The ESG Information System

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INTRODUCTION

The mounting focus on ESG has forced internal corporate decision-making into the spotlight. Investors are eager to support companies in innovative "green" technologies and scrutinize companies' transition plans. Activists are targeting boards whose decisions appear too timid or insufficiently explained. Consumers and employees are incorporating companies' sustainability credentials in their purchasing and employment decisions. These actors are asking companies for better information, higher quality reports, and granular data. In response, companies are producing lengthy sustainability reports, adopting ambitious purpose statements, and touting their sustainability credentials. Understandably, concerns about greenwashing and accountability abound, and policymakers are preparing for action.

This Article argues that a new governance system is emerging to address these concerns. This new regime, which we term the "ESG Information System," draws inspiration from the blueprint employed earlier by securities practitioners and regulators to resolve concerns about the accuracy of financial reporting. It reimagines the board as an ESG-competent monitor. It employs disclosure as a disciplining tool, combined with market scrutiny and the threat of liability. It promotes standardization and benchmarking, under the leadership of independent bodies created with industry support. Finally, it recruits outside professionals to validate company reports. The hope is that these institutional tools can solidify public confidence in companies' sustainability efforts, just as they reinforced the integrity of financial information.

The Securities Acts in the 1930s required companies to disclose financial information, so that investors could monitor management and make informed decisions.[1] However, for investors to effectively perform their oversight role, the financial information must be accurate.[2] Thus,

1. Oliver Binz & John R. Graham, *The Information Content of Corporate Earnings: Evidence from the Securities Exchange Act of 1934*, 60 J. ACCT. RES. 1379, 1380–81 (2022).

2. *See* Jing Li, Lin Nan & Ran Zhao, *Corporate Governance Roles of Information Quality and Corporate Takeovers*, 23 REV. ACCT. STUD. 1207, 1208–09 (2018) (noting that financial accounting information plays a pivotal role in the design of governance mechanisms); *see also* Robert M. Bushman & Abbie J. Smith, *Financial Accounting Information and Corporate Governance*, 32 J. ACCT. & ECON. 1, 1–3 (2001); Judd F. Sneirson, *The History of Shareholder Primacy*, *From Adam Smith*

market participants have spent decades fine-tuning the governance structure for producing accurate financial information.[3] For instance, waves of reforms strengthened the role of independent directors in monitoring management and institutionalized the Audit Committee as a hub for collecting information outside the CFO's long shadow.[4] Internal control departments grew not only in staffing and resources, but also in confidence.[5] Further, a special regulator, the Public Accounting Oversight Board (PCAOB), was created to provide auditing standards and regulate the audit profession, thus adding to its credibility.[6] By the early 2010s, these reforms had instilled confidence in the accuracy of *financial* reporting.[7]

Today, investors are demanding information related to environmental, social, and governance issues.[8] Such "ESG" information is valuable both internally, allowing managers to oversee teams and frame initiatives and interventions, and externally, helping investors understand the company and monitor management.[9] But companies have not produced this type of information in the past, at least not at a comparable scale or in a systematized way. Moreover, unlike financial reporting, the ESG movement calls for disclosures encompassing a wide range of topics and causes. Given its novelty and breadth, ESG disclosure in its current state is hampered by inconsistencies between companies, blurred lines between categories, and varying standards of measurement—much like financial reporting before reforms. For instance, some argue that issues like climate change or board diversity are too broad to fit into a standardized framework. Moreover, early ESG disclosures relied on lofty, do-good language,

through the Rise of Financialism, *in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 73–85 (Beate Sjåfjell & Christopher M. Bruner eds., 2019).

3. *See generally* T. A. LEE & R. H. PARKER, EVOLUTION OF CORPORATE FINANCIAL REPORTING (RLE ACCOUNTING) (2013).

4. *See* Stavros Gadinis, *Three Pathways to Global Standards: Private, Regulator, and Ministry Networks*, 109 AM. J. INT'L L. 1, 37–42 (2015).

5. *See generally* Stephen Wagner & Lee Dittmar, *The Unexpected Benefits of Sarbanes-Oxley*, HARV. BUS. REV., Apr. 2006, at 133, 133.

6. *See Driving Improvement in Audit Quality to Protect Investors*, PUB. CO. ACCT. OVERSIGHT BD. (2023), https://pcaobus.org/ [https://perma.cc/3HG5-XKQ8]; Donald C. Langevoort, *Internal Controls After Sarbanes-Oxley: Revisiting Corporate Law's "Duty of Care as Responsibility for Systems,"* 31 J. CORP. L. 949, 955–56 (2006); *see also* William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023, 1026–27 (2003).

7. *See infra* Part III(A).

8. The acronym "ESG" is used to sum up these three distinct areas of concern. For a history of the term ESG, see Elizabeth Pollman, *The Making and Meaning of ESG* 26 (Eur. Corp. Gov. Inst., Working Paper No. 659, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4219857 [https://perma.cc/W9BV-3MGC].

9. Faith Stevelman & Sarah C. Haan, *Boards in Information Governance*, 23 U. PA. J. BUS. L. 179, 180–181 (2020) (highlighting the board's role in "knowledge synthesis, reporting oversight, and institutional deliberation constitutive of the firm's identity" and introducing "information governance" as a new paradigm for board governance).

rather than concrete, standardized data. This variability prevented investors from verifying whether corporate initiatives were meaningful or effective.[10] If left unchecked, these uncertainties threaten to blunt corporate law's time-honored monitoring tools.

Consequently, critics baffled by companies' lofty pronouncements of their social missions have levelled charges of vagueness against the ESG movement.[11] Some argue that ESG merely represents a shift in rhetoric that produces no commitment from companies to reform their practices on the ground.[12] Others view it as inherently unenforceable, since it provides no guidance about how to balance stakeholder concerns against shareholder interests.[13] Underlying these fears is the concern that vagueness increases discretion for directors and officers, allowing them to escape both investor monitoring and judicial scrutiny—ushering in another era of managerialism.[14] Moreover, the ever-expanding array of topics under the ESG umbrella has not instilled confidence that companies can effectively address all social issues simultaneously.[15] In sum, these critics see ESG disclosure as unmanageable for corporations, intractable for

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10. Susanne Arvidsson & John Dumay, *Corporate ESG Reporting Quantity, Quality and Performance: Where to Now for Environmental Policy and Practice?*, 31 BUS. STRATEGY & ENV'T 1091, 1092 (2022) (noting that for decades investors and financial analysts have claimed that ESG information lacks "qualitative aspects such as value relevance, comparability and credibility").

11. Lucian A. Bebchuk & Roberto Tallarita, *The Perils and Questionable Promise of ESG-Based Compensation*, 48 IOWA J. CORP. L. 42, 62 (2022) (addressing vagueness in ESG-based compensation and arguing that "ESG-based incentives often use vague metrics with no specific, assessable objectives"); *see also* Gerald Baker, *The Rising Backlash Against ESG Investing*, WALL ST. J., at 23:14 (Mar. 8, 2023), https://www.wsj.com/podcasts/opinion-free-expression/the-rising-backlash-against-esg-investing/633ad782-974f-495b-955d-a7c62a0fd8a3 [https://perma.cc/A2QC-6RRW].

12. *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 101–02 (2020); *see also* Hans Nichols, *Scoop: GOP's "Existential" Attack Plan on ESG*, AXIOS (Mar. 8, 2023), https://www.axios.com/2023/03/08/republicans-esg-hearings-questions [https://perma.cc/T6SM-GZKV].

13. Roy Shapira, *Mission Critical ESG and the Scope of Director Oversight Duties*, 2 COLUM. BUS. L. REV. 732, 734–36 (2022) (observing the ambiguity surrounding the mechanisms for shareholders to hold managers accountable for neglecting crucial ESG issues).

14. Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467, 1475 (2021) (observing that commitments made to stakeholders by members of the Business Roundtable were "unlike commitments to shareholders or corporate leaders" and that such "pledges were vague, under-specified, and, importantly, accompanied by an explicit denial of any enforcement rights held by potential beneficiaries"); *see also* Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821, 1847 (2021) (noting that "some law firms recommend that companies phrase ESG disclosures in [aspirational or vague] terms" to "reduce liability risk."); Christopher P. Guzelian & Jeff Todd, *Sustainable Money*, 94 TEMP. L. REV. 453, 453–55 (2022) (highlighting that the ambiguous terminology used in sustainable development has come under criticism and noting that such vagueness allows a wide array of private governance standards to endorse virtually any company or project as "sustainable").

15. *See* Pollman, *supra* note 8, at 26 (noting that "ESG is a label vaguely signifying some level of attention to issues beyond the purely financial").

investors, and unsuitable for operationalization through courts or external monitors.

In response, we argue that proponents of ESG disclosure have turned to the same blueprint used by the reformers of financial reporting, creating what we term the "ESG information system."[16] Thus, to operationalize ESG disclosure, the sweeping promises of the past must be replaced by precise, standardized information that charts weak points, tracks progress, and illuminates failures and risks. Concrete, measurable initiatives—on which stakeholders, investors, and the public can rely—must be developed. This is analogous to past reforms in financial reporting. At first glance, financial accounting has very little in common with measuring environmental impact or assessing the effectiveness of diversity initiatives. One would not expect these very different areas to be governed in similar ways. But, we argue, this institutional isomorphism grants clear benefits to ESG disclosure, despite the different types of information it demands. It helps ESG disclosures gain credibility and take advantage of the monitoring that markets provide. Further, investors, policymakers, consumers, and courts are more familiar with existing institutional structures, and are more likely to see them as valid and reliable.[17] Thus, they can be more readily assimilated into current corporate governance practices. Moreover, reforms can move more quickly when they reproduce existing structures, rather than inventing new institutional mechanisms. Over the past decade, as ESG has become a mainstay on corporate agendas, the ESG information system has taken shape.

In this Essay, we show how the ESG information system modeled itself after the key corporate governance innovations of the last fifty years. We start with the introduction of the monitoring board in the 1970s, which paved the way for the rise of independent directors in overseeing company activity, providing a counterweight to management, and increasing responsiveness to investor concerns.[18] We argue that ESG's insistence on board oversight, diversity, and expertise reflects a similar intuition that board members with special expertise can have valuable contributions to decision-making.[19]

We then turn to the next wave of corporate governance reform, formalized in the Sarbanes-Oxley Act of 2002 (SOX), which made practices

16. *See infra* Part III.

17. *See generally* Satyajit Bose, *Evolution of ESG Reporting Frameworks*, *in* VALUES AT WORK 13–33 (D.C. Etsy & T. Cort eds., 2020).

18. *See infra* Part II(A).

19. *See infra* Part III(A).

already common in the market mandatory and introduced others.[20] With its emphasis on disclosure accuracy, SOX served as the prime archetype for the ESG information system. The global effort to standardize ESG echoes SOX's emphasis on standardization, either through market-led initiatives like the Sustainability Accounting Standards Board (SASB)[21] or through government-supported bodies.[22] Similarly, SOX's reliance on auditor certifications of internal controls—a measure heavily criticized by many as overly costly—is reproduced through market demands and regulatory mandates for assurance.[23] Finally, the buildup of sustainability departments emulates SOX's efforts to boost the independence of internal controls.[24]

Finally, by examining ESG disclosure in practice, we show that it offers managers and directors vital information about the social impact of their decisions. This perspective sheds light on the ESG disclosure debate, highlighting it as a logical evolution of (rather than a threat to) traditional corporate governance systems that enhance information flow to managers and the board.

I. THE BUILDING BLOCKS OF CORPORATE GOVERNANCE: PAST REFORM WAVES

A. The Monitoring Board

1. Independent Directors Serve as Channels for External Information to Monitor Management

The establishment of the monitoring board—comprised of independent directors tasked with overseeing management—was one of the most

20. *See infra* Part II(B); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15, 18, 28, and 29 U.S.C.). *See generally* John C. Coates IV, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERSP. 91 (2007).

21. *SASB Standards Overview*, SUSTAINABILITY ACCT. STANDARDS BD., (2023), https://www.sasb.org/standards/ [https://perma.cc/VQ5V-R4LN].

