The New “Reasonable Investor” and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation

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INTRODUCTION

In August 2019, 181 CEOs, as members of the Business Roundtable, published a statement on the purpose of a corporation asserting a fundamental commitment to all stakeholders.1 This statement dramatically departs from the long-espoused notion that the shareholder is a corporation’s top priority. The statement sent ripples across an already-fervent political debate over the public identity of businesses. In the investment context, the notion that corporations need to take seriously variables other than financial performance has been gaining ground over the past decade, as a growing number of investors have expressed interest in sustainability-related data2 pertaining to companies in their portfolios.3 They have been demanding that companies officially disclose more of their environmental, social, and governance (ESG) risks. In the absence of mandatory ESG disclosure, investors have also been subscribing to third-party ESG data providers and relying on ESG indices to obtain this data through less

2. For purposes of this article, the terms sustainability and ESG (Environmental, Social, Governance) will be used interchangeably to refer to the Krosinsky and Robins elaboration of ESG as “[t]he term that has emerged globally to describe the environmental, social, and corporate governance issues that investors are considering in the context of corporate behavior.” SUSTAINABLE INVESTING: THE ART OF LONG-TERM PERFORMANCE 213 (Cary Krosinsky & Nick Robins ed., 2008). While not an exhaustive list, ESG issues display one or more of the following characteristics: “non-financial or not material data; a medium or long-term horizon; qualitative objects that are readily quantifiable in monetary terms; externalities (costs borne by other firms or by society at large) not well captured by market mechanisms; a changing regulatory or policy framework; patterns arising throughout a company’s supply chain (and therefore susceptible to unknown risks); [and] a public-concern focus.” Id.
direct means. These investors, and a host of scholars, have been arguing that ESG data is relevant to effective asset management, and thus, that it is legally “material” for their purposes. Their increasing interest in ESG data marks a departure from a traditional approach to corporate disclosure, which more narrowly construes the domain of materiality to include only statements that directly relate to a company’s financial performance. The new approach notably expands the world of information that investors claim to rely on when making decisions regarding the purchase and sale of securities. Consequently, this article argues that the new approach broadens the scope of information that should be deemed material under the securities disclosure regime.

At the same time that mainstream investors have demonstrated an appetite for ESG data, a growing subclass of investors, who self-identify as sustainable investors or socially responsible investors (SRIs), ground their operational mandates in the procurement of ESG performance data and predictive ESG indicators. They set themselves apart from mainstream asset managers by committing to particular ethical and environmental performance measures and by screening for companies that meet these standards. These dual trends—the increased demand for ESG disclosures by mainstream investors and the expanding investment market share claimed by sustainability-minded investors—challenge a traditional characterization of the “reasonable investor” that sits at the heart of American securities doctrine. The reasonable investor

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5. TSC Indus., Inc. v. Northway, Inc. enshrined the economic model of the “reasonable investor” in securities doctrine as the litmus test for determining whether corporate disclosures and other statements are material or immaterial for the purposes of section 10(b) litigation. Accordingly, the notions of materiality and the reasonable investor go hand-in-hand. 426 U.S. 438 (1976).

6. For the purposes of this article, the shorthand designation socially responsible investors (SRIs) will be used to refer to the broad category of sustainability-minded investors who incorporate considerations of sustainability in addition to profit.

7. The reasonable investor who bases his/her investment decisions exclusively on economic rationality has been contested by empirical depictions of a more multi-faceted prototypical investor who is less than perfectly rational and who values more than just economic maximization. Recent scholarship has drawn from behavioral economics to undermine the premise that the audience of corporate disclosures consists of rational decision-makers. Instead, this body of scholarship portrays a more nuanced investor who is emotional, irrational, and activist, among other things. This work advances that a regulatory architecture premised on the reasonable investor fails to meet the desired objective of investor protection as originally intended by the Securities Exchange Act. Notably missing from these accounts is any mention of the SRIs and the novel considerations they present to a regulatory and legal regime concerned with protecting a reasonable investor while assuming that he/she is ethically agnostic. See, e.g., David A. Hoffman, The “Duty” to Be A Rational Shareholder, 90 Minn. L. Rev. 537, 542–43 (2006) (“To understand this ideological commitment, my empirical analysis turned to presumed immateriality’s rationales. This Article finds evidence that courts implicitly equate investors’ “reasonableness” with economic rationality, and irrationality as unreasonableness. This decision cannot be explained as a simple reflection of the way shareholders actually respond to information: it is an ideological choice.”). This article adds to the literature critiquing the solely economic model of the “reasonable investor” by taking into account SRIs and their ESG issue concerns.
archetype, which arose from early 20th century case law, conceives of the investor as an economically rational actor who relies solely on financial disclosures in making decisions about the purchase and sale of securities. A widening rift between this reasonable investor archetype and contemporary investors who make demands for and rely on nonfinancial information, including corporate ESG performance, challenges doctrinal precedent that deems non-financial ESG disclosures to be immaterial.

A number of recent securities cases highlight the emerging incongruities between established doctrine and the needs and expectations of contemporary investors who are increasingly concerned with corporate sustainability performance, and thus, ESG data. These cases arose from the increased prevalence of voluntary corporate ESG disclosures in formal securities reporting, such as in 10-K forms, as well as from informal corporate communications, including public statements, sustainability reports, and sustainability reviews. In a typical case, an investor or group of investors allege that a company has made misleading statements, or omitted information, concerning some aspect of a company’s ESG performance. The investor alleges that this misstatement or omission is a material misrepresentation. To a large extent, district and appellate courts have assimilated cases concerning ESG disclosures within the broader doctrine of securities litigation. Courts generally permit cases to proceed past the motion to dismiss stage, even when the claims concern information found in sustainability reports and reviews, and in media statements, rather than in the Securities and Exchange Commission’s (SEC) formal filings. Courts also consistently find specific and measurable ESG statements to be actionable and allow claims based on such statements to proceed beyond the motion to dismiss stage. By contrast, courts tend to dismiss forward-looking statements, commitments, aspirational statements and intentions as exempt from liability under the Private Securities Litigation Reform Act’s (PSLRA) safe harbor provision or otherwise as puffery that is inactionable as a matter of law.

The court’s dismissal of forward-looking statements, commitments, aspirations and intentions as immaterial to the reasonable investor presents some unique problems for the mainstream investor who is increasingly keen on factoring in ESG risks and performance into his/her decision-making. It also presents problems for the SRI whose core business is premised on screening companies based on their reputations, present practices, and future commitments related to ESG matters. The evolving nature of the reasonable investor demands a more discerning framework for distinguishing between certain forward-looking statements, commitments, aspirations and intentions that are in fact material, and others that are mere puffery.

8. See TSC Industries, 426 U.S. 438.
9. See infra notes 107-13 and accompanying text.
Part I of this article begins by situating ESG disclosure within leading theories regarding the purpose of the securities disclosure regime. Two prevailing interpretations explain the securities disclosure regime: the efficient markets hypothesis and the governance theory. Under the efficient markets hypothesis, disclosure of relevant information allows investors to accurately value securities. Accordingly, federal securities laws function to create “a system providing equal access to information necessary for reasoned and intelligent investment decisions.” Under the governance theory, disclosures are intended “to encourage investors to police the quality of corporate decision-making.” Both of these theories rely on a regulated marketplace of information that must be made available to investors and that is governed by the SEC’s disclosure rules and court interpretations of these rules. In theory, disclosure rules reward reasonable investors for relying on “good” information and punish them for relying on “bad” information when making investment decisions. The puffery defense is a key doctrinal tool used to regulate this informational marketplace by distinguishing between the types of speech that should affect investor consumption, which is material, and speech that should not, which is puffery. Information that is deemed to be puffery is inactionable as a matter of law and, accordingly, related claims do not survive a motion to dismiss. In the context of securities litigation, companies rely on the puffery defense to counter allegations by investors that certain ESG-related statements were material to them when making decisions regarding the purchase or sale of securities. The companies allege that because these statements are properly classified as puffery, investor reliance on such statements is not reasonable, and therefore, not protected by law. This defense has become integral to determining the scope of what ESG information is considered legally material, and, by extension, who qualifies as a “reasonable investor”.

Part II focuses on the notion of the reasonable investor and examines its contemporary relevance in light of changing investor demographics and increasing investor demand for ESG information. It concludes that, at the same time that ESG information has become material for the reasonable mainstream investor more generally, it has also become particularly material for the reasonable SRI. This section then evaluates ESG disclosures under the efficient markets and the governance theories of disclosure. Under the efficient markets hypothesis, the materiality of ESG disclosures is supported by increasingly popular evidence that such disclosures allow for more accurate risk-management and asset valuation by investors. Under the governance theory, the materiality

12. See infra notes 49-55.
of ESG disclosures is supported by the apparent phenomenon of investors filing securities lawsuits based on these disclosures to actively participate in corporate governance and to police corporate decision-making. This section concludes that the expansion of mainstream investor reliance on ESG disclosures and the rise of SRIs as a sub-class of investors support a case for ESG materiality under both theories.

Part III turns to more recent case law for a closer look at how the courts have actually been dealing with investor claims of materiality based on ESG-related disclosures. It examines a series of securities lawsuits brought by investor-plaintiffs alleging material misrepresentations or omissions based on corporate ESG statements. It observes four key trends in the courts’ handling of these lawsuits. The first trend concerns the degree of importance that the courts place on the type or form of document in which a statement appeared when determining materiality. Courts tend to place less emphasis on the form of disclosure, or type of document, where a statement appeared when deciding questions of materiality, and tend to focus more on the issue of attribution and the substance of a statement in question. The second trend concerns a statement’s generality or specificity. Courts tend to find more specific and measurable statements to be actionable while they dismiss general assertions as puffery. The third trend concerns the temporal posture of the disclosure in question. Courts are more inclined to find past and present-tense statements to be actionable while they dismiss forward-looking statements and aspirations as exempt under the PSLRA safe harbor provision or as inactionable puffery. Courts’ dismissals of investor claims based on forward-looking statements eliminates the opportunity for fact-intensive inquiries and for case-by-case examination of whether an investor actually relied on these statements in the purchase or sale of a security. The fourth trend concerns how courts treat ESG statements in codes of ethics and codes of conduct. They generally find such statements to be inherently aspirational and inactionable.

Based on the review of case law in Part III, Part IV identifies how courts treat forward-looking ESG statements, commitments, aspirations and intentions as incompatible with the needs and expectations of today’s reasonable investor. Part IV adopts Ann Lipton’s proposed framework for dealing with puffery and extends it to the ESG context. Under Lipton’s framework, a statement’s materiality is based on the degree of divergence between the reasonable expectations it induces, on the one hand, and actual steps taken by corporate management in furtherance of the statement and/or the magnitude of the violation law requiring state pension funds to perform climate risk assessments, noting that “Climate change presents an array of material financial risks, including transition risk, physical risk, and litigation risk, that reasonable investors must take into account when making investment decisions. Failure to acknowledge and address these risks will result in exposure to subsequent liabilities and financial risk.”)

14. See Lipton, supra note 11, at 140.
underlying the cause of action on the other hand.15 This approach is more in line with actual investor expectations and behavior. This Part argues that, as leading mainstream investors and SRIs demonstrate increasing interest in ESG data, forward-looking statements, commitments, aspirational statements and intentions that pertain to ESG performance acquire materiality for the reasonable investor. While scholars have documented the increased reliance on ESG, and have outlined potential solutions, few have explored the theoretical implications of such an approach. This article utilizes the two most widely accepted theories of corporate disclosures to demonstrate how Lipton’s framework is theoretically justified.

This article concludes by situating the role of the courts within a broader context that includes legislative, regulatory, and market interventions, which all have a role to play in promoting adequate and reliable disclosures to meet the needs of investors.

