of those in the S&P 600 small companies index specified majority voting schemes.¹⁴⁷ Under the majority system, new nominees that receive more “withhold support”¹⁴⁸ and “abstain” votes than “yes” votes cannot be seated on the board; if they are incum-

The Use and Abuse of Labor’s Capital, 89 N.Y.U. L. REV. 2106, 2119 (2014). In 2003, the SEC finalized a rule that extended this fiduciary duty to all registered investment advisers. Proxy Voting by Investment Advisers, 17 C.F.R. pt. 275 (2003) (“The duty of care requires an adviser with proxy voting authority to monitor corporate events and to vote the proxies.”), available at <https://www.sec.gov/rules/final/ia-2106.htm>.

142. 29 C.F.R. §2509.94-2(3).

143. See, e.g., YONCA ERTIMUR ET AL., BOARD OF DIRECTORS’ RESPONSIVENESS TO SHAREHOLDERS: EVIDENCE FROM SHAREHOLDER PROPOSALS 1 (draft working paper), available at http://www.hbs.edu/faculty/Publication%20Files/08-048_182eb805-b8f6-4f7a-bf04-2dd08ad52ae1.pdf.

144. CLAUDIA H. ALLEN, NEAL, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS (2007), available at <https://ssrn.com/abstract=2475122>.

145. Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119 n.3 (2016).

146. *Id.* at 1120.

147. SULLIVAN & CROMWELL LLP, 2018 PROXY SEASON REVIEW 6 (2018), <https://www.sullcrom.com/files/upload/SC-Publication-2018-Proxy-Season-Review.pdf>.

148. Under the plurality system that prevailed in the past, a “no” vote for an unopposed director was seen as nonsensical, and was substituted with the euphemism “withhold support,” a terminology that persists to this day. SEC, *Spotlight on Proxy Matters—The Mechanics of Voting*, https://www.sec.gov/spotlight/proxymatters/voting_mechanics.shtml (last modified May 23, 2012).

bents, in most cases, they must offer to resign.¹⁴⁹ Among 100 of the largest public U.S. companies in 2015, 80 have policies forcing incumbent directors to tender their resignations under such circumstances, while a further five state that unapproved directors must leave the board within 90 days of the vote.¹⁵⁰

Some scholars have raised the issue that because boards are free to either accept or reject tendered resignations depending upon a variety of factors—including the business judgment rule—there is no actual bite to the sanction.¹⁵¹ Further, instances of directors failing to win majority support are rare¹⁵² (there are, however, documented cases of directors being forced off boards,¹⁵³ as well as changes in corporate behavior, even when resignation offers are rejected).¹⁵⁴ In any case, directors will always find reputational damage distasteful. Given the power this wields, majority voting makes exercise of the shareholder franchise to withhold support the “nuclear option” when investors wish to emphasize their displeasure with a board of directors.

Second, increased shareholder power is evident as annual board elections increasingly replace “classified” or “staggered” boards. Under staggered board rules, not every director stands for election each year, making it difficult for shareholders to make wholesale board changes. A 1998 study of more than 2,400 U.S. companies found a 53% incidence of staggering.¹⁵⁵ The situation as of 2015 is that approximately 90% of S&P 500 companies, and 55% of the companies in the Russell 2000 small companies index, hold elections for all of their directors annually.¹⁵⁶ Thus,

today, unhappy shareholders can threaten to make sweeping changes in corporate leadership in ways previously unavailable to them.

Third, the separation of the chair of the board and CEO positions is thought to impart a greater degree of accountability to the board,¹⁵⁷ as a board with dual power centers would be less likely to act in autocratic fashion, especially if the chair is independent. Among S&P 500 companies in 2005, 29% had separated the CEO and chair positions, and 9% had a chair who was unaffiliated with company management. In 2017, the figures had climbed to 51% and 28%, respectively.¹⁵⁸

Finally, shareholders have assumed more power through proxy access, a concept that refers to the ability of a group of long-term, large-scale shareholders (who typically have owned at least 3% of a firm’s shares for at least three years) to place a minority of their own director nominees on the company’s ballot.¹⁵⁹ This practice eliminates the need for the challenger shareholder group to conduct its own costly communication campaign. Virtually nonexistent among firms as late as 2010, by 2017, proxy access rules were incorporated into 60% of the S&P 500.¹⁶⁰

In each of these cases, investors successfully broke down the walls around management and enhanced their own power vis-à-vis officers and directors. It is difficult to determine if these victories were the result of behind-the-scenes engagement, since engagements are private affairs where the substance of conversations goes unreported. But it is easier to gauge the impact of resolutions filed by shareholders, whether or not they come to a vote or are withdrawn in a settlement.¹⁶¹ For example, shareholder proposals seeking the appointment of an independent board chair were filed with only two companies in 2000, but rose steadily to be filed with 62 companies in 2014. Ernst & Young opines:

Shareholder proposals seeking the appointment of an independent board chair, as well as company-investor engagement on this topic, are drivers of change in board

149. This is assuming that a quorum has been reached.

150. SHEARMAN & STERLING LLP, MAJORITY VOTING STANDARDS, <https://pcg.law.harvard.edu/wp-content/uploads/2015/12/shearman-majority-voting.pdf>.

151. Choi et al., *supra* note 145, at notes 15-16.

152. The third-party proxy processing firm Broadridge Financial Solutions reports that among their 4,000-plus U.S. clients, the rate of directors failing to receive majority support has recently ranged from 1.5%-2%. The information can be found in a series of publications. See, e.g., Broadridge & PwC Governance Insights Center, *ProxyPulse*, <https://www.broadridge.com/proxypulse/all-reports> (last visited Dec. 6, 2018).

153. In Kimberly Gladman et al.’s study, between 2009 and 2012, one-half of the incumbents who failed to gain majority approval at majority voting companies left the board, although the sample was very small. KIMBERLY GLADMAN ET AL., IRRIC INSTITUTE & GMI RATINGS, THE ELECTION OF CORPORATE DIRECTORS: WHAT HAPPENS WHEN SHAREOWNERS WITHHOLD A MAJORITY OF VOTERS FROM DIRECTOR NOMINEES: 2 (2012), available at <http://files.ctctcdn.com/27d4e85b001/bd76ce30-9fc2-46ea-a61f-864b4af-d9ea5.pdf>.

154. Jay Cai et al., *A Paper Tiger? An Empirical Analysis of Majority Voting*, 21 J. CORP. FIN. 119, 133 (2013). It is important to note that the proportion of “no” votes that can force a director to leave a board has diminished in the era of activist investing: “[W]e find director turnover starts happening as soon as directors are getting 30% dissent votes Just twenty/thirty percent dissent votes can start making a difference.” SEC, Unofficial Transcript of Proxy Voting Roundtable 9 (Feb. 19, 2015), <https://www.sec.gov/spotlight/proxy-voting-roundtable/proxy-voting-roundtable-transcript.txt>; see also *id.* at 102 (“You didn’t have Say on Pay ten years ago, you didn’t have vote no campaigns ten years ago and twenty to thirty is the new fifty”).

155. LUCIAN BEBCHUK ET AL., HARVARD LAW SCHOOL, DISCUSSION PAPER NO. 353, THE POWERFUL ANTI-TAKEOVER FORCE OF STAGGERED BOARDS: THEORY, EVIDENCE, AND POLICY n.1 (2002) (citing VIRGINIA K. ROSENBAUM, CORPORATE TAKEOVER DEFENSES (1998)).

156. EY CENTER FOR BOARD MATTERS, BOARD MATTERS QUARTERLY 5 (2017), available at <http://www.ey.com/Publication/vwLUAssets/EY-board-matters->

[quarterly-january-2017/\\$FILE/EY-board-matters-quarterly-january-2017.pdf](http://www.ey.com/Publication/vwLUAssets/EY-board-matters-quarterly-january-2017/$FILE/EY-board-matters-quarterly-january-2017.pdf).

157. Matteo Tonello, *Separation of Chair and CEO Roles*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., Sept. 1, 2011, <https://corpgov.law.harvard.edu/2011/09/01/separation-of-chair-and-ceo-roles/>.

158. SPENCER STUART, 2017 SPENCER STUART U.S. BOARD INDEX (2017), https://www.spencerstuart.com/-/media/ssbi2017/ssbi_2017_final.pdf; SPENCER STUART, 2015 SPENCER STUART BOARD INDEX (2015), https://www.spencerstuart.com/-/media/pdf%20files/research%20and%20insight%20pdfs/ssbi-2015_110215-web.pdf.

159. Council of Institutional Investors, *Proxy Access*, <http://www.cii.org/proxy-access> (last visited Dec. 6, 2018).

160. *Id.*

161. Most corporate resolutions are slated by management. Shareholders are allowed to put forth their own proposals under certain conditions. While shareholder resolutions are nonbinding, it has become more common for a board of directors to implement one that has received majority support. ERTIMUR ET AL., *supra* note 143, at 1. The influential proxy advisory firm Institutional Shareholder Services recommends withholding support for one or more directors when management is deemed insufficiently responsive to a prior shareholder vote. In 2018, the number of directors who received a negative recommendation on this basis increased nearly fourfold over the prior year, and the average director received only 64% approval. See SULIVAN & CROMWELL LLP, *supra* note 147, at 3. Cf. *supra* note 154.

leadership structures. The increase in independent board chair shareholder proposals from 2000 to 2013 mirrors the significant increase in the appointment of independent board leaders over the same time period.¹⁶²

Board declassification (destaggering) proposals coming from shareholders have, on average, received majority support every year that they have been filed since 2004, and resolutions advocating majority voting for directors have, on average, been approved every year since 2007.¹⁶³ The 89 proxy access resolutions filed in 2015 and the 86 resolutions filed in 2016 received an average of 52% approval both years, helping to cause the stunning adoption of the rule at most of the large companies in America.¹⁶⁴ The efficacy of shareholder action in creating the significant corporate governance reforms that we are currently witnessing supports the contention that managements try to satisfy their investors, even if it means that the power of management is thereby reduced in relation to those same investors.

Plausible arguments can be made that governance issues directly impact the returns of shareholders if managements are not responsive to correcting firms' economic deficiencies.¹⁶⁵ This has prompted shareholders to engage and vote, winning battle after battle to enhance their influence over governance. Will analogous power now be applied to environmental and social issues? This question is harder

to answer given that a significant governmental impediment—guidance that discouraged pension plans from considering public policy issues in their investing, engagement, and voting, discussed below—has only recently been removed. There is reason to believe, however, that the current equivocal body of evidence will not be resolved in favor of strong shareholder motivation and pressure, without the additional leverage provided by the SASB standards.

Although environmental and social shareholder resolutions have been filed regularly since the 1970s,¹⁶⁶ they have rarely received significant vote totals. The Proxy Monitor Annual Report on Corporate Governance and Shareholder Activism of 2016 frames the issue:

In 2016, five shareholder proposals relating to environmental issues received the support of at least 40% of shareholders, compared with only two total in all of 2006-15 Although a political-spending-related shareholder proposal won majority support in 2016, and although the percentage of shareholders supporting certain environment-related shareholder proposals has increased, most shareholders continue to vote against these proposals. Since 2006, shareholders at Fortune 250 companies have voted on 445 board-opposed shareholder proposals relating to corporate political spending or lobbying and 439 board-opposed shareholder proposals relating to environmental policy. Only one of those 884 shareholder proposals has received majority shareholder support. Thus, increasing activity on the part of certain shareholders pursuing social and policy agendas should not be confused with broad shareholder support for these activists' pet issues.¹⁶⁷

One should be careful in adopting such a pessimistic view, however. The above analysis oversimplifies the shareholder resolution process in omitting a significant alternative outcome: the withdrawal of the resolution upon agreement with the filer.¹⁶⁸ Though scholars have lamented the poor quality of data concerning withdrawals,¹⁶⁹ the NGO Ceres has compiled a partial database of environmental and social shareholder resolutions, including withdrawals, dating back to 2009.¹⁷⁰ Among 1,241 environmental and social shareholder proposals in the database spanning the years 2009-2017, the greatest number, 244, advocate for publishing a sustainability report.

162. EY CENTER FOR BOARD MATTERS, LET'S TALK: GOVERNANCE—TRENDS IN INDEPENDENT BOARD LEADERSHIP STRUCTURES 3 (2014), [http://www.ey.com/Publication/vwLUAssets/EY-lets-talk-governance-trends-in-independent-board-leadership-structures/\\$FILE/EY-ind-board-leadership-october-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY-lets-talk-governance-trends-in-independent-board-leadership-structures/$FILE/EY-ind-board-leadership-october-2014.pdf).

163. Fund Votes, *Shareholder Resolutions: Average Shareholder Support by Sub-Category*, https://web.archive.org/web/20171116202929/http://www.fundvotes.com:80/resolutionsbysubcategory_countavg.php (last visited Dec. 6, 2018).

164. *Id.*

165. There is controversy as to whether insular managements are actually good or bad for shareholder returns. Proponents of insular boards argue that they create consistency and predictability in board decisions, and that "reliable, like-minded and known entities [are] the most logical strategy to build a board. After all, the purpose of the board [is] to support the chief executive officer's (CEO) plan and assure the shareholders that experienced, intelligent people [are] looking out for their interests." Russell Reynolds Associates, *Different Is Better: Why Diversity Matters in the Boardroom*, <http://www.russellreynolds.com/insights/thought-leadership/different-is-better-why-diversity-matters-in-the-boardroom> (last visited Dec. 6, 2018). There is some evidence supporting this theory: for example, one study found that Massachusetts companies forced to adopt a staggered board experienced an increase in firm value over the next 15 years. ROBERT DAINES ET AL., CAN STAGGERED BOARDS IMPROVE VALUE? EVIDENCE FROM THE MASSACHUSETTS NATURAL EXPERIMENT 4 (John M. Olin Program in Law and Economics, Stanford Law School, Working Paper No. 498, 2017), available at <https://ssrn.com/abstract=2836463>.

Detractors counter that insular boards can create situations in which entrenched members may behave in ways that may be the best for themselves personally, but that are not in the best interest of the shareholder. These critics can point to studies that reveal greater board independence correlates with improved decisions regarding executive compensation and the timing of stock option grants, and lowers the incidence of fraud. LUCIAN A. BEBCHUK & MICHAEL S. WEISBACH, THE STATE OF CORPORATE GOVERNANCE RESEARCH 7-8 (National Bureau of Economic Research, Working Paper No. 15537, 2009), available at <http://www.nber.org/papers/w15537.pdf>. The validity of each argument is beyond the scope of the Article. Rather, the important observation is that because shareholders generally believe insular managements are unhealthy, they try to ensure a greater degree of diversity and independence. See BEBCHUK ET AL., *supra* note 155, at 890 ("the more common view has been that . . . boards' decisions to remain independent . . . generally benefit shareholders").

166. See *supra* Section II.B.

167. JAMES R. COPLAND & MARGARET M. O'KEEFE, PROXY MONITOR 2016, AN ANNUAL REPORT ON CORPORATE GOVERNANCE AND SHAREHOLDER ACTIVISM 3 (2016), http://www.proxymonitor.org/pdf/pmr_13.pdf.

