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Galit A. Sarfaty

*Allard School of Law at the University of British Columbia, sarfaty@allard.ubc.ca*

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Article

## Regulating Through Numbers: A Case Study of Corporate Sustainability Reporting

*Galit A. Sarfaty*

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# Regulating Through Numbers: A Case Study of Corporate Sustainability Reporting

GALIT A. SARFATY\*

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*Over the past two decades, there has been a drive to reduce complex concepts into simple numbers. Corruption, rule of law, human rights, and more have all been reduced to quantitative indicators. The appeal of indicators lies in their ability to translate social phenomena into a numerical representation that is transparent, easy to understand, and comparable across actors. Under the theory that what gets measured gets done, international law has begun relying on these tools to operationalize global norms and assess compliance. In particular, private regulatory bodies are using indicators to seek legitimacy and claim scientific authority as they set global standards and shape domestic law. Yet legal scholarship has been largely silent about the implications of these statistical tools for governance.*

*In this Article, I analyze the prevalence of quantitative indicators as an emerging regulatory tool in domestic and global governance, identify the potential costs of using these tools to inform decision making, and offer recommendations on how to limit their costs and enhance their benefits. My analysis draws from an empirical study of the Global Reporting Initiative (GRI), based on personal interviews and participation in a GRI-certified training program. The GRI is a private transnational body that has produced the leading standard for sustainability reporting, used by more than three-quarters of the Global Fortune 250 companies. Its guidelines include 79 indicators for corporations to report on their social, environmental, and economic performance.*

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\* Assistant Professor, Faculty of Law, University of British Columbia. A.B., Harvard College, 2000; J.D., Yale Law School, 2005; Ph.D., Anthropology, University of Chicago, 2011. I am grateful to Rachel Brewster, Cary Coglianese, Kevin Davis, Oona Hathaway, Bill Laufer, Sally Engle Merry, Ariel Meyerstein, Nien-hê Hsieh, Benedict Kingsbury, Eric Orts, Adam Saunders, Amy Sepinwall, Richard Shell, David Wilkins, and David Zaring. This Article significantly benefited from my participation as a research scholar in NYU School of Law's project on indicators and global governance and the 2012 Junior Faculty Forum at Harvard Law School.

*Based on this study, I identify three potential costs of using indicators in regulation— specifically, the promotion of box ticking and superficial compliance, the dominance of technical experts over decision making, and the distortion of public values when converted to numbers. I then propose that government agencies and private actors design meaningful indicators and rankings that measure what is relevant to stakeholders, avoid data overload, require third-party verification, and expand participation by citizens and a broad group of experts.*

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## INTRODUCTION

Over the past two decades, there has been a drive to reduce complicated concepts into simple numbers. Corruption, rule of law, human rights, and more, have all been reduced to quantitative “indicators.” Based on the theory that what gets measured gets done, government agencies have incorporated quantitative indicators into performance-based rules, information disclosure regimes, and self-

regulation.<sup>1</sup> International law has recently begun using these statistical tools to operationalize global norms and thereby improve compliance.

As a second-order abstraction of statistical information, indicators rely on numbers to represent social phenomena and evaluate performance. Backed by technical expertise and designed to produce comparability, these tools are shaping decision making by domestic and global regulatory bodies. For instance, the World Bank's Doing Business indicators produce a ranking of developing countries based on the quality of their business laws and legal institutions.<sup>2</sup> The Bank's classification then influences its allocation of foreign aid as well as that of the U.S. government through the Millennium Challenge Corporation.<sup>3</sup> Domestic law has also incorporated indicators, as in the 2008 reauthorization of the Trafficking Victims Protection Act.<sup>4</sup> This law relies on performance indicators to assess foreign governments' compliance with minimum anti-trafficking standards and then categorize countries into three tiers.<sup>5</sup> Given their propensity to simplify complex concepts and translate them into quantifiable measures, indicators are often used to regulate more intangible, value-laden issues such as the rule of law (as in the Freedom House indicators), corruption (as in Transparency International's Corruption Perceptions Index), and human rights (as in the indicators developed by the Office of the U.N. High Commissioner for Human Rights to monitor treaty compliance).<sup>6</sup>

Indicators are playing an increasingly important role in regulatory governance.<sup>7</sup> If used effectively, they can offer a number of apparent benefits: they can measure accountability to standards and norms; assess

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1. See, e.g., Christopher Carrigan & Cary Coglianese, *The Politics of Regulation: From Institutionalism to New Governance*, 14 ANN. REV. POL. SCI. 107 (2011); Stephen D. Sugarman & Nirit Sandman, *Fighting Childhood Obesity Through Performance-Based Regulation of the Food Industry*, 56 DUKE L. J. 101 (2007); Cass R. Sunstein, *Informational Regulation and Informational Standing: Akins and Beyond*, 147 U. PA. L. REV. 613 (1999).

2. See World Bank, *Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises* (2012).

3. *Id.*; MILLENNIUM CHALLENGE CORPORATION, *GUIDE TO THE MCC INDICATORS AND THE SELECTION PROCESS FOR FISCAL YEAR 2013* (2012).

4. Pub. L. No. 110-457, 122 Stat. 5044 (codified as amended in scattered sections of 8, 18, 22 & 42 U.S.C.).

5. *Id.*

6. See FREEDOM HOUSE, *FREEDOM IN THE WORLD* (2010), available at <http://tinyurl.com/lkjquza>; TRANSPARENCY INT'L, *GLOBAL CORRUPTION BAROMETER* (2009); Office of the U.N. High Commissioner for Human Rights, *Report on Indicators for Promoting and Monitoring the Implementation of Human Rights*, U.N. Doc. HRI/MC/2008/3 (June 6, 2008).