I. THEORIZING THE SECURITIES DISCLOSURE REGIME

Mandatory securities disclosure began in the United States nearly a century ago in the wake of the 1929 stock market crash. At the time, it was widely perceived that the crash had been provoked by investor speculation in securities due to reliance on incomplete information from companies. The Securities Act of 1933,16 often referred to as the “Truth in Securities” law,17 was promulgated in the aftermath of the crash to reduce informational asymmetry between companies and investors. It required companies to disclose material financial information during the issuance and registration of securities, in order to enable investors to make informed purchasing decisions. The following year, the Securities Exchange Act (SEA)18 established the Securities and Exchange Commission (SEC) and empowered it to require periodic reporting by companies with publicly traded securities.19 Notably, the SEA included section 10(b) as its primary antifraud statutory provision. This section, through Rule 10b-5, prohibited the use of any “device, scheme, or artifice to defraud” investors,20 and it imposed liability “for any misstatement or omission of a material fact, or one that investors would think was important to their decision to buy or sell a

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15. Id. at 141.
20. 17 C.F.R. § 240.10b-5.
security.” Today, investors rely on section 10(b) to make materiality claims alleging misstatements or omissions related to ESG disclosures.

The SEC has not advanced any particular explanatory theory for the architecture of modern securities disclosure regulation, and neither legislative history nor the writings of commentators offer an authoritative account. However, two prevailing interpretations emerge from economic and legal scholarship to rationalize the disclosure system’s current design: (1) the efficient markets hypothesis and (2) the corporate governance theory. Understanding the rationales that these theories provide can offer guidance to contemporary debates concerning the optimal scope and content of corporate disclosures and the materiality that various types of information have for investors. These theories may serve as a reference for courts as they seek to develop doctrine that adequately responds to contemporary investor needs, such as dealing with the materiality of ESG disclosures, while also remaining consistent with the animating rationale of the securities regime.

The notion of a “reasonable investor,” whose interest the securities regime operates to protect, underlies mainstream theories of securities disclosure. This article focuses on challenging the interpretation of the reasonable investor currently enshrined in legal doctrine and advances that a revised consideration of this legal reference must take into account contemporary investor concerns regarding corporate ESG performance. It further considers how this updated understanding of investment concerns might be reflected in the courts’ current treatment of the materiality of forward-looking statements, commitments, aspirations and intentions as they pertain to ESG.

This section begins by rehearsing the main arguments of the efficient markets hypothesis and by demonstrating its assimilation and mainstreaming into SEC regulations and in related judicial interpretations. It goes on to introduce the governance theory of disclosure that has gained popularity in light of contemporary investor behavior, and which emphasizes the function of disclosure in enabling investors’ involvement in corporate oversight. Both of these theories rely on the availability of an informational marketplace of disclosures that makes material information available to investors. This section proceeds by examining the puffery defense as a key legal tool employed to limit the reach of securities claims. The puffery defense is employed in securities litigation to regulate corporate disclosures by distinguishing material statements that are legally actionable from immaterial puffery that is not legally actionable. This section concludes that both explanatory theories of corporate disclosure, as


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well as the key tools used to implement these theories, presuppose the “reasonable investor” as both an audience and functionary in the maintenance of an efficient securities market.

A. The Efficient Markets Hypothesis and Accuracy Enhancement

According to the efficient capital markets hypothesis, the function of federal disclosure standards is to provide investors with adequate information to facilitate and enhance the accurate pricing of securities.23 Federal securities laws operate to create “a system providing equal access to the information necessary for reasoned and intelligent investment decisions.”24 This publicly available information subsequently becomes reflected in stock market prices quickly and without bias.25 Under this model, a revised interpretation of the reasonable investor based on contemporary practices would give heightened significance to the incorporation of ESG data as relevant publicly available information.

The efficient markets hypothesis appeared in legal scholarship as early as the 1970s. In a Note in the Stanford Law Review, Philip J. Leas advanced the efficient markets model as a more accurate way to measure damages in Rule 10(b) cases than the methods previously adopted by the courts. The model provides a reference for the fair market price of a security absent distortions caused by fraud.26 A notable body of legal and economic scholarship from the 1980s sought to bolster the empirical merit of this theory.27 In a 1982 Harvard Law Review Article, Daniel Fischel argued that the efficient-markets hypothesis provided a rationale for a fraud-on-the-market legal theory that had begun emerging in securities fraud litigation.28 The fraud-on-the-market theory proposes that, because the securities market efficiently incorporates public information in stock price, fraudulent disclosures that artificially inflate or depress prices create fraud on the entire securities market and cause economic loss to investors.29 The fraud-on-the-market theory assumes the efficient-markets theory to be true and suggests that reliance by traders on misleading information distorts market prices, and therefore, justifies a finding for tort damages. By the end of the 1980s, the efficient markets hypothesis, including

29. See id.
the fraud-on-the-market theory, had gained mainstream acceptance in both the economic and legal canons.\textsuperscript{30}

The efficient markets hypothesis also influenced the SEC’s adoption of an integrated disclosure system in 1982.\textsuperscript{31} This involved integrating the disclosure system developed by federal securities law and comprehensively revising the rules and forms that governed securities registration pursuant to the Securities Act.\textsuperscript{32} Integrated disclosure was intended to provide investors with material information regarding publicly traded securities by making uniform the content of financial disclosures between annual reports to shareholders and annual financial statements filed with the SEC.\textsuperscript{34} The system was underpinned by the theory that, if periodic filings regularly and promptly provide material information, the market will absorb that data and reflect it in securities prices.\textsuperscript{35}

During that same time period, courts also began explicitly adopting the efficient markets hypothesis as the basis for fraud-on-the-market securities fraud cases. In one Rule 10(b) securities case from 1980, the U.S. District Court for the Northern District of Texas directly cited four economic studies that built an empirical argument for the efficient markets hypothesis.\textsuperscript{36} By the end of the 1980s, the debate over whether the theory had a place within legal doctrine unfolded at the highest legal levels in the Supreme Court’s \textit{Basic v. Levinson}

\textsuperscript{30} See, e.g., Basic Inc. v. Levinson, 485 U.S. 224, 246 (1988) (“Congress expressly relied on the premise that securities markets are affected by information, and enacted legislation to facilitate an investor’s reliance on the integrity of those markets . . . .”); \textit{id.} (“Recent empirical studies have tended to confirm Congress’ premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations.”).

\textsuperscript{31} \textsc{Securities \& Exchange Commission, Adoption of Integrated Disclosure System, Release No. 33-6383 (Mar. 3, 1982) [47 FR 11380] (“This action integrates the disclosure systems under the various Federal securities laws and simplifies and improves the disclosure requirements imposed under these systems.”).

\textsuperscript{32} \textit{id.}

\textsuperscript{33} \textit{id.} (“The Commission’s program to integrate the two disclosure systems has focused on two principal objectives: first, a comprehensive evaluation of the disclosure policies and procedures under both Acts to identify the information which is material to security holders and investors in both the distribution process and the trading markets, such as the minimum information package; and, second, a determination of the circumstances under which information should be disseminated to security holders, investors and the marketplace.”).


\textsuperscript{36} \textit{See In re LTV Sec. Litig., 88 F.R.D. 134, 144 (N.D. Tex. 1980) (“Recent economic studies tend to buttress empirically the central assumption of the fraud on the market theory—that the market price reflects all representations concerning the stock. Indeed, economists have now amassed sufficient empirical data to justify a present belief that widely-followed securities of larger corporations are ‘efficiently’ priced: the market price of stocks reflects all available public information—and hence necessarily, any material misrepresentations as well.”) (citing J. \textit{Van Horne}, \textit{Financial Management and Policy} 48 (4th ed. 1977); J. Francis \& S. Archer, \textit{Portfolio Analysis} 193 (1971); C. Coates, \textit{Investment Strategy} 363 (1978); Burton Malkiel, \textit{The Inflation Beater’s Investment Guide: Winning Strategies for the 1980’s} 64 (1980); Seaboard World Airlines v. Tiger International, 600 F.2d 355, 361-62 (2d Cir. 1979)).
opinion. In that securities fraud case, the Court’s majority opinion adopted a fraud-on-the-market theory, with a plurality of the Court expressly basing its acceptance of the fraud-on-the-market theory on academic support for the efficient markets hypothesis.

Assimilation of the efficient markets theory into regulatory and legal reasoning reflects the federal government’s commitment to enabling market efficiency and providing investors with the material information necessary to enable the accurate pricing of securities. In light of this, determining whether ESG disclosures are legally material should be a function of whether making that information available to investors enables more accurate pricing of securities.

B. The Governance Theory and Investor Suffrage

At the same time that the efficient markets hypothesis was gaining favor with the courts, an alternative vein of scholarship and advocacy was becoming increasingly concerned with the relationship between disclosures, the internal politics of corporate governance, and investors’ role within these dynamics. The governance theory of disclosure argued that the purpose of disclosures is “to encourage investors to police the quality of corporate decision-making.” According to the governance theory, alternatively termed the “agency cost model,” disclosure reduces the cost of monitoring an agent’s use of corporate assets and allows shareholders to monitor self-interested behaviors by management. Under this account, mandatory disclosure is intended to address principal-agent problems between corporate promoters and investors, and between corporate managers and shareholders. With respect to contemporary investor concerns with corporate ESG performance, this mandate would extend to ESG disclosures that enable investors to serve as a check on corporate management. While the governance theory has not been nearly as influential as the efficient markets theory in securities scholarship and regulation over the past fifty years, this trend has recently begun to change.

In the 1970s, the SEC rejected the claim that disclosures should enable investors to play a governance role in companies. The SEC deemed such a proposition to be inimical to congressional intent and exceeding the mandate conferred on federal securities law. Within legal scholarship, critics of the

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38. See id.
governance theory argue that in the division between state and federal law, matters of corporate governance should be governed by state corporation law, while federal law serves as a supplement to state regimes by requiring access to meaningful information through the disclosure system. Critics of the governance theory of disclosure argue that corporate governance falls within the purview of state corporations law and is not properly dealt with through the federal securities regime. This view limits the types of information that could be required through disclosure and severely constrains the possibility of shareholder activism relying on securities fraud litigation. Contemporary investor behavior, however, undermines this conceptual separation between federal and state mandates dealing with corporate governance.

Investors’ actual use of securities disclosures evidences a complex overlap between the state and federal mandates. This behavior reflects the expansion of a corporate governance agenda into the actual operation of federal securities law and shareholder securities fraud lawsuits. This trend may be observed in the growing prevalence of federal disclosure requirements concerning governance-related matters, such as executive compensation, environmental compliance, board diversity and independence, and attendance at board of directors meetings. These disclosures give shareholders insight into managerial decision-making and allow them an opportunity to oversee and influence those decisions. Increasingly, shareholders have asserted the importance of ESG disclosures to their effective engagement with corporate management. While some investors use ESG disclosures as a screening mechanism for investments, others use ESG disclosures to inform more direct engagement strategies taking the form of direct communication between investors and companies. The actual mechanics of federal securities enforcement demonstrate an evolving role for and their legislative history suggest that Congress intended the Commission to exercise its authority primarily “to require the dissemination of information which is or may be economically significant.” The SEC concluded, “although disclosure requirements may have some indirect effect on corporate conduct, the Commission may not require disclosure solely for this purpose.”

44. The federalism debate continues to undermine efforts to expand the scope of non-financial securities disclosures. Courts remain largely loyal to an interpretation that relegates corporate mismanagement claims to the domain of state law rather than securities law. As recently as 2007, an opinion in the U.S. District Court for the District of Colorado held that plaintiffs’ claim of misrepresentation due to a company’s failure to disclose violations of its code of ethics, was “bootstrapping [an] internal mismanagement claim into a federal securities action claim.” See Andropolis v. Red Robin Gourmet Burgers, Inc., 505 F. Supp. 2d 662, 683–84 (D. Colo. 2007).
45. Lipton, supra note 11, at 104.
46. Id.
shareholders who increasingly engage in shareholder activism. This activism notably allows regulation by the public. When deliberations in Congress have broken down along political lines, it allows for a means of market regulation based on what the investors find important, and it permits cost-benefit analyses to include nonmonetary values.