22. *See generally* Virginia Harper Ho, *Modernizing ESG Disclosure*, 2022 U. ILL. L. REV. 277.

23. Brandon Gipper, Samantha Ross & Shawn Shi, *ESG Assurance in the United States* 1–4 (Stan. Univ. Graduate Sch. Bus., Working Paper No. 4263085, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4263085 [https://perma.cc/CA67-QHWP] (finding a significant increase in ESG assurance, i.e., voluntary reporting of third-party verified ESG metrics among S&P 500 firms from 2010–2020, driven by assuror expertise in ESG reporting frameworks); *see also The Role of Auditors in Company Prepared ESG Information: Present and Future*, CTR. FOR AUDIT QUALITY (2023), https://www.thecaq.org/rota-esg/ [https://perma.cc/5NTG-VZDH] (breaking down the auditor's role in ESG).

24. *See* Gipper, Ross & Shi, *supra* note 23, at 17; *see also* Dieter Holger, *Companies Turn to Auditors to Verify Sustainability Data*, WALL ST. J. (June 10, 2021), https://www.wsj.com/articles/companies-turn-to-auditors-to-verify-sustainability-data-11623335573 [https://perma.cc/QEQ7-L2VG].

consequential developments in the history of corporate law.[25] Though the term did not enter the lexicon until the 1970s, the concept had its genesis in the New Deal era.[26] During that period, Adolf Berle and Gardiner Means published *The Modern Corporation and Private Property*, initiating an enduring debate on how to address corporations' concentration of power.[27] Berle did not detail the composition or function of the board, but drew scholarly attention to the folly of relying on managers (the "new princes" of industry) to hold themselves accountable to shareholders—and, ultimately, to society.[28] Famously comparing powerful corporations to states, Berle reasoned that directors are not purely private actors, but are also akin to public trustees.[29]

Then, in 1934, future SEC chairman William Douglas wove the idea of the public-regarding corporation into the first sketch of the monitoring board, although he did not refer to it as such.[30] In *Directors Who Do Not Direct*, Douglas blamed the Great Depression on management's control of the board.[31] His remedy was to grant the board independence from management—describing directors as "representatives of the stockholders" who were responsible for "supervising" the managers.[32] Going further, Douglas prescribed a professional class of paid, "vigilant," and well-informed independent directors—a sharp contrast to the passive boards of this time.[33] Consistent with the public sentiment of the era, Douglas also analogized corporate directors to public trustees—even referring to the outside director as a public director who would represent the stockholders

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25. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN L. REV. 1465, 1472–73 (2007) ("One of the most important empirical developments in U.S. corporate governance over the past half century has been the shift in board composition away from insiders (and affiliated directors) toward independent directors.").

26. Dalia Tsuk Mitchell, *Status Bound: The Twentieth Century Evolution of Directors' Liability*, 5 N.Y.U. J. L. & BUS. 63, 150–51 (2009) (describing the evolution of the role of directors from "trustees for the community to representatives of the shareholders to agents.").

27. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY 352 (1932) (describing the modern corporation as a "social organization" that "involves a concentration of power in the economic field comparable to the concentration of religious power in the medieval church or of political power in the national state").

28. *See id.* at 124.

29. *See, e.g.*, Dalia Tsuk Mitchell, *From Pluralism to Individualism: Berle and Means and 20th Century American Legal Thought*, 30 L. & SOC. INQUIRY 179, 187 (2005) (noting that Berle and Means' primary concern was the socioeconomic power afforded corporate directors as a result of the separation of ownership from control).

30. *See* William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305, 1306 (1934).

31. *See id.*; *see also* Lawrence E. Mitchell, *The Trouble with Boards*, *in* PERSPECTIVES ON CORPORATE GOVERNANCE 25 (Troy A. Paredes, ed., 2005) (describing the emergence of the monitoring board).

32. Douglas, *supra* note 30, at 1314.

33. *Id.* at 1332–34.

as well as the general public.[34] Despite these early foundations, the concept of the monitoring board remained dormant until the 1970s.[35] Perhaps this is unsurprising; the New Deal's robust regulatory agenda curbed fears of corporate power, at least for the time being.[36]

But as New Deal regulations dwindled, a tsunami of corporate crises in the 1970s aroused new demands for corporate accountability: the Pennsylvania Railroad collapsed amid myriad management failures; hundreds of companies admitted to bribing foreign officials in the wake of the Watergate scandal; and the list goes on.[37] The 1970s marked another inflection point for corporate law—with corporate transgressions going far beyond what Berle referred to as the public interest constraint.[38] These mounting scandals focused scholarly and policy attention on the role that boards played, or failed to play, in preventing these crises. As the public's confidence in corporate America plummeted, its demands for corporate accountability grew louder.

Progressive reformers vowed to "tame the giant corporation" and their proposals sought to, quite literally, invite society into the boardroom.[39] Ideas for the composition of the board ranged from mandatory constituency board members to "public directors" who could provide robust monitoring.[40] While these views remained fringe, there was a consensus, even among the business community itself, that the age of managerialism had reached its zenith. Demands for reform grew thunderous, reverberating through the business and investment community and forcing boards to face the music.[41] As the Business Roundtable aptly summed up in 1978, "[s]ome unfortunate developments of the last few years have

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34. *See id.* at 1321–24; Alfred F. Conard, *Reflections on Public Interest Directors*, 75 MICH. L. REV. 941, 943–44 (1977).

35. *See* Gordon, supra note 25, at 1477 ("'[I]ndependent director'" entered the corporate governance lexicon only in the 1970s as the kind of director capable of fulfilling the monitoring role.").

36. *See generally* William W. Bratton, *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471 (1989).

37. Phillip Shabecoff, *Collapse of Penn Central Reflects Ills of Railroads*, N.Y. TIMES, Feb. 11, 1973, at 1, 60; *The Enforcement Division: A History*, SEC. & EXCH. COMM'N HIST. SOC'Y, https://www.sechistorical.org/museum/galleries/enf/enf04c_watergate.php [https://perma.cc/NA2L-J57Y] (discussing the Watergate scandal).

38. Elizabeth Pollman, *Quasi Governments and Inchoate Law: Berle's Vision of Limits on Corporate Power*, 42 SEATTLE U. L. REV. 617, 617–39 (2019); *see also* Adolf A. Berle, Jr., *Legal Problems of Economic Power*, 60 COLUM. L. REV. 4, 7–8 (1960).

39. *See generally* RALPH NADER, MARK J. GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION (1977).

40. *See* Conard, *supra* note 34, at 941; *see also* Gary von Strange, *Corporate Social Responsibility Through Constituency Statutes: Legend or Lie?*, 11 HOFSTRA LAB. & EMP. L.J. 461, 466–467 (1994). S*ee generally* Thomas M. Jones & Leonard D. Goldberg, *Governing the Large Corporation: More Arguments for Public Directors*, 7 ACAD. MGMT. REV. 603 (1982).

41. *See* Conard, *supra* note 34, at 942–43; von Strange, *supra* note 40, at 467; Jones & Goldberg, *supra* note 40.

caused the U.S. business community to reexamine intensively board operations and procedures as well as board composition."[42]

With reforms imminent, Professor Melvin Eisenberg, who had been advocating for directors to exercise more oversight of managers,[43] emerged as the natural architect for the new conception of the board—the monitoring board. Throughout the 1970s, Eisenberg had been drawing attention to the simple fact that "most of the powers supposedly vested in the board are actually vested in the executives."[44] While this ruse seemed harmless enough, the scandals of the 1970s forced a reckoning. Eisenberg's design for the monitoring board had independent directors as its foundation.[45] A far cry from the "thinly informed, under-resourced, and boundedly motivated" independent directors, the original articulation of the monitoring board was more robust and furnished with an ample supply of two key ingredients—information and the time to assess and deploy that information for monitoring.[46] Tentative Draft No. 1 of the American Law Institute's (ALI) Principals of Corporate Governance, completed in 1984, stressed that "the concept of monitoring requires sophisticated and independent systems designed to gather and disseminate information concerning management performance, and independent directors who are sophisticated in interpreting both financial and nonfinancial data."[47] It also included several prescriptive requirements—for example, it mandated a majority independent directors, with the audit, nominating, and compensation committees composed of exclusively independent directors.[48] Finally, the draft contemplated liability for independent directors who violated the duty of care.[49]

The legal and business community, while recognizing that reform was inevitable, rejected many of these prescriptions, and began to chip away at them. As one commentator observed, the "perception [among the business community] was that the ALI's monitoring model was a

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42. *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation—Statement of the Business Roundtable*, 33 BUS. LAW. 2083, 2087 (1978).

43. *See* Melvin A. Eisenberg, *The Board of Directors and Internal Control*, 19 CARDOZO L. REV. 237, 250 (1997) (contending that "ultimate responsibility for internal control needs to be vested in the board."); *see also* Victor Brudney, *The Independent Director: Heavenly City or Potemkin Village*?, 95 HARV. L. REV. 597, 632 (1982).

44. Melvin A. Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants*, 63 CAL. L. REV. 375, 376 (1975).

45. Melvin A. Eisenberg, *The Modernization of Corporate Law: An Essay for Bill Cary*, 37 U. MIAMI L. REV. 187, 205 (1983).

46. Ronald J. Gilson & Jeffrey N. Gordon, *Board 3.0—An Introduction*, 74 BUS. LAW. 351, 353 (2019).

47. *Principles of Corporate Governance and Structure: Restatement and Recommendations* viii (Am. L. Inst., Tentative Draft No. 1, 1982) at 65.

48. *Id.* at 71, 79 (audit committee) 82 (nominating committee) and 97 (compensation committee).

49. *Id.* at 140.

backhanded way to impose upon business the social responsibilities it had escaped with the change in the political climate in 1980."[50] A decade-long drafting process began, and it was not until 1992 when the final principles of corporate governance were published.[51] The business and legal community prevailed in advocating against strict requirements, and the final version was consistent with a view of corporate law as an enabling device, as opposed to a set of mandatory rules.[52] In the final version, many of the prescriptions were downgraded to recommendations.[53] Still, the notion of the board had been altered, from a strategic advisor to management, to a well-informed monitor of management's malfeasance.[54]

Not only were the *means* of monitoring curtailed, but between the 1980s and the 1990s, its ends became fastened to a corporate purpose that prized shareholder wealth-maximization. By the early 1990s, the law and economics movement had successfully merged increasing share price with increasing social welfare.[55] Economists like Milton Friedman, Michael C. Jensen, and William H. Meckling steered the purpose of the firm from mediating between social and economic benefits towards addressing agency costs to maximize shareholder value.[56] Under this "agency cost" paradigm, then, the value of independent directors was the "ratification and monitoring of [corporate] decisions" to promote shareholder value.[57] Thus, the monitoring board's scope was primarily confined to collecting data about stock prices to oversee the CEO's performance. Despite this narrow focus, independent directors fortified the act of gathering information as a crucial pillar of good governance.[58]

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50. F. SCOTT KIEFF & TROY A. PAREDES, PERSPECTIVES ON CORPORATE GOVERNANCE 51 (2013).

51. *Restatement of the Law, Corporate Governance*, AM. L. INST. (2023). https://www.ali.org/projects/show/corporate-governance/ [https://www.ali.org/projects/show/corporate-governance/].

52. *See id.*

53. Roswell B. Perkins, *The ALI Corporate Governance Project in Midstream*, 41 BUS. LAW. 1195, 1201 (1986) ("The board can be as active as it wants to be, but the drafts impose very few functions as being essential.").

54. Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1053 (2014) (discussing that legal reforms require directors to "mediate the relationship between ownership and control of the corporation").

55. *See, e.g.*, William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE L. REV. 489, 507 (2013).

56. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 306 (1976); Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at SM17.

57. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. L. & ECON. 301, 302 (1983).

58. Douglas M. Branson, *Corporate Governance "Reform" and the New Corporate Social Responsibility*, 61 U. PITT. L. REV. 605, 627 (2000) ("Independent directors must be assured that they have good data on which to evaluate the performance of senior executive officers.").