7. Kevin E. Davis, Benedict Kingsbury & Sally Engle Merry, *Indicators as a Technology of Global Governance*, 46 LAW & SOC'Y REV. 71 (2012). This paper as well as my article are part of a larger research project on indicators and global governance based at NYU School of Law and sponsored by the National Science Foundation and the Carnegie Corporation of New York. The project features a network of scholars from several countries and has organized a series of conferences to develop a research agenda on this topic. See *Indicators Project*, INST. FOR INT'L L. & JUST., <http://tinyurl.com/ln3um85> (last visited July 24, 2013).

compliance with policies and specific targets; and evaluate performance with respect to stated objectives. They can also facilitate an efficient processing of information and reduce the costs and resources devoted to decision making. The appeal of indicators lies in their ability to translate phenomena, such as respect for the rule of law, into a numerical representation that is easy to understand and compare across actors. Moreover, their simplicity enables more effective communication with those who are governed as well as the general public, thereby promoting ideals of transparency and accountability (at least in theory). Yet legal scholarship has been largely silent about the implications of indicators for governance. While scholars have recognized the benefits of new governance mechanisms,<sup>8</sup> they have neglected to consider the limitations when these statistical tools are applied in practice. I contend that indicators are being embraced too wholeheartedly without sufficient attention to their costs.

In this Article, I analyze the prevalence of quantitative indicators as an emerging regulatory tool in domestic and global governance, identify the potential costs of using these tools to inform decision making, and offer recommendations on how to limit their costs and enhance their benefits. My primary aim is not to reject the use of indicators in governance. Rather, I propose ways in which government agencies and private actors can more effectively use these tools in regulation to meaningfully compare units of analysis and evaluate performance. I argue that indicators can serve as effective tools provided that they measure what is relevant to stakeholders, are designed by a broad group of experts and citizens, and are backed by reliable data. This Article contributes to scholarly debates on the effectiveness of new governance mechanisms in regulation as well as the legitimacy of private regulatory bodies, which have become key players in international governance.<sup>9</sup>

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8. See, e.g., Daniel C. Esty, *Good Governance at the Supranational Scale: Globalizing Administrative Law*, 115 YALE L. J. 1490, 1534 (2006) (“Institutions involved in international decisionmaking should be required to develop indicators and metrics that track issues of concern, and to collect data on a basis that is comparable across jurisdictions. A data-driven policy evaluation structure that gauges institutional performance can trigger competitive pressures and support a more empirical approach to decisionmaking, thereby contributing to policymaking effectiveness.”).

9. See, e.g., JOHN BRAITHWAITE & PETER DRAHOS, *GLOBAL BUSINESS REGULATION* (2000); BENJAMIN CASHORE ET AL., *GOVERNING THROUGH MARKETS: FOREST CERTIFICATION AND THE EMERGENCE OF NON-STATE AUTHORITY* (2004); NON-STATE ACTOR DYNAMICS IN INTERNATIONAL LAW: FROM LAW-TAKERS TO LAW-MAKERS (Math Noortmann & Cedric Ryngaert eds. 2010); MYRIAM SENN, *NON-STATE REGULATORY REGIMES: UNDERSTANDING INSTITUTIONAL TRANSFORMATION* (2011); ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* (2004); Kenneth Anderson, *Squaring the Circle: Reconciling Sovereignty and Global Governance Through Global Government Networks*, 118 HARV. L. REV. 1255 (2005) (reviewing Anne-Marie Slaughter’s book); Carrigan & Coglianese, *supra* note 1; Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543 (2000); Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 262 (2004); Walter Mattli & Tim Büthe, *Global Private*

Indicators address a visceral desire of policymakers to find mechanisms that can increase compliance with rules, a problem particularly acute in international law. Given its lack of coercive force, international law must rely on other means to affect state and non-state behavior. Scholars have studied the role of reputation, reciprocity, and acculturation, among other factors, in enhancing international law's ability to shape policy and decision making.<sup>10</sup> An emerging but as yet under-studied mechanism is the power of numbers.

Private regulatory bodies have emerged as significant players in the production and enforcement of international law.<sup>11</sup> However, the legitimacy of private actors is questionable given their lack of public accountability, an absence of oversight mechanisms, and possible manipulation by special interests.<sup>12</sup> Private regulatory bodies have recently turned to indicators to claim scientific authority, affirm legal values such as transparency and predictability, and assert their legitimacy to govern. Yet when indicators translate legal norms into quantifiable metrics, there are unintended consequences.

My analysis of indicators is based on an empirical study of the Global Reporting Initiative (GRI), a private regulatory body that has produced the leading standard for corporate sustainability reporting. The GRI guidelines include seventy-nine indicators on which corporations self-report on their social, environmental, and economic performance and are then assigned a score of A, B, or C.<sup>13</sup> According to a 2008 study by the accounting firm KPMG, more than three-quarters of the Global Fortune 250 companies use GRI guidelines as the basis for their reporting.<sup>14</sup> An increasing number of countries (including France, Spain, Denmark, and Sweden) have

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*Governance: Lessons from a National Model of Setting Standards in Accounting*, 68 LAW & CONTEMP. PROBS. 225 (2005); Michael P. Vandenberg, *The New Wal-Mart Effect: The Role of Private Contracting in Global Governance*, 54 UCLA L. REV. 913 (2007).