As this section elaborates, the expanding popularity of the governance theory into actual investor behavior and decision-making reflects a commitment to enabling investor activism and providing investors with the information necessary to allow their participation in corporate decision-making. In keeping with a governance theory, the materiality of ESG disclosures should be a function of whether the information that is disclosed better allows investors to participate in corporate governance and in the policing of corporate management.

C. Managing the Marketplace of Disclosure: The Puffery Defense

The effectiveness of both the capital markets and the governance theories of disclosure depends on investors having access to relevant information that informs their decision-making, whether expressed as securities valuation or as the exercise of governance oversight. In securities fraud litigation, public and private plaintiffs seeking to recover must prove omission or misrepresentation of “material” facts in order to establish a claim. Enforcing a mandatory disclosure regime requires a theory and mechanism for discerning between material and immaterial information. Within securities doctrine, the puffery defense operates to distinguish material disclosures, or disclosures that are substantially likely to be relevant to a reasonable investor, from immaterial ones.49 Thus, the puffery defense provides a tool for regulating the informational economy of securities disclosures.

The puffery defense appears in securities cases where companies have made vague statements characterizing current or past performance and on-going transactions, or made statements about the company’s future performance. In these cases, investors bring securities fraud suits on the grounds that the statements in question constitute material misrepresentations. In the last decade, defendants have been increasingly successful in getting these claims dismissed based on the argument that these statements are mere puffing that is “so obviously unimportant to a reasonable investor that reasonable minds could not differ.”50 Companies rely on the puffery defense to counter allegations by

49. See Jennifer O’Hare, The Resurrection of the Dodo: The Unfortunate Re-Emergence of the Puffery Defense in Private Securities Fraud Actions, 59 Ohio St. L.J. 1697, 1698 (1998) (“If the statement is labeled as puffery, it is deemed to be immaterial as a matter of law. Because one of the required elements of securities fraud-materiality—is absent, the court will dismiss the action...[T]he puffery defense offers a defendant a powerful tool to avoid liability under the federal securities laws. Once a court determines that a statement constitutes puffery, the company will be shielded from liability arising from that statement.” (citations omitted)).

investors that certain ESG-related statements were material to them when deciding whether to purchase or sell securities. The puffery defense has become integral to determining the parameters of what ESG information is considered legally material, and by implication, who qualifies as a “reasonable investor,” whose reliance on particular disclosures is protected by securities law.

Over the past decade, defendants have found particular success in using the puffery defense to obtain dismissals of complaints based on forward-looking statements.\(^\text{51}\) This is due to courts being more skeptical in their evaluation of corporate optimism about the present than optimism about the future.\(^\text{52}\) The Supreme Court case *Virginia Bankshares, Inc. v. Sandberg* laid the groundwork for the actionability of forward-looking statements, noting that such opinions “rest on a factual basis that justifies them as accurate, the absence of which renders them misleading.”\(^\text{53}\) Based on this assertion, forward-looking statements without a factual basis could presumably be found actionable. However, in the two years following *Virginia Bankshares*, the Second, Fourth, and Fifth Circuit Courts of Appeals held that forward-looking statements concerning a company’s projections were immaterial puffery as a matter of law.\(^\text{54}\) The courts notably failed to address the informational value of such puffery to the securities markets. While puffing about current conditions generally receives close scrutiny to determine whether it affects actual purchasing decisions,\(^\text{55}\) puffing about the future is almost always found to be immune based on the rationale that such disclosures should not affect consumption.\(^\text{56}\)


52. *See O’Hare, supra* note 49, at 1734 (citing McCarthy v. C-Cor Electronics, Inc., 909 F. Supp. 970, 976 (E.D. Pa. 1995), *on reconsideration in part*, 929 F. Supp. 199 (E.D. Pa. 1996) to illustrate the court’s reasoning that “[f]orward-looking statements are . . . less material than are statements of present fact.” The court elaborated that reasonable investors “know that prediction is necessarily an inexact art, and so treat forward-looking statements as less reliable than statements about present facts” and so do not grant as much significance to forward-looking statements).


54. See *Friedman v. Mohasco Corp.*, 929 F.2d 77, 79 (2d Cir. 1991) (“Appellants endeavor in their brief to reframe their theories of misrepresentation, but each attempt rests on the unavailing claim concerning the advisors’ opinion of expected market value.”); *Krim v. BancTexas Grp., Inc.*, 989 F.2d 1435, 1446 (5th Cir. 1993) (“[P]rojections of future performance not worded as guarantees are generally not actionable under the federal securities laws.”); *Raab v. Gen. Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993) (“Analysts and arbitrageurs rely on facts in determining the value of a security, not mere expressions of optimism from company spokesmen. The market gives the most credence to those predictions supported by specific statements of fact, and those statements are, of course, actionable if false or misleading. However, projections of future performance not worded as guarantees are generally not actionable under the federal securities laws.”) (citation omitted).


56. See, e.g., *Raab*, 4 F.3d at 290 (quoting *Krim*, 989 F.2d at 1446 (applying a strong presumption against the materiality of forward-looking statements).
The puffery defense lends insight into the courts’ assumptions about the rationality of consumption and the motivations underlying economic transactions: it demonstrates acceptance of a rational-actor model of investor behavior. In line with this theory, rational consumption based on reasonable information should be rewarded while irrational consumption based on unreasonable information should be punished. Accordingly, the puffery defense fails if a reasonable investor would have relied on the corporate speech in question, and it succeeds if a reasonable investor would not have relied on the corporate speech in question. The puffery defense also evidences the courts’ implicit acceptance of the efficient-markets theory and its emphasis on the importance of backward-looking and present information over forward-looking statements in informing investor decision-making.

The efficient markets and the governance theories of disclosure, as well as the puffery defense, are all premised on a presumed characterization of the “reasonable investor” who is both the subject of protection for the securities regime and also an active and essential functionary in the maintenance of an efficient securities market. Part II unpacks the key accepted assumptions underlying this characterization of the “reasonable investor” and reconsiders this notion in light of contemporary investor demographics and behavior. It considers the implications that a revised characterization of the reasonable investor might have for the disclosure theory and the puffery defense.

II. THE NEW REASONABLE INVESTOR AND CHANGING FRONTIERS OF MATERIALITY

As illustrated in Part I, the regulatory scheme of mandatory corporate disclosure is premised on an assumption that there is a prototypical reasonable investor, whose vantage point serves as the basis for classifying certain information as material or immaterial. Scholars have interrogated and challenged this characterization from a range of critical perspectives. The

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57. David A. Hoffman, The Best Puffery Article Ever, 91 IOWA L. REV. 1395, 1398 (2006), but see Peter H. Huang, Moody Investing and the Supreme Court: Rethinking the Materiality of Information and the Reasonableness of Investors, 13 SUP. CT. ECON. REV. 99, 112 (2005). Recent behavioral economics literature has challenged the assumed relationship between puffing speech and consumption. Peter Huang draws on behavioral finance to argue that the puffery defense is essentially flawed because it does not take into account the power of puffery to influence investors’ “mood” or non-cognitive decision-making. Huang, supra., at 102-03. He argues that a model of the reasonable investor that takes into account “moody investing” would result in different parameters for materiality and investor rationality that take into account both cognition and affect. Id. at 115.

58. See TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976) (“The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor. Variations in the formulation of a general test of materiality occur in the articulation of just how significant a fact must be or, put another way, how certain it must be that the fact would affect a reasonable investor’s judgment.”); see also Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988) (“We now expressly adopt the TSC Industries standard of materiality for the § 10(b) and Rule 10b–5 context.”).
dominant critique argues that a theoretical model in which investor decision-making only considers economic rationality does not reflect actual investor behavior. A more accurate model, critics argue, would incorporate non-economic values and irrational moods when characterizing the reasonable investor. Legal characterization of the reasonable investor is highly consequential in securities jurisprudence as it bears directly on judicial determinations of materiality. Increasing demand for ESG disclosures prompted by changes in investor demographics and activism in recent years prompts a closer look at, and reconsideration of, the established notion of the reasonable investor.

With the emergence of a mandatory disclosure regime, two key phenomena distinguish today’s reasonable investor from the version that dominated public imagination when the SEA was promulgated: (1) the increasing materiality of ESG data to mainstream investors as evidenced in their public statements, and (2) a growing investment market share of socially responsible investing. The increased interest by investors in ESG data has spurred a whole industry of ESG data aggregators, analysts, and advisors. These third-party data and service providers use a wide range of proprietary methodologies and sources to conduct their assessments. The ecosystem of data providers has bloomed in the last decade with the development of specialized firms such as Sustainalytics, ISS Oekom, MSCI ESG Research, and Reprisk. In addition, an ecosystem of ESG indices has proliferated, including Thomson Reuters Corporate Responsibility Indices, Calvert Responsible Index Series, FTSE4Good Index Series, Dow Jones Sustainability Indices, MSCI ESG Indexes, and Morningstar Global Sustainability Index Family. This transformation of the investment landscape,

59. See e.g., Huang, supra note 57, at 112; Stefan J. Padfield, Is Puffery Material to Investors? Maybe We Should Ask Them, 10 U. PA. J. BUS. & EMP. L. 339, 341 (2008) (arguing that judges should rely on investor surveys to determine what is material); Tom C.W. Lin, Reasonable Investor(s), 95 B.U. L. REV. 461, 462 (2015) (suggesting that investors are not homogenous so there cannot be a singular view of what is a reasonable investor); Hoffman, supra note 7, at 543-44. “Margaret V. Sachs, Materiality and Social Change: The Case for Replacing ”The Reasonable Investor” with ”The Least Sophisticated Investor” in Inefficient Markets, 81 TUL. L. REV. 473 (2006) (proposing courts lower the required level of materiality but raise the required level of scienter necessary for securities fraud claims to be successful).

60. It is worth noting that the ESG data environment is still in its relative infancy, with attendant challenges for the quality and accuracy of the data that ESG providers include in their reports. This is particularly significant for issuers who, when seeking to correct errors in the information that the ESG data providers are including in their reports, often do not find these corrections reflected. This has implications for investment decisions made by asset managers and for inclusion of those issuers in ESG indexes and portfolios. These dynamics complicate the premise that providing increased information to ESG data providers results in increased transparency for investors.

61. Id.


and the introduction of new actors as part of the investment ecosystem, has prompted an evolving discourse on the meaning and parameters of materiality for today’s reasonable investor.

This section examines the notion of the reasonable investor in light of changing investor demographics and the increasing demand for, and availability of, ESG information in the informational marketplace. It illustrates that the incorporation of ESG disclosures into asset risk-management and valuation is consistent with the efficient markets hypothesis. It also illustrates that the use of ESG disclosures to enable investor participation in corporate governance and to facilitate engagement with corporate management is consistent with the governance theory of disclosure. This section concludes that the expansion of mainstream investor reliance on ESG disclosures, and the rise of SRIs as a subclass of investors with activist ESG agendas, supports a case for ESG materiality under both theories.

**Increasing Importance of ESG Data to Mainstream Investors**

The past century has witnessed an evolution of mainstream investor demographics and behavior. The 2008 market crash and subsequent popular activism have resulted in investors becoming more attuned to companies’ long-term sustainability and the social repercussions of their activities. In recent years, several high-profile mainstream investors have publicly announced their concern with the social impacts and contributions of the companies they invest in. One headlining example is the annual letter to companies published by Laurence Fink, Blackrock’s Chairman and CEO. As the world’s largest investment firm, Blackrock is an industry icon, and Fink’s annual letter has come to represent a proxy for the pulse of the mainstream investment world. In his January 2019 letter, Fink asserted that “[p]rofits are in no way inconsistent with purpose – in fact, profits and purpose are inextricably linked.” He characterized a company’s purpose as a strategic “framework for consistent decision-making” that “ultimately, helps sustain long-term financial returns for . . . shareholders.” Fink’s letter is acutely aware of the changing expectations from companies by the investing public, noting that millennials “express new expectations of the
companies they work for, buy from, and invest in.” His letter explicitly pointed to the evolving nature of materiality, noting that “[a]s wealth shifts and investing preferences change, environmental, social, and governance issues will be increasingly material to corporate valuations.” Such statements evidence that, in the interest of using disclosures to value securities, as is consistent with the efficient markets hypothesis, investors are keen to incorporate ESG data to achieve accurate pricing. As evidenced by Fink’s letter, ESG data is acquiring financial materiality for firms with a more traditional, rather than SRI directed, orientation and is being integrated across entire investment platforms.