168. Once a resolution is filed, the target has several alternative responses besides placing it on the proxy ballot for a vote. It may desire to omit the resolution from the ballot and request a "no action" letter from the SEC regarding the matter. SEC Division of Corporation Finance, Shareholder Proposals: Staff Legal Bulletin No. 141 (CF) (Nov. 1, 2017), <https://www.sec.gov/interp/legals/cfs141.htm>. Alternatively, it may choose to negotiate with the filer in the hopes that it will satisfy the filer's concerns such that the resolution is withdrawn before it comes up for a vote. Robert Boylan et al., *An Analysis of Omitted Shareholder Proposals*, J. FIN. & ACCT. (draft), <http://www.aabri.com/manuscripts/141834.pdf>; ERTIMUR ET AL., *supra* note 143.

169. ERTIMUR ET AL., *supra* note 143, at note 7.

170. Ceres, *Engagement Tracker*, <https://engagements.ceres.org/> (last visited Dec. 6, 2018).

Forty-five percent of these proposals were withdrawn by the filer following an engagement with management that produced a commitment to publish, and therefore never came to a vote.

Shareholder pressure has been a contributing factor to the almost ubiquitous production of sustainability reports among large public companies in the United States.¹⁷¹ The Ceres database is self-reported and therefore subject to methodological limitations, but it indicates that shareholder influence upon corporate environmental and social behavior has made significant improvements in disclosure practices by some companies, while failing to produce marketwide, consistent disclosure of ESG data.

The issue of shareholder influence over CSR behavior is further muddled in light of DOL's negative guidance on environmental and social engagement and proxy voting from 2008 until 2016. When DOL issued its 1994 opinion establishing engagement and voting as consistent with the duties of an ERISA fiduciary, in a companion bulletin, it discussed what it called "economically targeted investments," or public policy "investments selected for the economic benefits they create apart from their investment return to the employee benefit plan."¹⁷² While reminding fiduciaries that they were prohibited from "subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives,"¹⁷³ DOL advised that these were acceptable holdings as long as they exhibited a similar risk and return pattern to alternatives.

In 2008, however, DOL changed its guidance regarding economically targeted investments. It stipulated that these could only be pursued after a qualitative and quantitative analysis concluded that the risk-return patterns were "truly equal" to alternative investments.¹⁷⁴ Moreover, it stated that "[v]otes shall only be cast in accordance with a plan's economic interests . . . objectives, considerations, and economic effects unrelated to the plan's economic interests cannot be considered."¹⁷⁵ This bulletin caused practitioners to counsel their clients to avoid any attempt to further public policy objectives through the proxy voting process.¹⁷⁶ It

was not until 2015 that ERISA guidance was relaxed to treat economically targeted investments as they had originally been in 1994,¹⁷⁷ and not until late 2016 before DOL permitted fiduciaries to engage with management and vote proxies based on the long-term effects of public policy issues upon portfolio value.¹⁷⁸

Because DOL's stricter language was rescinded only at the end of 2016, the spring 2017 annual general meeting season was the first since 2008 in which ERISA fiduciaries, and public pension plans that look to ERISA for fiduciary guidance, could freely exercise their concerns around long-term environmental and social portfolio impacts.¹⁷⁹ This brave new world yielded encouraging signs, discussed below. While it is possible that a new era has dawned, certain structural aspects of the asset management industry indicate that shareholder pressure will improve the corporate CSR situation, but not as broadly and as quickly as desired. These impediments to the rise of the shadow regulators will be discussed next.

of pension plan assets to further policy or political issues through proxy resolutions that have no connection to enhancing economic value of the investment violate the prudence and the exclusive purpose requirements."), http://www.seyfarth.com/dir_docs/news_item/9e12e42e-84c4-45bd-829e-9edaa299d775_documentupload.pdf.

Other practitioners found the guidance more nuanced, equating compliance with careful documentation. See Larry Hass et al., *DOL Issues New ERISA Interpretive Bulletins Regarding Economically Targeted Investments and Proxy Voting*, PAUL HASTINGS, Oct. 2008 ("[F]iduciaries should be particularly fastidious about conducting and documenting . . . the proposed course of action on purely economic grounds prior to adopting or taking action that is motivated in part by social or shareholder activist considerations."), available at <https://www.paulhastings.com/docs/default-source/PDFs/1058.pdf>. In any case, the result of the guidance was confusion. BRIAN TOMLINSON ET AL., *FIDUCIARY DUTY IN THE 21ST CENTURY—U.S. ROADMAP 12* ("The Shareholder Rights Bulletin has had the effect of raising doubts as to the circumstances in which ERISA fiduciaries are able to engage with investee companies and vote proxies."), <https://www.genfound.org/media/1388/fiduciary-duty-in-the-21st-century-us-roadmap-1.pdf>.

177. Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65135 (Oct. 26, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-10-26/pdf/2015-27146.pdf>.

178. Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95879 (Dec. 29, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-12-29/pdf/2016-31515.pdf>. In April 2018, DOL issued additional guidance, which partly seemed aimed at union campaigning, but does not alter the arguments presented here. See Employee Benefits Security Administration, Field Assistance Bulletin No. 2018-01 (Apr. 23, 2018), available at <https://www.dol.gov/sites/default/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.pdf>.

179. ERISA is the law only for private pension plans, but as referred to *supra* note 141, is often modeled by state and local pension plans. Mutual funds, regulated by the Investment Advisers Act and the Investment Company Act, need not comply. Nevertheless, many asset managers have chosen to centralize the proxy voting function across all of their various funds, and it is easier to distill voting to the lowest common denominator. In addition, there have long existed studies that link ESG performance to enhanced equity value; these studies can be cherry picked to support a contention that voting for public policy resolutions would reasonably be expected to economically benefit plan participants. If fiduciaries felt strongly enough about the virtues of environmental and social responsibility, they could have acted, even in the period between 2008 and 2016.

171. KPMG INTERNATIONAL, *supra* note 81, at 11. Unfortunately, investors and civil society groups frequently perceive such sustainability reports to be of very low quality. See *infra* note 278 and accompanying text; *supra* note 81. Other types of resolutions have yielded a lower withdrawal rate. The second most common class of resolution, to adopt a greenhouse gas reduction target, was withdrawn with a commitment 27% of the time; resolutions that ask management to report on lobbying, or to provide an analysis of how a two-degree temperature change could impact operations, were withdrawn after a successful engagement in 10% or less of all cases (with regard to the two-degree resolutions, environmentalists generally argue that a rise in global temperatures above two degrees Celsius from preindustrial levels will induce catastrophic climate change; investors fear that this will prompt widespread taxation of carbon emitters or other forms of onerous regulation).

172. 29 C.F.R. §2509.94-1.

173. *Id.*

174. *Id.* §2509.08-1.

175. *Id.* §2509.08-2(1).

176. SEYFARTH SHAW LLP, MANAGEMENT ALERT: DEPARTMENT OF LABOR ISSUES ADDITIONAL GUIDANCE ON INVESTING BENEFIT PLAN ASSETS (2008) ("The DOL strongly states that a plan fiduciary risks violating ERISA's exclusive purpose rule if it exercises its fiduciary authority in an attempt to further legislative, regulatory or public policy issues through the proxy process. Use

IV. The Sustainability Interests of the “Universal Owner”

A. The Increasing Influence of Large Investment Advisers Over the U.S. Stock Market

The aforementioned index and closet index funds, rather than individuals, are the typical shareholders of today. The proportion of U.S. public equities controlled by institutional investors has risen from less than 10% in 1950¹⁸⁰ to 70% currently.¹⁸¹ Further, the asset management industry has become highly concentrated. For example, among mutual fund and exchange-traded fund (ETF) providers, which represented 31% of total U.S. equity in 2015, the percentage of assets held by the 10 largest fund families grew from 44% in 2000 to 56% in 2015.¹⁸² For the five largest, the percentage grew from 32% in 2000 to 45% in 2015.¹⁸³ This trend toward increased concentration of ownership shares in the hands of a few—and, in turn, the increased authority that these owners can exercise over business—shows no signs of stopping.

The combination of the growth of institutional investing with the increasing concentration of the asset management industry means that the leading asset management firms are enormous. The scale of large managers' ownership of the stock market can be framed in this way: the total equity capitalization¹⁸⁴ of the world's public companies was \$79.2 trillion at the end of 2017,¹⁸⁵ while the equity assets managed by the 10 largest investment advisers totaled \$14.2 trillion,¹⁸⁶ accounting for 18% of the global stock market. Concentrated ownership is even higher among U.S. companies, where it has been estimated that the three largest asset managers (BlackRock, Vanguard, and State Street Global Advisors (SSGA)) control on average almost 18% of the stock of nearly 1,700 corporations.¹⁸⁷ This outsized ownership positions large asset managers to exert inordinate influence over the corporations they own—including

what disclosures are deemed “material,” as will be explained below.

Large institutional investors have a completely different set of incentives than a smaller shareholder. This stems from their nearly ubiquitous ownership stakes: not only do they own the shares of XYZ Company, they also own shares of XYZ's competitors, customers, and suppliers. Because large asset managers are accurately characterized as having a stake in the entire economy, they are known as “universal owners”¹⁸⁸ (this phenomenon may also be referred to as “investor capitalism,”¹⁸⁹ “horizontal shareholding,”¹⁹⁰ or “agency capitalism”¹⁹¹).

Universal ownership was originally thought to be a great boon to CSR. As one conference concluded:

Because universal owners own cross-sections of the economy, they inevitably find that some of their holdings are forced to bear the cost of other sectors' or firms' externalities. This creates an incentive for universal owners to minimize negative externalities and maximize positive ones across portfolio holdings. Typically, the cost of negative externalities significantly exceeds the cost of their mitigation, resulting in a “dead weight loss” to universal owners if corrective action is not taken.¹⁹²

Adding to the optimism surrounding the role of universal owners in promoting CSR is the fact that many of them are signatories to the UN PRI,¹⁹³ signaling their acquiescence to the CSR philosophy. Of the five largest global equity managers, BlackRock signed the principles in 2008, Vanguard in 2014, SSGA in 2012, Capital Group in 2010, and Fidelity in 2017.¹⁹⁴ Universal owners therefore are not only incentivized to prevent externalities across the economy; in addition, the most salient of them have publicly committed to promoting sustainable behavior among their vast holdings.

Moreover, universal owners have a business imperative to make social responsibility an explicit and significant aspect of their brand. Here, we refer to the “\$30 trillion” problem. This figure estimates the magnitude of the wealth transfer from baby boomers to millennials and members of Generation X over the next 30 years.¹⁹⁵ This transfer is

180. SEC Commissioner Luis A. Aguilar, Institutional Investors: Power and Responsibility, Remarks to Georgia State University, J. Mack Robinson College of Business, Center for the Economic Analysis of Risk Workshop (Apr. 19, 2013), <https://www.sec.gov/news/speech/2013-spch041913laa.htm>.

181. BROADRIDGE & PwC, 2018 PROXY SEASON REVIEW 2 (2018), available at https://www.broadridge.com/_assets/pdf/broadridge-2018-proxy-season-review.pdf.

182. INVESTMENT COMPANY INSTITUTE, 2016 INVESTMENT COMPANY FACT BOOK 14, 17 (56th ed. 2016), https://www.ici.org/pdf/2016_factbook.pdf.

183. *Id.*
184. Total equity capitalization refers to the total value of an equity market (also referred to as a stock market), which is calculated by adding together the total value of all companies in the equity market. Investopedia, *Equity Market Capitalization*, <https://www.investopedia.com/terms/e/emc.asp> (last updated May 18, 2018).

185. The World Bank, *Market Capitalization of Listed Domestic Companies (Current US\$)*, <http://data.worldbank.org/indicator/CM.MKT.LCAP.CD> (last visited Dec. 6, 2018).

186. BLACKROCK, VIEWPOINT: THE INVESTMENT STEWARDSHIP ECOSYSTEM 3 (2018), <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf>.

187. Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 313 (2017).

188. *See infra* note 192.

189. Michael Useem, *Investor Capitalism: How Money Managers Are Changing the Face of Corporate America* (1996).

190. Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267 (2016), available at <https://harvardlawreview.org/2016/03/horizontal-shareholding/>.

191. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013).

192. SAINT MARY'S COLLEGE OF CALIFORNIA & MERCER INVESTMENT CONSULTING, UNIVERSAL OWNERSHIP: EXPLORING OPPORTUNITIES AND CHALLENGES, CONFERENCE REPORT, April 10-11, 2006, at 4 (2006), available at <https://community-wealth.org/sites/clone.community-wealth.org/files/downloads/report-hawley-williams.pdf>.

193. UN PRI, *supra* note 121.

194. A database confirming these dates of signing may be found at UN PRI, *Signatory Directory*, <https://www.unpri.org/directory/> (last visited Dec. 6, 2018).

195. Anna Robaton, *Promises, Problems on Horizon as \$30T Wealth Transfer Looms*, CNBC, Feb. 16, 2017, <https://www.cnbc.com/2017/02/16/promis->

fraught with danger for asset managers; a 2015 survey of advisers found that children fire their parents' wealth managers upon inheritance 66% of the time.¹⁹⁶

As asset managers try to preserve what they currently oversee and jockey for an extra share of the money that will change hands, the shifting preferences of those newly coming into wealth loom large. Surveys indicate that millennials and women—two groups that will inherit much of this wealth—place higher value on social responsibility in their investment considerations than their boomer male counterparts who currently control the lion's share of U.S. assets.¹⁹⁷ This means that asset managers will likewise begin to prioritize these same ESG considerations to attract clients.

A universal owner that chooses social responsibility to differentiate itself from the competition may be realizing that some of the more established points that traditionally generate competitive distinction—the quality of a product or cost, for example—no longer apply to the extent they once did. Universal owners, by virtue of their extensive holdings, exhibit high degrees of overlap in their portfolios with other major asset managers. It is therefore difficult to distinguish themselves from competitors based on what managers own, and, by extension, relative investment performance.¹⁹⁸ The similarity of performance among managers also helps drive compression in asset management fees throughout the industry,¹⁹⁹ diminishing the ability to use pricing as a competitive advantage.²⁰⁰ Marketing socially responsible bona fides would be one of the few ways for prescient universal owners to build loyalty with the future beneficiaries of the \$30 trillion transfer.

B. Dissecting the CSR Effort Lag

Despite these factors that suggest that universal owners should be leading the way in pressing for more corporate social and environmental responsibility, the evidence for

this is not at all obvious. For example, universal owners rarely, if ever, file shareholder resolutions, even for governance issues.²⁰¹ Even more confounding, perhaps, is the tendency of universal owners to vote against environmental and social shareholder resolutions filed by others.²⁰² Perhaps, universal owners make up for these shortfalls in their engagement activities, but as these are private conversations, it is impossible to know. At any rate, given that sustainability disclosure is still considered to be minimally compliant, the engagement that has taken place has yet to yield satisfactory results.²⁰³

Hypotheses for this seeming indifference to promoting responsible environmental and social behavior focus on structural impediments within the asset management industry. One suggestion is that some asset managers may not want to develop a reputation for voting against company recommendations because they seek business from corporate pension funds.²⁰⁴ In a second scenario, CSR advocacy efforts are stymied by the uneven distribution of (concentrated) costs and (dispersed) benefits among shareholders.²⁰⁵ For example, among active funds, which seek to outperform indices, success relative to other firms wins customers, rather than absolute performance. Engagement is expensive.²⁰⁶

es-problems-on-horizon-as-30t-wealth-transfer-looms.html; see also SSGA, ROADMAP FOR A NEW LANDSCAPE: MANAGING THE TRANSITION OF WEALTH ACROSS GENERATIONS 2 (2016), https://us.spdrs.com/docs-advisor-education/practice-management/multi-generational-wealth-management/Managing_the_Transition_of_Wealth_Across_Generations_101716.pdf.