10. See, e.g., ANDREW T. GUZMAN, *HOW INTERNATIONAL LAW WORKS: A RATIONAL CHOICE THEORY* (2010); Paul Schiff Berman, *Seeing Beyond the Limits of International Law*, 84 TEX. L. REV. 1265 (2006); Ryan Goodman & Derek Jinks, *How to Influence States: Socialization and International Human Rights Law*, 54 DUKE L.J. 621 (2004); Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 U. CHI. L. REV. 469 (2005).

11. See, e.g., Benedict Kingsbury et al., *The Emergence of Global Administrative Law*, 68 LAW & CONTEMP. PROBS. 15 (2005); Errol Meidinger, *The Administrative Law of Global Private-Public Regulation: The Case of Forestry*, 17 EUR. J. INT'L L. 47 (2006); Paul B. Stephan, *Privatizing International Law*, 97 VA. L. REV. 1573 (2011); Jenia Iontcheva Turner, *Transnational Networks and International Criminal Justice*, 105 MICH. L. REV. 985 (2007).

12. See Eyal Benvenisti & George W. Downs, *National Courts Review of Transnational Private Regulation*, (Tel Aviv Univ. Law Faculty Papers, Working Paper No. 125) available at <http://law.bepress.com/taulwps/art125/>; Esty, *supra* note 8.

13. GLOBAL REPORTING INITIATIVE, *SUSTAINABILITY REPORTING GUIDELINES* (2011), available at <http://tinyurl.com/88jve9>.

14. KPMG INT'L, *KPMG INTERNATIONAL SURVEY OF CORPORATE RESPONSIBILITY REPORTING* (2008).

recently mandated sustainability disclosure by companies (some of which rely on GRI guidelines), while many others are actively considering such a regime and have already adopted voluntary sustainability reporting standards.<sup>15</sup> In addition, mainstream institutional investors, not just socially responsible ones, are increasingly considering sustainability performance in their investment decisions and thus consulting GRI reports.

As the case of the GRI illustrates, indicators facilitate the process by which legal norms are interpreted and implemented, particularly in areas of international law where norms may be ill defined and traditional enforcement mechanisms are absent. For instance, the GRI indicators aim to make corporate sustainability reporting more mainstream as part of a larger goal of achieving corporate accountability. In this way, they are operationalizing emerging norms on corporate responsibility for human rights, among other issues. Soft law instruments such as the U.N. Global Compact lack independent monitoring and enforcement and have been criticized for being conceptually vague and difficult to implement.<sup>16</sup> While advocates have turned to U.S. litigation under the Alien Tort Claims Act, the U.S. Supreme Court recently limited its extraterritorial application.<sup>17</sup> The GRI is an example of an alternative approach — information regulation through numbers — for changing corporate behavior.<sup>18</sup> It represents a shift in governance towards data-based tools such as quantitative indicators to enhance compliance with legal norms.

Yet my study of the GRI demonstrates that the use of quantitative indicators can be fraught with problems, which are often overlooked due

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15. KPMG INT'L ET AL., *CARROTS AND STICKS: PROMOTING TRANSPARENCY AND SUSTAINABILITY* (2010). Moreover, the European Commission hosted a series of six workshops between September 2009 and February 2010 on the disclosure of ESG information by companies. See *Workshops on Disclosure*, EUR. COMMISSION, <http://tinyurl.com/ybca7ox> (last updated May, 2 2013). The final workshop report suggested the possibility of using the GRI as a reference point in future European policy. *European Workshops on Disclosure of Environmental, Social and Governance Information, Final Workshop, Summary of Discussions*, p. 16 (Feb. 25, 2010).

16. Created in 2000, the UN Global Compact is a voluntary initiative to encourage companies to embrace nine principles drawn from the Universal Declaration of Human Rights, the International Labor Organization's Fundamental Principles on Rights at Work, and the Rio Principles on Environment and Development. See *United Nations Global Compact*, UNITED NATIONS, <http://www.unglobalcompact.org> (last visited July 24, 2013).

17. See *Kiobel v. Royal Dutch Petroleum*, 133 S.Ct. 1659 (2013). The Alien Tort Claims Act allows U.S. district courts to hear "any civil action by an alien for a tort only, committed in violation of the law of nations . . ." 28 U.S.C. § 1350 (1789).

18. Information regulation has become prevalent in the field of environmental law. See, e.g., David W. Case, *Corporate Environmental Reporting as Informational Regulation: A Law and Economics Perspective*, 76 U. COLO. L. REV. 379 (2005); Daniel C. Esty, *Environmental Protection in the Information Age*, 79 N.Y.U. L. REV. 115 (2004); Paul R. Kleindorfer & Eric W. Orts, *Informational Regulation of Environmental Risks*, 18 RISK ANALYSIS 155 (1998); Bradley C. Karkkainen, *Information as Environmental Regulation: TRI and Performance Benchmarking, Precursor to a New Paradigm?*, 89 GEO. L.J. 257 (2001); Douglas A. Kysar & James Salzman, *Foreword: Making Sense of Information for Environmental Protection*, 86 TEX. L. REV. 1347 (2008).



to the authoritative quality of numbers. For instance, one potential cost of indicators is the promotion of box ticking and superficial compliance, as evident in the GRI's system of grading reports. Companies that issue GRI reports receive a grade of A, B, or C based on the *quantity* of indicators that they report on, rather than the *quality* of their performance.<sup>19</sup> In addition, because third-party verification is optional, NGOs do not trust the data behind the indicators. We therefore see that the motivation behind the GRI is not whether the reports are credible to NGOs or whether they reflect a company's good or bad performance, but that more and more companies participate which perpetuates the existence of the GRI and raises its status as the leading standard for corporate sustainability reporting. In this way, the GRI has strayed from its original audience of consumers and NGOs, and its initial aim of corporate accountability. The use of indicators as ends, in and of themselves, has threatened the perceived legitimacy of the organization that produces and relies on them.