Survey data on actual investor use of ESG information suggests that Blackrock’s orientation towards ESG is representative of the wider investment community. In a 2018 study, Amir Amel-Zadeh and George Serafeim surveyed investors to understand why and how they use ESG data. Survey respondents were largely mainstream investors, comprising 43% of global institutional assets under management. Amel-Zadeh and Serafeim’s findings showed that 82% of investors consider ESG data when making investment decisions. They also showed that investors primarily use ESG information for financial, rather than ethical motives, because the information is financially material to investment performance and because clients demand it. Notably, 63% of investors reported that they consider ESG information in their investment decisions because it is financially material to investment performance. Amel-Zadeh and Serafeim found that investors predominantly use ESG information to engage with firms, as input into their valuation models, or for screening. They also found that, at the portfolio (rather than firm) level, ESG data is used mostly as a screening tool. Such empirical findings demonstrate that ESG data is being incorporated into the scope of material information, and that investors are increasingly relying on ESG data in their portfolio allocations. As expressed in their own words and as reflected by their own behaviors, investors are treating ESG data as material information.

A. The Growing Popularity of Socially Responsible Investing

Alongside the changing rationality of mainstream investors, another notable trend in investment behavior has been the dramatic expansion of socially responsible investing. Interest in social and environmental disclosures predates...
the rise of SRIs by nearly half a century. Formal efforts to mandate environmental and civil rights disclosures began in the late 1960s in the political context of the anti-war and environmental movements.\textsuperscript{76} In 1971, the Natural Resources Defense Council (NRDC) and the Project on Corporate Responsibility brought a rulemaking petition to the SEC, calling for the expansion of federal securities disclosure on civil rights and the environment.\textsuperscript{77} The SEC considered the petition for a decade, ultimately concluding that expanded social disclosure was not required under its mandate.\textsuperscript{78} In determining whether to mandate social disclosure, the SEC looked to the interest of the reasonable investor at the time. In a 1975 decision, it dismissed these social disclosure campaigns as irrelevant and as falling outside the scope of its mandate.\textsuperscript{79} It elaborated that since ethical funds at the time only comprised 0.0005% of mutual fund assets, this was far too negligible a portion to characterize mainstream investor interest.\textsuperscript{80} The SEC also looked to proxy voting on social issues as an indicator of investors’ interest in social disclosure and found that, on average, social issue proposals received affirmative votes only 2 to 3% of the time in the early 1970s.\textsuperscript{81} Based on these indicators, the SEC found first that investors were primarily concerned with economic, not social, issues in making investment decisions, so it would not require social disclosure. Second, it found that to the extent social disclosure was sought in order to influence corporate conduct, to require such disclosure was beyond its authority. The SEC concluded that since investors were primarily concerned with economic, not social, issues in making investment decisions, it would accordingly maintain an economic understanding of materiality in weighing disclosure proposals.\textsuperscript{82} While the NRDC case was, first and foremost, about the SEC’s authority to require social disclosure, it does provide a stark illustration of how the constituent audience of the SEC’s federal disclosure requirements has changed in the decades since this debate unfolded.

\textsuperscript{76} Cynthia A. Williams, \textit{The Securities and Exchange Commission and Corporate Social Transparency}, 112 \textit{Harv. L. Rev.} 1197, 1246 (1999) (“Efforts to use the federal securities laws to promote expanded social disclosure began during the late 1960s, growing out of the anti-war and environmental movements.”) (citations omitted).

\textsuperscript{77} The 1979 lawsuit brought by the NRDC against the SEC demonstrates a broader debate over the scope of required disclosure that may be required by the SEC pursuant to the SEA. The boundary between financial and non-financial corporate disclosures remains contested today. \textit{See} Nat. Res. Def. Council, Inc. \textit{v. Sec. & Exch. Comm’n}, 606 F.2d 1031, 1039 (D.C. Cir. 1979) (“[The SEC] argued, first, that its discretion to adopt particular disclosure requirements was very broad, depending in every case on balancing, in its expert judgment, the incremental value of the proposed disclosure against the potentially confusing effect on investors and the increased costs to registrants. Despite this broad discretion, however, the Commission contended that its authority was limited to contexts related to the objectives of the federal securities laws. And these laws, in the Commission’s view, were designed generally to require disclosure of financial information in the narrow sense only.”).

\textsuperscript{78} Williams, \textit{supra} note 76, at 1246–48.

\textsuperscript{79} Id. at 1251–52.

\textsuperscript{80} Id. at 1251.

\textsuperscript{81} Id.

\textsuperscript{82} Id.
The portion of sustainability-minded investors comprising the investment community today differs significantly from the 1970s. In a 2018 report on sustainable, responsible, and impact investing trends in the United States, US SIF noted that US domiciled assets under management incorporating sustainability strategies increased from $8.7 trillion in 2016 to $12 trillion in 2018. This number represents 26% of total assets under professional management in the US. Globally, investors with nearly $82 trillion of capital collectively have signed on to the UN Principles for Responsible Investment, expressing their commitment to incorporating ESG factors in their investment and voting decisions. SRI investors offer the opportunity to direct their investments to companies that adhere to their selected social and/or environmental values. Some SRIs also use ESG performance data as the basis for lobbying company decision-making that better aligns with their values. The expanding presence of SRIs as an influential class of shareholders challenges established notions of the archetypical shareholder’s narrow focus on profit maximization. For SRIs, the collection and use of ESG data is a core aspect of their value proposition. Accordingly, in order to operate reasonably in a manner that upholds their fiduciary mandate, companies must incorporate ESG data into their decision-making processes.

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84. While the US SIF numbers are widely quoted, other evidence suggests that even though policy commitments are quite large, including under the PRI, actual ESG assets under management fall short of those commitments. See MORGAN, Sustainable Funds U.S. Landscape Report: More funds, more flows, and strong performance in 2018 (Feb. 2019). While the general trend is one of upward growth in both instances, this is a gap worth noting.


86. PRINCIPLES FOR RESPONSIBLE INVESTMENT, https://www.unpri.org/about-the-pri/about-the-pri/322.article.


88. The Responsibility Factor, ARIEL INVESTMENTS 1 (April, 2018), https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjOp4bAxtXqAhWj2QIHVPzAQQFjAgEgtQIAAxAb&url=https%3A%2F%2Fwww.arielinvestments.com%2Frepertoire%2Ffund%2Fdownload%2Ffilecatid%2FC40%2F&usg=AOvVaw3TcfT-sUSMs3eNzPpFl62... http://www.arielinvestments.com%2Frepertoire%2Ffund%2Fdownload%2Ffilecatid%2FC40%2F&usg=AOvVaw3TcfT-sUSMs3eNzPpFl62... “(“We further believe ethical business practices make good investment sense and seek companies in alignment with our social quality criteria, similar to how we search for a margin of safety. More specifically: Our value and deep value strategies do not invest in corporations whose primary source of revenue is derived from the production or sale of tobacco products or the manufacture of firearms.”);

“Integrating Environmental, Social and Corporate Governance (ESG) Analysis in the Investment Process, IMPAX ASSET MANAGEMENT” (Mar. 2020), https://impaxam.com/wp-content/uploads/2019/05/Impax_ESG_Policy_2020.pdf?pmw=2077 (“We seek to avoid companies involved in significant controversies that violate global norms related to human rights, labour, environment and corruption. We source information about company involvement in these controversies from external ESG research providers. If Impax determines a company is the subject of significant ESG controversy, it will likely be excluded from investment. We periodically reassess company involvement in ESG controversies.”);

iShares ESG MSCI USA ETF, BLACKROCK (2020), https://www.blackrock.com/investing/products/286007/esgu (“The iShares ESG MSCI USA ETF seeks to track the investment results of an index composed of U.S. companies that have positive environmental, social and governance characteristics as identified by the index provider while exhibiting risk and return characteristics similar to those of the parent index.”).
their materiality considerations. The reasonable SRI investor, therefore, diverges from the economically rational, mainstream investor who currently dominates legal doctrine.89

Investors’ concern with, and involvement in, soliciting ESG disclosures and influencing companies’ ESG performance today is reflected in shareholder proposals, proxy voting behavior, and engagement reports.90 In 2018, social and environmental proposals comprised 43% of all shareholder proposals submitted.91 In a review of shareholder proposals from 2000 to 2018, Corporate Governance and Activism expert Kosmas Papadopoulos observed that investors’ voting behavior changed significantly over the two decades examined, with the most significant change pertaining to environmental and social issues.92 Support for environmental and social shareholder proposals increased from 6% of votes cast in 2000, to 24% of votes cast in 2018.

Papadopoulos further observed a change in the approach used by shareholder proponents of environmental and social proposals. In the early 2000s, most proposals concerned companies adopting or amending social and environmental policies or taking specific actions with respect to business activities. Over the subsequent two decades this approach shifted to one focusing on reporting, assessment, and risk monitoring. This shift, Papadopoulos argued, changed the conversation “from a values-based argument to an economic discussion about how environmental and social risks can impact the company’s long-term value.”93 Papadopoulos’s analysis also demonstrated changes in investors’ voting strategies. While a significant portion of investors formerly abstained from voting on environmental and social issues, based on the understanding that these issues did not have quantifiable economic impact, by 2018, the percentage of those abstaining dropped to merely 3% of votes cast.94 At the same time, investor votes for environmental and social proposals increased from less than


93. Id.

94. Id.
10% of votes cast in 2000 to 25% of votes cast in 2018. The decline in percentage of abstaining investors reflects their more active engagement with companies on related environmental and social issues. As a complementary indicator of increased investor engagement on ESG issues, the percentage of environmental and social shareholder proposals withdrawn by proponents increased from 37% in 2008 to 48% in 2018, which shows an increased willingness to engage with proponents and to reach an agreement about disclosures or policy adoptions. As these trends demonstrate, investors increasingly rely on ESG performance indicators to devise their agendas for active engagement with management.

B. The Case for ESG Materiality

The changing attributes of a reasonable investor usher in an expanded view of the type and content of disclosures that such investors deem material to their decisions to invest in, engage with, or divest from particular companies. If, as the securities doctrine maintains, material information is that which is important to a reasonable investor, then the observed trends, which depart from shareholder demographics and behavior of the past decades, suggest a corresponding need to change the scope of disclosures considered legally material.

The case for ESG disclosure materiality is supported under both the efficient markets hypothesis and the governance theory of disclosure. Under the efficient markets hypothesis, disclosures that facilitate the accurate pricing of securities and that encourage good consumption would be deemed material. In recent years, investors have argued that ESG is an essential consideration for accurate risk-management, which in turn is a key component of asset valuation. They have directly lobbied the SEC and made demands asking companies to provide them with access to this information. Under the governance theory, investors would consider disclosures that enable the policing of management to be material. As shareholder proposals and proxy voting behaviors demonstrate, investors are employing ESG disclosures to actively participate in corporate governance and influence corporate decision-making. Investors are also pursuing securities lawsuits prompted by misleading ESG disclosures as an additional avenue for policing and engaging with managerial decision-making. While there is a strong case for considering ESG data as a material category of disclosure, the finer points concerning what types and forms of statements and data should be material and what should be properly classified as puffery remain muddled.

Several different initiatives have sought to fill this void by defining specifically what type, scope, and form of ESG information should be considered.