196. Liz Skinner, *The Great Wealth Transfer Is Coming, Putting Advisers at Risk*, INVESTMENT NEWS, July 13, 2015, <http://www.investmentnews.com/article/20150713/FEATURE/150719999/the-great-wealth-transfer-is-coming-putting-advisers-at-risk>.

197. See, e.g., TIAA-CREF ASSET MANAGEMENT, SOCIALLY RESPONSIBLE INVESTING: STRONG INTEREST, LOW AWARENESS OF INVESTMENT OPTIONS 3 (2015), <https://www.tiaa.org/public/pdf/survey-of-TIAA-CREF-retirement-plan-participants.pdf>; MORLEY WINOGRAD & MICHAEL HAIS, BROOKINGS INSTITUTION, HOW MILLENNIALS COULD UPEND WALL STREET AND CORPORATE AMERICA 2 (2014) (discussing the “generationally-driven shift” that millennial values will have on investing priorities), https://www.brookings.edu/wp-content/uploads/2016/06/Brookings_Winogradfinal.pdf.

198. This duplicative performance is exacerbated in the index space, where performance across providers is almost identical.

199. Sean Collins & James Duvall, *Trends in the Expenses and Fees of Funds, 2016*, 23 ICI RES. PERSP. 1 (2017), available at <https://www.ici.org/pdf/per23-03.pdf>.

200. In addition, switching costs from one fund manager to another are low for nontaxable retirement funds, further compounding the danger of commoditization in asset management services.

201. James R. Copland & Margaret M. O'Keefe, *Proxy Monitor 2017: Season Review*, PROXY MONITOR, Fall 2007, fig. 3, http://www.proxymonitor.org/Forms/pmr_15.aspx; COPLAND & O'KEEFE, *supra* note 167, fig. 5. The filing of environmental and social shareholder resolutions is a fascinating topic in its own right. Filers have essentially developed their own cottage industry, composed of a handful of large pension funds (New York State, New York City, California Teachers), a shareholder advocacy nonprofit (As You Sow), small asset managers (Calvert Funds, Trillium Asset Management, Walden Asset Management, Zevin Asset Management, and a few others), and a collection of church funds. These actors are occasionally joined by various labor unions and a gaggle of individuals.

The three pension funds, the four cited asset managers, As You Sow, and the various religious groups generally account for two-thirds to three-quarters of all E&S resolutions filed in any given year, according to the Ceres database. Ceres, *supra* note 170. Universal owners will vote on these resolutions, but will not file themselves for fear of antagonizing managements (see *infra* notes 207-09 and accompanying text). These actors have developed a symbiotic relationship with universal owners: they serve a purpose that the behemoth asset managers rely upon, but cannot perform themselves. Incidentally, this pattern did not change during the 2017 and 2018 filing seasons.

202. CERES, SUPPORT OF CERES-TRACKED CLIMATE-RELATED RESOLUTIONS 2016-2017, available at https://www.ceres.org/sites/default/files/images/Blog%20images/MutualFund_Table1.pdf; see also *infra* note 215.

203. See *supra* note 81 (describing the drawbacks of sustainability reports and other ESG disclosure).

204. Gerald F. Davis & E. Han Kim, *Business Ties and Proxy Voting by Mutual Funds*, 85 J. FIN. ECON. 552 (2007).

205. Gilson & Gordon, *supra* note 191.

206. BlackRock employs a team of 30 stewardship specialists. BlackRock, *Michelle Edkins*, <https://www.blackrock.com/investing/biographies/michelle-edkins> (last visited Dec. 6, 2018). They engage with 1,500 companies each year. BlackRock, *Investment Stewardship*, <https://www.blackrock.com/corporate/about-us/investment-stewardship> (last visited Dec. 6, 2018). Vanguard deployed a stewardship team of 20 in conducting 950 engagements in 2016/2017. VANGUARD, INVESTMENT STEWARDSHIP 2017 ANNUAL REPORT (2017), <https://about.vanguard.com/investment-stewardship/annual-report.pdf>. SSGA held 611 in-person meetings in 2016 (SSGA, 2016 YEAR END ANNUAL STEWARDSHIP REPORT 27 (2017), <https://www.ssga.com/investment-topics/environmental-social-governance/2017/2016-Annual-Stewardship-Report-Year-End.pdf>).

Since a number of universal owners likely own stakes in any given company that they would target for CSR practices, any improvement in company performance, and hence potential improvement in stock price, accrues to both the asset manager and its competitors. Any universal owner that engages in this way bears all of the costs of the engagement but is forced to share the benefits, providing little, if any, incentive to promote ESG issues. In the case of index funds, the only goal for the manager is to reduce costs. In this instance, there is absolutely no incentive for a fund to spend money on engagement.

A third explanation rests on the idea that asset managers value communication with officers and directors of their holdings, and fear that the quality of that communication could be impaired if boards are put off by a perceived adversarial relationship. As one scholar notes, “Companies reward the large and loyal investor with privileged access; they punish the critical or inaccurate analyst with the cold shoulder.”²⁰⁷ BlackRock is explicit about the goal of good relations hindering a more aggressive engagement approach: “We do not engage in filing shareholder resolutions either directly or on behalf of clients. As a long-term investor, we are patient and persistent in working with our portfolio companies to build trust and develop mutual understanding.”²⁰⁸ As a portfolio manager for a large public pension fund recently remarked, when asked the institutional view as to the value of shareholder proposals, “[W]e do sometimes submit shareholder proposals to companies, [but] we always like to send a letter and engage with the company first. I mean, our goal isn’t to get our name in the proxy, we don’t think that serves anyone.”²⁰⁹

The management team of a universal owner that is uneasy about the \$30 trillion problem but remains concerned with corporate pension asset gathering, the potentially wasted costs of engagement, and the preservation of good relations with its portfolio companies faces a dilemma. One solution would be to trumpet its commitment to CSR (e.g., by joining UN PRI) while avoiding any real action on the issue. This is exactly what the Seattle City Employees’ Retirement System (SCERS) alleged against BlackRock.

The tale is instructive: BlackRock, as mentioned, became a signatory to the UN PRI in 2008. Since that time, the firm has spoken about its willingness to defend its customers when portfolio companies exhibit poor environmental and social behavior, as in this 2014 corporate governance publication:

We may vote against the election of directors where we have concerns that a company might not be dealing with SEE [social, ethical, environmental] issues appropriately. Sometimes we may reflect such concerns by supporting a shareholder proposal on the issue, where there seems to be either a significant potential threat or realized harm to shareholders’ interests caused by poor management of SEE matters.²¹⁰

In addition, Laurence Fink, BlackRock’s CEO, has actively promoted BlackRock’s image as a socially conscientious actor through corporate roundtables,²¹¹ sustainability publications,²¹² and public statements.²¹³ News reports have likewise highlighted BlackRock’s innovative approach to social responsibility.²¹⁴ Despite this notoriety, through 2016, BlackRock had never voted in support of an environmental shareholder proposal; nor had a number of other universal owners, including Vanguard, Fidelity, and Capital Group.²¹⁵

In late 2016, a small socially responsible investor, Walden Asset Management, filed shareholder resolutions with universal owners BlackRock, Vanguard, J.P. Morgan, and T. Rowe Price for the 2017 proxy season, calling for a review of the firms’ proxy voting process and record on climate change.²¹⁶ SCERS joined as a co-filer on the resolution targeting BlackRock.²¹⁷ At the same time, SCERS, with \$339 million invested in a BlackRock index fund, placed the asset manager on a watch list due to its “reticence to oppose management, limited focus on environmental and social issues, inconsistency between their proxy voting record

207. USEEM, *supra* note 189, at 168. As the finance manager of an automobile manufacturer remarked, “Certainly the people that we’re comfortable with, that cooperate with us, would tend to get a little bit better service than some of the people that really cause us problems.” *Id.* at 200.

208. UN PRI, *BlackRock PRI Transparency Report 2016 Response to LEA 17.5*, <https://reporting.unpri.org/surveys/PRI-Reporting-Framework-2016/8e658fa7-6f68-483b-b7a6-0aaec8184a1/2a7d294f507c4360a53a26c0be193e36/html/2/?lang=&ca=1> (last visited Dec. 6, 2018).

209. Answer From Aeisha Mastagni, Portfolio Manager, California State Teachers’ Retirement System, SEC-New York University (NYU) Dialogue on Securities Markets Regulation: Shareholder Engagement, YouTube (Jan 19, 2018), <https://youtu.be/QouhJ20J90U>.

210. BLACKROCK, GLOBAL CORPORATE GOVERNANCE AND ENGAGEMENT PRINCIPLES 7 (2014), available at <https://www.sec.gov/Archives/edgar/data/1181249/000119312515334876/d21153dex99corp.gov.htm>. A 2016 report to the UN PRI adopted a slightly different gloss: “[W]e prefer to engage with boards and management on environmental and social factors, as matters of operational efficiency and risk management. . . . We will vote against management when we judge that direct engagement has failed.” UN PRI, *supra* note 208.

211. BUSINESS ROUNDTABLE, CREATE, GROW, SUSTAIN: PEOPLE AND TECHNOLOGY AT WORK 21 (2016), https://s3.amazonaws.com/brt.org/archive/BRT%202016%20Sustainability%20Report.2016.04.23_0.pdf.

212. BLACKROCK & CERES, 21ST CENTURY ENGAGEMENT: INVESTOR STRATEGIES FOR INCORPORATING ESG CONSIDERATIONS INTO CORPORATE INTERACTIONS 1 (2017), <https://www.ceres.org/sites/default/files/reports/2017-03/21st%20Century%20Engagement%20-%20Investor%20Strategies.pdf>.

213. Matt Turner, *Here Is the Letter the World’s Largest Investor, BlackRock CEO Larry Fink, Just Sent to CEOs Everywhere*, BUS. INSIDER, Feb. 2, 2016, <http://www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2>.

214. Louise Armitstead, *BlackRock’s Michelle Edkins Behind Wave of Shareholder Revolts*, TELEGRAPH, May 4, 2012, <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9247055/BlackRocks-Michelle-Edkins-behind-wave-of-shareholder-revolts.html>.

215. Rob Berridge, *Is Your Mutual Fund Company Taking Climate Change Seriously?*, CERES, Jan. 6, 2017, <https://www.ceres.org/news-center/blog/your-mutual-fund-company-taking-climate-change-seriously>.

216. WALDEN ASSET MANAGEMENT, RESEARCH & ENGAGEMENT BRIEF, SECOND QUARTER 2017, at 4 (2017), available at <http://waldenassetmgmt.com/wp-content/uploads/2017/10/R26EBriefQ2-2017.pdf>. See also Walden Asset Management, Statement in Response to BlackRock Post on Its Website on Climate Change (Mar. 13, 2017), <http://waldenassetmgmt.com/wp-content/uploads/2017/10/StatementBlackRock3-13-17.pdf>.

217. SCERS, Minutes, Board of Administration Meeting 4 (Dec. 8, 2016), https://www.seattle.gov/Documents/Departments/Retirement/Board/Minutes/Minutes_2016_12.pdf.

with their policies and public pronouncements and limited transparency on investment stewardship activities.”²¹⁸

The pension fund’s investment consultants, Mercer and NEPC, supported SCERS in its actions. Consulting firms advise a wide range of pension clients on investment policy and the hiring and firing of asset managers, ensuring that this controversy could potentially infect the thinking of other pension funds. Following a dialogue with the filers, BlackRock promised to improve its focus on ESG when engaging with companies, and the resolution was withdrawn.²¹⁹ Soon after, BlackRock disclosed on its website that climate risk would be a priority in its conversations with managements and boards.²²⁰

BlackRock’s new attitude was displayed when, on May 12, 2017, it voted for a shareholder resolution calling for the Occidental Petroleum Corp.’s board to produce “an assessment of long-term portfolio impacts of plausible scenarios that address climate change. . . . The assessment . . . should explain how capital planning and business strategies incorporate analyses of the short- and long-term financial risks of a lower carbon economy.”²²¹ The resolution, cosponsored by a group of pension funds and asset managers, received 65.7% approval,²²² and marked the first time a proposal of this type had been passed over a board’s objections. BlackRock, owner of 7.8% of the shares, issued a statement that, “[w]hen we do not see progress despite ongoing engagement, or companies are insufficiently responsive to our efforts to protect the long-term economic interests of our clients, we will not hesitate to exercise our right to vote.”²²³ As Bloomberg noted, “This year’s vote marks the first time BlackRock has supported a climate-change related shareholder proposal, according to spokesman Ed Sweeney.”²²⁴

BlackRock’s behavior is consistent with a hypothesis that some universal owners will advertise their concern for CSR, but will not act on it meaningfully unless forced by the threat of monetary loss or adverse publicity. This pressure again surfaced when BlackRock also voted for a similar resolution at ExxonMobil,²²⁵ which passed with 62% of the vote,²²⁶ and additionally voted against one director at Occidental Petroleum and two directors at Exxon.²²⁷ Though BlackRock has not quieted all of the skeptics,²²⁸ its practices marked a significant shift in willingness to influence business into advancing CSR.

This transformative approach to climate-related shareholder resolutions caused 2017 to become a watershed year for environmental proposals. A third resolution, similarly worded to those of ExxonMobil and Occidental, passed at the electric utility PPL Corp., and other proposals received 40% vote levels or higher at six energy and utility companies.²²⁹ It must also be mentioned, though, that 41 of the 50 environmental resolutions tracked by Proxy Monitor (a universe of the 250 largest U.S. companies by revenue) received less than 40% support, more than four-fifths of those submitted.²³⁰ Among other universal owners, Vanguard, another Walden target, supported two resolutions

218. *Id.*

219. Specifically, BlackRock committed to urging companies to be prepared to discuss climate risk, and stated that it would advise those in sectors that contribute disproportionately to global warming—such as those in the oil, gas, and mining industries—to establish their “demonstrable fluency in how climate risks affect business,” and to explain how they plan to address those risks. This satisfied the would-be resolution filers: “As a result of BlackRock’s new initiative, Smith said Walden and others including a Seattle city employees’ retirement system have withdrawn a proposal calling for the fund giant to review its proxy-voting process and record on climate change.” Ross Kerber, *Exclusive: BlackRock Vows New Pressure on Climate, Board Diversity*, REUTERS, Mar. 13, 2017, <https://www.reuters.com/article/us-blackrock-climate-exclusive/exclusive-blackrock-vows-new-pressure-on-climate-board-diversity-idUSKBN16K0CR>.

220. BlackRock, *2018 Priorities*, <https://www.blackrock.com/corporate/about-us/investment-stewardship/voting-guidelines-reports-position-papers#2018-priorities> (last visited Dec. 6, 2018).

221. Occidental Petroleum Corporation, Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (May 12, 2017), https://www.sec.gov/Archives/edgar/data/797468/000130817917000065/loxy2017_def14a.htm (last visited Dec. 6, 2018).

222. These results can be found through a search of Proxy Monitor’s shareholder resolution database, which is available at Proxy Monitor, *Search Fortune 250 Shareholder Proposals*, <http://www.proxymonitor.org/Default.aspx> (last visited Dec. 6, 2018).

223. Emily Chasan, *Occidental Holders Override Board in Approving Climate Proposal*, BLOOMBERG, May 12, 2017, <https://www.bloomberg.com/news/articles/2017-05-12/blackrock-to-back-climate-shareholder-proposal-at-occidental>.