My analysis of the GRI applies an anthropological approach as I look inside the black box of indicators and analyze the various stages in which they are implicated in governance, including their production, implementation, and impact. Towards that end, I have conducted interviews with the producers of the indicators (members of the GRI's secretariat in Amsterdam and its New York City office), users (company officials that use GRI guidelines in their sustainability reports), consumers (investors and NGOs who read GRI reports), and U.S. government representatives (SEC officials who are considering whether to mandate disclosure on environmental and social issues as part of securities filings). In addition, I have participated in a GRI-certified training program in order to look behind the numbers and understand how GRI reports are made and evaluated.

This Article will proceed as follows. Part I analyzes the prevalence of indicators as a tool of domestic and international governance and then explores the broader historical and sociological context that explains their emergence in policymaking. Part II describes the development of the GRI as the leading standard for corporate sustainability reporting and its impact on regulation and financial markets. Part III draws upon the case study to outline the potential costs of using indicators, including the promotion of superficial compliance, the dominance of technical experts over decision making, and the distortion of public values when converted to numbers. Finally, Part IV offers recommendations on how to enhance the promise and minimize the perils of using indicators. In order to maximize their effectiveness, I propose that government agencies and private actors

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19. GLOBAL REPORTING INITIATIVE, GRI APPLICATION LEVELS (2011), *available at* <http://tinyurl.com/ny9gtek>.

design meaningful indicators and rankings that measure what is relevant to stakeholders, avoid data overload, require third-party verification, and expand participation by citizens and a broad group of experts.

### I. INDICATORS AS A TOOL OF REGULATORY GOVERNANCE

A regulatory tool that has become increasingly prevalent in domestic and international governance is the indicator, defined as follows:

An indicator is a named, rank-ordered representation of past or projected performance by different units that uses numerical data to simplify a more complex social phenomenon, drawing on scientific expertise and methodology. The representation is capable of being used to compare particular units of analysis (such as countries or persons), and to evaluate their performance by reference to one or more standards.<sup>20</sup>

Comprising such aggregators as indices, rankings, and composites, indicators serve as second-order abstractions of statistical information and are used to evaluate performance according to a standard.<sup>21</sup>

Indicators attempt to imbue a technocratic rationality into decision making and, by doing so, render domains (however complex, such as health or criminality) calculable and susceptible to evaluation and intervention. A guise of neutrality and objectivity exists behind these tools and masks underlying power relations. Their effectiveness depends on experts with specialized skills and esoteric knowledge — “[e]xperts hold out the hope that problems of regulation can remove themselves from the disputed terrain of politics and relocate onto the tranquil yet seductive territory of truth.”<sup>22</sup> Given their ability to translate phenomena into a numerical representation that is transparent, easy to understand, and comparable across actors, indicators are increasingly incorporated in domestic regulation and international law.

#### A. *The Prevalence of Indicators in Domestic Regulation*

Domestic agencies frequently incorporate indicators into “new governance” mechanisms, which comprise alternative regulatory strategies that impact the behavior of business and other organizations.<sup>23</sup> These approaches include performance-based rules, information disclosure

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20. Davis et al., *supra* note 7, at 2.

21. *Id.*

22. PETER MILLER & NIKOLAS ROSE, GOVERNING THE PRESENT: ADMINISTERING ECONOMIC, SOCIAL AND POLITICAL LIFE 69 (2008).

23. Carrigan & Coglianese, *supra* note 1. *See also* THE TOOLS OF GOVERNMENT: A GUIDE TO THE NEW GOVERNANCE (Lester M. Salamon ed., 2001).

regimes, voluntary programs, and self-regulation, all of which offer regulated entities more flexibility than traditional regimes.<sup>24</sup> New governance mechanisms stand in contrast to command and control methods that rely on specific, inflexible mandates to change behavior. These methods are not mutually exclusive, for instance a voluntary program could feature a performance-based standard or a self-regulatory regime could be based on information disclosure rules.

Rather than specifying a certain behavior, performance-based regulation sets measurable outcomes and often entails the application of performance indicators. It provides regulated entities with the flexibility to develop innovative, cost-effective methods to achieve a performance standard.<sup>25</sup> Recent administrations have promoted the use of performance goals in designing regulations. For example, former President Clinton's Executive Order No. 12866 directs agencies "to the extent feasible, [to] specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt."<sup>26</sup> President Obama reaffirmed this principle in a 2011 Executive Order and further called for "evidence-based regulation."<sup>27</sup> A variety of performance-based governmental initiatives incorporate indicators. A prominent example is the No Child Left Behind Act, signed into law in January 2002.<sup>28</sup> This federal legislation requires schools to achieve specified academic results as measured by a variety of indicators — for example, the percentage of students who are at or above the proficient levels in reading and math; the percentage of classes being taught by "highly qualified" teachers; and the percentage of students who drop out of school.<sup>29</sup> Another example is the Nuclear Regulatory Commission's Reactor Oversight Process, which relies on a series of performance indicators to monitor the safety of commercial nuclear power reactors.<sup>30</sup>

Like performance-based regulation, informational regulation does not mandate specific behavioral change; it instead requires actors to collect and disclose information which is often based on indicators.<sup>31</sup> Information disclosure requirements feature prominently in regulation on such areas as

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24. See Lobel, *supra* note 9.