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95. Id.
96. Id.
97. Id.
material. In 2011, the Sustainability Accounting Standards Board (SASB) was established as a non-profit aimed at filling this need by setting industry-specific sustainability disclosure standards that are intended to capture financially material sustainability matters. The SASB, modeled after the FASB, adopted a definition of materiality that accords with financial materiality – “issues that are reasonably likely to impact the financial condition or operating performance of a company and therefore are most important to investors.” The SASB provides a selection of material issues classified by sector. By contrast, the Global Reporting Initiative argues that companies should report on all its impacts, regardless of the financial materiality of the information. In the absence of an authoritative verdict on ESG materiality, investors have taken to the courts to litigate the materiality, and consequently legal actionability, of ESG disclosures.

Part III discusses recent lawsuits to discern the courts’ current treatment of this evolving question. It identifies gaps in the courts’ approach based on the trends noted in this section. Part IV then follows with a proposal for how the courts might better deal with this ambiguity in dealing with forward-looking ESG statements, commitments, aspirations, and intentions.

III. MATERIAL MISSTATEMENT OR MERE PUFFERY? LITIGATING SUSTAINABILITY DISCLOSURES

The evolving characterization of the reasonable investor elaborated in Part II has become widely accepted in the business domain. With this characterization as its reference, more recent scholarship has focused on testing the empirical case for financial materiality of ESG disclosures. Scholars and practitioners are now concerned with specifically identifying which ESG disclosures are material. In the absence of an authoritative determination on the legal

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100. Why is Financial Materiality Important?, SUSTAINABILITY ACCOUNTING STANDARDS BOARD (2018), https://www.sasb.org/standards-overview/materiality-map; SASB’s Approach to Materiality for the Purpose of Standards Development SB002-07062017 (“The determination of materiality and duty to disclose lies with corporations, which are subject to federal securities laws.”).
103. See, e.g., GIBSON DUNN, Corporate Social Responsibility Statements—Recent Litigation and Avoiding Pitfalls (Mar. 9, 2017), https://www.gibsondunn.com/corporate-social-responsibility-
materiality of ESG disclosures, investors have decided to litigate the nuances of this question. This section reviews the courts’ current treatment of the actionable versus puffery distinction when making determinations about the materiality of disclosures. Within this broader context, it focuses specifically on the unique challenges presented to the doctrine by ESG statements, as distinct from other types of disclosures. It identifies an incongruity between the courts’ current treatment of forward-looking statements, commitments, aspirations, and intentions, and the actual expectations and behaviors of today’s reasonable investors. Part IV will build on this analysis to offer a revised approach for how courts should deal with ESG statements as actionable or as aspirational puffery in the context of a changing reasonable investor profile.

A. Current Trends in the Courts’ Treatment of ESG Statements

The antifraud provision of the Securities Exchange Act, found in section 10(b), is one of the most important legal tools used to address securities fraud. In order to make a successful section 10(b) claim, a plaintiff must prove “(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.” A review of section 10(b) case law brings to light four key trends in the courts’ determination of a corporate statement’s classification as actionable (implying materiality and reliance) or as aspirational (dismissed under the puffery defense). First, courts tend to give greater weight to the content of a statement rather than the type of document where it is published when determining its materiality. Second, courts generally find specific statements to be actionable and dismiss general or vague statements as puffery. Third, courts find past- and present-focused statements to be actionable and dismiss forward-looking statements as puffery. Fourth, courts generally dismiss statements of intent, aspirational statements, codes of conduct, and codes of ethics as puffery. While these trends can, in some ways, be carried over seamlessly from the domain of financial disclosures to that of ESG disclosures,


104. A prior paper by Ajax and Strauss looked at how investors and consumers are attempting to hold companies accountable for their voluntary disclosures. They examined the courts’ responses to these attempts and found that, in the context of ESG disclosures, the criteria used to differentiate between actionable statements and those that are puffery were ambiguous. See Caitlin M. Ajax & Diane Strauss, Corporate Sustainability Disclosures in American Case Law: Purposeful or Mere "Puffery"?, 45 ECOLOGY L. Q. 703 (2019).


in other ways they fall short of meeting the needs of today’s reasonable investor and should be replaced with a more discerning analytical framework.

B. Document Type & Attribution

In its preliminary determination of whether a statement was material to the reasonable investor when deciding to purchase or sell a security, a court must find that such statement was made “in connection with” the transaction as required by section 10(b). Looking to section 10(b), some scholars and litigators have argued that ESG-related statements are not made “in connection with” the purchase or sale of a security because they appear in formats that are not included in mandatory SEC filings. The courts have been trending towards a broad and contextualized interpretation of the “in connection with” requirement. The U.S. District Court for the Southern District of New York articulated the standard for meeting the “in connection with” requirement as “any statement that is reasonably calculated to influence the average investor.” Accordingly, a revised understanding of the reasonable investor would include statements found in a company’s sustainability reports and reviews in this interpretation of the “in connection with” requirement.

Courts have been inclined to consider statements made in a wide variety of formats and publications as meeting the “in connection with” requirement, and thus as potentially material statements. They have found that content contained in press releases and investment prospectuses, news articles and publicly filed annual reports, financial statements and audit reports, websites, and technical advertisements may be actionable. The Second, Third, and Ninth Circuits have held that plaintiffs “may establish the ‘in connection with’ element simply by showing that the misrepresentations in question were disseminated to the public in a medium upon which a reasonable investor would rely, and that they were material when disseminated.” The Third Circuit has further liberalized this statutory element. It has eliminated a strict requirement of investor reliance and held that plaintiffs are “not required to establish that the defendants actually envisioned that members of the Class would rely upon the

107. 17 CFR § 240.10b-5.
109. See, e.g., McGann v. Ernst & Young, 102 F.3d 390, 397 (9th Cir. 1996); S.E.C. v. Rana Research, Inc., 8 F.3d 1358, 1362 (9th Cir. 1993).
112. In re Plains All Am. Pipeline, L.P. Sec. Litig., 245 F. Supp. 3d 870, 900 (S.D. Tex. 2017) (“[T]he third statement—that Plains makes repairs and replacements when needed on all of its pipelines—is actionably misleading . . . . This website statement is actionable and material.”).
113. In re Carter-Wallace, Inc. Sec. Litig., 150 F.3d 153, 156 (2d Cir. 1998) (“Technical advertisements in sophisticated medical journals detailing the attributes of a new drug could be highly relevant to analysts evaluating the stock of the company marketing the drug.”).
114. Id. at 176.
alleged misrepresentations when making their investment decisions,” but “must only show that the alleged misrepresentations were reckless.”115 These rulings demonstrate a general attempt by the courts to create accountability for a wide range of corporate communications, provided they were used to inform the reasonable investor.

When determining the materiality of an ESG statement, at least one court has distinguished between attributed and unattributed statements116 contained in a company’s sustainability reports and reviews when determining materiality. In the case of In re BP p.l.c. Securities Litigation, concerning claims that BP and its chief executive had misled shareholders regarding the company’s ability to manage risk in its operations, the U.S. District Court for the Southern District of Texas discussed differentiated treatment for attributed and unattributed statements in BP’s Sustainability Report. However, this discussion was in the context of determining whether the requirement of scienter had been met for the statements in question, and the discussion took the “in connection with” requirement as a given.117 Of the three statements in question, the court found only the statement attributed to the company to be actionable.118

In a related case, the same court found that statements made in BP’s Sustainability Reviews by its then CEO were actionable by plaintiffs pleading section 10(b) violations, while other statements found in its Sustainability Reports were inactionable.119 In explaining the balancing test that it used to decide whether or not statements contained in these reports should be actionable, the court focused on the question of attribution.120 The court reasoned that the essential nature of the corporate structure required an attribution requirement.121 It noted that corporations regularly publish or share lengthy documents to transmit information to shareholders and that these documents may be unsigned or without specific authors.122

Consequently, plaintiffs may be unable to impute specific statements to individuals since “many allegedly ‘fraudulent’ corporate statements are the

115. Id. (“The purpose underlying § 10(b) and Rule 10b–5 is to ensure that investors obtain fair and full disclosure of material facts in connection with their decisions to purchase or sell securities. . . . That purpose is best satisfied by a rule that recognizes the realistic causal effect that material misrepresentations, which raise the public’s interest in particular securities, tend to have on the investment decisions of market participants who trade in those securities.”).

116. Attributed statements refer to statements with a clear author, while unattributed statements are made under a company’s broader authority.

117. Id. at 614.

118. In re BP p.l.c. Sec. Litig., 843 F. Supp. 2d 712, 789 (S.D. Tex. 2012) (citing the Seventh Circuit opinion Tellabs II v. Makor Issues & Rights, Ltd., to support a holding that unattributed corporate statements may be actionable where a false or misleading statement is “so dramatic [it] would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false.”). See U.S. 308, 330, 127 S. Ct. 2499, 2514, 168 L. Ed. 2d 179 (2007).


120. Id. at 630.

121. Id.

122. Id.
product of ‘a series of acts’ taken pursuant to a ‘hierarchal and differentiated corporate structure,’ none of which were both (1) done with scienter and (2) imputable to the company.” This reasoning implies that a reasonable investor only relies on statements with a clearly personified author and dismisses statements from the broader corporate entity. Since most ESG statements appear on company sustainability pages and in published sustainability reports and reviews (documents that tend to be unsigned), under this rationale they will generally be designated as unattributed. Nonetheless, these formats do factor directly into assessments of corporate ESG orientation and performance by third-party data providers and are relied on by investors. While the aforementioned district court’s broad construal of corporate communications in deciding issues of materiality appears in line with actual investor reliance on these documents, its distinction between attributed versus unattributed statements does not account for actual investor reliance on unattributed statements. Thus, the attribution test does not appear to provide a meaningful proxy for distinguishing between the types of statements that a reasonable investor might rely on.

C. General & Optimistic Statements

Perhaps the most decisive factor in a court’s materiality determination is a statement’s generality or specificity. Presumptively, specific statements induce justifiable investor reliance, while general or vague statements do not inform the decision-making of a reasonable investor. The First, Second, Fourth, Fifth, Sixth, Seventh, Eighth and Tenth circuits have identified generality or vagueness as criteria for distinguishing puffery from actionable statements. The First Circuit noted that, while determinations of materiality are generally reserved for the trier of fact, courts may deem “rosy affirmation” to be immaterial as a matter of law. The court reasoned that no reasonable investor could find loosely optimistic statements “that are so vague, so lacking in specificity, or so clearly

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124. Id.


126. See, e.g., Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1217 (1st Cir. 1996); Lasker v. New York State Elec. & Gas Corp., 85 F.3d 55, 59 (2d Cir. 1996); Raab v. General Physics Corp, 4 F.3d 286, 289-90 (4th Cir. 1993); Nathenson v. Zonagen, Inc., 267 F.3d 400, 404, 419 (5th Cir. 2001); In re Ford Motor Co. Sec. Litig., Class Action, 381 F.3d 563, 570–71 (6th Cir. 2004); Sears v. Glasser, 64 F.3d 1061, 1066 (7th Cir. 1995); In re K–tel Int’l, Inc. Sec. Litig., 300 F.3d 881, 897 (8th Cir. 2002); Grossman v. Novell, Inc., 120 F.3d 1112, 1119 (10th Cir. 1997).

127. See supra note 126.
constituting the opinions of the speaker” to be important to the total mix of information.\textsuperscript{128} The Fourth Circuit similarly distinguished immaterial expressions of optimism as a category separate from that of actionable facts. When considering the materiality of a company’s optimistic statements regarding prospects for growth, the Fourth Circuit differentiated statements of belief or opinion concerning present facts from those concerning future conditions. \textsuperscript{129} It opined that while the former could be found material, such a determination would not extend as easily to “uncertain future events.”\textsuperscript{130} The Tenth Circuit elaborated that corporate puffing is typically comprised of forward-looking statements or “generalized statements of optimism that are not capable of objective verification” and that these statements are not actionable “because reasonable investors do not rely on them in making investment decisions.”\textsuperscript{131} The courts’ conception of puffing appears to be primarily concerned with statements of corporate optimism and is based on an assumption that investors do not actually rely on these statements.