By the turn of the century, independent directors had become "an essential part of a new corporate governance paradigm."[59] The impetus for the monitoring board was to introduce new and external perspectives into the boardroom, and to increase the quantity and quality of information. It was an important turning point for the role of the board, and a crucial starting point for designating the board as the clearinghouse of information gathering and processing.

2. Delaware Strengthens the Role of Information-Gathering in Good Governance

A series of Delaware cases continued to fortify the monitoring board—and characterized information-gathering as the independent director's defining role. This focus on the board's information-gathering apparatus began in 1985 with *Smith v. Van Gorkom*, which instructed boards to "inform themselves . . . of all material information reasonably available to them."[60] The landmark *Caremark* case and its progeny further articulated that information-gathering is part of the board's duty of loyalty, emphasizing that "relevant and timely information is an essential predicate for satisfaction of the board's supervisory and monitoring role under Section 141 of the Delaware General Corporation Law."[61]

Since *Caremark*, recent Delaware decisions signal a shift in shareholders' ability to meet their pleading burden under *Caremark* and reinforce the board's duty to be informed.[62] *Marchand v. Barnhill* introduced the concept of "mission-critical" business risk, emphasizing the need for enhanced board monitoring of those risks.[63] Notably, plaintiffs can plead specific facts about how much information the board receives because of

59. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1466 (2007); *see also* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM L. REV. 1253, 1279 (1999) ("Today, the monitoring model of the board has been almost universally accepted and adopted in large publicly held corporations.").

60. 488 A.2d 858, 872 (Del. 1985).

61. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996); *see In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 122 (Del. Ch. 2009) (stating that to receive the protection of the business judgment rule, directors must have informed themselves of "all material information reasonably available [to them]"); *see also* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 367 (Del. 1993) ("[D]irectors 'have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties.'"). For an analysis of the increasing scope of *Caremark*, see Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2021–25 (2019).

62. Marchand v. Barnhill, 212 A.3d 805, 809 (Del. 2019) (reversing the denial of a motion to dismiss in the food safety context and stating that a "board's 'utter failure to attempt to assure a reasonable information and reporting system exists' is an act of bad faith in breach of the duty of loyalty") (quoting *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996)).

63. *Id.* at 824.

the court's more deferential stance towards Section 220 demands. In *Marchand*, food safety was "mission-critical" for an ice-cream maker.[64] Subsequent cases, including *Boeing*, *Hughes*, and *Armstrong*, portend that *Marchand* launched a new *Caremark* era, in which Delaware courts are zeroing in on the quantity and quality of information the board receives.[65] Notably, the *Boeing* case emphasized the absence of a board committee tasked with receiving and assessing information about airplane safety.[66] Although *Marchand* does not directly address ESG information, experts and policymakers anticipate that the same rationale can be extended to encompass ESG. For example, Cynthia Williams has argued that oversight of climate risk is a "mission-critical" risk for many corporate boards.[67] We argue that these cases will reinforce the ESG information system, just as we have previously argued that the *Caremark* case enhanced compliance and internal controls.[68]

64. *See id.* at 822 (stating that food safety "has to be one of the most central issues at the company" and "a compliance issue intrinsically critical to the company's business operation"); *see also* Cynthia A. Williams, Sarah Barker, & Alex Cooper, *Directors' Fiduciary Duties and Climate Change: Emerging Risks*, HARV. L. SCH. F. ON CORP. GOV. (Dec. 8, 2021), https://corpgov.law.harvard.edu/2021/12/08/directors-fiduciary-duties-and-climate-change-emerging-risks/ [https://perma.cc/EX3Y-5B7H] ("Climate change significantly increases the risks a corporation faces, and therefore may catalyze a breach of directors' and officers' duty of oversight.").

65. *See In re* Boeing Co. Derivative Litig., No. CV 2019-0907-MTZ, 2021 WL 4059934, at *7 (Del. Ch. Sept. 7, 2021); *see also* Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1860 (2021) ("Delaware courts have been carving a constantly-growing exception to the deferential standard, in the form of 'mission critical compliance': in situations where meeting certain regulatory demands is critical to the firm's success, directors should be especially alert to yellow and red flags, and proactively monitor compliance."); *In re* Clovis Oncology, Inc. Derivative Litig., No. CV 2017-0222-JRS, 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019) (denying motion to dismiss in the pharmaceutical regulatory approval context); Hughes v. Xiaoming Hu, No. CV 2019-0112-JTL, 2020 WL 1987029, at *1 (Del. Ch. Apr. 27, 2020) (denying a motion to dismiss in the financial reporting and oversight context); Inter-Mktg. Grp. USA, Inc. on Behalf of Plains All Am. Pipeline, L.P. v. Armstrong, No. CV 2017-0030-TMR, 2020 WL 756965, at *1 (Del. Ch. Jan. 31, 2020) (denying a motion to dismiss in part in the environmental compliance context).

66. *In re Boeing*, 2021 WL 4059934, at *5 ("None of Boeing's Board committees were specifically tasked with overseeing airplane safety, and every committee charter was silent as to airplane safety.").

67. Jonathan Drimmer & Yousuf Aftab, *ESG and Mission-Critical Issues for Director & Officer Liability*, CORPGOV (2019), https://corpgov.com/esg-and-mission-critical-issues-for-director-officer-liability/ [https://perma.cc/2SLW-PM7P] ("For global companies across sectors, a growing array of ESG issues increasingly play a similar [mission-critical] role and are increasingly being regulated as such."); *see also* Cole Gray, *Climate Enterprise Risk as Socially Critical*, U.C. DAVIS L. REV. (forthcoming 2024) (student note, on file with authors) (arguing that climate change risk should be considered "mission critical" for most companies).

68. *See* Stavros Gadinis & Amelia Miazad, *The Hidden Power of Compliance*, 103 MINN. L. REV. 2135, 2146 (2019) (explaining how Caremark prompted the growth of compliance programs to ensure that the board receives adequate information to monitor legal and regulatory risk).

3. The Complexity of Today's Business Risks Necessitates a Stronger Information-Gathering System, Ushering in the ESG Information System

Today, independent directors far exceed the "majority" that is required by statute—to put numbers to this, roughly 85% of the SP 500 board members are independent.[69] This is not too surprising; from Delaware common law to regulatory reforms like the Sarbanes-Oxley Act (SOX) and the Dodd-Frank Act, to stock exchange listing requirements, there were plenty of incentives for companies to embrace the monitoring board model by adding independent directors.[70] Despite its popularity, the complexities of the business world quickly outgrew the monitoring board's capacity.[71] As businesses became global and risks became more complex, it has become readily apparent that the monitoring board "simply does not scale."[72] The disappointment with the monitoring board hinges on informational asymmetries—commentators argue that the independent director certainly did not solve, and may have exacerbated, the problem of management capture.[73] The very fact that independent directors were external to the firm and not insiders meant that they were dependent on managers, and mostly the CEO, for their information. Moreover, even if they had access to information, they lacked the time and the expertise to make use of it to monitor the CEO.[74]

The monitoring board's limitations have prompted a series of reforms—a closer look at these reforms reveals that they are, at bottom, aimed at improving the quantity and quality of information to the board. For example, professors Kobi Kastiel and Yaron Nili have argued that the

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69. SPENCER STUART, 2023 U.S. SPENCER STUART BOARD INDEX 8 (2023), https://www.spencerstuart.com/-/media/2023/september/usbi/2023_us_spencer_stuart_board_index.pdf?sc_trk=BDB9A48933CA433C9DDD7D4E85D62A38 [https://perma.cc/7CS9-YGL7].

70. *See* N.Y.S.E. Listed Company Manual, §§ 303A.01, 303A.04 (2009), 303A.05 (2103), 303A.06 (2009); NASDAQ Stock Mkt. LLC Rules §§ 5605(b)(1), 5605(c)(2), 5605(d)(2), 5605(e) (2019); *see also Developments in the Law: Corporations and Society*, 117 HARV. L. REV. 2169, 2187 (2004).

71. Gilson & Gordon, *supra* note 46, at 351 ("The problem we see is the inability of the monitoring board model to keep up with changes in the business of the corporations that board structure was supposed to monitor."); *see also* Jill E. Fisch, *Taking Boards Seriously*, 19 CARDOZO L. REV. 265, 267 (1997); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 798 (2001).

72. Gilson & Gordon, *supra* note 46, at 351.

73. A more cynical view is that independent directors were always intended to protect managers from scrutiny by shareholders. *See, e.g.*, Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1281 (2017).

74. Kobi Kastiel & Yaron Nili, *"Captured Boards": The Rise of "Super Directors" and the Case for a Board Suite*, 2017 WIS. L. REV. 19, 63–64 (arguing that Delaware General Corporate Law encourages directors to rely on outside expertise); *see* Lisa Fairfax, *The Elusive Quest for Director Independence*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 182 (Claire A. Hill & Brett H. McDonnell eds., 2012) ("Such scholars maintain that a monitoring system that relies on people without sufficient knowledge is not only inefficient, but potentially damaging.").

board should include a suite, consisting of an office and separate general counsel, to close the board's information gap.[75] As they explain:

Such suite is a dedicated office within the board, consisting of a full-time special counsel to the board (and supporting staff) that would serve as information facilitators: requesting information and collecting outside sources, receiving the information requested, editing it, and providing it in a simple, clear, and efficient way to the board with a critical eye on management's actions.[76]

While the board suite is internal to the firm, Jeffrey Gordon has proposed a similar solution for addressing the board's capacity constraints—by "outsourcing" monitoring to full-time directors.[77] We argue that the ESG information system also addresses the problem of the board's information capture in ways that have not yet been appreciated, as we explore below.

B. The Sarbanes-Oxley Act (SOX)

Strengthening boards' monitoring capabilities preoccupied firms and their advisors for the next two decades. But after the intensity of the 1980s' deal wave, and the arrival of the internet era that fueled the growth of Nasdaq, the corporate governance edifice faced its next serious challenge in the early 2000s.[78] The burst of the dot-com bubble had left investors uneasy about the earnings projections and valuations in many companies and wary about boards' abilities to constrain chief executives. Then, Enron's implosion exposed the underbelly of the accounting system. It showed how top executives could manage to game the accounting standards,[79] exploit the conflicts of interest that plague gatekeepers,[80] and mask the true extent of the problem from directors.[81] Worldcom's collapse, which followed shortly thereafter, added to the disappointment as internal

75. *See* Kastiel & Nili, *supra* note 74, at 52–55 (claiming that a board suite, consisting of an office of the board and an independent general counsel to the board, would close the board's information gap); *see also* Lynne L. Dallas, *Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson*, 54 WASH. & LEE L. REV. 91, 93, 130–37 (1997) (arguing that a board ombudsperson would gather information, present it to independent directors, and make recommendations based on the information).

76. Kastiel & Nili, *supra* note 74, at 24.

77. Gilson & Gordon, *supra* note 46, at 364–65.

78. John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269–270 (2004).

79. *See* Uday Chandra, Michael L. Ettredge & Mary S. Stone, *Enron-Era Disclosure of Off-Balance-Sheet Entities*, 20 ACCT. HORIZONS 231, 231 (2006).

80. John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid"*, 57 BUS. LAW. 1403, 1405 (2002) (asserting that Enron revealed a deep failure in the market for gatekeeping services).

81. *See generally* Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reactions*, 69 U. CHI. L. REV. 1233 (2002).

control employees had repeatedly tried to raise flags, only to be silenced both by external gatekeepers and by their superiors, who prevented their warnings from reaching directors.[82]

In response, the 2002 Sarbanes-Oxley Act ("SOX") institutionalized a series of governance reforms aimed at improving the flow of information to the board, strengthening its independent decision-making, and separating the influence of potentially conflicted executives.[83] At the board level, SOX formalized Audit Committees, and required them to be comprised of entirely independent members.[84] Independent board committees had been widely used by Delaware courts as a means of remedying conflicts of interest.[85] Thus, SOX imported into accounting oversight a technique already used in other contexts. But SOX did not stop there. It also set an agenda for the Audit Committee, requiring oversight of the CFO and placing the Audit Committee in charge of the firm's relationship with its external auditors, so that it can serve as an independent center of review against executive misconduct. Further, it also requires reports and meetings with the head of internal controls of the company.[86] Thus, it emphasizes board independence not only as a check on the power of executives, but also as a guarantee that relevant information for the board will make it through to the board.