25. See Carrigan & Coglianese, *supra* note 1, at 114; Cary Coglianese et al., *Performance-Based Regulation: Prospects and Limitations in Health, Safety, and Environmental Protection*, 55 ADMIN. L. REV. 705 (2003); Sugarman & Sandman, *supra* note 1.

26. Exec. Order No. 12,866, § 1(b)(8), 58 Fed. Reg. 51,735 (Oct. 4, 1993).

27. Exec. Order No. 13,563, § 1(b)(4), 76 Fed. Reg. 3,821 (Jan. 18, 2011); The Regulatory Plan, 75 Fed. Reg. 79,455 (Dec. 20, 2010).

28. No Child Left Behind Act, Pub. L. No. 107-110, 115 Stat. 1425 (2002) (codified as amended primarily in scattered sections of 20 U.S.C.).

29. *Id.*

30. See *US NRC Reactor Oversight Process*, U.S. NUCLEAR REGULATORY COMM'N, <http://tinyurl.com/kqm372w> (last visited Aug. 1, 2011).

31. See sources cited *supra* note 18.

corporate financial reporting, environmental protection, auto safety, and campaign finance. For instance, the U.S. Environmental Protection Agency's (EPA) Toxic Release Inventory requires periodic disclosure of industrial release of toxic chemicals as an indicator of a firm's environmental performance.<sup>32</sup> This form of regulation can serve a variety of purposes: "provid[ing] information to the public to correct for information asymmetries," "promot[ing] more informed consent or deliberation," and "chang[ing] the behavior of the firm by making managers more aware of and concerned about their organization's social outputs."<sup>33</sup>

Finally, there are voluntary government programs and self-regulation efforts by business, which rely on incentives and social pressure to bring about behavioral change. Voluntary government programs reward participants "by offering educational resources, financial assistance, awards and certifications, and exemptions from more formal requirements."<sup>34</sup> One such program that is also performance-based is the EPA's National Environmental Performance Track, which operated from 2000 through 2009.<sup>35</sup> This initiative provided regulatory and administrative benefits (e.g., reduced inspections) to firms that achieved superior levels of environmental performance.<sup>36</sup> It also worked with participating firms to improve performance based on a variety of environmental indicators, including water use, greenhouse gas emissions, and hazardous waste generation.<sup>37</sup>

Industry groups, non-governmental organizations, and standards-setting bodies administer and enforce initiatives of self-regulation, which depend on the cooperation of firms for their compliance.<sup>38</sup> While these efforts are sometimes largely symbolic and an attempt to avert more stringent government action,<sup>39</sup> they can potentially leverage market or activist pressure to bring about desired behavior. There are also instances where

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32. *What Is the Toxic Release Inventory (TRI) Program?*, U.S. ENVTL. PROTECTION AGENCY, <http://tinyurl.com/m23ym3r> (last visited Aug. 1, 2011). See Bradley C. Karkkainen, *Information as Environmental Regulation: TRI and Performance Benchmarking, Precursor to a New Paradigm?*, 89 GEO. L.J. 257 (2001).

33. Cary Coglianese & David Lazer, *Management-Based Regulation: Prescribing Private Management To Achieve Public Goals*, 37 LAW & SOC'Y REV. 691, 695 (2003).

34. Carrigan & Coglianese, *supra* note 1, at 116.

35. See *National Environmental Performance Track*, U.S. ENVTL. PROTECTION AGENCY, <http://www.epa.gov/performancecetrack/> (last visited Aug. 1, 2011).

36. Carrigan & Coglianese, *supra* note 1, at 117.

37. *Id.*

38. See generally BRAITHWAITE & DRAHOS, *supra* note 9; VIRGINIA HAUFLE, A PUBLIC ROLE FOR THE PRIVATE SECTOR: INDUSTRY SELF-REGULATION IN A GLOBAL ECONOMY (2001); CHRISTINE PARKER, THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY (2002).

39. See Darren Sinclair, *Self-Regulation Versus Command and Control? Beyond False Dichotomies*, 19 LAW & POL'Y 529, 531 (1997) (describing common fears of those who oppose self-regulation).

self-regulation has transitioned into formal regulation.<sup>40</sup> When used as part of corporate self-regulation, indicators can serve as useful diagnostic tools that facilitate problem solving and strategy development. They gauge the magnitude and scope of a problem and measure progress over time toward clearly defined goals. For example, the chemical industry's Responsible Care Program prescribes voluntary codes of practice for participating companies to improve their environmental, health, and safety performance.<sup>41</sup> Launched in 1985 by the U.S. Chemical Manufacturers Association, the program requires companies to measure progress using performance indicators, such as energy consumption and number of fatalities.<sup>42</sup> By motivating actors to set priorities, design strategies, and assess their behavior, indicators (such as those used in the Responsible Care Program) can help firms manage their resources in order to achieve improvements in performance.

### B. *Indicators in International Law*

The innovative regulatory practices described above are beginning to appear in the international system, thus creating a model of “transnational new governance.”<sup>43</sup> Indicators are increasingly becoming a prominent feature in global governance, as they operationalize legal principles and provide a mechanism to measure compliance (frequently as part of a ranking of states or firms). A variety of actors are relying on indicators for the implementation of international law. First, UN treaty bodies and the U.S. State Department are incorporating indicators into their compliance assessments of international human rights standards. Second, indicators are guiding the decision making of international organizations and domestic aid agencies and thus indirectly shaping the laws of countries seeking development assistance. Finally, private standard-setting institutions are using indicators to evaluate and implement global norms as they facilitate their incorporation into domestic law.