A recent case from the U.S. District Court for the Southern District of Texas offers insight into how the courts extend this reasoning to statements made in an ESG context. The court found that an affirmative statement regarding a company’s compliance with laws and regulations, included in its Health, Safety, Environmental, and Sustainability Overviews, were actionable because the statement was specific, not limited, and not an opinion.\textsuperscript{132} However, it deemed other statements printed in the same documents and assertions that the company “works to ensure”\textsuperscript{133} compliance were “too vague to be actionable.”\textsuperscript{134} The key distinction between the two types of statements, as noted by the court, was that affirmative statements regarding compliance, absent any qualifying language, would be important to inform the reasonable investor’s investment decisions.\textsuperscript{135} By contrast, more aspirational statements would not give a reasonable investor reason to imply absolute compliance.\textsuperscript{136}

The Texas district courts’ general assumption that a reasonable investor does not rely on opinions or aspirational statements does not square with the more

\textsuperscript{128}\textit{Shaw}, 82 F.3d at 1217.
\textsuperscript{129}\textit{Raab}, 4 F.3d at 290.
\textsuperscript{130} \textit{Id.}
\textsuperscript{131} \textit{Grossman}, 120 F.3d 1112, 1119 (10th Cir. 1997).
\textsuperscript{133} \textit{Id.} at *4 (“[w]e work to ensure that all of our activities are conducted to meet or surpass applicable health, safety, and environmental laws, regulations, and international standards.”).
\textsuperscript{134} \textit{Id.} at *11 (“[w]e work to ensure that all of our activities are conducted to meet or surpass applicable health, safety, and environmental laws, regulations, and international standards; “our [health, safety, and environment] team works seamlessly with operations and facilities to ensure compliance with all applicable laws and regulations”).
\textsuperscript{135} \textit{Id.} at *15.
\textsuperscript{136} \textit{Id.} at *11.
recent trends in mainstream investors’ demands and behavior, and by the growing popularity of SRIs. For these investors, aspirations and commitments may signal a company’s long-term sustainability orientation and carry material relevance for differentiating the relative value of competing companies. For example, Walden Asset Management, an investor with a long-term investment horizon, asserts that it considers future indicators and commitments made by companies as positive indicators for investment. Walden considers climate change to be the key material ESG element and interprets forward-looking commitments as a signal that a company is not only aware of a particular material risk, but that it is setting expectations going forward. Such practices undermine the judicial presumption that optimistic and general statements are immaterial as a matter of law and that a reasonable investor does not rely on them. Instead, materiality determinations should be reserved to the trier of fact who can determine whether or not there was actual investor reliance and assess that reliance relative to actual decision-making among the broader investor base.

D. Past, Present, and Future

Courts also place great weight on the temporality of statements in determining their status as actionable versus puffery. This differentiation takes root in the 1995 Private Securities Litigation Reform Act (PSLRA). The 1995 Act distinguishes between statements that are focused on the past and present, and those that are forward-looking. Specifically, it grants a “safe harbor” to forward-looking statements, making them inactionable. The PSLRA was intended to prevent frivolous securities lawsuits. At the time of its introduction, the Act’s proponents argued that plaintiffs’ lawyers were targeting deep-pocket defendants and filing “fraud by hindsight” suits for their settlement value. Proponents alleged that plaintiffs were filing these suits shortly after a substantial drop in a company’s stock price, citing a generic list of complaints, imposing massive costs on defendants through discovery requests, and pressuring

137. Phone interview on February 12, 2019.
138. Id. However, the firm distinguishes between aspirational statements that “don’t have teeth” and specific, measurable, attainable goals.
139. Phone interview, supra note 137.
140. See, e.g., In re Bofi Holding, Inc. Sec. Litig., No. 315CV02324GPCKSC, 2017 WL 2257980, at *7 (S.D. Cal. May 23, 2017) (“[G]enerally immune from Section 10(b) challenges, are ‘forward-looking statements.’ Forward-looking statements, unlike actionable statements, are not ‘descriptive of historical fact.’”) (quoting 15 U.S.C. § 78u-5(i)(1)(A) and S.E.C. v. Todd, 642 F.3d 1207, 1221 (9th Cir. 2011)); Institutional Inv’rs Grp. v. Avaya, Inc., 564 F.3d 242, 256 (3d Cir. 2009) (“Forward-looking statements are protected under § 78u–5(c) if they are identified as forward-looking and are ‘accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.’”).
The defendants to settle.\textsuperscript{142} Today, the safe harbor provision prevents liability for forward-looking statements that are “accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.”\textsuperscript{143} Present-tense statements may also qualify as forward-looking “if the truth or falsity of the statement cannot be discerned until some point in time after the statement is made.”\textsuperscript{144} The PSLRA’s rationale for, and treatment of, forward-looking statements faces some challenges in the context of forward-looking ESG statements.

First, the types of statements that the PSLRA explicitly covers differ from forward-looking ESG statements. According to the PSLRA, forward-looking statements include statements concerning projected revenues, income and income loss, earnings and earnings loss, capital expenditures, dividends, capital structure, and other financial items, statements of future economic performance, and statements concerning “assumptions underlying or relating to these types of statements.”\textsuperscript{145} ESG statements, by contrast, typically relate to considerations of risk management and/or non-financial values.\textsuperscript{146} It appears then that the scope of the PSLRA would not extend to non-financial statements relating to ESG variables, except of those ESG statements directly concerning assumptions underlying or relating to the enumerated categories.

Second, the PSLRA does not provide guidance for handling corporate commitments. These commitments are typically expressed as the forward-looking outcomes of a presently adopted strategy. For example, Colgate-Palmolive asserts in its Policy on Responsible and Sustainable Sourcing of Palm

\textsuperscript{142} Id.
\textsuperscript{143} 15 U.S.C.A. § 78u-5 (West).
\textsuperscript{144} In re Ligand Pharm., Inc. Sec. Litig., No. 04CV1620DMS(LSP), 2005 WL 2461151, at *17 (S.D. Cal. Sept. 27, 2005).
\textsuperscript{145} Id. (paraphrasing the PSLRA); \textit{Forward-Looking Statement}, CORNELL LAW SCHOOL, https://www.law.cornell.edu/definitions/uscode.php?width=840\&height=800\&iframe=true\&def_id=15-USC-1658834582-1964343826\&term_occurs=1\&term_src=title:15:chapter:2B:section:78u–5 ((1))The term “forward-looking statement” means— (A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items; (B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer; (C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission; (D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C); (E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or (F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.”).
\textsuperscript{146} Paul A. Davies et al., \textit{Environmental, Social and Governance Matters: The Rapidly Evolving ESG Reporting Landscape – Part 1}, 41 NO. 7 \textit{SECURITIES & FED. CORP. L. REP.} NL 1 (July 2019) (“Governance also broadly encompasses the manner in which companies address environmental and social risks and the processes companies implement to integrate those risks into company strategy.”); see Laura Weiss, CQ Roll Call, \textit{Ceres report urges boards to oversee ESG risks with thorough process}, 2019 WL 6227223 (Nov. 22, 2019).
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Oils that it is “committed to sourcing responsible palm oil, palm kernel oil (PKO) and palm oil derivatives that do not contribute to deforestation” and that “[b]y 2020 [it] will source palm oil, PKO and their derivatives that are responsibly and sustainably produced and from sources that can be traced from plantation to product.” Such statements adopting forward-looking targets based on present-tense commitments do not easily assimilate within the PSLRA structure. Furthermore, Colgate-Palmolive asserts that in fulfilling these commitments, it will “strive to meet” several goals, including achieving full traceability of their supply chains by the end of 2020. While such a statement is clearly forward-looking, it is relatively specific and does not fit within the rationale animating the PSLRA. This incongruity extends more broadly to many sustainability statements, which use a mix of present and future tenses as well as both vague and specific aspirational statements.

E. Codes of Ethics and Codes of Conduct

Courts have diverged over their treatment of the materiality of codes of ethics and codes of conduct. Most courts adopt additional considerations, sometimes finding these types of statements to be actionable and other times finding them to be puffery. At the same time, some courts automatically consider these types of statements to be in actionable.

One case at the Second Circuit dealt with the materiality of statements in a company’s Annual Report about its commitment to ethics and integrity. The Second Circuit held that statements were not actionable due to their generality “prevent[ing] them from rising to the level of materiality required to form the basis for assessing a potential investment.” The court did note, however, that statements concerning a company’s integrity or ethical conduct could give rise to a securities violation in two particular cases: if they emphasize the relationship between the company’s reputation for integrity or ethical conduct and its bearing on its financial condition, or if the statements are used to distinguish the company among specific competitors in the same industry.

By contrast, in an opinion affirmed by the Ninth Circuit, the U.S. District Court for the Northern District of California held that, even though Hewlett-Packard’s Chief Ethics and Compliance Officer had characterized the company’s Standards of Business Conduct (SBC) as a “competitive advantage,” this claim

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148. Id.
150. Id. (citations omitted).
151. Id.
alone did not “tip the scale enough to find the SBC to be material to a reasonable investor.”

According to the California court’s discussion, the SBC and related representations about corporate ethics would have to provide a “warranty of compliance” in order to be material. The function of codes of ethics and codes of conduct in creating a competitive advantage remains an open question for the courts.

Some courts consider reasonable reliance to be the decisive factor when determining the materiality of codes of ethics and codes of conduct. In *In re Petrobras Securities Litigation*, the U.S. District Court for the Southern District of New York failed to dismiss securities claims that a Brazilian oil company’s code of conduct constituted a material misstatement in light of widespread practices of bribery and corruption. The court emphasized the importance of context in determining whether a representation is mere puffery or whether it is material to a reasonable investor. It concluded that even though isolated statements about reputation, integrity, and compliance with ethical norms may be mere puffery, where such statements are made repeatedly and in an effort to reassure investors about a company’s integrity, “a reasonable investor could rely on them as reflective of the true state of affairs at the [company].” This approach seemed to allow a greater role for context and actual investor reliance when making materiality determinations.

In some cases, courts have gone so far as to find codes of ethics and codes of conduct inherently aspirational and inactionable because companies are required to have them in order to comply with SEC and NASDAQ requirements. According to this rationale, because companies do not intend to set themselves apart by adopting such codes, these assertions are effectively more of a formality.

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153. *Id.* at 971; see also ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co., 553 F.3d 187, 205–06 (2d Cir. 2009) (The Second Circuit adopted similar language, holding that statements by JP Morgan Chase regarding its “highly disciplined” risk management and standard-setting reputation for integrity “did not, and could not, amount to a guarantee that its choices would prevent failures in its risk management practices” and could not be found actionable.).


155. *Id.*

156. *Id.*

157. See, e.g., Andropolis v. Red Robin Gourmet Burgers, Inc., 505 F.Supp.2d 662, 685–86 (D. Colo. 2007) (“[A] code of ethics is inherently aspirational; it simply cannot be that every time a violation of that code occurs, a company is liable under federal law for having chosen to adopt the code at all, particularly when the adoption of such a code is effectively mandatory.”); Bondali v. Yum! Brands, Inc., 620 F. App’x 483, 490 (6th Cir. 2015) (“Yum’s statement is not actionable because it was a statement of aspiration made in Yum’s corporate Code of Conduct rather than rather an assertion of objective fact made in a public filing or press release.”); Retail Wholesale & Dep’t Store Union Local 338 Ret. Fund v. Hewlett-Packard Co., 845 F.3d 1268, 1277 (9th Cir. 2017) (“[T]he substance and online publication of the SBC were mandated by the SEC. 17 C.F.R. § 229.406(a). In fact, the ethical issues most relevant to this litigation—conflicts of interest, disclosure, internal handling of violations—are directly addressed by SEC regulations.”).
than a deliberate statement of values and intent that investors should rely on.\textsuperscript{158} Notably, the rationale that codes of ethics and codes of conduct are not actionable by virtue of being mandated by SEC and NASDAQ requirements would not extend to sustainability commitments. Until now, these types of commitments are not mandatory and are voluntary declarations made by companies in response to investor demands. Accordingly, it could be reasoned that companies choose to set themselves apart by expressing sustainability commitments and that reasonable investors would be justified in relying on these commitments as an expression that is more substantive than puffing.