The board can function as SOX intended only if the right information reaches it, so SOX turned its attention to how the company's internal control department generates this information. SOX heralded the establishment of audit standards and created a new regulatory body, the Public Company Accounting Oversight Board (PCAOB),[87] tasked with setting the standards and certifying the auditors that comply with them. PCAOB passed new standards for auditing, established an auditor certification process, and liaised with foreign jurisdictions to ensure that foreign issuers' auditors complied with its standards. It spearheaded a global effort to regulate the audit profession.[88] In a highly controversial move, SOX required all companies to conduct an audit of their internal controls that certifies

82. Kathleen F. Brickey, *From Enron to Worldcom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L. Q. 357, 369–70 (2003).

83. *See* Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); Coates, *supra* note 20, at 92.

84. § 301, Pub. L. No. 107-204, 116 Stat. 775–77.

85. *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

86. Donald C. Langevoort, *Internal Controls After Sarbanes-Oxley: Revisiting Corporate Law's "Duty of Care as Responsibility for Systems"*, 31 J. CORP. L. 949, 954–55 (2006).

87. *See* Bratton, *supra* note 6, at 1024.

88. Klaus J. Hopt, *Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron* 449–450 (Eur. Corp. Gov. Inst., Working Paper No. 05/2002, 2006), https://www.ecgi.global/sites/default/files/working_papers/documents/ssrn-id356102.pdf [https://perma.cc/ZN2E-SWMU].

their adequacy and repeat that exercise periodically.[89] The burden of the initial audit, both in monetary terms as well as in terms of staff resources, led to an uproar.

Twenty years later, assessing the success of these reforms remains an elusive question for empirical research.[90] But the governance institutions it has created remain deeply engrained in corporate practice. Audit Committees are the hub of oversight regarding the thorniest issues and have gained investors' trust. External auditors, while still plagued by conflicts of interest, have stayed clear of pitfalls like those that brought down Arthur Andersen. PCAOB has remained in charge of audit standards. Internal controls continue to grow stronger. According to some, the quality of financial reporting seems to have improved, though it is unclear whether this can be causally attributed to SOX.[91] Overall, the approach embraced by SOX, based on strengthening independent director oversight on key issues, boosting internal procedures and external validation, and improving the flow of information to the board has become the mainstay of modern corporate governance.

III. ESG BUILDS UPON PAST REFORMS BY INCREASING THE QUANTITY AND QUALITY OF INFORMATION

A. The "ESG Competent Board" Addresses Information Gaps

As Melvin Eisenberg argued, to effectively monitor management, boards must be comprised of "independent outside directors" who are "capable of obtaining adequate and objective information concerning management."[92] We argue that investors are demanding "ESG competent boards" precisely because it reinforces the monitoring board's two pillars—independence and information.[93]

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89. Sarbanes-Oxley Act of 2002, § 404, Pub. L. No. 91-190, 116 Stat. 404, 789 (2002).

90. *See* John C. Coates & Suraj Srinivasan, *SOX After Ten Years: A Multidisciplinary Review*, 28 ACCT. HORIZONS 627 (2014).

91. Melvin Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors and Accountants*, 63 CAL. L. REV. 375, 407 (1975).

92. *Id.* at 404; *see also* Stephen Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034, 1037 (1993).

93. Memorandum from Martin Lipton, Steven A. Rosenblum, Karessa L. Cain, Hannah Clark & Bita Assad on Some Thoughts for Boards of Directors in 2021 4 (Dec. 7, 2020), https://www.wlrk.com/docs/Some_Thoughts_for_Boards_of_Directors_in_2021.pdf [https://perma.cc/9M9S-7TZQ] (noting expectation for "ESG competent" boards).

1. Board Composition & Expertise

Though it varies by industry, the ESG-competent board is diverse and includes directors with distinct subject matter expertise. Such diversity of experience and background increases the quantity and quality of the board's information. For industries such as fossil fuels or agriculture, that means expertise on climate risk. Take, for instance, the historic proxy fight by activist shareholder Engine No. 1, which won three board seats by challenging ExxonMobil on its handling of environmental matters, reflecting the investor focus on board-level expertise in climate risk.[94] While the Exxon board was (like most boards) majority independent, Engine No. 1 argued that the board was uninformed because it lacked expertise in sustainable energy.[95] In its presentations to investors, Engine No. 1 emphasized that an important role of independent directors is to challenge the CEO and scrutinize management's strategy.[96] This requires, they argued, directors with expertise and access to information about sustainable energy transitions.[97] Exxon's independent directors lacked this expertise, making it impossible for them to monitor the CEO and management.[98] There was merit to the activist's claim—despite Exxon's dismal stock price performance and the fact that Exxon's CEO, Darren Woods, ignored investor demands, his compensation continued to grow, outpacing market peers.[99] This focus on subject matter expertise is reminiscent of past governance reforms, too. For example, while SOX does not specifically mandate that the audit committee's independent directors have any specific expertise in financial risk, it is certainly considered a best practice.

Beyond differences in subject matter expertise, a key feature of the ESG-competent board is diversity. Proponents of board diversity also argue that diversity reinforces the second pillar of the monitoring board—access to information.[100] Even more than traditional independent directors, diverse directors introduce a wider range of external perspectives, thereby increasing the scope of information that the board has access to. One academic study suggests that decision-making groups that are made up of individuals with diverse human capital, attitudes, cognitive functions and

94. *See* ENGINE NO. 1, INVESTOR PRESENTATION, REENERGIZE EXXON 60 (2021), https://reenergizexom.com/documents/Investor-Presentation-May-2021-v2.pdf [https://perma.cc/3G5M-8DQH].

95. *Id.* at 37.

96. *See id.* at 60–62.

97. *Id.* at 65.

98. *Id.*

99. *See id.* at 64.

100. *See* Warren E. Watson, Kamalesh Kumar & Larry K. Michaelsen, *Cultural Diversity's Impact on Interaction Process and Performance: Comparing Homogeneous and Diverse Task Groups*, 36 ACAD. MGMT. J. 590, 592–99 (1993); *see also* Afra Afsharipour, *Bias, Identity and M&A*, 2020 WIS. L. REV. 469, 479 (discussing gender-based differences in corporate decision making).

beliefs are more likely to have a wider breadth of information available to them and to incur cognitive conflict.[101]

Another compelling reason that investors are advocating for diverse boards is that it improves the board's ability to monitor executive management, primarily the CEO. For example, institutional investors have argued that "a diverse board is less likely to be beholden to management" and that diverse directors are more likely to stand up to the CEO[102] Some scholars have argued that boards with more female directors are correlated with stronger oversight of the CEO, as proxied by different factors such as "enhanced CEO turnover-performance sensitivity" or "the restraining effect of governance on CEO overconfidence."[103] In sum, we argue that the focus on board diversity reflects an evolution of the monitoring board's access to and ability to assess information.

2. Board Structure—ESG Committees

Corporate boards conduct their monitoring through committees. The value of committees as the board's hub for information-gathering and exchange is reflected in several legal and market mandates. As we discussed above, federal regulation, which typically refrains from weighing in on board processes, mandates independent board committees for the audit, nominating and governance, and executive compensation.[104] These independent committees function as hubs for collecting, analyzing, and communicating information. The audit committee is perhaps the best example of this phenomenon at play—it provides a forum for internal and external controls on financial information and expands the source of information beyond the CEO and management. Through the audit committee, external auditors provide directly to the board, as opposed to having that information filtered through the CEO. The audit committee also enhances internal controls by serving as a hub within the board to verify the accuracy of disclosure.

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101. See discussion *supra* note 100.

102. Willard T. Carleton, James M. Nelson & Michael S. Weisbach, *The Influence of Corporate Governance Through Private Negotiations: Evidence from TIAA-CREF*, 53 J. FIN. 1335, 1343 (1998); *see also Board Diversity at BlackRock*, BLACKROCK, https://ir.blackrock.com/governance/board-of-directors/Board-Diversity-at-BlackRock/ [https://perma.cc/H3PB-HZYW] ("The diverse backgrounds of our individual directors help the Board better oversee BlackRock's management and operation.").

103. Renée B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. FIN. ECON. 291, 297 (2009); Jie Chen, Woon Sau Leung, Wei Song & Marc Goergen, *Why Board Gender Diversity Matters: The Role of Female Directors in Reducing Male CEO Overconfidence*, J. EMPIRICAL FIN. 70, 73 (2016).

104. *See infra* Part II(B).

Today, we are seeing unprecedented investor focus on formal board oversight of ESG risks.[105] Critics worry that focusing on committee charters rewards style over substance. But, as Lisa Fairfax has argued, these charters "establish important information flows aimed at supporting boards' oversight function."[106] Consistent with this view, Delaware courts are looking more closely at the language of corporate charters to scrutinize whether the charters specify the quantity and quality of information reported to the board.[107] As noted above, recent line of "Caremark" cases have equated the existence, or lack, of board committees tasked with overseeing "mission critical" risks as dispositive of whether the board is discharging its duty to monitor.[108] Demands for more disclosure on board oversight of ESG risks has dominated shareholder proposals in 2022.[109] Moreover, the SEC's Proposed Rule for Climate Disclosure requires companies to disclose how the board is overseeing climate risk.[110] Specifically, the rule asks companies to describe the board of directors and management of climate-related risks as well as the specific processes the company has for "identifying, assessing, and managing climate-related risks" as well as how these processes are integrated into the company's "overall risk management system."[111] Notably, the proposed rule homes in on how the board

105. *See, e.g.*, David M. Silk, Sebastian V. Niles & Carmen X. W. Lu, *Board Oversight of ESG: Preparing for the 2022 Proxy Season and Beyond*, HARV. L. SCH. F. ON CORP. GOV. (Mar. 28, 2022), https://corpgov.law.harvard.edu/2022/03/28/board-oversight-of-esg-preparing-for-the-2022-proxy-season-and-beyond/ [https://perma.cc/5ZB2-PTB3]; Allison Herren Lee, Comm'r, SEC, Keynote Address at the 2021 Society for Corporate Governance National Conference (June 28, 2021); KRISTEN SULLIVAN, MAUREEN BUJNO & JON RAPHAEL, DELOITTE, THE ROLE OF THE BOARD IN OVERSEEING ESG 12 (2022), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-cbe-the-role-of-the-board-overseeing-esg.pdf [https://perma.cc/XT49-LZPQ].

106. Lisa M. Fairfax, *Board Committee Charters and ESG Accountability*, 12 HARV. BUS. L. REV. 371, 390 (2022); *see also* Marchand v. Barnhill, 212 A.3d 805, 823 (Del. 2019) (emphasizing the importance of periodic reports and reviews to plaintiffs' consistent loss of oversight claims).

107. Fairfax, *supra* note 106, at 388–90.

108. *Marchand*, 212 A.3d at 809 (holding that the complaint "pled facts supporting a fair inference that no board-level system of monitoring or reporting on food safety existed," in part because no such board committee existed); *In re* Clovis Oncology, Inc. Derivative Litig., No. CV 2017-0222-JRS, 2019 WL 4850188, at *13 (Del. Ch. 2019) (stating that plaintiffs failed *Caremark* prong one, given that "the Board's Nominating and Corporate Governance Committee was specifically charged with provid[ing] general compliance oversight . . . with respect to . . . Federal health care program requirements and FDA requirements."); *In re* Boeing Co. Derivative Litig., No. CV 2019-0907-MTZ, 2021 WL 4059934, at *5 (Del. Ch. Sept. 7, 2021) ("None of Boeing's Board committees were specifically tasked with overseeing airplane safety, and every committee charter was silent as to airplane safety.").

109. *See, e.g.*, GLASS Lewis, 2022 POLICY GUIDELINES 7 (2022), https://www.glasslewis.com/wp-content/uploads/2021/11/ESG-Initiatives-Voting-Guidelines-GL-2022.pdf [https://perma.cc/5RG7-XJ28]; *see also* Silk, Niles & Lu, *supra* note 105.