Indicators are playing an important role in the monitoring of international legal norms and the imposition of sanctions on foreign governments. For instance, the Office of the UN High Commissioner for

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40. See *infra* Part II.

41. See Neil Gunningham, *Environment, Self-Regulation, and the Chemical Industry: Assessing Responsible Care*, 17 LAW & POL'Y 57, 59 (1995); Andrew A. King & Michael J. Lenox, *Industry Self-Regulation Without Sanctions: The Chemical Industry's Responsible Care Program*, 43 ACAD. MGMT. J. 698, 699–700 (2000).

42. American Chemistry Council, *Responsible Care Performance Results*, RESPONSIBLE CARE, <http://tinyurl.com/7zp65vz> (last visited July 24, 2013).

43. Kenneth W. Abbott & Duncan Snidal, *Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit*, 42 VAND. J. TRANSNAT'L L. 501, 541 (2009) (developing a model for the new regulatory institutions that have emerged on the international sphere).

Human Rights has developed human rights indicators to assist treaty bodies in their monitoring of major human rights conventions.<sup>44</sup> The treaty bodies can thereby more efficiently process state party reports and monitor countries' performance over time.<sup>45</sup> On the domestic front, the U.S. State Department uses indicators to evaluate and rank foreign governments' compliance with international standards of antitrafficking under the Trafficking Victims Protection Act (TVPA).<sup>46</sup> On the basis of the TVPA rankings, the United States imposes sanctions on countries that are not making efforts to meet minimum standards.

Intergovernmental organizations like the World Bank are indirectly shaping domestic law through country rankings that are based on indicators. The World Bank's Doing Business indicators classify countries based on the quality of their business laws and legal institutions.<sup>47</sup> These indicators guide the allocation of development aid by not only the World Bank but also the U.S. Agency for International Development, the United States's Millennium Challenge Corporation, and other multilateral development banks. Countries are therefore motivated to reform their laws in order to rank higher and garner more foreign aid.<sup>48</sup> While the World Bank produces its Doing Business indicators in-house, it also relies on indicators produced by NGOs (e.g., those on corruption by Transparency International and on human rights by Freedom House) when determining eligibility for aid.<sup>49</sup>

Finally, private standard-setting organizations are relying on indicators to interpret and implement global norms while also facilitating their transition into domestic regulation. For instance, the GRI has developed guidelines, including a set of seventy-nine indicators, to implement global norms on corporate sustainability reporting.<sup>50</sup> As a non-state actor, the GRI cannot enforce compliance by requiring all companies to report on their performance using its indicators. But it has influenced governments and stock exchanges to model their standards for sustainability reporting on its guidelines.<sup>51</sup> Thus, the GRI guidelines are not only indirectly shaping

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44. See Office of the U.N. High Commissioner for Human Rights, *supra* note 6, at 10–15.

45. For a critique of this development, see AnnJanette Rosga & Margaret L. Satterthwaite, *The Trust in Indicators: Measuring Human Rights*, 27 BERKELEY J. INT'L LAW 253, 281–85 (2009).

46. William Wilberforce Trafficking Victims Protection Reauthorization Act of 2008, Pub. L. No. 110-457, 122 Stat. 5044 (codified as amended in scattered sections of 6, 8, 18, 22 & 42 U.S.C.).

47. WORLD BANK, *supra* note 2.

48. See Kevin E. Davis & Michael B. Kruse, *Taking the Measure of Law: The Case of the Doing Business Project*, 32 LAW & SOC. INQUIRY 1095, 1114 (2007); Alvaro Santos, *Labor Flexibility, Legal Reform, and Economic Development*, 50 VA. J. INT'L L. 43, 51 (2009).

49. For example, see the methodology behind the World Bank's governance indicators. World Bank, *WGI Data Sources, Governance & Anti-Corruption Resources 1996–2012*, WORLDWIDE GOVERNANCE INDICATORS PROJECT, <http://tinyurl.com/l7jbzb3> (last visited July 24, 2013).

50. GLOBAL REPORTING INITIATIVE, *supra* note 13.

51. See *infra* Part II.B.

domestic law but are also themselves adopted as part of mandatory and voluntary standards.

Transnational governance regimes frequently address collective action problems (e.g., climate change) and coordination problems (e.g., harmonizing accounting standards) as they draw upon specialized expertise.<sup>52</sup> Private bodies, such as the International Organization for Standardization (ISO), the International Accounting Standards Board, and the Fair Labor Association, bypass government involvement and independently set standards on safety, accounting, and labor rights for developing countries.<sup>53</sup> While private bodies may replace direct governmental regulation or regulate areas not subject to governmental oversight, they raise important legitimacy concerns given their lack of public accountability.<sup>54</sup> On the legitimacy of supranational bodies, Daniel Esty observes: “When a matter is largely scientific or technical, having designated supranational experts address the problem may be uncontroversial. As an issue becomes more political or normatively charged, however, delegation to those lacking electoral legitimacy becomes increasingly problematic.”<sup>55</sup> Data exchange or policy benchmarking are examples of activities with a scientific or technical focus that could “establish the legitimacy of policymaking.”<sup>56</sup> This is where indicators come in.