\textit{F. A New Approach to Dealing with Forward-looking Statements, Aspirations, Intentions, and Commitments}

The evolution of the reasonable investor elaborated in Part II presents a challenge for the courts’ current treatment of the materiality versus puffery distinction. This is particularly so in the case of forward-looking statements, commitments, aspirations, and intentions. In light of the new reasonable investor, some forward-looking and aspirational statements in sustainability reports and communications, codes of ethics, and codes of conduct acquire a contemporary materiality and should thus be treated as actionable. Trends in the courts’ treatment of securities claims based on sustainability disclosures demonstrate that, while the disclosure’s tense, specificity, and incorporation of cautionary language are part of the assessment for actionability, context and reliance play a significant role in informing an assessment of scienter, reliance, and materiality. Part IV offers an approach to dealing with forward-looking statements, commitments, aspirations, and intentions that centers on investor reliance and better reflects actual investor needs and behavior.

\textbf{IV. RE-CENTERING REASONABLE RELIANCE}

As Part III demonstrates, courts tend to dismiss forward-looking statements, commitments, aspirations, and intentions as inactionable puffery in securities fraud cases. This is based on their claims about the reasonable investor and the types of statements that are material to him/her. However, acknowledging the investment context and behavior elaborated in Part II undermines current assumptions about the reasonable investor that underlie the courts’ materiality determinations. The courts’ general dismissal of forward-looking statements, commitments, aspirations, and intentions does not reflect actual reliance by mainstream and socially responsible investors who factor such statements into their decision-making. By failing to take into account the mechanics of third-party ESG ratings and indices and the mainstreaming of ESG data into investor decision-making, the courts’ current approach undermines the objectives of the

\textsuperscript{158} \textit{See supra} note 157.
efficient markets hypothesis. By limiting the investors’ ability to hold management liable for ESG statements through securities fraud claims, even when these statements have induced actual reliance, the courts’ approach also undermines the objectives of the governance theory.

This section advances an approach to materiality that reconceivers the reasonable investor in light of contemporary demographics and the realities of investor decision-making, in order to more effectively meet the objectives of the securities disclosure regime. Such an approach requires re-centering reliance as the key distinguishing element between actionable statements and puffery. In this manner, it better reflects actual investor needs and expectations. It also better accounts for a new ecosystem of investment decision-making, which includes third-party ESG ratings firms and indices and depends on (and reinforces) the production of and reliance on ESG data.

The reliance requirement of a section 10(b) claim has been weakened by an expanded puffery defense that deems certain statements immaterial as a matter of law, irrespective of actual investor reliance. It has also been narrowed by the PSLRA and its safe harbor provision exempting forward-looking statements from liability. The approach proposed here revises a traditional conception of materiality in light of an updated perspective on the reasonable investor and reflects this onto judicial interpretations of materiality when dealing with ESG disclosures. This section begins by advancing the argument that judicial doctrine should re-center investor reliance and should allow the fact finder to make determinations concerning the materiality of forward-looking statements, commitments, aspirations, and intentions rather than dismissing such statements as inactionable under the PSLRA and the puffery defense. It goes on to elaborate a framework for determining the materiality of such statements that are based on a balance between what investors can reasonably expect from management based on corporate statements, and the respective actions that companies actually take towards fulfilling these statements.

159. See PSLRA, supra note 145.

160. This proposal builds on the framework advanced by Ann Lipton. See Lipton, supra note 11, at 147 (quoting In re Dynex Capital, Inc. Sec. Litig., No. 05 Civ. 1897(HB), 2009 WL 3380621, at *8 (S.D.N.Y. Oct. 19, 2009) (“At some point, statements by a defendant that it ‘generally’ adheres to a particular policy become misleading when in fact there is no such policy or the policy is something else altogether.”)). In a recent D.C. Superior Court case against Tyson Foods, Inc., the plaintiffs adopted this rationale in the context of a consumer law claim. The plaintiffs alleged that Tyson violated D.C. consumer law by making statements in its sustainability report and marketing/advertising materials about environmental performance and treatment of animals that were false and misleading. The complaint juxtaposed detailed and specific statements by Tyson foods concerning performance and commitments, against alleged specific and detailed facts about actual performance, which they contended counter the performance claims. See Complaint at 4–49, Food & Water Watch, Inc., and Organic Consumers Association v. Tyson Foods, Inc., 2019 CA 004547 B (July 10, 2019).
A. “Reasonable” Reliance and the Reasonable Investor

In a section 10(b) fraud claim, the element of reliance provides a causal connection between the plaintiff’s injury and the defendant’s act by establishing that harm suffered by the plaintiff was actually induced by the defendant. With the growing popularity of the fraud-on-the-market theory, the expansion of the puffery defense, and the promulgation of the PSLRA, securities doctrine has weakened section 10(b)’s reliance requirement. Re-centering actual investor reliance as the key determinant of materiality for a section 10(b) claim and adopting a reference of the reasonable investor that is based on investor demographics, preferences, and decision-making will better serve the needs of today’s reasonable investor.

The fraud-on-the-market doctrine allows courts to presume that false statements harm investors by distorting a security’s market valuation. It eliminates the requirement of proving individualized reliance by each plaintiff and implies that the whole market has suffered a general harm. While this theory facilitates the aggregation of class actions, it substitutes the reliance requirement with a courts’ normative views on what information should or should not have affected investors’ market responses. As illustrated in Part II, the courts’ characterization of the reasonable investor and his/her priorities is increasingly out of sync with what investors themselves claim to value. Restoring investor reliance as an integral part of a section 10(b) cause of action would substitute the courts’ normative assumptions with descriptive references based on actual investor needs. A reliance-based approach would, instead, allow a fact finder to give weight to non-financial considerations that mainstream and socially responsible investors are professing to take into account in their decision-making.

The puffery doctrine in its present form similarly allows courts to substitute their presumptions about the types of information that investors value in place of evidence of what they actually value as represented in plaintiffs’ own reliance arguments. Courts essentially decide the background assumptions that shareholders make about the conduct of companies in which they are invested and determine when misconduct constitutes a significant enough deviation from these assumptions so as to constitute a misleading statement. In this manner, puffery effectively protects a category of managerial misconduct and treats it as unremarkable and inactionable, relative to the court’s reference of what investors

161. Fischel, supra note 28, at 1144.
162. See id. at 1146 (“The fraud-on-the-market cases are a loosely defined group of decisions in which courts have allowed reliance on the integrity of the market to substitute for reliance on the defendant or the defendant’s conduct.” The courts substitute the element of specific reliance with a more general presumption that false statements distort a security’s valuation, thus disrupting the integrity of the market and defrauding investors).
163. Lipton, supra note 11, at 94–95.
should expect from companies. A test for materiality that is based on actual investor reliance would, alternatively, consider whether a statement in question did factor, rather than whether it should have factored, into an investor’s decision-making. Another approach that maintains but narrows the scope of the puffery defense would focus on the discrepancy between the content of a statement and underlying facts concerning its implementation. Instead of gauging whether statements are too general or aspirational to induce shareholder reliance, a fact finder would instead focus on the nexus between a corporate disclosure and the corporate practice being challenged. The materiality analysis would balance between a statement’s generality and tone, and the severity and pervasiveness of an underlying corporate violation. Based on this approach, a general positive or aspirational statement would be rendered actionable when a corresponding violation is severe, but not when a violation is limited to a minor incident or segment of business operations.

The courts’ current application of the PSLRA further limits the scope of reliance in a section 10(b) claim by granting safe harbor to forward-looking statements. The PSLRA’s safe harbor provision does not on its face explicitly cover non-financial forward-looking statements. Nothing in the text precludes the courts from considering non-financial forward-looking statements under a different test for materiality than financial statements. In fact, advocates of ESG disclosure have argued that a safe harbor provision should be extended to sustainability and ESG disclosures, implying that the current interpretation of the safe harbor provision does not. Re-centering reliance would leave open the possibility that, under more egregious circumstances, an ESG statement could be found actionable if an investor can demonstrate reliance irrespective of the statement’s temporal posture.

164 Id. at 140-41.
166 See PSLRA, supra note 145.
167 See, e.g., WACHTELL LPTON, Letter to the Securities and Exchange Commission (May 16, 2016), https://www.sec.gov/comments/s7-06-16/s70616-9.pdf (“Disclosure of risk management, sustainability and ESG-related information also could be encouraged if the Commission makes clear that such disclosure does not create incremental liability risk, for example, by similarly providing that such disclosures are eligible for the forward-looking statement safe harbors, and by adopting an interpretation that such disclosures should not be read as assertions that the risks described in risk factor disclosures have been mitigated.”); see also Viewpoint: Exploring ESG: A Practitioner’s Perspective, BLACKROCK (June 2016) https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-exploring-ESG-a-practitioner’s-perspective-june-2016.pdf (Calling for “safe harbor provisions that ensure companies who initiate ESG factor reporting do not face retrospective litigation.”).
168 There is serious merit to the opposing position that explicit acknowledgment of PSLRA’s application to forward-looking ESG statements would facilitate disclosures that are useful to investors and that companies would otherwise hesitate to provide because of the litigation risk. However, we take the position that disclosing more ESG statements of a legally inactionable nature does not meet the needs of current reasonable investors.
A judicial approach to ESG disclosures that centers on investor reliance as a central element of a materiality determination would better reflect investor behavior and needs. Such an approach would narrow the scope of statements dismissed under the puffery doctrine and would explicitly limit the application of the PSLRA safe harbor provision to financial statements. The reliance-based approach has direct implications for forward-looking statements, commitments, aspirations, and intentions in the ESG context. It departs from the courts’ current semantic reading of corporate disclosures as general (puffery) versus specific (material) and their categorical dismissal of aspirational statements as inactionable. Instead, it offers a revised approach to puffery that gives consideration to a statement’s context and focuses on the expectations a statement induces for investors, as contrasted with the underlying facts of the corporate violation in question. This approach differentiates three categories of statements based on the degree of investor reliance they induce: (1) forward-looking statements that incorporate specific, measurable targets, (2) commitments that imply a company is taking actual steps in the present to implement some future-oriented goal, and (3) aspirational statements and intentions that are optimistic but generally vague.

B. Implications for Forward-looking Statements, Commitments, Aspirations, and Intentions

The following examples illustrate how a reliance-based materiality framework might be applied to forward-looking statements, commitments, aspirations, and intentions in the ESG context.

1) The Science-Based Targets Initiative

The Science-Based Targets Initiative provides an example of forward-looking commitments that would likely be found actionable under a reliance-based framework. The Initiative encourages companies to commit to “science-based” targets to reduce greenhouse gas emissions. It allows companies to “demonstrate their leadership on climate action by publicly committing to adopt science-based emissions reduction” and rewards signatories with recognition “through events and media opportunities, as well as through sciencebasedtargets.org, the We Mean Business website, and other partner websites.” Companies can join the Initiative by signing a commitment letter

169. See What is a Science Based Target?, SCIENCE BASED TARGETS, https://sciencebasedtargets.org/what-is-a-scienc3e-based-target/ (“Targets adopted by companies to reduce greenhouse gas (GHG) emissions are considered “science-based” if they are in line with the level of decarbonization required to keep global temperature increase below 2 degrees Celsius compared to pre-industrial temperatures[.]”).

that indicates they will work to set a science-based emission reduction target, in keeping with a set of rigorous criteria, within 24 months.\textsuperscript{171} In the U.S., 62 companies, including major corporations like Nike, Merck, and Hershey, have officially committed to science-based targets, while 47 companies, including Colgate-Palmolive, Hewlett Packard, and Pfizer, have taken the further step of officially setting targets.\textsuperscript{172} Targets are measurable and include concrete deadlines. For example, Colgate-Palmolive’s published target states that it “commits to reduce . . . greenhouse gas emissions from manufacturing by 25% from 2002 to 2020, with a longer term goal of a 50% reduction by 2050” and to “reduce emissions associated with consumer behaviour by up to 5% from 2016 to 2022, and increase the recycled content of our packaging to 50% by 2020.”\textsuperscript{173} The specificity of the targets creates clear metrics of accountability for investors who choose to rely on such commitments in making investment decisions.