224. *Id.*

225. BLACKROCK, SUPPORTING A SHAREHOLDER PROPOSAL FOLLOWING EXTENSIVE MANAGEMENT ENGAGEMENT (2017), <https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2017.pdf>.

226. Marianne Lavelle, *Exxon Shareholders Approve Climate Resolution: 62% Vote for Disclosure*, INSIDECLIMATE NEWS, May 31, 2017, <https://insideclimatenews.org/news/31052017/exxon-shareholder-climate-change-disclosure-resolution-approved>.

227. BlackRock’s voting records can be found at <http://vds.issproxy.com/Search-Page.php?CustomerID=1615> (last visited Dec. 6, 2018).

228. Stephen Gandel, *Larry Fink Talks the Talk but Neglects the Walk*, BLOOMBERG, Jan. 16, 2018, <https://www.bloomberg.com/gadfly/articles/2018-01-16/blackrock-s-larry-fink-talks-the-talk-but-neglects-the-walk>; Joe Aston, *BlackRock Still Kidding Itself on Its (Lack of) Shareholder Activism*, AUSTRALIAN FIN. REV., Nov. 8, 2017, <http://www.afr.com/brand/rear-window/blackrock-still-kidding-itself-on-its-lack-of-shareholder-activism-20171108-gzha46>.

229. Proxy Monitor, *supra* note 222. Following the vote against PPL, the company committed in August 2017 to “publish an assessment of the potential impacts on PPL resulting from future requirements and technological advances aimed at limiting global warming to 2° Celsius over pre-industrial levels” and produced the report on November 30, 2017. See PPL CORPORATION, PPL CORPORATION CLIMATE ASSESSMENT: ASSESSING THE LONG-TERM IMPACT OF CLIMATE POLICIES ON PPL 1 (2017), <https://www.pplweb.com/wp-content/uploads/2017/12/PPL-Corporation-Climate-Assessment-Report.pdf>.

On December 11, 2017, Exxon announced that it would begin disclosing its thinking regarding “energy demand sensitivities, implications of two degree Celsius scenarios, and positioning for a lower-carbon future.” See Ross Kerber & Gary McWilliams, *Exxon to Provide Details on Climate-Change Impact to Its Business*, REUTERS, Dec. 11, 2017, <https://www.reuters.com/article/us-exxon-mobil-climate/exxon-to-provide-details-on-climate-change-impact-to-its-business-idUSKBN1E602L>. Exxon produced its report in February 2018. EXXONMOBIL, 2018 ENERGY & CARBON SUMMARY: POSITIONING FOR A LOWER-CARBON ENERGY FUTURE, <http://cdn.exxonmobil.com/-/media/global/files/energy-and-environment/2018-energy-and-carbon-summary.pdf>. Occidental Petroleum produced its first-ever climate report in February 2018. OCCIDENTAL PETROLEUM, CLIMATE-RELATED RISKS AND OPPORTUNITIES: POSITIONING FOR A LOWER-CARBON ECONOMY (2018), https://www.oxy.com/SocialResponsibility/overview/SiteAssets/Pages/Social-Responsibility-at-Oxy/Assets/Occidental_Climate%20Report_2018.pdf. Duke Energy, whose resolution received minority (45%) support, did the same. DUKE ENERGY, 2017 CLIMATE REPORT TO SHAREHOLDERS (2018), https://www.duke-energy.com/_/media/pdfs/our-company/shareholder-climate-report.pdf.

230. Proxy Monitor, *supra* note 222.

(ExxonMobil and Occidental); State Street supported 33 of the 90 proposals tracked by Ceres²³¹; Fidelity 15 of 90; and Capital Group 10 of 90. Of the “big five” universal owners, four of them supported environmental resolutions for the first time.²³²

In general, however, social proposals did not fare well in 2017: 23 proposals tracked by Fund Votes referring to non-discrimination and equal employment received an average approval level of 16%.²³³ Fourteen resolutions on the Holy Land Principles²³⁴ garnered on average 4% support.²³⁵ Nine proposals regarding various human rights issues achieved an average approval level of 9%.²³⁶

CSR initiatives also extended beyond shareholder resolution advocacy, and likewise illustrate the bipolar nature of large asset managers’ approaches toward important ESG issues. Take SSGA’s stance on gender, for example, the most significant 2017 action a major asset manager took to advance the “S” in ESG. In March of that year, in honor of International Women’s Day, the firm issued guidance to its portfolio holdings in the United States, the U.K., and Australia—totaling more than 3,500 companies—pressing for increased board gender diversity.²³⁷ The asset manager isolated approximately 470 companies with all-male boards, and sent letters in an attempt to engage over the issue. Ultimately, 42 boards made commitments to enhance diversity, and SSGA withheld votes for a director on a governance or nominating committee at 400 businesses that ignored the issue.

The \$30 trillion problem may have figured into this campaign; also in March, SSGA sponsored the famous Fearless Girl statue that appeared on Wall Street opposite Charging Bull.²³⁸ One controversy generated by the statue concerned an embedded plaque touting the firm’s SSGA Gender Diversity ETF, traded under the ticker symbol “SHE.”²³⁹ Fearless Girl was, in fact, an advertisement. This marketing campaign was ultimately undermined, however, when SSGA reached a \$5 million settlement with DOL in October 2017 related to underpaying women and minor-

ity employees.²⁴⁰ The Bloomberg report on the settlement sniffed that “more often than not, State Street has voted against gender pay shareholder proposals.”²⁴¹ As with other companies, SSGA’s actions exhibit a calculated inconsistency with regard to its approach to CSR issues.²⁴²

Despite the uneven progress, if one is accustomed to seeing glasses as half-full, the events of late 2016 and 2017 present themselves in a very positive fashion. Following the restatement of ERISA fiduciary guidance, environmental shareholder proposals received an unprecedented level of support, generating a certain amount of behavioral change.²⁴³ Directorial voting was used as a broad cudgel to support a social issue for the first time as well. Precedent for shareholders leading change can be observed in the truly startling transformation of board governance. Optimists may therefore be prompted to allow the capital markets to take their natural course, content to watch the evolution of CSR as a reflection of the ongoing progress of society.

In this regard, 2018 could have made an interesting test case: Have the floodgates of shareholder power over sustainable corporate behavior truly opened? Or has the tension that universal owners feel between appearing responsible and minimizing engagement expense while remaining on good terms with their portfolio companies led to only incremental advancement? The evidence suggests the latter. Various analyses of 2018 environmental and social proxy voting patterns differ in their choice of universe²⁴⁴ and categorization²⁴⁵ of resolutions, but agree that shareholder support has increased only somewhat. For example, one study found that five environmental resolutions passed in 2018 compared to three in 2017, while average support for these resolutions grew to 31% from 29% one year earlier.²⁴⁶ In light of support levels of 24% in 2016 and 18% in 2015, there is no evidence of a 2018 acceleration in shareholder support.²⁴⁷ The same analysis found

231. Rob Berridge, *Four Mutual Fund Giants Begin to Address Climate Change Risks in Proxy Votes: How About Your Funds?*, CERES, Dec. 21, 2017, <https://www.ceres.org/news-center/blog/four-mutual-fund-giants-begin-address-climate-change-risks-proxy-votes-how-about>.

232. *Id.*

233. Fund Votes, *supra* note 163.

234. The Holy Land Principles concern corporate conduct in Israel and Palestine. Press Release, Holy Land Principles Inc., Holy Land Principles Reaches Agreement With the Corning Company (Dec. 21, 2016), http://www.csr-wire.com/press_releases/39557-Holy-Land-Principles-Reaches-Agreement-with-the-Corning-Company.

235. Fund Votes, *supra* note 163.

236. *Id.*

237. Ben Maiden, *State Street’s Diversity Push Hits the Road*, CORP. SECRETARY, Nov. 7, 2017, <https://www.corporatesecretary.com/articles/esg/30935/state-street-s-diversity-push-hits-road>.

238. Tom McCarthy, *Fearless Girl v Charging Bull: New York’s Biggest Public Art Controversy in Years*, GUARDIAN, Apr. 14, 2017, <https://www.theguardian.com/us-news/2017/apr/14/fearless-girl-statue-women-new-york-bull>.

239. Jen Wiczner, *Why the Fearless Girl Statue’s Controversial “SHE” Plaque Was Removed*, FORTUNE, Apr. 17, 2017, <http://fortune.com/2017/04/17/fearless-girl-statue-nyc-plaque-she-nasdaq/>.

240. Patrick Coffee, *Financial Firm Behind “Fearless Girl” Will Pay \$5 Million for Allegedly Underpaying Women and Minorities*, ADWEEK, Oct. 5, 2017, <http://www.adweek.com/agencies/financial-firm-behind-fearless-girl-will-pay-5-million-for-allegedly-underpaying-women-and-minorities/>.

241. Jordyn Holman, *Bank Behind Fearless Girl Statue Settles Gender Pay Dispute*, BLOOMBERG, Oct. 5, 2017, <https://www.bloomberg.com/news/articles/2017-10-05/bank-behind-fearless-girl-statue-settles-u-s-gender-pay-dispute>.

242. To SSGA’s credit, the firm has targeted more than 1,200 companies worldwide as of September 2018, of which more than 300 added a female director. Press Release, State Street Corporation, State Street Global Advisors Reports Fearless Girl’s Impact: More Than 300 Companies Have Added Female Directors (Sept. 27, 2018), <https://www.businesswire.com/news/home/20180927005518/en/State-Street-Global-Advisors-Reports-Fearless-Girl's>.

243. *Id.*; see generally *supra* note 229.

244. “Universe” refers to the group of stocks that were reviewed—S&P 500, Russell 3000, and so forth.

245. “Categorization” refers to the resolution’s topic, such as board diversity, which is sometimes classified as a social issue, other times a governance issue, and so on.

246. SULLIVAN & CROMWELL LLP, *supra* note 147, at 7.

247. SULLIVAN & CROMWELL LLP, 2017 PROXY SEASON REVIEW 21 (2017), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_2017_Proxy_Season_Review.pdf; SULLIVAN & CROMWELL LLP, 2016 PROXY SEASON REVIEW 19 (2016), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_2016_Proxy_Season_Review.pdf.

that human rights resolutions have stalled at support levels of 7%-9% over the past four years.²⁴⁸

The one discontinuity that characterized 2018 surrounded the negotiated withdrawals of resolutions, which increased significantly.²⁴⁹ Estimates of environmental and social resolutions withdrawn range from one-third²⁵⁰ to nearly one-half.²⁵¹ While this has been portrayed as a shareholder victory,²⁵² one should view negotiated withdrawals with caution.²⁵³ These cases of “private ordering” (the sharing of regulatory authority with private actors) are rarely disclosed, obliquely framed if they are, and difficult to enforce.²⁵⁴ At least some of the 2018 climate settlements did not achieve shareholders’ ultimate goals.²⁵⁵ Indeed, negotiated withdrawals are currently recommended as a strategic tool by corporate legal advisors.²⁵⁶ It seems that shareholder engagement will continue to make steady, but slow, improvement as a tool for creating greater corporate responsibility in the absence of a faster catalyst.²⁵⁷

248. For a similar but more hopeful analysis, see EY CENTER FOR BOARD MATTERS, 2018 PROXY SEASON REVIEW (2018), [https://www.ey.com/Publication/vwLUAssets/EY-cbm-proxy-season-review-2018/\\$FILE/EY-cbm-proxy-season-review-2018.pdf](https://www.ey.com/Publication/vwLUAssets/EY-cbm-proxy-season-review-2018/$FILE/EY-cbm-proxy-season-review-2018.pdf).

249. As Meaghan Kilroy reports:

63% of 27 sustainability proposals were withdrawn or not in proxy/not presented this year, while that happened for 50% of 38 greenhouse gas emissions proposals. Last season, the figures were 50% of 24 sustainability proposals and 48% of 31 greenhouse gas proposals . . . 76% of 29 board diversity proposals were withdrawn or not in proxy/not presented this year, while that was the case in 68% of 25 gender/race/ethnicity pay gap proposals. Last year, the figures were 70% of 34 board diversity proposals and 38% of 21 pay gap proposals.

Meaghan Kilroy, *Environmental, Social Issues Big in Proxy Season*, PENSIONS & INVESTMENTS, July 9, 2018, <http://www.pionline.com/article/20180709/PRINT/180709889/environmental-social-issues-big-in-proxy-season>.

250. EY CENTER FOR BOARD MATTERS, *supra* note 248, section 3, key board takeaway.

251. SULLIVAN & CROMWELL LLP, *supra* note 147, at 8.

252. Andrew Logan, *This Year’s Quiet Shareholder Season Demonstrates Investor Strength on Climate Action*, RESPONSIBLE-INVESTOR.COM, July 12, 2018, https://www.responsible-investor.com/home/article/2018s_quiet_shareholder_season_demonstrates_investor_strength_on_climate_act/.

253. Estimates of these proposals include a number that were withdrawn due to the uncertainties posed by the November 1, 2017, Staff Legal Bulletin No. 14I. A number of proponents engaged in tactical withdrawals to avoid adverse decisions on long-standing models of proposals, due to the vagaries of the new staff legal bulletin and changing staff decisionmaking approaches. E-mail from Sanford Lewis, Director, Shareholder Rights Group, to Paul Rissman (Sept. 26, 2018, 2:29 p.m.) (on file with author).

254. Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262 (2016), available at <http://digitalcommons.law.yale.edu/ylj/vol126/iss2/1>.

255. See, e.g., Logan, *supra* note 252 (explaining that energy companies AEP, Duke Energy, and Southern Company negotiated long-term greenhouse gas reduction goals that were not ambitious enough to meet the Paris Agreement’s goal of keeping the temperature rise below two degrees Celsius).

256. See, e.g., RONALD O. MUELLER ET AL., GIBSON DUNN, SHAREHOLDER PROPOSAL DEVELOPMENTS DURING THE 2018 PROXY SEASON 1 (2018) (“[C]ompanies may want to consider potential engagement and negotiation opportunities with proponents as a key strategic option for dealing with certain proposals and proponents”), available at <https://www.gibsondunn.com/wp-content/uploads/2018/07/shareholder-proposal-developments-during-the-2018-proxy-season.pdf>.

257. Even the shining instance of shareholder pressure of 2017, the successful Exxon climate resolution, transpired to have a disappointing result by 2018. The promised climate change report (see *supra* note 229) was widely vilified upon publication. See, e.g., KATHY HIPPLE & TOM SANZILLO, INSTITUTE FOR ENERGY ECONOMICS AND FINANCIAL ANALYSIS, EXXONMOBIL’S CLIMATE RISK REPORT: DEFECTIVE AND UNRESPONSIVE (2018), [In contrast to the optimists, those who tend to view the glass as half-empty will be dissatisfied with a pace of corporate social and environmental change seen as too feeble, and shareholder pressure seen as too feckless. They will take account of the structural biases that universal owners face²⁵⁸ that may cause them to pay lip service to CSR while doing what they may feel is the minimum required to stave off public sanction and continue to attract assets. In perceiving that the more things change, the more they stay the same, this group will demand further action to ensure that large investment advisers feel meaningful pressure to take real and extensive actions. For this group we offer the SASB, and its effect on the fiduciary duties of the universal owners who have affiliated with the organization.](http://ieefa.org/wp-</p>
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V. The Creation of the SASB Principles and Their Effect on Fiduciary Duty

As previously mentioned, the SEC has long stated that non-financial matters, including ESG matters, can be material, but because companies make this determination internally, and there is little guidance from the SEC regarding when such materiality arises, disclosure of these issues is honored in the breach. The preceding discussion of SEC and Supreme Court views of materiality suggest that, unless it can be shown that environmental and social disclosures are items that reasonable shareholders would find important in their decisionmaking, managements should not be held liable in disclosing (or not) these issues. Indeed, managements should avoid disclosing them, lest they “bury the shareholders in an avalanche of trivial information.”²⁵⁹

Investors agree that materiality is a critical factor in their ESG engagement and voting behavior. As BlackRock has stated, “The trigger for engagement on a particular SEE concern is our assessment that there is potential for material economic ramifications for shareholders.”²⁶⁰ In Vanguard’s words, “When evaluating shareholder proposals, we ask questions such as: Does the proposal ask for disclo-

content/uploads/2018/03/ExxonMobils-Climate-Risk-Report-Defective-and-Unresponsive-March-2018.pdf; CARBON TRACKER INITIATIVE, FALLING SHORT—AN ASSESSMENT OF EXXONMOBIL’S DISCLOSURE OF CLIMATE-RELATED RISK (2018), <https://www.carbontracker.org/reports/company-profile-exxon-mobil/>. This prompted the resolution’s lead filer, New York State Common Retirement Fund, to send a letter to management with a series of clarifying questions. Andrea Vittorio, *Exxon Back in Hot Seat Over Reply to Investors on Climate Risk*, BLOOMBERG L., Apr. 3, 2018, <https://www.bna.com/exxon-back-hot-n57982090737/>.