110. The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11,042, Exchange Act Release No. 94,478, 87 Fed. Reg. 21334, 21359 (proposed Apr. 11, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239 & 249).

111. 87 Fed. Reg. at 21345 (to be codified at 17 C.F.R. pts. 210, 229, 232, 239 & 249).

committee tasked with overseeing climate risk interacts with the board committee tasked with overseeing financial risk more broadly.[112]

In sum, board monitoring of ESG risks has become synonymous with good governance. Boards are responding to these demands in familiar ways—by designating responsibility to one or several board committees. For example, Lockheed's Nominating and Corporate Governance Committee Charter states that its purpose is: to "assist the Board of Directors in fulfilling its oversight responsibilities relating to the Corporation's ethical conduct, sustainability, environmental stewardship (including climate change), corporate culture and health and safety programs."[113] Notably, over the past three years, over 85% of the boards of companies who signed the BRT statement have amended their committee charters to delegate ESG-risk monitoring to one or several board committees.[114]

B. SOX and The ESG Information System Leverage Disclosure as a Disciplining Tool

In both SOX and the ESG information system, the impetus for reform centers around information and disclosure as the key disciplining mechanism for directors and managers. SOX is designed to addresses the concern that executives would enrich themselves by presenting a rosy but unrealistic picture of the company's financial condition.[115] Distortions and manipulations in accounting risked upending both the smooth pursuit of the company's business on the ground and the efficient operation of market monitoring and price formation. This approach served dual purpose. Internally, by implementing robust internal controls supervised by external gatekeepers and overseen by an independent audit committee, SOX deterred executive misconduct. Externally, the law enhanced the accuracy of company disclosures, enabling investors to evaluate the company more accurately. Additionally, it made investors more likely to spot unusual patterns and raise concerns when necessary. Thus, disclosure was regarded as a tool for influencing management behavior and sustaining markets.

Similarly, in ESG, the concern is that companies can easily make promises they do not intend to keep, while also presenting, if not a rosier, then certainly a greener picture of the underlying reality. Like accounting inconsistencies, corporate hypocrisy impacts the internal operation of the

112. *See id.*

113. *Nominating and Corporate Governance Committee Charter*, LOCKHEED MARTIN (Oct. 6, 2022), https://www.lockheedmartin.com/en-us/who-we-are/leadership-governance/board-of-directors/nominating-corporate-governance-committee-charter.html [https://perma.cc/GD72-CPLF].

114. Fairfax, *supra* note 106, at 394.

115. *See* Coates, *supra* note 20.

company and the goals that management pursues, as well as investors' abilities to assess the extent to which management efforts are contributing to the lofty goals already announced. Disclosure operates as a public accountability device that makes it more difficult for managers to renege on their promises. Once initiatives are announced, managers are more likely to take concrete steps to reach them, devoting the attention, staffing, and resources necessary to achieve these goals. Thus, disclosure can help drive change within the corporation, even without regulatory enforcement. At the same time, disclosure provides a concrete focus for investor attention. The more specific the announced goal, the more concrete the ensuing commitment grows. For example, net-zero commitments provide investors with a guidepost and invite questions about progress over time.[116] Moreover, disclosure by public companies also generates liability under the federal securities laws, raising the stakes even further if managers are caught engaging in misleading statements.[117]

C. Standardization: Benchmarking and Uniform Applicability

Both SOX and the ESG information system spawned new standardization efforts, whose primary goal is to benchmark companies' performance against one another and ensure uniform applicability of key requirements and processes. The epicenter of the accounting scandals of the early 2000s was U.S. GAAP, an existing set of standards. Previously considered quite robust, U.S. GAAP were suddenly seen as in need of substantial revisions if they were to accurately capture firms' performance.[118] Amendments were passed to limit the use of off-balance sheet entities like those utilized by Enron, with the goal of restoring confidence in the financial statements companies were releasing.[119] Moreover, the collapse enabled competition from another set of accounting standards, the IFRS, issued by IASB and more lately championed by the European Union. The SEC, which is responsible for supervising FASB and rubber stamping its standard setting, allowed foreign issuers to use IFRS in their U.S. listings,

116. *See* UNITED NATIONS FRAMEWORK' HIGH-LEVEL EXPERT GRP. ON THE NET ZERO EMISSIONS COMMITMENTS OF NON-STATE ENTITIES, INTEGRITY MATTERS: NET ZERO COMMITMENTS BY BUSINESSES, FINANCIAL INSTITUTIONS, CITIES AND REGIONS 28–30 (2022), https://www.un.org/sites/un2.un.org/files/high-level_expert_group_n7b.pdf [https://perma.cc/GV9R-FP4K]; *see also Net Zero Asset Managers Initiative*, NET ZERO ASSET MANAGERS (2023), https://www.netzeroassetmanagers.org/ [https://perma.cc/P7X8-YP6H]; SHAMIK DHAR & BRIAN DAVIDSON, BNY MELLON INV. MGMT., AN INVESTOR'S GUIDE TO NET ZERO BY 2050 3–5, https://www.bnymellonim.com/content/dam/imemea/static-html-files/net-zero/bny-mellon-investment-management-fathom-consulting-net-zero-report-oct-2022.pdf [https://perma.cc/K8AE-EKPD].

117. James Park, *ESG Securities Fraud*, WAKE FOREST L. REV. (forthcoming 2023).

118. *See* Chandra, Ettredge & Stone, *supra* note 79, at 4.

119. *See id.* at 5–6.

and came close to permitting U.S. issuers to use IFRS too. But the main new standardization effort spearheaded by SOX involved the creation of a new set of standards for auditing. Rather than setting substantive goals, audit standards concern the process of information gathering, the internal structures more resistant to conflicts of interest, as well as standards of conduct for those participating in the effort. By intervening in the process of auditing, regulators seek to clarify processes so that it becomes easier for auditors to demand it and companies to buy into it. Uniformly high quality of accounting and auditing is the goal.[120]

In the ESG space, efforts for standardization arise from similar motivations, but the goal is to create an established set of standards rather than amend and improve an existing one. Defining what is environmentally friendly, socially impactful, or governance improving has been a key challenge for a move that seeks to encompass a broad array of causes and allow for experimentation along the way. Yet, there is a finite number of companies and industries, for which some key issues arise with a level of regularity that allows for standardization. By crystallizing interventions toward key standards, standard-setters hope to inspire confidence toward company efforts as substantial, impactful, and measurable, rather than trivial, ineffective, and hopelessly vague. Thus, the goal is to add heft to the company's own portrayal of itself as green, socially conscientious, or well-governed.

Like accounting, the push toward standardization in ESG has also developed into a competition among different standard-setters, some sponsored by private initiatives while others organized in conjunction with governmental regulatory efforts. Thus, the SASB standards, which are largely supported by market initiatives and adopted on a voluntary basis, have sought to define what environmental and social activities would have material financial implications.[121] On the other hand, the European Union is launching its own standardization effort, establishing a platform of experts that will map activities to designate as sustainable.[122] Moreover, some of these standards pay more attention to substantive goals, while others pay more attention to internal governance and the oversight of sustainability, echoing the establishment of audit standards. For example, the TCFD standards emphasize internal governance and board oversight as a

120. *See* Coates, *supra* note 20, at 102.

121. *See SASB Standards Overview*, *supra* note 21.

122. Parliament and Commission Regulation 2020/852, 2020 O.J. (L 198) 13.

corollary of setting and achieving goals in sustainability performance and climate change.[123]

It is no surprise that, with such energy devoted to standardization both after the accounting scandals and during the rise of ESG, attention quickly shifted to the standard-setting bodies themselves. It became clear that maintaining and updating the standards would become an ongoing task delegated to private industry experts. On one hand, private expertise was indispensable to the effort, as accounting firms had vast expertise that government regulators like the SEC could not easily match. Moreover, the industry could finance the effort much more readily. On the other hand, the private nature of the standard-setter raised questions about industry capture, legitimacy, and representativeness.[124]

Up until the early 2000s, the International Accounting Standards Board derived its ranks mostly from countries in the Anglo-Saxon accounting tradition, whose perspectives often clashed with long-established practices in Europe.[125] In 2001, the EU negotiated a series of structural reforms as a condition for fully adopting the standards.[126] The reforms initiated a separation between the trust, which was responsible for funding and administration, and the experts, who would be solely responsible for setting standards.[127] This arrangement helps alleviate concerns about using financial donations to influence standard-setting.[128] In selecting nominees for the standard-setting body, the trustees must ensure broad geographic representation across main regions of the world, thus preventing the views of a certain country or a certain accounting tradition from dominating the standards.[129] Once appointed, standard-setters may be removed only for

123. TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES 19 (2023), https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf [https://perma.cc/MLS6-PQBN].

124. Dylan Bruce, Tyler Gellasch, Todd Phillips & Alexandra Thornton, *The SEC Should Write Its Own Environmental, Social, and Governance Rules*, CTR. FOR AM. PROGRESS (Dec. 13, 2021), https://www.americanprogress.org/article/the-sec-should-write-its-own-environmental-social-and-governance-rules/ [https://perma.cc/VYW7-JZ4Y].

125. Sarah B. Eaton, *Crisis and the Consolidation of International Accounting Standards: Enron, the IASB, and America*, 7 BUS. & POL. 1, 8 (2005) (noting that "much to the dismay of the European commission" the restructuring of the IASC more closely resembled American preferences).

126. *See generally* PAUL A. VOLCKER, INT'L ACCT. STANDARDS COMM. FOUND., IASCF ANNUAL REPORT 2001 (2001), https://www.iasplus.com/en/binary/resource/01iascfar.pdf [https://perma.cc/E794-W4XG].

127. *Id.* at 2.

128. *See id.*

129. *IASB Board Membership*, IAS PLUS (2023), https://www.iasplus.com/en/resources/ifrsf/iasb-ifrs-ic/iasb-board [https://perma.cc/2EQV-Z5DP]; *see also Process for IASB Member Appointments*, IFRS (2023), https://www.ifrs.org/groups/international-accounting-standards-board/board-member-appointments-/ [https://perma.cc/JU4Y-YTSK] (discussing the process of globally advertising vacant IASB member positions to interested applicants).

cause before the expiry of their tenure, thus insulating them further from political or financial pressures.[130] Since 2001, subsequent reforms have broadened geographic representation, established bodies responsible for providing authoritative interpretations in a timely manner, and instituted additional transparency through notice-and-comment processes.[131] By instituting separation between resources and standard-setting, aiming for geographic representation, and engaging with auditors and issuers around the world to ensure representativeness, IASB has emerged as a successful international standard-setter.[132]

A decade later, when the need for standardization in ESG arose, one private initiative, SASB (the Sustainability Accounting Standards Board) modeled itself after IASB.[133] The goal was to include expert professionals, broad industry representation, separation between financial contributions and standard-setting, and due process guarantees.[134] Like IASB, SASB has two separate boards. The SASB Standards Board is comprised of industry experts that determine the substantive requirements in the standards, while the SASB Board of Directors manages resources and appoints staff.[135] SASB launched a broad consultation effort with the business and investment community, seeking to encourage adoption but also receive feedback.[136] Moreover, SASB has adopted Rules of Procedure which set out its standard-setting effort in a manner closely modeled on notice-and-comment processes familiar from the Administrative Procedure Act.[137] In 2022, the IFRS Foundation, as the funding and administrative body overseeing IASB is now called, announced that it would combine its own standard-setting efforts in sustainability with SASB's, which became absorbed into it.[138] Thus, the organizational similarity between the two standard-setters proved helpful toward their eventual merger.

130. IFRS FOUND., CONSTITUTION 10 (2001)., https://www.ifrs.org/content/dam/ifrs/about-us/legal-and-governance/constitution-docs/ifrs-foundation-constitution-2021.pdf [https://perma.cc/Z8KG-PXJ5].

131. *See Who We Are—History*, IFRS (2023), https://www.ifrs.org/about-us/who-we-are/#history [https://perma.cc/DT7N-WFHF].