Indicators are an important tool for private transnational institutions that are vulnerable to criticisms of accountability and legitimacy. They provide private actors with an easily accessible tool that allows them to efficiently process information, attract public attention, and govern the conduct of others. While non-state actors lack enforcement power, they appeal to indicators to provide them with scientific authority and the leverage to pressure actors to comply with their standards. By relying on indicators, they can exert their power indirectly by “taking what is essentially a political problem, removing it from the realm of political discourse, and recasting it in the neutral language of science.”<sup>57</sup> As a result, their credibility is increased and their power is less subject to contestation.

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52. See Mattli & Büthe, *supra* note 9, at 230.

53. For general information on these organizations and how they set their relevant standards, see INT’L ORG. FOR STANDARDIZATION, <http://www.iso.org/iso/home.html> (last visited July 24, 2013), INT’L ACCT. STANDARDS BOARD, <http://www.ifrs.org> (last visited July 24, 2013), and FAIR LAB. ASS’N, <http://www.fairlabor.org> (last visited July 24, 2013).

54. Benvenisti & Downs, *supra* note 12.

55. Esty, *supra* note 8, at 1511–12.

56. *Id.* at 1513.

57. HUBERT L. DREYFUS & PAUL RABINOW, MICHEL FOUCAULT: BEYOND STRUCTURALISM AND HERMENEUTICS 196 (1982).

C. *The Sociological and Historical Factors Behind the Power of Numbers*

In order to command scientific authority, indicators rely on numbers, as they serve as second-order abstractions of complex phenomena. Numbers construct new categories and new relations among people and things through standardization and commensurability and, in the process, “profoundly transform what we choose to do, who we try to be, and what we think of ourselves.”<sup>58</sup> Commensuration fosters detachment by objectifying subjective values, standardizing relations between often disparate characteristics, and enabling a depersonalization that is critical for bureaucratic and economic rationality.<sup>59</sup> This process “changes the terms of what can be talked about, how we value, and how we treat what we value.”<sup>60</sup>

Commensuration (through such tools as indicators) is a means of managing uncertainty, depersonalizing relations, imposing control, securing legitimacy, and enforcing discipline.<sup>61</sup> Numbers serve as a “technology of distance,”<sup>62</sup> whose authority comes from “their capacity to create and overcome distance, both physical and social.”<sup>63</sup> They abstract away the individual and the local while also creating a universal language that transcends distance.<sup>64</sup> In this way, objectivity through numbers becomes a proxy for truth and fairness. In her study of human rights indicators, Sally Engle Merry contends that indicators “convey an aura of objective truth and facilitate comparisons. However, indicators typically conceal their political and theoretical origins and underlying theories of social change and activism.”<sup>65</sup> Merry further notes that “[a] key dimension of the power of indicators [and other technologies of audit] is their capacity to convert complicated, contextually variable phenomena into unambiguous, clear, and impersonal measures.”<sup>66</sup> Numbers display governmentality because they serve as a technology of power that constitutes populations and makes individuals calculable and therefore governable — both by others and themselves. They create “a promise of control” through the administration of everyday life — for instance, they

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58. IAN HACKING, *THE TAMING OF CHANCE* 3 (1990).

59. See GEORG SIMMEL, *THE PHILOSOPHY OF MONEY* (1978).

60. Wendy Nelson Espeland & Mitchell L. Stevens, *Commensuration as a Social Process*, 24 ANN. REV. SOC. 313, 315 (1998).

61. See *id.* at 316.

62. THEODORE M. PORTER, *TRUST IN NUMBERS: THE PURSUIT OF OBJECTIVITY IN SCIENCE AND PUBLIC LIFE* ix (1995).

63. Wendy Espeland, *Authority by the Numbers: Porter on Quantification, Discretion, and the Legitimation of Expertise*, 22 LAW & SOC. INQUIRY 1107, 1107 (1997).

64. PORTER, *supra* note 62, at 77.

65. Sally Engle Merry, *Measuring the World: Indicators, Human Rights, and Global Governance*, 52 CURRENT ANTHROPOLOGY S83, S84 (2011).

66. *Id.*



reassure citizens “against the uncertainties of poverty, crime, unemployment, and more recently environmental and technological risk.”<sup>67</sup>

Why have officials and the public at large come to appreciate and even demand numbers to solve problems, make decisions, and exert control? Quantification methods have achieved considerable prestige and power in the modern world.<sup>68</sup> We see the prevalence of cost-benefit analysis in U.S. government bureaucracies since the early-twentieth century as well as within economics since the mid-twentieth century. State bureaucrats introduced cost-benefit methods and other accounting technologies to achieve uniformity and public trust, and to dispel the notion that their decisions were arbitrary and biased given that they lacked the mandate of a popular election.<sup>69</sup> The notion of statistics as the science of the state suggests how the accumulation and tabulation of facts (e.g., through censuses, tax returns, and crime figures) transforms reality and the qualitative world into a calculable form (i.e., what Ian Hacking calls “the taming of chance”), and thus makes it susceptible to evaluation and intervention.<sup>70</sup>

The emergence of indicators as techniques of governance is part of the broader prevalence of economic expertise within the world of bureaucracies as well as in domestic and international public policymaking. Economic knowledge has diffused across national bureaucracies in many countries throughout the twentieth century.<sup>71</sup> Marion Fourcade argues that “[e]conomics has become central to the nation . . . because the nation has become more economic.”<sup>72</sup> The globalization of economics and the economic profession is related to the global circulation of capital (e.g., through public aid and foreign direct investment) and the resulting economic interdependence of nations.<sup>73</sup> The globalization of the law has also created opportunities for economists to enter legal arenas worldwide.<sup>74</sup> As Fourcade demonstrates, there has been a “transformation of economic knowledge into a technology of political and bureaucratic

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67. SHEILA JASANOFF, *STATES OF KNOWLEDGE: THE CO-PRODUCTION OF SCIENCE AND THE SOCIAL ORDER* 33 (2004).