Exxon published its reply to New York State on May 8, 2018. Jeffrey J. Woodbury, *Enhanced Disclosures and Subsequent Engagement*, EXXONMOBIL, May 8, 2018, <https://corporate.exxonmobil.com/en/current-issues/climate-policy/climate-perspectives/enhanced-disclosures-and-subsequent-engagement>. Shareholders took no subsequent action, despite the fact that the central thrust of the original resolution, to report on the financial effects of a “reduction in demand result[ing] from carbon restrictions and related rules or commitments adopted by governments consistent with the globally agreed upon 2 degree target”—was never addressed. The resolution’s text is available at SEC, Schedule 14A: ExxonMobil Corporation 62 (Apr. 13, 2017), https://www.sec.gov/Archives/edgar/data/34088/00011931251722538/d182248ddef14a.htm#toc182248_23.

258. See *supra* Section IV.B.

259. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 448 (1976).

260. BLACKROCK, *supra* note 210.

sure that is material and relevant to the company's long-term value?"²⁶¹ SSGA echoes these sentiments, explaining that "[a]s a fiduciary, SSGA considers the financial and economic implications of environmental and social issues first and foremost."²⁶² Since material disclosure has become the central regulating mechanism for corporate behavior in the United States, would it not be useful to craft a set of sustainability disclosure standards that BlackRock, Vanguard, SSGA, and other investors agree to be material, so that they know exactly what information to press for? This is the *raison d'être* of the SASB.

Formed in 2011,²⁶³ the SASB standards-setting process has been undertaken with the specific goal of advancing what information a reasonable investor considers "material" to his or her decisionmaking.²⁶⁴ In order to create support and ensure the standards reflected industry understandings of materiality, SASB conducted broad consultations with key players between 2012 and 2015, hosting industry working groups (IWGs) to provide market feedback on its standards. Participation in IWGs was balanced among 2,800 professionals with at least five years of industry experience, including approximately one-third corporate experts, one-third investors, and one-third market intermediaries.

"These professionals vetted the evidence and weighed consensus regarding the likely materiality of each topic, with generally a 75 percent approval benchmark for inclusion in the standards."²⁶⁵ Each topic was rigorously tied to financial impact.²⁶⁶ In eight of 11 sectors, more than 80%

of respondents agreed on the likely materiality of all proposed disclosure topics, exceeding the 75% benchmark.²⁶⁷ Nearly 90% of "reasonable investors" agreed that the disclosure topics were likely to constitute material information.²⁶⁸ These encouraging figures hint at broad-based support for the materiality of the standards, a key to their successful implementation.²⁶⁹

After releasing provisional industry-specific ESG disclosure standards, SASB concluded a consultation phase in March 2017,²⁷⁰ and conducted a public comment period until January 2018.²⁷¹ SASB published the standards in November 2018.²⁷² The standards, which range across 11 sectors and 79 industries,²⁷³ encourage companies to disclose information on a variety of topics, including greenhouse gas emissions, water usage, engagement with neighboring communities, security and human rights impacts, indigenous rights, labor relations, and analogous issues.²⁷⁴

The SASB standards will join a bewildering array in the compendium of voluntary sustainability reporting. One source, for example, cites 13 sustainability frameworks, 7 sets of standards, and 9 ratings schemes in use as of 2015.²⁷⁵ The proliferation has led to widespread dissatisfaction with reporting schemes²⁷⁶: corporate officers and directors "can be swamped with questionnaires and surveys from investors, ratings agencies, media outlets, and others regarding their company's ESG performance,"²⁷⁷ while investors in a recent survey registered only a 21% satisfaction level in the quality of ESG disclosures provided by their portfolio holdings.²⁷⁸ Large corporations have typically settled on

261. VANGUARD, 2018 INVESTMENT STEWARDSHIP ANNUAL REPORT 23 (2018), https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2018_investment_stewardship_annual_report.pdf; see also Vanguard, *Policies and Guidelines: Environmental and Social Matters*:

As a fiduciary, Vanguard is required to manage our funds in the best interests of shareholders and obligated to maximize returns in order to help shareholders meet their financial goals. . . . The Investment Stewardship team actively engages with portfolio companies and their boards to discuss material risks, ranging from business and operational risks to environmental and social risks.

<https://about.vanguard.com/investment-stewardship/policies-and-guidelines/> (Staff Bulletin Dec. 7, 2018).

262. SSGA, PROXY VOTING AND ENGAGEMENT GUIDELINES: NORTH AMERICA 8 (2018), <https://www.ssga.com/investment-topics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-Guidelines-NA-20180301.pdf>.

263. SASB, ANNUAL REPORT 7 (2017), <https://www.sasb.org/wp-content/uploads/2018/09/SASB-Annual-Report-2017.pdf>.

264. SASB, *SASB's Approach to Materiality for the Purpose of Standards Development*, Staff Bulletin No. SB002-01102017 (copy on file with authors).

265. SASB, KEY FACTS ABOUT SASB (2017), <http://using.sasb.org/wp-content/uploads/2017/12/About-SASB-Sheet-120717-v6.pdf>.

266. Letter from SASB, to Brent J. Fields, Secretary, SEC 15 (July 1, 2016) (Re: Concept Release on Business and Financial Disclosure Required by Regulation S-K):

[A]ny topics identified as likely being material have undergone a rigorous analysis of the likelihood and magnitude of its effect on the financial condition or operating performance of a company, or on the entire industry. Direct evidence was sought to establish a link between performance on the sustainability-related factor and financial performance. Actual or potential financial impacts were characterized by their impact on revenue and growth, operating expenses, the cost of capital, and/or the value of assets or liabilities. Where possible, SASB analysts modelled [sic] the range of impact using a typical discounted cash flow analysis to understand possible impacts within a five-year time horizon. If financial materiality and

the link to financial impact could not be demonstrated for a particular topic, the topic was not included in the standards.

<https://www.sec.gov/comments/s7-06-16/s70616-25.pdf>.

267. SASB, *supra* note 264, at app. B.

268. *Id.*

269. There is some debate as to the efficacy of disclosure in truly changing CSR behavior. Here, SASB has followed scholarly advice. In bringing industry representatives into the standard-setting process, the organization creates buy-in and therefore maximizes the chances of success. See, e.g., Karin Buhmann, *Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU's Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action*, 3 BUS. & HUM. RTS. J. 23 (2018), available at <https://ssrn.com/abstract=3058603>.

270. See *supra* note 263, at 8.

271. SASB, *SASB Standards Board Meeting* (Mar. 9, 2018), available at https://www.sasb.org/wp-content/uploads/2018/03/MASTER-Deck-March-9-meeting.FINAL_3.9.2018.pdf.

272. See *supra* note 17.

273. SASB, *supra* note 263.

274. The SASB standards are downloadable at <https://www.sasb.org/standards-overview/download-current-standards/> (last visited Dec. 7, 2018).

275. Renard Y.J. Siew, *A Review of Corporate Sustainability Reporting Tools (SRTs)*, 164 J. ENVTL. MGMT. 180 (2015), available at <http://dx.doi.org/10.1016/j.jenvman.2015.09.010> (full text copy on file with author).

276. See, e.g., Jeff Leinawever, *Is Corporate Sustainability Reporting a Great Waste of Time?*, GUARDIAN, Jan. 6, 2015, <https://www.theguardian.com/sustainable-business/2015/jan/06/corporate-sustainability-reporting-waste-time>.

277. DELOITTE, SUSTAINABILITY DISCLOSURE: GETTING AHEAD OF THE CURVE (2016), <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/risk/us-risk-sustainability-disclosure.pdf>.

278. PWC GOVERNANCE INSIGHTS CENTER, INVESTORS, CORPORATES, AND ESG: BRIDGING THE GAP 9 (2016), <https://www.pwc.com/us/en/governance-insights-center/publications/assets/investors-corporates-and-esg-bridging-the-gap.pdf>.

the Global Reporting Initiative (GRI) framework,²⁷⁹ with surveys citing up to 80% compliance,²⁸⁰ but investors seem to be generally displeased with it.²⁸¹

What will SASB add to this brew that will make it superior (in the eyes of investors)? Its exclusive focus on materiality as it benefits the reasonable shareholder. This is best illustrated by contrasting the GRI definition of materiality: “Material Aspects’ are those that reflect the organization’s significant economic, environmental and social impacts; or that substantively influence the assessments and decisions of stakeholders.”²⁸² In comparing this definition with the Supreme Court’s attempt to restrict material facts to those that bear on a shareholder’s decision to invest or vote, one can imagine that GRI disclosure may be found overly broad. In 2016, BlackRock reviewed the various disclosure regimes and urged policymakers to understand “the distinction between social, mission or ‘values’ driven goals and investment (‘value’) goals.”²⁸³ For good measure, the firm praised SASB as a “preeminent example of an industry body seeking standardized ESG disclosures that are relevant to business performance.”²⁸⁴ One of the aforementioned surveys found that investors preferred the SASB to the GRI standards by a factor of 2:1, even though the SASB standards were not yet circulating.²⁸⁵

When the standards were released in November 2018, they assumed a unique status: they are material, but they are also voluntary. The SEC has agreed to enforce material standards compiled by other private organizations such as the Financial Accounting Standards Board for financial reporting to investors,²⁸⁶ and the Public Company Accounting Oversight Board, which oversees accounting professionals who provide independent audit reports for publicly traded companies.²⁸⁷ SASB itself suggested that, “unlike these other examples where non-governmental rulemaking has been incorporated into the SEC’s rules themselves, we are merely urging that the SEC acknowledge the appropriateness of the SASB standards for use by companies seeking to make more fulsome and complete MD&A [management’s discussion and analysis] and risk factor disclosures.”²⁸⁸

We have previously pointed to suggestions that the current stance of the SEC may be more antiregulatory than in the past. Speculating on the implications if the SEC accepts the standards as material, and the liability opportunities that will arise if corporations then omit material facts that are “necessary in order to make the statements made . . . not misleading,” makes one’s head spin. We would think that unless the SEC decides to incorporate SASB’s standards into its own rules, the SEC would acknowledge the appropriateness of the standards in a subtle way, if at all.

How, then, could these standards possibly be effective in shaping corporate behavior? We argue that the “reasonable investors” who have formulated, voted on, and promoted the standards will drive their adoption across corporate America, because it is their fiduciary duty to reasonably attempt to do so.

A. *Fiduciary Duty and the SASB Standards*

I. *Fiduciary Duty and Fiduciary Breach*

Fiduciary duties—which generally refer to a service provider’s obligation to handle another’s property with care and loyalty²⁸⁹—derive from a variety of legal sources, and vary depending upon the particular service provider in question.²⁹⁰ The contours of an asset manager’s fiduciary duty to act in the client’s best interest emerge from a web of statutes and common law: the Investment Advisers Act of 1940 regulates the behavior of investment advisers and protects their customers from any deceptive behavior,²⁹¹ while subsequent case law from the Supreme Court and lower courts alike affirm that this protection specifically creates fiduciary duties of care and loyalty on investment advisers.²⁹² For an asset manager,²⁹³ these obligations mean

279. GRI, *GRI Standards*, <https://www.globalreporting.org/standards/> (last visited Dec. 7, 2018).

280. KPMG INTERNATIONAL, *supra* note 81, at 12; PWC GOVERNANCE INSIGHTS CENTER, *supra* note 278, at 6.

281. PWC GOVERNANCE INSIGHTS CENTER, *supra* note 278.

282. CDP ET AL., STATEMENT OF COMMON PRINCIPLES OF MATERIALITY OF THE CORPORATE REPORTING DIALOGUE 6 (2016), <http://corporatereportingdialogue.com/wp-content/uploads/2016/03/Statement-of-Common-Principles-of-Materiality1.pdf>.

283. BLACKROCK, EXPLORING ESG: A PRACTITIONER’S PERSPECTIVE 1 (2016), <https://www.blackrock.com/corporate/en-us/literature/whitepaper/view-point-exploring-esg-a-practitioners-perspective-june-2016.pdf>.

284. *Id.* at 5.

285. PWC GOVERNANCE INSIGHTS CENTER, *supra* note 278, at 6.

286. The Roles of the SEC and the FASB in Establishing GAAP: Hearing Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, House Committee on Financial Services, 107th Cong. (2002) (testimony of Robert K. Herdman, Chief Accountant, SEC), <https://www.sec.gov/news/testimony/051402tsrkh.htm>.

287. SEC, *Public Company Accounting Oversight Board (PCAOB)*, <https://www.sec.gov/fast-answers/answerspcaobhtm.html> (last modified Jan. 16, 2013).

288. Letter from SASB, *supra* note 266, at note 86.

289. Tamar Frankel, *Definition of Fiduciary Duties*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 127 (Peter Newman ed., Palgrave Macmillan 2002), available at <https://cyber.harvard.edu/trusting/unit5all.html>.

290. For example, statutes create the fiduciary duty between partners in corporate partnerships, courtroom proceedings govern the fiduciary duty in administrator-heir interactions, and contracts prescribe the fiduciary duties in a range of contractual relationships. Robert A. Kutcher, *Breach of Fiduciary Duties*, in BUSINESS TORTS LITIGATION 3 (Ann Georgehead et al. eds., American Bar Association 2005), available at https://apps.americanbar.org/abastore/products/books/abstracts/5310344_chap1_abs.pdf.

291. Investment Advisers Act of 1940, 15 U.S.C.A. §80b-6 (2010).

292. Securities & Exch. Comm’n v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963); Securities & Exch. Comm’n v. Washington Inv. Network, 475 F.3d 392, 404 (D.C. Cir. 2007). *But see* Arthur B. Laby, SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940, 91 B.U. L. REV. 1051 (2011) (arguing that the seminal *Capital Gains* case technically did not assign asset managers the title “fiduciaries,” but acknowledging that subsequent case law has interpreted it as such).