132. *See id.*

133. *See Governance Archive*, SASB (2023), https://sasb.org/about/governance-archive/ [https://perma.cc/RSK4-9WCR].

134. *See id.*

135. *See id.*

136. [add cite to SASB's consultation period

137. *See Rules of Procedure*, SASB, https://www.sasb.org/standards/rules-of-procedure/ [https://sasb.org/standards/rules-of-procedure/].

138. *IFRS Foundation Completes Consolidation with Value Reporting Foundation*, IFRS (Aug. 1, 2022), https://www.ifrs.org/news-and-events/news/2022/08/ifrs-foundation-completes-consolidation-with-value-reporting-foundation/ [https://perma.cc/FM5G-S3Z7].

D. External Validation: Gatekeepers, Auditing and Assurance

Since their inception, federal securities laws have established gatekeeper liability both at the public offer stage and for ongoing reporting under Rule 10b-5. Gatekeepers—investment bankers, auditors, and lawyers—are external parties that confirm the accuracy of the company's disclosures to investors, risking not only liability but also their own professional reputation if misstatements arise.[139] Gatekeepers direct disclosure drafting in pivotal moments, like the IPO, because their expertise helps the company sift through business issues, focus on what is material, and present a coherent and truthful account of its successes and challenges.[140] As the conventional theory goes, gatekeepers rely on their unblemished reputation for future hires, so they would be unwilling to endanger their future revenue stream and bend to the whims of an individual client pushing for untrue or misleading disclosure.[141] This theory suffered from one significant black hole, as the Enron and Worldcom scandals demonstrated.[142] While each company's fees are a small portion of the gatekeepers' total revenues, they are very significant for the partner in charge of the relationship, who has stronger incentives to join the company's CFO in cheating.

Rather than foregoing gatekeepers, SOX strengthened the separation between gatekeepers and the executives they supervise to increase their relative bargaining power.[143] Auditors are now hired and fired by the Audit Committee, comprised of independent directors, rather than by the CFO.[144] They have a more expanded role, required to oversee not only the composition of the financial statements themselves, but also the internal controls process that gathers and feeds the information into the financial statements.[145] If the auditors identify deficiencies, they must report to the Audit Committee and the Board; and if they do not see the expected reaction, they must bring the issue to the SEC's attention.[146] Overall, these independent supervision arrangements aim to make auditors more reliable partners for investors, who expect an independent viewpoint on the disclosed information and its credibility.

In ESG, where investors' informational needs are stronger and companies' systems are still developing, gatekeeper participation has evolved

139. *See* Stavros Gadinis & Colby Mangels, *Collaborative Gatekeepers*, 73 WASH. & LEE L. REV. 797, 802–04 (2016).

140. *See id.* at 809–10.

141. *Id.* at 802–04.

142. *See* Kathleen F. Brickey, *From Enron to Worldcom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L. Q. 357, 369–70 (2003).

143. *See* Coates, *supra* note 20, at 105.

144. *See id.* at 104.

145. *Id.*

146. *Id.* at 100.

into a strong feature of public disclosures. As investors need help in understanding the choices companies are making and confirming that provided disclosures accurately reflect developments on the ground, companies are increasingly turning to "assurance," or confirmation by qualified third parties.[147] These third parties often assist companies in conceptualizing and designing their ESG disclosures, as industry practices are still evolving, and uniform standards are lacking.[148] Some assurance providers are boutique firms specializing in certain areas, such as environmental or supply chain issues.[149] Often, audit firms take on the role of providing assurance as well.[150] Recent legislative and regulatory initiatives, like the CSRD in the EU, are requiring assurance for public disclosures.[151]

E. Internal Controls

Beyond external reporting and assurance, The ESG information system builds upon past efforts to strengthen internal controls. Currently, the most widely used framework for establishing internal controls is developed by The Committee of Sponsoring Organizations (COSO).[152] COSO considers ESG an evolution of internal controls and is updating its framework to incorporate ESG.[153] Importantly, COSO does not recommend that companies set up a parallel or distinct internal control mechanism for ESG issues. Instead, it emphasizes the need to incorporate ESG issues into existing enterprise risk management and internal controls.[154] Indeed, the

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147. INT'L FED'N OF ACCTS., THE STATE OF PLAY: SUSTAINABILITY DISCLOSURE & ASSURANCE 2019–2021 TRENDS & ANALYSIS (2023), https://www.ifac.org/knowledge-gateway/contributing-global-economy/publications/state-play-sustainability-disclosure-assurance-2019-2021-trends-analysis [https://perma.cc/2YD9-4FMU].

148. *See generally* Mary Canning, Brendan O'Dwyer & George Georgakopoulos, *Processes of Auditability in Sustainability Assurance—The Case of Materiality Construction*, 49 ACCT. BUS. RSCH. 1 (2019).

149. INT'L FED'N OF ACCTS., *supra* note 147, at 3.

150. Michael O'Dwyer & Andrew Edgecliffe-Johnson, *Big Four Accounting Firms Rush to Join ESG Bandwagon*, FIN. TIMES (Aug. 29, 2021), https://www.ft.com/content/4a47fb4a-4a10-4c05-8c5d-02d83052bee7.

151. *See generally* Directive of the European Parliament and Council 2022/2464, 2022 O.J. (L 322) 15.

152. *See generally* ROBERT H. HERZ, BRAD J. MONTERIO & JEFFREY C. THOMSON, LEVERAGING THE COSO INTERNAL CONTROL—INTEGRATED FRAMEWORK TO IMPROVE CONFIDENCE IN SUSTAINABILITY PERFORMANCE DATA (2017), https://www.imanet.org/-/media/73ec8a64f1b64b7f9460c1e24958cf7d.ashx [https://perma.cc/V3CH-SE2Y].

153. *Id.* at 8 (defining internal control as "a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance").

154. *See id.*; *see also* AM. INST. OF CERTIFIED PUB. ACCTS., KEY ACTIONS FOR ESTABLISHING EFFECTIVE GOVERNANCE OVER ESG REPORTING 3 (2021), https://us.aicpa.org/content/dam/aicpa/interestareas/businessindustryandgovernment/resources/sustainability/downloadabledocuments/key-

COSO framework, developed in 1992, was "always intended to apply to nonfinancial measures," but SOX, "particularly Section 404, typecast the Framework as one aimed at providing reasonable assurance over external financial reporting only."[155] One of the first steps COSO recommends is establishing a cross-functional team inviting participation from departments including "finance and accounting," "information technology" and "sustainability."[156] Hosting such a forum for "diverse perspectives" on the business breaks down corporate silos, promoting information sharing within the organization and ultimately improving internal controls.[157] As risk management experts have noted, fostering such information sharing is one of the ESG system's greatest strengths.[158]

As briefly noted above, the SEC, too, is scrutinizing internal controls over sustainability disclosures.[159] Indeed, its recent Proposed Rule has been criticized as being too prescriptive for companies' integration of climate risk into their existing internal controls at the board and management levels.[160] Notwithstanding this uncertainty, the SEC is using its existing regulatory enforcement powers to investigate and prosecute "greenwashing" claims in sustainability reports. The recently formed Climate and ESG Task Force within the Division of Enforcement has launched several investigations into ESG-related disclosures and investment practices that lacked sufficient internal controls.[161] For instance, in April 2022, the SEC

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actions-for-establishing-effective-governance-over-esg-reporting.pdf [https://perma.cc/FN8Z-59W3] (noting of the COSO framework that "companies likely would find it most effective to leverage the control framework currently used in financial reporting to establish internal control over ESG reporting").

155. *See* HERZ, MONTERIO & THOMSON, *supra* note 152, at 9; Sarbanes-Oxley Act of 2002 §404, 15 U.S.C. § 7201.

156. *See* HERZ, MONTERIO & THOMSON, *supra* note 152, at 49.

157. *See id.* at 49.

158. *See, e.g.*, Daniel Heller, Andres Reiter, Sebastian Schöbl & Henning Soller, *ESG Data Governance: A Growing Imperative for Banks*, MCKINSEY (Feb. 8, 2023), https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/tech-forward/esg-data-governance-a-growing-imperative-for-banks [https://perma.cc/LLH7-ADHQ] (noting "Effective ESG data governance thus requires a coordinated and centralized approach across multiple stakeholders.").

159. *See generally* The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (proposed Apr. 11, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, 249).

160. *See generally* Mortion Pierce & Michelle Rutta, *SEC's Proposed Climate Rules Are Problematic for Boards*, WHITE & CASE (Nov. 11, 2022), https://www.whitecase.com/news/media/secs-proposed-climate-rules-are-problematic-boards [https://perma.cc/8NFT-79EU]. Notably, both the SEC and the Public Company Accounting Oversight Board (PCAOB) have endorsed the COSO framework for verifying internal controls of financial information, and legal and financial risk advisors are encouraging companies to proactively adopt the COSO framework, even though the fate of the SEC's climate disclosure rule remains uncertain.

161. *Enforcement Task Force Focused on Climate and ESG Issues*, U.S. SEC. & EXCH. COMM'N (Nov. 29, 2022), https://www.sec.gov/spotlight/enforcement-task-force-focused-climate-esg-issues [https://perma.cc/SR6P-F5C3].

charged Brazilian mining company Vale with making misleading claims regarding dam safety in its sustainability reports.[162] The complaint specifically faults the company for inadequate internal controls.[163] Likewise, the SEC's Division of Examinations in 2021 emphasized that it will continue to observe "deficiencies and internal control weaknesses from examinations of investment advisers and funds regarding ESG investing."[164] SEC commissioners have also chosen to emphasize the applicability of internal controls to ESG disclosures in recent speeches.[165] For example, Commissioner Caroline A. Crenshaw recently encouraged companies to "think about [ESG risks] in the context of your internal accounting controls and audit functions":

> [T]here are a few specific ESG risks where internal corporate accounting controls play a critical role, and it is particularly important to assess whether these existing corporate internal accounting controls are sufficient to provide reasonable assurances that each business and its assets are, in fact, adequately controlled.[166]

Considering these developments, commentators are predicting that the SEC will continue to expand the scope of internal controls beyond accounting to encompass oversight of ESG risks.[167]

IV. The ESG Information System Diverges from Past Governance Reforms

A. The ESG Information System Casts a Wider Net

One key difference between the ESG information system and past governance reforms is the sheer number of internal and external stakeholders who are involved in information exchange. Under SOX, inputs into the

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162. Press Release, Sec. & Exch. Comm'n, SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse (Apr. 28, 2022), https://www.sec.gov/news/press-release/2022-72 [https://perma.cc/6AC6-VS5W].

163. Complaint & Demand for Jury Trial at ¶¶ 265–66, Sec. & Exch. Comm'n v. Vale, S.A., No. 22-cv-2405 (E.D.N.Y. 2022).

164. U.S. Sec. & Exch. Comm'n, Div. of Examinations, The Division of Examinations' Review of ESG Investing 2 (2021), https://www.sec.gov/files/esg-risk-alert.pdf [https://perma.cc/F7AP-B7MD].

165. Caroline A. Crenshaw, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at the PepsiCo-PwC CPE Conference: Controlling Internal Controls (Nov. 16, 2021), https://www.sec.gov/news/speech/crenshaw-controlling-internal-controls-20211116 [https://perma.cc/AW3A-7S5J].

166. *Id.*

167. *See generally* Peter K.M. Chan, Amy J. Greer & Kristal D. Petrovich, *SEC Enforcement Will Expand Its Policing of Public Companies Under the Biden Administration*, 54 Rev. Sec. & Commodities Reg. 111 (2021).

system were limited to internal and external financial auditors. In contrast, the ESG information system invites input from a far broader set of sources.[168] From NGOs to local government regulators, the ESG information system welcomes input from a range of stakeholders.[169] Take Uber, for example: after several incidents, the company committed to addressing sexual harassment and assault on its platform.[170] Rather than turning inward, Uber recognized "the need for outside expertise to create a research-informed categorization system," or taxonomy for sexual misconduct and violence.[171] To address this information gap, Uber partnered with a number of NGOs with expertise in sexual harassment and assault.[172] Such external outreach gave Uber the ability to systematize its information-gathering of sexual harassment risk, thereby improving its monitoring. Crucially, the taxonomy captures instances of sexual harassment that fall short of legal violations.[173]

At first blush, it may seem that expanding the sources of information could result in "information overload," potentially hampering the board's ability to oversee risk. But a closer look at the ESG information system in practice demonstrates how systematized its information gathering apparatus is. The process begins with a materiality assessment, which unfolds in four distinct stages, relying heavily on collaboration with stakeholders and investors.[174] First, the company engages with internal and external stakeholders to identify the full gamut of environmental, social, and governance risks that are relevant to its operations, products, services,

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168. *See, e.g.*, *Stakeholder Engagement and ESG Materiality*, CISCO (2022), https://www.cisco.com/c/m/en_us/about/csr/esg-hub/governance/materiality.html [https://perma.cc/K56W-JAJT] ("Input from key stakeholders and a comprehensive materiality assessment helps us set ESG strategy, commitments, and maximize impact.").