The context within which the Initiative operates and the evidence of systematic investor reliance on the information it provides supports the designation of such commitments as material. As such, they would be vulnerable to section 10(b) claims in the absence of any concrete steps being taken by a company to meet its targets. The significance of these commitments becomes more evident when they are situated within the mechanics of the wider investment context. Such public statements provide a way for companies to signal to the investment marketplace that they are good actors and provide them a competitive advantage among peers. A number of decarbonized indices\textsuperscript{174} have emerged in recent years, with a focus on developing funds that are sensitive to climate change. They rely on company publications and data from third-party providers.\textsuperscript{175} The Portfolio Decarbonization Coalition,\textsuperscript{176} for example, aims to


\textsuperscript{172} See Meet the Companies Already Setting Their Emissions Reduction Targets in Line with Climate Science, SCIENCE BASED TARGETS https://sciencebasedtargets.org/companies-taking-action/.

\textsuperscript{173} See id.


\textsuperscript{175} MSCI Global Low Carbon Target Indexes Methodology, MSCI (Sept. 2014), https://www.msci.com/eqb/methodology/meth_docs/MSCI_Low_Carbon_Target_Indexes_Methodology.pdf (“The data is updated on an annual basis and based on information disclosed by companies. Sources include company publications, other public records and third-party data providers.”).

\textsuperscript{176} PORTFOLIO DECARBONIZATION COALITION, https://unepfi.org/pdc/.
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redirect capital from carbon-intensive companies, products, and technologies towards carbon-efficient ones of the same sector. Investor reliance on these indices is evident in the behavior of institutional investors. The New York State Common Retirement Fund has committed $10 billion to the Sustainable Investment Program and specifically $4 billion to the low emissions index, which invests in low-emissions equities. This investment vehicle directs funds to more environmentally friendly companies and excludes or reduces holdings in high-polluting companies. The California State Teachers’ Retirement System (CalSTRS) has also committed $2.5 billion to a low-carbon index. One way that companies signal their climate change risk management to investors is through their commitment to the Science-Based Targets Initiative. As these examples evidence, a company’s commitment to reduce its carbon emissions as signaled through avenues like the Science-Based Targets Initiative has a direct bearing on its positioning among competitors and has specific significance to concerned investors choosing between companies in the same industry when making investment decisions.

Under the courts’ current approach, company commitments under the Science-Based Targets Initiative would likely be dismissed as puffery due to their aspirational nature. Under a reliance-based approach, however, the concrete nature of these targets with their projected timelines and measurable goals, considered within an investment context where carbon-emissions have acquired a broadly publicized significance, justifiably induces investor reliance. A company that commits to a science-based target but does not reflect this commitment in any actual decisions would, accordingly, be vulnerable to a section 10(b) claim.

2) A Commitment to Causes

Companies routinely make commitments concerning their sustainability and sign on to business-driven initiatives aimed at addressing challenges specific to their respective industries. The Harkin-Engel Protocol and cocoa companies’ commitment to eradicate “the worst forms of child labor” in their supply chains


178. NY State Comptroller DiNapoli Doubles Low Emissions Index Investment to $4 Billion, OFFICE OF THE NEW YORK STATE COMPTROLLER (Jan. 31, 2018), https://www.osc.state.ny.us/press/releases/jan18/013118.htm (“The Fund was the first public pension fund in the U.S. to create an index that excludes or reduces holdings in the worst carbon emitters and shifts investments to lower emitting corporations.”).


provides an example of one such commitment. Evaluation of this commitment under a reliance-based framework could conclude that it is material, depending on the outcome of a balancing test evaluating the nature of the commitment made and actual steps taken to realize it.

In 2001, Hershey, Mars, Ferrero, and Nestle, among other chocolate companies, signed on to an industry protocol—the Harkin-Engel Protocol—committing to eliminating the worst forms of child labor in the cocoa industry. Article I affirmed that every ratifying member would “take immediate and effective measures to secure the prohibition and elimination of the worst forms of child labour as a matter of urgency.” In 2009, Mars committed to sourcing 100% certified cocoa by 2020, and Ferrero and Hershey made the same commitment in 2012. To date, the companies’ actual delivery on these commitments has fallen far short of earlier targets. Under the courts’ current approach, these commitments would be dismissed as puffery. Under a reliance-based framework, however, if investors were to bring a section 10(b) claim against Harkins-Engel signatories, the statements would need to be weighed against actual steps taken by the companies. The burden would shift to the companies to demonstrate that steps are taken in pursuit of expressed commitments and that these steps are communicated to investors to protect them from claims of misrepresentation.

Another example is Colgate-Palmolive’s Policy on Responsible and Sustainable Sourcing of Palm Oils. The company has “committed to sourcing responsible palm oil,” stating that by 2020 it will source palm oil that is responsibly and sustainably produced and obtained from traceable sources. Colgate-Palmolive asserts “we will strive to meet the following goals” and lists detailed steps that it intends to take to fulfill this commitment. Meanwhile, Greenpeace’s review of Colgate-Palmolive labels it to be “failing” its
commitment to sustainable sourcing as it “cannot trace any of its palm oil back to the plantation.”\textsuperscript{188} If investors were to bring a section 10(b) claim against Colgate-Palmolive based on its commitment, a reliance-based approach would weigh the company’s statements against actual steps taken, leaving open the possibility that such expressions of commitment could be found legally actionable.

3) Codes of Conduct

Codes of business conduct and codes of supplier conduct, among other similar code of conduct documents, provide examples of aspirational statements that are unlikely to be found material under a reliance framework, absent extreme discrepancy between the expressed statement and corporate conduct or flagrant disregard of professed aspirations. In the case of \textit{In re Plains All American Pipeline}, investors brought a section 10(b) claim based on statements in a company’s Code of Business Conduct, which were published on its website and incorporated in its filings.\textsuperscript{189} One statement concerned the company’s “commitment to safe and environmentally responsible operations,”\textsuperscript{190} and another statement concerned its “compliance with applicable environmental, health and safety rules, laws, and regulations.”\textsuperscript{191} The plaintiffs’ complaint arose in the aftermath of a major oil spill on the California coast.\textsuperscript{192}

Plaintiffs argued that these statements “falsely represent[ed] a record of past or present compliance with the Code’s policies.”\textsuperscript{193} The U.S. District Court for the Southern District of Texas sided with the defendants, however, holding that the statements in question “are not specific or objective factual representations” and “are not actionable because they are aspirational statements in a code of business conduct.”\textsuperscript{194} Under a reliance framework, discovery would be permitted, such that the trier of fact could assess these statements relative to evidence of steps the defendants took to fulfill the expressed commitments and to meet their promise of compliance. Falling short of the commitment would not

\textsuperscript{188} See \textsc{Greenpeace}, \textit{Cutting Deforestation out of the Palm Oil Supply Chain: Company Scorecard 7} (2016), https://www.greenpeace.org.uk/wp-content/uploads/2017/05/9fb0ba4a-palm-oil-scorecard-final.pdf.
\textsuperscript{190} “Plains All American supports its commitment to safe and environmentally responsible operations through extensive and ongoing education and training, as well as investment in any necessary equipment, systems, processes, or other resources.” \textsc{Plains All American, Code of Business Conduct 7}, https://www.lw.com/MLP-Portal/SiteAttachmentHandler.ashx?attachmentid=32b8d68b-f022-4e89-bd75-2799b0408af.
\textsuperscript{191} “Our commitment [to safe and environmentally responsible operations] also includes compliance with applicable environmental, health and safety rules, laws, and regulations.” \textit{Id.}
\textsuperscript{193} \textit{In re Plains All Am. Pipeline, L.P. Sec. Litig.}, 307 F. Supp. 3d 583, 625 (S.D. Tex. 2018).
\textsuperscript{194} \textit{Id.} at 626.
be a sufficient justification for a materiality determination. Instead, the focus would be on the degree of discrepancy between these commitments and the facts of the violation in question.

C. Limitations of a Reliance-Based Approach to Materiality

The proposed reliance-based approach to materiality determinations under section 10(b) claims present some notable limitations. One potential outcome of judicial interpretation based on investor reliance is that companies will recognize new opportunities for liability as a deterrent to disclosing aspirations and commitments and to publishing codes and standards of conduct. From that perspective, limiting disclosure of these types of statements would be a negative consequence of this interpretive framework. A reliance-based framework that narrows the scope of the puffery defense would also leave companies more vulnerable to litigation expenses associated with allowing a case to proceed past the motion to dismiss stage. Notwithstanding these limitations, the revised approach would better reflect actual investment dynamics, meet contemporary investor needs, and further the objectives of the securities disclosure regime.

CONCLUSION

While this article has focused on the role of the courts in determining the actionability of voluntary ESG disclosures, other analyses might consider how legislation or SEC regulations could reform mandatory disclosure requirements. One possibility for balancing, between investors’ interest in reliable disclosures and companies’ interest in avoiding liability, is for the SEC to require companies to provide annual reporting on their expressed

195 Until now, the SEC’s guidance and rulemaking on ESG disclosures has continued to lag behind investor demands. In April 2016, the Commission sought public comment on a concept release that dealt with modernizing disclosure requirements in Regulation S-K, which underpins reporting obligations of the Securities Act and the Securities Exchange Act. The Commission specifically sought comments on ESG disclosure requirements, observing that “the role of sustainability and public policy information in investors’ voting and investment decisions may be evolving as some investors are increasingly engaging on certain ESG matters.” SECURITIES AND EXCHANGE COMMISSION, CONCEPT RELEASE, “BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K,” RELEASE NO. 33-10064; 34-77599, 211 (April 13, 2016), https://www.sec.gov/rules/concept/2016/33-10064.pdf. While only four pages of the Concept Release’s 92 pages were devoted to sustainability disclosures, the majority of received comment letters addressed sustainability disclosures. SUSTAINABILITY ACCOUNTING STANDARDS BOARD, “BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K — THE SEC’S CONCEPT RELEASE AND ITS IMPLICATIONS,” https://www.sasb.org/wp-content/uploads/2016/09/Reg-SK-Comment-Bulletin-091416.pdf. The SEC’s watch and wait approach to regulating ESG disclosures is notable in a March 2019 speech by William Hinman, Director of the SEC’s Division of Corporation Finance: “We recognize that market participants have raised questions about the sufficiency of sustainability disclosures, and I think this is a complicated issue . . . We hear differing views on whether disclosure requirements should be principles-based or prescriptive, and whether they should utilize a specific set of reporting standards to enhance comparability. So it appears to me that the market is still evaluating what, if any, additional disclosure on these topics would provide consistently material and useful information.” William Hinman, “APPLYING A PRINCIPLES-BASED APPROACH TO DISCLOSING COMPLEX, UNCERTAIN AND EVOLVING RISKS,” Remarks at the 18th Annual Institute on Securities Regulation in Europe (March 15, 2019).
commitments. These reports could either include updates to investors detailing specific steps they have taken to further their expressed commitments, or, otherwise to inform investors if the company is explicitly abandoning those commitments. In the investors’ interest, mandatory reporting on the status of ESG commitments would afford the market (i.e., ratings firms and audit firms) more information regarding the implementation of these commitments into their ratings, therefore allowing for more accurate pricing and assessment of the company. In the companies’ interest, regular reporting on ESG commitments would protect against claims based on unreasonable reliance.