293. These fiduciary duties also attach to asset owners, in other words trustees of both defined benefit and defined contribution pension funds, and other employee benefit plans. In the case of public pension funds, these duties are created by state law. T. Leigh Anenson, *Public Pensions and Fiduciary Law: A View From Equity*, 50 MICH. J.L. REFORM 251, 258 (2016):

All fifty states authorize the assets of public retirement systems to be held in trust. . . . The respective fiduciary duties of designated governing bodies and third parties may arise under state constitutions, statutes, and common law. The obligations imposed on the

that he or she “owes the duty of fidelity to a principal in carrying out the duties with which he or she is charged. Anything less than the highest ethical conduct can result in liability.”²⁹⁴

The broad responsibility to abide by the “highest ethical conduct” has been interpreted in a multitude of ways, with more concrete guidance on what constitutes “ethical” behavior emerging from the specific facts of the case at hand. Courts have found that fiduciaries can breach this ethical duty through myriad forms of misconduct, including misappropriation of funds, self-dealing, abusing a superior or influential position, or even a generalized failure to act in another’s best interest.²⁹⁵ Importantly, such a failure is a breach in equity,²⁹⁶ meaning that a customer does not have the burden of establishing harm: “Thus, in addition to damages—a remedy in common law—fiduciaries must account for ill-gotten profits even if their entrustors suffered no injury—a remedy in equity.”²⁹⁷ A would-be plaintiff has no requirement to establish that *but for* the asset manager’s failure, he or she would have earned higher returns. All an aggrieved customer has to demonstrate is that the fiduciary failed to act in his or her best interest.

2. The Duty to Investigate

One of the primary fiduciary duties, the duty of care, is represented by the common-law prudent person standard.²⁹⁸ Implicit in the concept of prudence is the duty

to investigate. As the U.S. Court of Appeals for the Third Circuit has stated when grounding the ERISA prudence standard in common law:

Consistent with these common law principles, the courts measure section 1104(a)(1)(B)’s “prudence” requirement according to an objective standard, focusing on a fiduciary’s conduct in arriving at an investment decision, not on its results, and asking whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment.²⁹⁹

There is wide agreement in the law that the duty to investigate is an integral component of the duty of care.³⁰⁰ The staff of the SEC has affirmed that this duty applies to any investment adviser registered under the Investment Advisers Act, stating that an adviser must “make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information.”³⁰¹ The model legislation for state fiduciary law, the Uniform Prudent Investor Act,³⁰² discusses “the traditional responsibility of the fiduciary investor to examine information likely to bear importantly on the value or the security of an investment.”³⁰³

Any investment decision must be undertaken only after investigating a stock’s or bond’s risks and potential future returns.³⁰⁴ Failure to investigate the financial implications of any particular investment decision can lead to a breach of an asset manager’s fiduciary duty. Importantly, this demands conducting investigations not only *before* the initial investment decision is made; rather, there is an ongoing duty to monitor the investment, which is a “continuing duty [that] exists separate and apart from the trustee’s duty to exercise prudence in selecting investments at the outset.”³⁰⁵ This continuing fiduciary duty to investigate extends long after that initial purchase, such that an asset manager must reevaluate a holding’s value whenever a change in circumstances suggests that the investment’s worth may have changed.³⁰⁶ In such cases, fiduciaries must

board and third party managers include duties of undivided loyalty and reasonable care that are at the core of fiduciary law.

The fiduciary duty for private pension and employee benefit plans, by contrast, is created by ERISA. ERISA, 29 U.S.C. §1102(a)(1) (“Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.”). Common-law duties of loyalty and care are also imposed upon ERISA plan trustees. *See, e.g.,* Central States, S.E. & S.W. Areas Pension Fund v. Central Transp., Inc., 472 U.S. 559, 570 (1985) (finding the fiduciary duties that apply to pension plan advisers by virtue of ERISA track those same duties that apply to other fiduciaries under the common law of trusts).

It should be noted that employee benefit plans often display some combination of in-house management of their assets and an outsourced portion to outside investment advisers. Charles McGrath, *Public Plans Managing In-House*, PENSIONS & INVESTMENTS, Oct. 13, 2017, <http://www.pionline.com/article/20171013/INTERACTIVE/171019896/public-plans-managing-in-house>. Whether assets are managed in-house or are outsourced, the duties of loyalty and care apply.

294. Kutcher, *supra* note 290, at 15.

295. *Id.* at 11.

296. “Equity” refers to “the spirit and the habit of fairness, justness, and right dealing which would regulate the intercourse of men with men.” BLACK’S LAW DICTIONARY, <https://thelawdictionary.org/equity/> (last visited Dec. 7, 2018). Unlike typical tort claims, which require the plaintiff to show a demonstrable injury, claims in equity have no such requirement.

297. Frankel, *supra* note 289.

298. As noted by Tamar Frankel and Arthur Laby:

The Restatement (Third) of Trusts §77 (2007) provides: (1) The trustee has a duty to administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust. (2) The duty of prudence requires the exercise of reasonable care, skill, and caution. (3) If the trustee possesses, or procured appointment by purporting to possess, special facilities or greater skill than that of a person of ordinary prudence, the trustee has a duty to use such facilities or skill.

Tamar Frankel & Arthur Laby, *Investment Advisers and Money Managers Are Fiduciaries*, in REGULATION OF MONEY MANAGERS: MUTUAL FUNDS AND ADVISERS 66 n.13 (2018).

299. *In re Unisys Sav. Plan Litig.*, 74 F.3d 42064 (3d Cir. 1996).

300. “The touchstone of fiduciary duty under almost every legal framework governing pension plans—ERISA, common law, state statutes governing public pension plans—is the ‘prudent man’ standard . . . It is axiomatic that to meet this standard the fiduciary’s decisions must be adequately informed.” David M. Furbush & Nathaniel M. Cartmell III, *Pension Plan Fiduciaries: When Is There a Duty to Investigate?*, 2 BLOOMBERG L. REP. (2009), available at <https://www.pillsburylaw.com/images/content/2/7/v2/2757/28D859AC7DAF388D616AE320903BEDB5.pdf>.

301. SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 21 (2011), <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

302. The Uniform Prudent Investor Act, adopted by the Uniform Law Commission in 1994, outlines a number of duties that trustees have when managing money on behalf of clients. These include rules pertaining to the duty of loyalty, portfolio diversification and risk management, periodic review of investments, and more. Uniform Prudent Investor Act (1994), 7B U.L.A. 16 (Supp. 1995).

303. *Id.* at 8.

304. Furbush & Cartmell, *supra* note 300.

305. *Tibble v. Edison Int’l*, 135 S. Ct. 1823, 1828 (2015).

306. Furbush & Cartmell, *supra* note 300.

reconsider whether to hold, sell, or modify the ownership.³⁰⁷ Investment advisers have a continuing obligation to investigate even those stocks that they have owned on behalf of clients for decades, not just new shares they consider purchasing.

The ongoing duty to investigate does not mean that fiduciaries are burdened with daily investigations of all of their long-owned holdings, however. The duty to investigate after initial purchase may be triggered by certain “red flags,” or warning signs that would make a reasonably prudent person suspect that something might be amiss. While there is no bright-line rule for what constitutes a red flag, David Furbush and Nathaniel Cartmell explain:

[A]nything that gives rise to a suspicion of misstatement, concealment, misappropriation, negligence, incompetence, violation of rules or policies or other form of irregularity should be investigated. In addition, as a general rule, prudent inquiry should be made into anything that is unexpected or contradictory, or that is accompanied by an explanation that doesn’t make sense, or that appears to lack appropriate documentation.³⁰⁸

It bears emphasis that the duty to investigate extends beyond signs of more egregious actions like intentional deception of shareholders; even inadequate documentation of a company’s statements about any material information would trigger a fiduciary’s duty to investigate. Indeed, the staff of the SEC subscribes to this view, having stated that an investment adviser has a duty to “make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or *incomplete* information.”³⁰⁹

But what exactly does “investigation” mean in concrete terms? Broadly speaking, “investigation” refers to uncovering all material facts that can reasonably be expected to impact a stock’s value. While the particular steps of what constitutes an adequate investigation will vary depending upon the context and stock in question, investigations demand more than simply absorbing information issued by management. While that remains one important source of information, “the adviser must [also] verify assertions by the issuer’s management with great care by examining financial statements and additional evidence.”³¹⁰ Examining “additional evidence” can refer to analyzing any documents that are likely to influence a holding’s value or stability, such as audit reports.³¹¹

In cases where key information is missing or unclear, the duty to investigate might require the fiduciary follow up

with the company for clarification, or to request additional information on a particular point.³¹² However, when the fiduciary encounters troubling issues that raise “concerns about the honesty or integrity of persons to whom responsibility has been delegated, or involving complex legal or accounting issues, it will be advisable to engage independent counsel to conduct the investigation.”³¹³ Thus, the duty to investigate extends beyond a simple box-ticking activity, in which the asset manager accepts a company’s own statements about its stock without question; rather, the asset manager has an active duty to investigate beyond these statements, and pore over financial statements and any appropriate additional evidence.

This duty does not demand that literally every last imaginable avenue for finding material information has been exhausted. Rather, fiduciary guidelines stemming from common law variously refer to “reasonable effort,”³¹⁴ “appropriate consideration,”³¹⁵ or “reasonable investigation.”³¹⁶ The “prudent-person” standard requires a fiduciary to act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matter would use.”³¹⁷ As long as the fiduciary can establish that his or her investigative efforts were in line with those of a prudent asset manager faced with an analogous set of facts, he or she would not have to prove that every possible means of uncovering information about the stock’s prospects had been attempted. However, the failure to look beyond a company’s cursory statements about material information, or to reasonably investigate a material matter that has gone undisclosed, may constitute a breach of the fiduciary duty of care, exposing the asset manager’s liability to aggrieved customers.

B. The SASB Standards and Investigation

The implications of an asset manager’s duty to investigate information that could materially affect its decisions about investment and corporate suffrage, and the lack of a requirement to show actual financial harm, loom large. Any time a fiduciary affirms that it believes a certain type of information is material, it legally commits itself to reasonably examine the information that a company issues on those topics, and to press that company for additional information whenever it issues unsatisfactory disclosure about those material topics. Reasonable investigation would include engagement with the company’s officers and directors³¹⁸; and if the engagement did not produce the desired result, withholding support from directors would be the next reasonable and permissible step. This investigation requirement not only holds true for any new pur-

307. *Tibble*, 135 S. Ct. at 1828 (“Under trust law, a trustee has a continuing duty to monitor trust investments and remove imprudent ones.”); *see also id.*

308. Furbush & Cartmell, *supra* note 300, at 2.

309. SEC, *supra* note 301, at 21; *see also* Concept Release on the U.S. Proxy System, Release No. 34-62495, 75 Fed. Reg. 42982 (July 22, 2010) (stating that this duty to investigate likewise applies to proxy advisory firms) (emphasis added), *available at* <https://www.sec.gov/rules/concept/2010/34-62495.pdf>.

310. Frankel & Laby, *supra* note 298, at 72.

311. *Id.*

312. Furbush & Cartmell, *supra* note 300, at 3.

313. *Id.*

314. Uniform Prudent Investor Act §2(d).

315. 29 C.F.R. §2550.404a-1.

316. SEC, *supra* note 301, at 21.

317. ERISA §404(a)(1)(B), 29 U.S.C. §1104(a)(1)(B).

318. *See supra* note 142.

chases, but similarly applies to existing holdings whenever a change in circumstances means that previously immaterial information has suddenly become material.

The adoption of the SASB standards has the potential to create a seismic shift in the type of information that the world's most powerful asset managers might now be required to investigate. Because industry behemoths like BlackRock, Vanguard, and SSGA have not only embraced but helped to *create* the SASB standards, which redefine "material" information to encompass social and environmental topics, their belief in the materiality of those ESG standards would be challenging to dispute. All three investment advisers, as well as other sizable asset managers such as Capital Group, Nuveen/TIAA, and the investment management divisions of Goldman Sachs, Morgan Stanley, and Bank of America Merrill Lynch, are members of the SASB Investor Advisory Group (IAG).³¹⁹ As SASB notes on the IAG web page:

Investors can play an important role in enhancing disclosure effectiveness by expecting companies to disclose performance on *material ESG factors* and by *participating in the development of disclosure standards*³²⁰. . . [The IAG] comprises leading asset owners and asset managers who are *committed* to improving the quality and comparability of sustainability-related disclosure to investors.³²¹

IAG members subscribe to various statements disclosed on its web page, involving participation in ongoing standards development, encouragement of companies to disclose material ESG information, and the belief that SASB's approach, "which is industry-specific and materiality-focused," will help provide investors with "decision-useful" information.³²² Those asset managers have now committed themselves to upholding the standards. By endorsing the standards, these managers implicitly have (1) affirmed that they view the information called for in the standards to be material; (2) created for themselves a duty to investigate such information; and (3) exposed themselves to the risk of potential liability to aggrieved clients, if those managers have failed adequately to investigate material facts.

And as mentioned above, because such a failure would be a breach in equity, a plaintiff would have no need to prove financial harm; the failure to investigate alone would be enough to establish a fiduciary breach. Moreover, because the adoption of the SASB standards represents a change of circumstances that impacts what type of information is "material," asset managers could be hauled into court not only for failure to investigate the ESG performance of new

acquisitions, but also for failure to investigate ESG performance of any existing holdings.

The SASB standards can, therefore, be viewed as creating a new basis for potential liability that asset managers must now take into account when determining whether they have reasonably pushed for material disclosure, or adequately evaluated and verified the ESG information published in a company's corporate statements. If it can be shown that an asset manager has accepted the SASB standards as "material," that manager arguably is now obligated to investigate the social and environmental practices of *every company in which client assets are invested*, regardless of whether the company is headquartered in the United States or abroad. Anything short of a reasonably prudent investigation could well expose such an asset manager to claims that it has breached its fiduciary duty.³²³ Given how many socially conscientious investors each of these asset managers is likely to count among its client base—and how that figure stands to rise over the coming years—an asset manager's failure to investigate holdings to ensure compliance with SASB's material ESG criteria could land that asset manager in court. For asset managers who have embraced SASB standards,³²⁴ ignoring the social and envi-

319. SASB, *supra* note 16.

320. Stated another way, "IAG members have *actively* worked to achieve a market standard for disclosure of ESG information to investors, including providing feedback on SASB's standards," said Chris Ailman, Chair of SASB's IAG and Chief Investment Officer at CalSTRS." Press Release, SASB, SASB Foundation Expands Investor Advisory Group (Apr. 3, 2018) (emphasis added), https://www.prnewswire.com/news-releases/sasb-foundation-expands-investor-advisory-group-300622815.html?tc=eml_cleartime.

321. SASB, *supra* note 16 (emphasis added).

322. *Id.*

323. There is nothing in this argument specific to ESG disclosure in and of itself. If the phases of the moon were some day determined to have a material effect on values of stocks, and an investment adviser acknowledged the materiality of this factor, then the adviser's fiduciary duty would include the duty to investigate the phases of the moon.

324. There are potential layers of liability connected to SASB involvement. At the pinnacle is BlackRock, whose efforts to promote SASB include not only membership in the IAG, but also public statements endorsing the standards (*supra* note 284) and even membership on the SASB Standards Board. SASB, *Standards Board*, https://www.sasb.org/about-the-sasb/the_sasb/ (last visited Dec. 7, 2018). A BlackRock vice president serves as co-vice chair of SASB and chairs the committee that writes standards for the extractives sector, while serving on the committees that write standards for the infrastructure, financials, and technology/communications sectors. SASB, SASB Board Meeting Agenda 1 (July 11, 2018), <https://www.sasb.org/wp-content/uploads/2018/07/SASB-BoardMtg-July-071118-PUBLIC.v2.pdf>. The next level would include universal owners such as Vanguard, SSGA, and Capital Group, members of the IAG whose representatives (in Vanguard's case, the CEO and chairman) have opined about the standards as speakers at SASB Symposia. SASB, *Symposium Agenda*, <http://using.sasb.org/symposium-agenda/> (last visited Dec. 7, 2018). The third layer comprises members of the SASB IAG.