169. *See* ALLISON TAYLOR, CHARLOTTE BANCILHON, CECILE OGER & JONATHAN MORRIS, FIVE-STEP APPROACH TO STAKEHOLDER ENGAGEMENT (2019), https://www.bsr.org/en/reports/stakeholder-engagement-five-step-approach-toolkit [https://perma.cc/Q5LD-UU2U] (asserting that ESG systems invite input from all stakeholders through digital and social media channels).

170. RALIANCE BUS., EXAMINING UBER'S USE OF THE SEXUAL MISCONDUCT AND VIOLENCE TAXONOMY AND THE DEVELOPMENT OF UBER'S UNITED STATES SAFETY REPORT 2 (2019), https://www.raliance.org/wp-content/uploads/2019/12/Examining-Ubers-Use_102021.pdf [https://perma.cc/6MAT-V3JE].

171. *Id.* at 2 (describing The Sexual Misconduct and Violence Taxonomy which includes "21 behaviorally specific categories that do not overlap (are mutually exclusive) and capture the full array of possible incidents").

172. Elise Maiolino, *Driving Change: Partnering to End Gender-Based Violence*, UBER (2022), https://www.uber.com/newsroom/driving-change-to-end-gender-based-violence/ [https://perma.cc/M98R-SD6S].

173. *See* RALIANCE BUS., *supra* note 170, at 13.

174. NYU STERN CTR. FOR SUSTAINABLE BUS., SUSTAINABILITY MATERIALITY MATRICES EXPLAINED 3 (2019), https://www.stern.nyu.edu/sites/default/files/assets/documents/NYUSternCSB-SustainabilityMateriality_2019_0.pdf [https://perma.cc/C8HG-8KFQ]; *see also* Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1429–30 (2020).

markets, and other areas where the company can make positive contributions to society.[175] Second, the company engages key internal decision-makers and managers who have direct knowledge of strategic business priorities and local market issues, as well as external stakeholders who have knowledge of local conditions, the state of civil society, and current social and environmental issues.[176] The company then plots the results on a matrix that depicts how each environmental, social, and governance issue impacts business value and stakeholders.[177] Third, the company uses the matrix to conduct a gap assessment of its existing risk inventory, including its Enterprise Risk Management (ERM) processes.[178] This assessment determines the likelihood and impact of a risk and allows the company to develop preventative mitigation strategies.[179] Fourth, once the company has a clear picture, the sustainability team, in collaboration with other business units, creates a sustainability or ESG plan and strategy with specific key performance indicators and goals. The company then reports progress against this plan internally as well as externally through its annual reports and engagements.[180] The final plan allows the company to create the right strategy and governance and management systems that will deploy necessary capital and resources throughout the organization.[181]

B. The ESG Information System Educates Directors and Managers

Directors and managers generally enter the boardroom with at least a minimum level of familiarity with accounting and *financial* disclosures. As a mainstay of modern management, financial statements offer managers useful and reliable tools for running the company and support their mission to maximize profits. Moreover, managers and directors have relied on financial statements as a tool for overseeing the company's various departments, identifying areas of intervention, and reflecting the outcomes of their choices. At the same time, financial statements are the basis on which investors assess the prospects of the company and shape stock prices.[182] They are a primary means of communication between management and the market, revealing trends in the company's results, allowing

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175. *See* NYU STERN CTR. FOR SUSTAINABLE BUS., *supra* note 174, at 3.

176. *See id.*

177. *See id.* at 3–4.

178. *See id.*

179. *See id.*

180. *See id.*

181. *See id.*

182. *See* Paul M. Healy & Krishna G. Palepu, *The Effect of Firms' Financial Disclosure Strategies on Stock Prices*, 7 ACCT. HORIZONS 1, 7–8 (1993) (explaining that "investors make probabilistic assessments on the quality of earnings in determining stock prices. Any events that cause revisions in these probabilistic assessments, such as criticism of management's accounting assumptions by independent analysts, will affect stock prices.").

comparisons with similar companies, and illustrating the full effect of management's strategies.[183] Both internally in the company and externally toward markets, financial statements are meant to ensure that the company stays on track regarding its business performance.

In contrast, collecting and presenting ESG information is seen as a key mechanism for triggering interest in managers and directors about the underlying issues.[184] At the risk of generalizing, neither managers nor directors are as well-versed in environmental and social issues as they are in financial and business ones. For them, collecting the information is an important step in exploring the problems and opening their minds to concerns that had not been considered in their decision-making. Airbnb is an example of a company that has invested considerably in board governance to elicit information from stakeholders.[185] Airbnb's board includes a Stakeholder Committee that is tasked with electing feedback from key stakeholders, and "[r]eviewing the Company's progress with respect to the Stakeholder Principles, including periodic review of the Company's performance against the Stakeholder Metrics, which are inclusive of environmental, social, and governance (ESG) criteria."[186]

ESG is a relatively recent entrant in the business vernacular, and consequently, the information gathering effort has an educational or investigatory mission. By bringing directors and managers face to face with the social implications of their choices, the ESG information system can prod them into taking concrete action. Thus, ESG disclosures do not simply inform, commit, and discipline, as financial statements do. They also draw greater focus to problems that managers may not have addressed before.

C. SOX Solidified a Developed System, the ESG Information System Is Still Taking Shape

By 2002, when SOX intervened, accounting was already a well-established system for collecting and codifying information regarding production, operation, and returns.[187] With an explicit mission to accurately depict financial performance, accounting standards sought to limit management's flexibility as to what and how to report it. Because of their widespread adoption, collective use, and high level of standardization,

183. *See id.* at 2–4.

184. *See, e.g.*, ALAN GUTTERMAN, STAKEHOLDER ENGAGEMENT AND THE BOARD (2023), https://ssrn.com/abstract=4393167 [https://perma.cc/2XEF-9NNJ].

185. AIRBNB, STAKEHOLDER COMMITTEE CHARTER 3 (2023), https://s26.q4cdn.com/656283129/files/doc_downloads/governance_doc_updated/Stakeholder-Committee-Charter.pdf [https://perma.cc/69VK-ML97].

186. *Id.*

187. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 18 U.S.C.), amended by §§ 992, 929A, 124 Stat. 1842, 1852.

accounting standards had instilled great confidence in the informational efficiency of US public markets. Public companies already had extensive internal controls departments, which proved central in tracking information about scandals such as Worldcom, even though they were plagued by conflicts of interest.[188] It was precisely because of that overconfident portrayal that Enron's collapse was perceived as a momentous scandal that merited a swift response. Yet for all its might, SOX refined a governance system whose main building blocks had been in place for some time. By strengthening the audit committee's role, establishing greater safeguards for independence, or creating reporting channels between the board and internal controls, SOX introduced governance reforms to an already sophisticated edifice.

ESG, we argue here, is seeking to erect a similar governance system, but it is still in its infancy. Compared to financial disclosures, companies have much more flexibility in choosing what to include in their ESG disclosures. While global regulatory developments, most notably the EU's Corporate Sustainability Reporting Directive (CSRD) are quickly injecting greater discipline and comparability, it is still early days and there is still much variability.[189] Some companies are using executive compensation as a lever for pushing ESG goals; others are not.[190] Some boards have recruited experts in some ESG areas , while others do not see the need to move in that direction.[191] The level of effort, commitment, and resources that companies are placing on ESG varies widely. Sustainability and ethics officers have become more popular in the last decade, but their responsibilities are still evolving.

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188. *See infra* Part III(D).

189. *See generally* Directive 2022/2464, of the European Parliament and of the Council of 14 December 2022, Amending Regulation (EU) No. 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, As Regards Corporate Sustainability Reporting, 2022 O.J. (L 322) 15; David Cifirino, *The Rise of International ESG Disclosure Standards*, HARV. L. SCH. F. ON CORP. GOV. (June 29, 2023), https://corpgov.law.harvard.edu/2023/06/29/the-rise-of-international-esg-disclosure-standards/ [https://perma.cc/T7BD-LKJY] ("The categorisation of ESG funds on a standardised basis under new European and US funds regulations can be expected to significantly mitigate the problem of inconsistent terminology and nomenclature as to what is and isn't fairly categorised as an ESG investment.").

190. https://onlinelibrary.wiley.com/doi/10.1111/1475-679X.12481 (finding that 38% of companies tie executive compensation to ESG goals).

191. https://www.stern.nyu.edu/experience-stern/about/departments-centers-initiatives/centers-of-research/center-sustainable-business/research/research-initiatives/fortune-100-board-members-lacking-esg-credentials (finding that in 2019 only in 2019 29% of Fortune 100 directors had relevant ESG expertise).

By following the SOX template closely, the ESG information system is developing into a full-blown governance system at lightning speed.[192] Anchored on disclosures and investor engagement, ESG is gaining roots within the company's internal hierarchy through the sustainability, risk, and legal departments. ESG also gains external validation through assurance and benefits from a global push toward standardization and regulation. It took almost three decades from the formalization of FASB in the early 1970s to SOX in 2002.[193] ESG is looking to cover the same ground in barely 10 years.

D. The Normative Goals of the ESG Information System Remain Contested

The emerging ESG system pursues normative goals that are broader, more complex, and more controversial than those of past governance reforms, which primarily focused on reducing self-dealing and accounting fraud.[194] For instance, in the 1970s, corporate crises were wide-ranging; in response, the public demanded that regulators and private actors rein in the managers responsible for such scandals.[195] The monitoring board was the business community's answer to these public pressures.[196] Its adoption

192. *See, e.g.*, KPMG, THE "SOXIFICATION" OF ESG 2 (2021), https://advisory.kpmg.us/articles/2021/soxification-esg-reporting.html [https://perma.cc/F6N8-NVX7] (asserting that banking institutions and investment companies have a growing interest in their ESG commitments).

193. *See infra* Part III(C); *see also Comparability in International Accounting Standards—A Brief History*, FIN. ACCT. STANDARDS BD., https://www.fasb.org/page/PageContent?pageId=/international/briefhistory.html&bcpath=ff&isStaticPage=true [https://perma.cc/UH93-BC25].

194. The present ESG backlash highlights the contentious and debated nature of the ESG movement. *See, e.g.*, Mark Brnovich, *ESG May Be an Antitrust Violation*, WALL ST. J. (Mar. 6, 2022), https://www.wsj.com/articles/esg-may-be-an-antitrust-violation-climate-activism-energy-prices-401k-retirement-investment-political-agenda-coordinated-influence-11646594807 [https://perma.cc/PU4U-7FZ5] ("The biggest banks and money managers seek to implement a political agenda, such as compliance with the Paris Climate Accord. Then a group mobilizes: Climate Action 100+, for example, comprised of hundreds of big banks and money managers that together manage $60 trillion."); *see also, e.g.*, Andrew Freedman, *BlackRock, UBS and 348 ESG Funds "Banned" in Texas*, AXIOS (Aug. 25, 2022), https://www.axios.com/2022/08/25/texas-bans-blackrock-ubs-esg-backlash [https://perma.cc/Y2LM-MT8N]; Letter from House Judiciary Republicans to Climate Action 100+ Steering Committee (Dec. 6, 2022), https://nsjonline.com/wp-content/uploads/2022/12/2022-12-06-612712009-House-Republican-letter-to-Climate-Action-100.pdf [https://perma.cc/Y5LD-S3J9].