The fourth level includes firms such as J.P. Morgan, which are not members of the IAG, but whose employees sat on several of the industry working groups that formulated the standards. In J.P. Morgan's case, analysts participated in the Services and Transportation Working Groups. SASB, *TRANSPORTATION WORKING GROUPS BY INTEREST GROUP* (2014), http://www.sasb.org/wp-content/uploads/2014/11/Transportation_Participant_List.pdf. Although SASB cautions that participation in these groups was on an individual basis (SASB, *Industry Working Groups Orientation Material*, <http://www.sasb.org/wp-content/uploads/2014/02/SASB-IWG-Orientation-Materials.pdf>), it would be difficult to claim that participation took place without the knowledge and acceptance of the employer. Lastly would be asset managers such as Fidelity, for which the authors could find no official connection. However, if SASB standards become widely accepted as de facto material, there is the potential that even those asset managers that have not yet explicitly endorsed them could be held liable for falling beneath the prudent-person standard of care, should they fail to investigate their holdings for these ESG standards. All fiduciaries must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matter would use." ERISA §404(a)(1)(B), 29 U.S.C. §1104(a)(1)(B).

ronmental performance of their holdings will become an expensive prospect.³²⁵

This is the mechanism that will likely transform universal owners into shadow ESG regulators. If the legal theory espoused in this Article has merit, many of the largest universal owners will have no prudent option other than to demand enhanced ESG disclosure from the issuers of all of their holdings. This group of universal owners has, in the aggregate, a stake in virtually every public company in the world.

Issuers that are unwilling to provide such disclosure will leave themselves exposed to the risk of shareholder challenges to their nominees for election as directors. While this is admittedly a “soft” sanction, it may result in directors being forced off corporate boards or at least facing substantial embarrassment, and for recalcitrant bad actors, the threat of customer reaction and work force dissatisfaction. The disadvantage of a weaker sanction might well be more than compensated by its scope. The perhaps unwilling rise of the shadow ESG regulators could thus have powerful and far-reaching effects upon corporate environmental and social disclosure and, if electric light is truly the most efficient policeman, then upon corporate responsibility as well.

VI. Implications of the Rise of the Shadow Regulators

There are a number of potential implications for the increased power that asset managers can exercise over corporations. These include a decreasing urgency of *government-mandated* ESG disclosure; the ability of asset managers to counterbalance the power of activist investors, like black-and-white Capital, that are bent on driving corporations away from “expensive” attention to ESG issues; and a rise in the value of engaging with companies, as opposed to threatening divestment. When taken together with the new incentives these managers will have to push for transparency in their holdings’ human rights and environmental performances, this increased power bodes well for improved social outcomes.

A. The Need for Mandatory Line Item ESG Disclosure

In its 2016 concept release, the SEC posed the following question: “Are there sustainability or public policy issues for which line item disclosure requirements would be consistent with the Commission’s rulemaking authority and our mission to protect investors, maintain fair, orderly and

efficient markets and facilitate capital formation . . . ?”³²⁶ Many commenters replied in the affirmative.³²⁷ As previously noted, however, the SEC seems in no mood to commit to mandatory ESG disclosure. Further, SASB itself did not request a mandatory disclosure rulemaking.³²⁸ Once universal owners are forced into the role of shadow regulators, however, the current inadequacies of mandatory line item sustainability disclosure are somewhat ameliorated. De jure regulations can be augmented by the de facto oversight of the largest investment advisers.

B. Countervailing Power Versus Activist Investors

While directors of U.S. companies may be growing more fearful of activist investors such as black-and-white Capital, the influence of activists may prove insignificant compared to the potential clout of the shadow regulators. The shareholder services consulting firm Morrow Sodali discussed this point with the two heads of BlackRock’s Global and Americas Investment Stewardship Teams, charged with communicating about ESG issues to company managements. Their advice is:

Talk to shareholders before agreeing to a settlement with an activist. The BlackRock team wants companies targeted by activists to engage directly with shareholders . . . there is a real concern among investors that standard negotiated settlements—such as giving board seats to a dissident or announcing a stock buyback—may favor short-term gains at the expense of long-term performance.³²⁹

BlackRock’s CEO Laurence Fink reiterated that “a central reason for the rise of activism—and wasteful proxy fights—is that companies have not been explicit enough

326. Business and Financial Disclosure Required by Regulation S-K, *supra* note 89.

327. *See, e.g.*, CDP, Response From CDP to: Concept Release: Business and Financial Disclosure Required by Regulation S-K 9 (June 22, 2016) (“We [CDP, formerly Carbon Disclosure Project] believe that the SEC must conclude that it is in the public interest and for the protection of investors to require line item disclosures about sustainability issues”), <https://www.sec.gov/comments/s7-06-16/s70616-29.pdf>; Interfaith Center on Corporate Responsibility (ICCR), Re: File No. S7-06-16—Business and Financial Disclosure Required by Regulation S-K 7 (July 14, 2016) (“ICCR urges the SEC to adopt a policy where line-item disclosure of material information across sectors is required . . .”), <https://www.sec.gov/comments/s7-06-16/s70616-103.pdf>; Forum for Sustainable and Responsible Investment (US SIF), Re: Concept Release on Business and Financial Disclosures Required by Regulation S-K, File Number S7-06-16, Release Number 33-10064; 34-775599, at 19 (July 14, 2016) (“US SIF urges the Commission to require line item disclosures in Regulation S-K for sustainability issues, which would result in more consistent and comparable disclosures”), <https://www.sec.gov/comments/s7-06-16/s70616-107.pdf>. On October 1, 2018, the latest petition for rulemaking on mandatory ESG disclosure was filed with the SEC. Letter from Cynthia Williams, Osler Chair in Business Law, York University, and Jill E. Fisch, Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania Law School, to Brent J. Fields, Secretary, SEC (Oct. 1, 2018), <https://www.sec.gov/rules/petitions/2018/petn4-730.pdf>.

328. Letter from SASB, *supra* note 266.

329. John C. Wilcox, *Getting Along With BlackRock: America’s Most Influential Investor Wants Companies to Engage, Open the Boardroom Door and Do a Better Job Telling Their Story*, MORROW SODALI, Nov. 2017, https://www.morrow sodali.com/attachments/1509464839-Client%20Memo%202017-2018%20BlackRock_NOV.pdf.

325. This Article has not explored liability arising from breach of the duty of loyalty. Failure to pursue disclosure that an asset manager reasonably believes to be material, across a wide array of holdings, because it would be too costly to the manager, or because doing so might not be viewed favorably by potential institutional clients, could theoretically constitute breach of the duty of loyalty.

about their long-term strategies . . . Where activists do offer valuable ideas . . . we encourage companies to . . . engage with shareholders like BlackRock . . .”³³⁰ The aggregated power of the shadow regulators, holders of large blocks of stock for the long term, is of the size to counteract the influence of activist investors.³³¹

C. Invest or Divest?

The rise of the shadow regulators implies that engagement will be greatly strengthened relative to divestment as a tool of shareholder influence. At first glance, it appears that the divestment strategy is trending up: fossil fuel divestment, for example, appeared to gain momentum in late 2017/early 2018 after the central bank of Norway,³³² which administers the world’s largest sovereign wealth fund³³³; the governor of New York,³³⁴ speaking for the nation’s fourth-largest pension fund³³⁵; and the mayor of New York City,³³⁶ with reference to its five public employees’ pension funds, collectively fifth-largest in the United States, all delivered high-profile announcements that they intended to remove fossil fuel companies from their portfolios.

330. Letter from Larry Fink, Chairman and CEO, BlackRock, to CEOs: A Sense of Purpose (2018), <https://www.blackrock.com/corporate/en-no/investor-relations/larry-fink-ceo-letter> (last visited Dec. 7, 2018).

331. Of interest, several activist investors have begun to emphasize social responsibility in their campaigns. For example, JANA Partners teamed with the California State Teachers’ Retirement System to ask Apple Inc. to investigate how parents can exert more control over children’s use of electronic devices and social media. New Letter from JANA Partners and California State Teachers’ Retirement System, to Apple Inc. (June 4, 2018), <https://thinkdifferentlyaboutkids.com/>. ValueAct Capital bought a stake and was given a seat on the board of power generator AES Corp. in order to assist the company in its transition to renewable fuel sources. Press Release, AES Corp., Jeffrey Ubben Joins AES Board of Directors (Jan. 18, 2018), <http://www.aes.com/investors/press-releases/press-release-details/2018/Jeffrey-Ubben-Joins-AES-Board-of-Directors/default.aspx>. There is confusion as to the motives of activist investors who engage on CSR topics. Charles Nathan, *Activists and Socially Responsible Investing*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., Jan. 31, 2018, <https://corpgov.law.harvard.edu/2018/01/31/activists-and-socially-responsible-investing/>.

332. Clifford Krauss, *Norway’s Wealth Fund Considers Divesting From Oil Shares*, N.Y. TIMES, Nov. 16, 2017. A government-appointed commission contradicted this recommendation, however, reasoning that it would harm the fund’s diversification, that there is no need to “change an institution that has worked very well,” and that Norway’s declining oil reserves mitigates against what might otherwise be overexposure. *Norway’s \$1 Trillion Wealth Fund Should Keep Oil Stocks—Commission*, REUTERS, Aug. 24, 2018, <https://www.reuters.com/article/norway-swff/norways-1-trillion-wealth-fund-should-keep-oil-stocks-commission-idUSO9N1U5011>.

333. Sovereign Wealth Fund Institute, *Sovereign Wealth Fund Rankings*, <https://www.swfinstitute.org/sovereign-wealth-fund-rankings/> (last visited Dec. 7, 2018).

334. News Release, Office of the Governor of New York, Governor Cuomo Unveils 9th Proposal of 2018 State of the State: Calling on the NYS Common Fund to Cease All New Investments in Entities With Significant Fossil Fuel-Related Activities and Develop a De-Carbonization Plan for Divesting From Fossil Fuel (Dec. 19, 2017), <https://www.governor.ny.gov/news/governor-cuomo-unveils-9th-proposal-2018-state-state-calling-nys-common-fund-cease-all-new>.

335. P&I Research Center, *U.S. Plan Sponsors/Top 1000*, <http://researchcenter.pionline.com/rankings/plan-sponsor/specialreports/top1000?year=2018> (last visited Dec. 7, 2018).

336. News Release, Office of the Mayor of New York City, Climate Action: Mayor, Comptroller, Trustees Announce First-in-the-Nation Goal to Divest From Fossil Fuels (Jan. 10, 2018), <http://www1.nyc.gov/office-of-the-mayor/news/022-18/climate-action-mayor-comptroller-trustees-first-in-the-nation-goal-divest-from/#/0>.

Yet, there is less here than meets the eye. The Norwegian wealth fund is the recipient of all of the cash flow from the country’s oil production,³³⁷ which is then invested in a global index. Norway also owns two-thirds of the national oil company, Statoil (renamed Equinor).³³⁸ In recommending divestment, the central bank noted:

The market value of the government’s holding in Statoil is currently around the same as the market value of the fund’s investments in oil and gas companies. When the fund’s investments and the holding in Statoil are taken together, we find that exposure to oil and gas stocks in the government’s overall equity portfolio is around twice what it would have been had this portfolio been invested in line with a broad global stock index.³³⁹

The bank found that the nation’s investments were therefore overexposed to energy risks by a factor of two. It emphasized that the divestment advice “is based solely on financial arguments and does not reflect any particular view of future movements in the oil prices or the profitability or sustainability of the sector.”³⁴⁰ Thus, Norway’s announcement cannot be ascribed to ethical considerations, and the attempt to balance a skewed portfolio rather than pursue a sustainability agenda may have muted the divestment announcement’s ultimate impact.

The press around U.S. divestment likewise has proven less momentous than it may have initially seemed: the sole trustee of the New York State Common Retirement Fund, the State Comptroller Thomas DiNapoli, responded to the governor’s announcement, stating “there are no immediate plans to divest our energy holdings.”³⁴¹ In the same statement, he touted the benefits of engagement, noting, “We’ve shown that shareholders have the power to compel major corporations, like ExxonMobil, to address climate change.”³⁴² The chief investment officer of the pension fund also went on record shortly afterward promoting engagement over divestment.³⁴³ New York City’s efforts have had

337. The terms of reference for an expert group appointed to review energy stocks are available at the Norwegian Ministry of Finance, *Terms of Reference for an Expert Group Appointed to Review Energy Stocks in the GPF*, <https://www.regjeringen.no/en/whatsnew/Ministries/fin/news/2018/expert-group-to-review-energy-stocks-in-the-gpfg/terms-of-reference-for-an-expert-group-appointed-to-review-energy-stocks-in-the-gpfg/id2589519/> (last updated Feb. 14, 2018).

338. Equinor, *Our Shareholders*, <https://www.statoil.com/en/investors/our-dividend/our-shareholders.html> (last visited Dec. 7, 2018).

339. Memorandum from the Norwegian Ministry of Finance, Investment Strategy for the Government Pension Fund Global (Nov. 14, 2017), https://static.norges-bank.no/contentassets/5f4d6b9f67534cdebbd09a29215748bf/201711114_letter.pdf?v=11/16/20171115935&ft=.pdf.

340. *Id.*

341. Press Release, Office of the New York State Comptroller, DiNapoli Statement to the Governor’s 9th Proposal for the 2018 State of the State (Dec. 19, 2017), <https://www.osc.state.ny.us/press/releases/dec17/121917a.htm>.

342. *Id.* New York State was the lead filer of the aforementioned Exxon shareholder resolution of 2017; see <http://proxymonitor.org/Results.aspx> (last visited Dec. 7, 2018). Non-shareholders cannot of course file or vote on shareholder resolutions.

343. John Gittelsohn, *Divestment Doesn’t Change Company Behavior, Pension Managers Say*, BLOOMBERG, May 1, 2018, <https://www.bloomberg.com/news/articles/2018-05-01/divestment-doesn-t-change-company-behavior-pension-managers-say>.

somewhat more traction: at board meetings of the five pension funds, a resolution to study the fiscal implications of divestment was passed by three of the plans, but tabled by the Firemen and defeated by Police Pension Fund.³⁴⁴ Taken together, these examples illustrate that what initially appeared to be changes that were poised to generate far-reaching impact may yield more modest effects.

Indeed, there are good reasons why U.S. pension funds may not wish to use divestment as a tool. These relate to notions of the fiduciary duties of trustees. The prohibition on the use of pension assets for any purpose other than to serve the economic interest of the beneficiary is well-established in trust law, the basis of both ERISA and public pension statutes.³⁴⁵ Another pillar of trust law is diversification of assets.³⁴⁶ Both of these duties could be breached in the event that a fund trustee decides to divest from a substantial sector of the market, such as the fossil fuel value chain (which includes exploration and production, transport, refining and marketing; divesting an insignificant industry in terms of market capitalization, such as fire arms manufacturers, would not apply to this discussion).