195. *See, e.g.*, Phillip Shabecoff, *Collapse of Penn Central Reflects Ills of Railroads*, N.Y. TIMES, Feb. 11, 1973, at 1, 60 (discussing how Senate staff put Penn Central management at the top of blameworthy "perpetrators"); *The Enforcement Division: A History*, *supra* note 37.

196. *See* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 140–41 (1976). The concept of the monitoring board itself, however, does not embed a normative orientation. As one commentator explained, "under the model, the officers attempt to achieve the corporation's goals, whatever they may be, and the board evaluates management's performance, a task that necessarily entails setting the corporation's goals." George W. Dent, Jr., *The Revolution in Corporate Governance, the Monitoring Board, and the Director's Duty of Care*, 61 B.U. L. REV. 623, 632–33 n.49 (1981).

admitted that directors were ill-equipped to manage the corporation's strategy and tasked directors with something they *could* do—monitor management, primarily the CEO. Though Eisenberg argued that independent directors should consider social factors along with financial goals, the rising law and economics movement successfully tethered the monitoring board's aims to ensuring that CEOs increased the company's stock price.[197] Similarly, in the early 2000s, the stock market was in freefall.[198] Much like they did in the 1970s, the public demanded a regulatory response, leading to the enactment of SOX and Dodd-Frank regulations designed to strengthen internal controls and prevent accounting fraud.[199] Building on the gains of the monitoring board, SOX sought to address corporate fraud and align management conduct with that which is best for shareholders and financial markets.

Though preventing fraud and averting manipulation of financial disclosures are not simple problems, they fall in line with corporate law's long-established goal of protecting shareholders. Unlike these past governance reforms, the ESG information system's emergence was triggered by concurrent *societal* crises, from income inequality (Occupy Wall Street) to gender and racial diversity (#MeToo, BLM) to climate change.[200] The ESG information system is designed to respond to increasing demands for companies to address environmental and social externalities, even those the company is not directly causing.[201] But critics of ESG have seized on the point that the ESG system asks companies to look

197. *See* Gilson & Gordon supra note 46, at 356 (Discussing the evolution of the monitoring board and explaining that "the firm's stock price performance, year-to-year and in comparison to peers, has become the key metric for Board 2.0 directors, not only because it corresponds to some idea of shareholder welfare but because it provides a thinly informed director the most reliable measure of management's success.").

198. *See* Ben Geier, *What Did We Learn from the Dotcom Stock Bubble of 2000?*, TIME (Mar. 12, 2015), https://time.com/3741681/2000-dotcom-stock-bust/ [https://perma.cc/C8JL-D7WF].

199. *See generally* Coates & Srinivasan, *supra* note 90.

200. *See generally* Akshaya Kamalnath, *Social Movements, Diversity, and Corporate Short-Termism*, 23 GEO. J. GENDER & L. 449 (2022).

201. While there have been attempts to incorporate a company's social and environmental impacts into its accounting, these endeavors never gained widespread acceptance within the mainstream business community. For a historical overview of "social accounting," see Douglas M. Branson, *Corporate Governance "Reform" and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 614 (2001):

> In a super social audit, a corporation would attempt to quantify every adverse impact the corporation had on environments in which the corporation operated, along with corporate efforts to ameliorate them. Thus, a super social audit might attempt to quantify the effect on clean air of the corporation's employees commuting to work singly rather than in van pools.

Id.; *see* Pollman, *supra* note 8 at 27 ("ESG has notably entered a new phase of possible meanings as politicians tout it as a hot button issue or proxy for other values and beliefs.").

beyond traditional financial considerations to political or social ones.[202] This growing backlash is muddying the waters for boards; a vocal group of ESG critics, including the CEO of Big Three asset manager Vanguard, claims that there is no correlation between ESG and financial returns.[203] Similarly, conservative lawmakers are demanding that companies stay in their lane and refrain from taking positions on social issues.[204] On the other end of the spectrum, stakeholder advocates argue that the ESG information system ought to, and is designed to, measure impacts beyond what is financially material.[205]

In response to these critiques, we argue that ESG risks often *are* material, given heightened social expectations for corporations. In fact, the original report coining the term "ESG" was specifically premised on the notion that integrating environmental and social risks into financial decisions "will ultimately contribute to more stable and predictable markets."[206] As briefly shown above, this view is hotly debated. Therefore, unlike prior trends of governance reform, the ESG information system is not tethered to a single or undisputed goal—instead, it aims to align corporate incentives with broader social issues, which are controversial and ever-changing. In sum, the ESG information system is different from past governance reforms because its normative ends remain contested.

V. IMPLICATIONS AND CONCLUSION

By illustrating the parallels between the ESG information system and past corporate governance reforms, we have shown how accommodating environmental and social concerns can take hold within the conventional corporate law framework. We now turn to the question: what can we hope to achieve through this policymaking tool? In the voluminous literature on ESG, the policymakers' perspective is often overlooked. Scholars have

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202. Need Citation (https://www.ft.com/content/cd226411-f0db-4027-90cb-f067381817fa)

203. Terrence Keeley, *Vanguard's CEO Bucks the ESG Orthodoxy*, WALL ST. J. (Feb. 26, 2023), https://www.wsj.com/articles/vanguards-ceo-bucks-the-esg-orthodoxy-tim-buckley-net-zero-emissions-united-nations-initiative-nzam-f6ae910d [https://perma.cc/TW4Z-JA6P].

204. A high-profile example is Florida's Governor Ron DeSantis, who revoked Disney's special tax district in the state following the company's criticism of the state's "Don't Say Gay" bill on social justice grounds, asserting that Disney "crossed the line." *See* David Kihara, *DeSantis Says Disney 'Crossed the Line' in Calling for 'Don't Say Gay' Repeal*, POLITICO (Mar. 29, 2022), https://www.politico.com/news/2022/03/29/desantis-disney-dont-say-gay-repeal-00021389 [https://perma.cc/TUA4-R6R2].

205. This view underlies European regulators who have opted for "double materiality" in mandatory ESG reporting.

206. THE GLOBAL COMPACT, WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD 3 (2004), https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf [https://perma.cc/E3MQ-WAMA].

argued that stakeholders and shareholders stand to benefit from ESG,[207] managers are likely to abuse their newly broadened mandates,[208] and investors are pushing for a regulatory agenda,[209] or that consumers are better off with the ESG revolution.[210] But from a policymaking perspective, does it make sense to entrust critical environmental and social issues to a governance framework based on standardization, disclosure, and decentralized monitoring? Let's compare the governance system that we described above to other modes of regulation—such as voluntary commitments managers are free to undertake under the business judgment rule or, in contrast, mandatory compliance with requirements set by regulators. What can the ESG framework do better than alternatives, and what are the main concerns that arise?

A key advantage of the ESG information system, we argue, lies in the collective and iterative process for creating the standards. Addressing problems such as climate change, data privacy, or workplace discrimination requires immense resources. Identifying the challenges on the ground can only be achieved through direct input by industry representatives, a channel that current standard-setters are well-placed to utilize. Moreover, it makes sense to pool our collective resources in conceptualizing and formulating standards, rather than expect individual companies to undertake this task.[211] Corporate executives do have a role to play: current standards set threshold requirements, but leave discretion to managers to make the choices that work best with their business model. Take environmental standards, for example. Each industry faces different challenges, with emissions being critical for some industries, while water use more critical in others.[212] Industry input is necessary to identify the right metrics and assess at appropriate levels, though individual corporate managers are the

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207. Mozaffar Khan, George Serafeim & Aaron Yoon, *Corporate Sustainability: First Evidence on Materiality*, 91 ACCT. REV. 1697, 1703 (2016) (categorizing "good" and "bad" ESG firms to examine stock returns); Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647, 651 (2016) (examining "non-financial risks" that can influence stock price); *see also* ALEX EDMANS, GROW THE PIE, HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT, EDWARD FREEMAN, THE POWER OF AND: RESPONSIBLE BUSINESS WITHOUT TRADEOFFS.

208. *See* Pollman, *supra* note 8, at 43.

209. *See* Dorothy S. Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. 77, 80 (2022).

210. Johnathan Muncey & Leslie Roter Rebnord, *ESG Increasingly a Top Priority for Consumer-Facing Businesses*, NORTON ROSE FULBRIGHT (Dec. 2022), https://www.nortonrosefulbright.com/en/knowledge/publications/79c04870/esg-increasingly-a-top-priority-for-consumer-facing-businesses [https://perma.cc/N7GC-HMSN]

211. *See* Amelia Miazad, Investor Alliances 18 (unpublished manuscript) (on file with authors).

212. Indeed, that is why the SASB standards are industry specific. *Materiality Finder*, SASB, https://sasb.org/standards/materiality-finder/, [https://perma.cc/PNH6-KQP3] ("The sustainability-related risks and opportunities that are most likely to affect cash flows, access to finance and cost of capital vary by industry.").

ones to formulate a strategy that will help their company attain that level. In this way, standards help both set a general framework for assessment and allow for customization by individual companies.

Standardization also brings well-known benefits for monitoring and investors. It helps educate investors, who can transfer the know-how they developed in assessing one company to subsequent assessments of other companies. It establishes comparability among companies, and thus facilitates monitoring, as markets become well-versed in the disclosures provided through repeat discussions and alternative corporate approaches. As industry participants continuously update the standards and markets undertake a serious monitoring effort, the burden of operating this governing framework falls on private shoulders, reducing costs for the taxpayers.

All governance frameworks bear the imprint of their drafters. The ESG information system remains largely an industry-led effort, as most of the representatives drafting the standards, the companies making disclosures, and the gatekeepers and investors monitoring compliance are private entities. Thus, the risk that private incentives may not always align with public interest remains a crucial one. Regulators and policymakers should be vigilant about potential missteps, confirm that progress occurs at the required speed, and support the observance of standards. Private monitors can rely on reputational sanctions, funds' withdrawal, and private securities litigation. But government authorities have more extensive tools for supervision and enforcement, which they can deploy in order to strengthen enforcement and encourage compliance. Moreover, as standards are being developed on a global scale, it is important to ensure representativeness along geographical and cultural lines, and be alert about potential mishaps.

Like any emerging governance framework, the costs of building up an ESG information system, both to effect real changes on the ground and to accurately measure and report them, are significant. It requires establishing dedicated departments, introducing new staff and training existing staff, and taking up time and effort from the most senior executive officers, like the CFO and the CEO. For most publicly traded companies, obtaining assurance through external gatekeepers is quickly become standard market practice. Moreover, as ESG standards and goals are fast moving, these costs are going to become regular. One wonders whether we would be better off if, instead of investing all these efforts into double-checking disclosures, reaching specific standards, and addressing investor questions and proposals, companies were left alone and redirected resources to, say, actually reducing carbon emissions.

While concerns about costs are justified, they are overblown. Goals like reducing emissions, mitigating climate change and biodiversity loss,

and improving equity in the workplace are ambitious and multi-faceted. They require an institutional infrastructure to track progress in measurable ways, establish incentives and accountability, and address barriers along the way. Achieving these goals without incurring internal costs is hard to imagine. Because this infrastructure is necessary for operationalizing environmental and social commitments, companies are going to incur costs regardless of whether they are making disclosures to investors or not. In fact, the ESG information system mitigates these costs. Standardization helps companies share know-how, observe peers and competitors, and convince their investors more readily about their choices. Consulting investors and other stakeholders helps companies economize by focusing their efforts in areas where improvement is going to matter most. Assurance helps top performers distinguish themselves from those falling behind, so that their stock valuations can more accurately reflect their prospects and thus, lower their cost of capital.

The ESG information system can help companies avoid violating the public interest constraint, a concern that Berle warned about.[213] In conclusion, the ESG information system represents both an evolution of past governance reforms and a revolutionary social risk management tool that is being finely tuned for the modern era.

213. *See* Pollman, *supra* note 38, at 639. *See generally* Adolf A. Berle, Address Before the Association of the Bar of the City of New York: Corporate Decision-Making and Social Control (Apr. 23, 1968) (on file with authors).