The pension consultant NEPC detailed the economic disadvantages of fossil fuel divestment to the San Francisco Employees' Retirement System in a memorandum dated January 24, 2018.³⁴⁷ It noted that divestment would likely cause the system's investment performance to exhibit greater volatility via reduced diversification, diminishing overall expected risk-adjusted returns.³⁴⁸ NEPC asserted

344. "Unions contend that divestiture may be a politically expedient rallying cry for liberals, but they say it's coming at the expense of real fiscal concerns about the health of public employee pension systems, which experts describe as increasingly underfunded." Danielle Muoio, *Divesting From Big Oil a Tough Sell—Even in the Bluest Cities and States*, POLITICO, Mar. 3, 2018, <https://www.politico.com/states/new-york/albany/story/2018/03/07/divesting-from-big-oil-a-tough-sell-even-in-the-bluest-cities-and-states-303119>; see also Press Release, Office of the New York City Comptroller, Mayor de Blasio, Comptroller Stringer, Pension Fund Trustees Launch Next Step in Comprehensive Effort to Divest From Fossil Fuels (Apr. 19, 2018), <https://comptroller.nyc.gov/newsroom/mayor-de-blasio-comptroller-stringer-pension-fund-trustees-launch-next-step-in-comprehensive-effort-to-divest-from-fossil-fuels/>.

345. See, e.g., Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1108 (1988), available at <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=4590&context=uclevr>; Natalya Shnitser, *Trusts No More: Rethinking the Regulation of Retirement Savings in the United States*, 2016 B.Y.U. L. REV. 629, 646 (2016), available at <http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=2052&context=lsfp>.

346. RESTATEMENT (THIRD) OF TRUSTS §90(b) (2003) ("In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so."). See *infra* note 348 for an explanation of the outsized importance of the fossil fuel sector in a well-diversified portfolio.

347. Letter from Allan Martin et al., to SFERS Board and Staff, Fossil Fuel Divestment Commentary (Jan. 24, 2018), <https://mysfers.org/wp-content/uploads/012418-special-board-meeting-Attachment-B-NEPC-Commentary.pdf>.

348. *Id.* at 7. The energy sector is particularly well-suited as a diversifying influence on a broad portfolio, as the Allan Martin et al. memorandum argues. First, price fluctuations of energy stocks are among the least correlated to the broader stock market of any sector (with correlation of 0.61 from 1989 to 2017). *Id.* at 8. Second, "energy equities are one of a limited set of assets which perform well in higher inflation environments." *Id.* at 10. Third, the energy sector is a significant proportion of a number of popular, specialized benchmarks, constituting, for example, 11% of the Russell 1000 Value Index as of the third quarter of 2017. *Id.* at 9.

that in surveying 11 of the largest U.S. pension consultants, none had recommended full fossil fuel divestment.³⁴⁹ The city pension plan ultimately decided not to divest.³⁵⁰ A similar conflict is brewing in Norway, where a government-appointed commission recommended against the central bank's move to divest from fossil fuels, contending that "[i]f energy stocks are excluded from the Fund, the composition of the investments will differ from market weights, and the Fund will be expected to either achieve lower return or higher risk."³⁵¹ Thus, divestment strategies, owing to reasons of diversification and economic impact to beneficiaries, are unlikely to become widespread.³⁵²

On the other hand, engagement and voting on environmental and social issues, as they are currently practiced, have also been unsatisfactory in the eyes of many. The central argument of this Article is that the universal owners affiliated with SASB, in recognizing their new fiduciary duties to consider environmental and social factors that they have declared material, must undertake reasonable attempts to investigate these material factors, thereby forcing disclosure—and investigation requires engagement, not divestment. ERISA has recognized monitoring and communication as reasonable investigatory methods, and fiduciaries are required both to engage and vote for resolutions and directors if they perceive that the result can increase the economic well-being of their beneficiaries. This process, as it plays out, will tip the scales in favor of engagement and away from divestment as tools to improve corporate behavior.³⁵³

D. The Need for Client Pressure

Given asset managers' obligation to investigate, and the adoption of the newly minted "material" SASB standards,

349. *Id.* at 16.

350. Laura Waxmann, *SF Retirement Board Shirks Full Divestment From Fossil Fuels, Urges Timeline for Action*, S.F. EXAMINER, Jan. 24, 2018. The pension plan instead plans to gradually reduce its exposure to fossil fuels, and in October 2018 voted to divest from five energy stocks, constituting 2% of its total energy exposure. Rob Kozlowski, *San Francisco Divests 5 Fossil-Fuel Holdings*, PENSIONS & INVESTMENTS, Oct. 22, 2018, <http://www.pionline.com/article/20181022/ONLINE/181029984/san-francisco-divests-5-fossil-fuel-holdings>.

351. Press Release, Norwegian Ministry of Finance, The Government Pension Fund Global Should Still Be Invested in Energy Stocks (Aug. 24, 2018), <https://www.regjeringen.no/en/whatsnew/Ministries/fin/press-releases/2018/energiaksjer-i-statens-pensjonsfond-utland/the-government-pension-fund-global-should-still-be-invested-in-energy-stocks/id2609203/>; see also *Norway's \$1 Trillion Wealth Fund Should Keep Oil Stocks—Commission*, *supra* note 332.

352. Notably, the New York City divestment press release stated that "[t]he trustees will also seek legal opinion as to whether carrying out the divestment would be consistent with trustees fiduciary duties to beneficiaries. Assuming a positive legal opinion, the trustees would then instruct BAM [Bureau of Asset Management] to carry out the divestment with specified steps and timelines." News Release, Office of the Mayor of New York City, *supra* note 336.

353. The goal of divesting fossil fuels from the New York State and New York City pension funds, if successful, will deprive shareholders of two of their major advocates for environmental progress. The two funds together have submitted more than 15% of all shareholder resolutions in the Ceres database. Ceres, *supra* note 170. As mentioned, non-shareholders cannot submit resolutions, nor vote on them.

these managers must soon engage with their corporate holdings to evaluate their adherence to the social and environmental criteria that SASB demands. As discussed above, this investigation should push (virtually all publicly held) companies to improve their policies and practices across a spectrum of human rights and environmental concerns. Those asset managers that fail to engage, despite having publicly declared these standards material, will find themselves in potential breach of their fiduciary duty of care.³⁵⁴

Regardless of the expanded scope of investigative duties that SASB has created, we predict that many of these fiduciaries will initially have little appetite for engaging with companies over the requirements detailed in the SASB standards. Asset managers may have little interest in absorbing the costs associated with creating whatever institutional capacity is necessary to understand the standards, and then pressing their holdings for transparency on the myriad environmental and social issues that SASB regulates. Engagement, we have observed, is expensive.

Fortunately, so is litigation. A customer has standing to file a claim against his or her asset manager for embracing the SASB standards as “material,” yet failing to investigate whether these standards are upheld. The anticipated reluctance of asset managers to investigate means that this lever will very likely have to be pulled. Given that breach of fiduciary duty is a breach in equity—meaning that no actual financial loss has to be proven in order for a plaintiff to prevail—and the enormous number of customers that these asset managers serve, there will be no shortage of potential litigants who can drag the world’s largest asset managers³⁵⁵ into court.

Any socially conscientious customer of these managers will find himself or herself with the power to indirectly enforce the adoption of the SASB standards. Considering the aforementioned rise in assets controlled by millennials and women, and the high value they place on social responsibility, the pool of likely plaintiffs only stands to grow. Whether it only takes a single landmark case for asset managers to understand that what constitutes “material” information has seeped into the social and environmental sphere, or it takes a series of claims to spur them to investigate their holdings, litigation may be a necessary tool in driving the rise of the shadow regulators.

Of course, progress does not always have to be achieved at the point of a gun. Though an adversarial approach may be necessary to ignite the CSR transformation that we predict the SASB standards will generate, collaborative approaches will likewise have a significant role to play. Universal owners can partner with civil society groups that are focused on promoting strong human rights and

environmental performance in the private sector in order to (1) understand the substance of the SASB standards within each industry; and (2) determine what their corporate holdings must be doing, in concrete terms, in order to adhere to these standards. Such partnerships will prove critical, as the standards require specific behavior and performance benchmarks on many technical issues that sit far outside an asset manager’s expertise.

For example, the Mining & Metals guidelines detail disclosure about levels of greenhouse gas emissions, due diligence regarding indigenous land rights in line with international human rights norms, and measurement of operations near active conflict zones. Ensuring that companies have adhered to those standards will require environmental scientists, human rights lawyers, and other civil society experts that can evaluate corporate performance on such issues. Universal owners would be ill-equipped to grade corporate performance on their own. By the same token, it hardly merits mention that civil society groups will benefit enormously from the added leverage that these universal owners exercise over companies they own.³⁵⁶

The stage is thus set for the rise of the shadow regulators to progress the CSR landscape: asset managers that embrace the SASB standards as material will have created for themselves a fiduciary duty to investigate their holdings for compliance with these standards. This new obligation, in turn, provides socially conscientious customers with a legal hook to force asset managers to engage with these companies to ensure that they are, in fact, reporting transparently on the human rights and environmental topics that SASB governs. Then, to the extent that universal owners are able to influence disclosure, and disclosure acts to govern business behavior, we can anticipate a far-reaching change in the way that corporations view their social and environmental obligations.

356. There has been some grumbling from the human rights field that the SASB standards have emphasized environmental concerns over social issues. *See, e.g.*, NYU Stern Center for Business and Human Rights & the International Corporate Accountability Roundtable (ICAR), Public Comment on SASB Exposure Draft Standards (Jan. 30, 2018) (claiming that “SASB’s limited view of human rights leads to uneven disclosure requirements”), https://static1.squarespace.com/static/583f3fca725e25fcd45aa446/t/5a71ece271c10b8bbad62a0e/1517415651715/NYU+Stern_ICAR_SASB+Comment+Final.pdf. The authors suspect that part of this problem lies with the challenges of obtaining sufficient data on human rights performance, given the rigorous financial materiality tests that SASB standards require. *See, e.g.*, Letter from SASB, *supra* note 266.

Human rights NGOs have begun to quantify the financial effects of corporate human rights violations. *See, e.g.*, RACHEL DAVIS & DANIEL FRANKS, COSTS OF COMPANY-COMMUNITY CONFLICT IN THE EXTRACTIVE SECTOR (Harvard Kennedy School CSR Initiative Report No. 66, 2014), https://sites.hks.harvard.edu/m-rcbg/CSRI/research/Costs%20of%20Conflict_Davis%20%20Franks.pdf. It is hoped that a larger volume of such work will shift SASB’s standards toward a more balanced distribution between the “E” and the “S.” In this regard, it is notable that ICAR has put out a request for its members to join SASB’s new sector advisory groups, which will provide to SASB feedback about emerging issues in the standards development process. Letter from Amol Mehra, Former Executive Director, ICAR (Apr. 11, 2018) (copy on file with author).

354. *See supra* Section V.B.

355. As discussed in note 324, the extent to which various asset managers have embraced the SASB standards, and thus could be found to have endorsed them as material, varies. These tiers, ranging from BlackRock (which forcefully advocates for the standards) to Fidelity (which is silent on the issue), may lead a prospective plaintiff to decide that those asset managers that have most ardently trumpeted the standards as “material” make ideal initial defendants.

VII. Conclusion

These are problematic times for those of us who believe that freedom and human rights are in danger due to the rise of authoritarian and nationalist governments around the world, and for those of us who worry about the prospect of catastrophic climate change. Where do we turn for solutions? Not reliably to government, as government (at least, our government) is a source of the problem. We could turn to NGOs, but the influence of human rights-focused NGOs may diminish in proportion to the strength of authoritarianism: in many parts of the world, NGOs are under attack by governments hostile to the further opening of their societies,³⁵⁷ putting the ability of the NGO sector to promote freedom, human rights, and environmental health in decline. Are we overlooking the corporate sector, the “greedy fat cats” who have, until now, done so little to take responsibility for healing the world? Private-sector actors, which exercise increasing power over global affairs and the enjoyment of human rights,³⁵⁸ may be best positioned to push for positive change.

If we can accept the premise that multinationals are not inherently evil, but are simply motivated to please their investors, then we can construct a chain of logic that takes current investment trends as its inputs and leads to a situation in which corporations become actual champions of liberty and ecological health. First, we must recognize that authoritarianism, nationalism, and catastrophic climate change construct an unpredictable business environment where it is difficult to trust laws, obtain reliable information, allocate resources, and accurately forecast profit. This environment is detrimental to the management of any corporation, and, by extension, to the returns of its shareholders. Second, insofar as corporations are held back from being more responsible because they are either worried about activist shareholders, or neglect to disclose information—and hence hinder transparency—because social and environmental information is not considered material, these two factors may shortly change.

Because of the actions of SASB, universal owners are about to declare that environmental and social disclosures will be much more material than they are presently. Their fiduciary duties of care will cause them to demand material disclosure from their holdings. And, since their holdings are substantially the entire public corporate sector, the actions of a small number of universal shareholders will

have large ramifications throughout the economy. SASB has managed to harness the ambiguity of the materiality standard to the power of the universal owner. The world may never be the same.

This potentially happy circumstance does not mean that those with retirement savings in pension or mutual funds are able to declare victory and walk away. It will be necessary to constantly remind those who invest on our behalf that we demand they consider all material disclosure, including environmental and social disclosure, in their investment decisions.

The routes to attaining enhanced levels of corporate responsibility are diverse. BlackRock’s votes against Occidental and Exxon illustrate that the chain of causality to create positive change can comprise a number of links: a small, socially responsible asset manager who owned shares of a universal owner teamed up with a socially responsible pension fund who was a client of the universal owner, in order to jointly pressure the target. The universal owner, in turn, pressured a corporate board. Other varieties of this chain will proliferate. The old model of the corporate gadfly launching single-issue shareholder proposals and receiving little outside support is morphing.

The new model will resemble a flow chart in which individuals demand material compliance from their pension sponsors, funds, and directly owned corporations; pension sponsors demand compliance from their asset managers and their direct corporate holdings; and asset managers engage with companies on behalf of their pension and individual customers. The companies, then, will ultimately adopt stronger human rights and environmental standards or risk shareholder retaliation, such as voting against boards—a transformation that stands to yield concrete benefits for communities across the globe. As this model progresses, shareholder engagement about material disclosure; the shareholder resolution, whether voted upon or agreed to and withdrawn before voting; and, finally, withholding votes for a director, will attain unprecedented power in forcing the corporate sector into positive social and environmental effort.

The global environment that corporations and investors face, and the motivations and challenges that develop along with it, are changing at a rapid pace. Significant news about human rights, environmental threats, corporate responses, and socially responsible investor behavior spews forth every week. Much of the material, events, and ideas cited herein are just months or weeks old. The juxtaposition of this dizzying pace with the glacial progress heretofore seen is truly astonishing. It is entirely possible that sometime in the near future, the corporate sector will be seen as the primary channel for the improvement of human rights and environmental protection throughout the world. Wouldn’t that be interesting?

357. See, e.g., Cathal Gilbert, *It’s Time for G-20 Leaders to Embrace Civil Society*, AL JAZEERA, July 4, 2017:

The restrictions on civil society are no longer confined to “authoritarian” parts of the world, but are now also prevalent in many democracies too. In 2015, UN High Commissioner for Human Rights Zeid Ra’ad Al Hussein tried to list all of the countries currently persecuting civil society but said: “There are now too many countries on that list for me to name them here today. This is a grim indictment . . .” The High Commissioner’s list included several G20 members such as China, Australia and Brazil.

<https://www.aljazeera.com/indepth/opinion/2017/07/time-g20-leaders-embrace-civil-society-170704111743621.html>.

358. See KAISERSHOT & CONNOLLY, *supra* note 3.