68. See PORTER, *supra* note 62, at viii.

69. See PORTER, *supra* note 62, at 8.

70. See HACKING, *supra* note 58; PETER MILLER & NIKOLAS ROSE, *GOVERNING THE PRESENT: ADMINISTERING ECONOMIC, SOCIAL AND PERSONAL LIFE* (2008).

71. See Marion Fourcade, *The Construction of a Global Profession: The Transnationalization of Economics*, 112 AM. J. SOC. 145, 161–68 (2006).

72. *Id.* at 167.

73. *Id.* at 150.

74. See YVES DEZALAY & BRYANT GARTH, *THE INTERNATIONALIZATION OF PALACE WARS: LAWYERS, ECONOMISTS, AND THE CONTEST TO TRANSFORM LATIN AMERICAN STATES* 170 (2002).

power,” including a global diffusion of the neoclassical paradigm for economies, independent of local or historical context.<sup>75</sup>

Economists, statisticians, and accountants are playing a central role in the data collection and information processing required for developing and applying indicators. They decide what should be counted, the methods of collecting data, and how that data should then be interpreted and aggregated. When indicators are used as a regulatory tool and become incorporated into law, these experts exert a significant influence over political decision making, as I will demonstrate in the case of the GRI.

## II. THE EMERGENCE OF THE GLOBAL REPORTING INITIATIVE AS THE LEADING STANDARD FOR CORPORATE SUSTAINABILITY REPORTING

The field of corporate social responsibility (CSR) is a fertile area for the use of indicators. Scholars have argued that companies have legal obligations under international law, particularly for violations of human rights, labor rights, and environmental protection.<sup>76</sup> A variety of initiatives have aimed to hold multinational companies accountable under domestic or international law but they have remained largely ineffective. The extraterritorial operations of companies are largely unregulated through domestic law, with the exception of litigation under the U.S. Alien Tort Claims Act, whose extraterritorial application to corporations was recently curtailed by the U.S. Supreme Court.<sup>77</sup> International, regional, and non-governmental organizations, such as the UN, the International Labor Organization (ILO), the Organization for Economic Cooperation and Development (OECD), and the ISO, have drafted standards and principles addressed to companies (e.g., the UN Global Compact and ISO 26000) and governments (e.g., the OECD’s Guidelines for Multinational Enterprises and the ILO’s Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy).<sup>78</sup> However, these voluntary

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75. Fourcade, *supra* note 71, at 156.

76. See, e.g., ANDREW CLAPHAM, HUMAN RIGHTS OBLIGATIONS OF NON-STATE ACTORS (2006); José E. Alvarez, *Are Corporations “Subjects” of International Law?*, 9 SANTA CLARA J. INT’L L. 1 (2011); Andrew Clapham & Scott Jerbi, *Categories of Corporate Complicity in Human Rights Abuses*, 24 HASTINGS INT’L & COMP. L. REV. 339 (2001); David Kinley & Junko Tadaki, *From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law*, 44 VA. J. INT’L L. 931 (2004); Steven R. Ratner, *Corporations and Human Rights: A Theory of Legal Responsibility*, 111 YALE L.J. 443 (2001); John Gerard Ruggie, *Business and Human Rights: The Evolving International Agenda*, 101 AM. J. INT’L L. 819 (2007).

77. See *Kiobel v. Royal Dutch Petroleum*, 133 S.Ct. 1659 (2013). See also Julian G. Ku, *The Curious Case of Corporate Liability Under the Alien Tort Statute: A Flawed System of Judicial Lawmaking*, 51 VA. J. INT’L L. 353 (2010) (challenging modern Alien Tort Statute doctrine and advocating for a more restrictive approach to corporate liability under the statute).

78. INT’L LABOR ORG., TRIPARTITE DECLARATION OF PRINCIPLES CONCERNING

instruments lack independent monitoring, implementation, enforcement mechanisms, do not include performance metrics to assess compliance, and are not certifiable.<sup>79</sup> Self-regulatory initiatives by the private sector (e.g., codes of conduct and industry programs) may have a normative impact on corporate behavior, but are devoid of third-party accountability systems and subject to critiques of greenwashing.<sup>80</sup>

As John Ruggie, the then-UN Special Representative on Business and Human Rights to the Human Rights Council, concluded:

[T]here is no single silver bullet solution to the multi-faceted challenges of business and human rights . . . . [T]he tools available for dealing with business and human rights differ from those addressing State-based human rights violations, where only public international law can impose binding obligations. The business and human rights domain is considerably more complex . . . . Moreover, the standards that business initiatives incorporate are typically self-defined rather than tracking internationally recognized human rights. And accountability mechanisms for ensuring adherence to the standards tend to remain weak and decoupled from firms' own core oversight and control systems.<sup>81</sup>

This state of affairs is ripe for governance through indicators. Given that the international legal duties of corporations remain “ill-defined and ineffective,”<sup>82</sup> technologies of compliance can substitute for legal regulation.<sup>83</sup> If incorporated into domestic law, indicators can give teeth to international legal norms by serving as a tool for evaluation and implementation.

Enter the Global Reporting Initiative. The GRI was created in 1997 as a framework for corporations to report on their environmental, social, and

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MULTINATIONAL ENTERPRISES AND SOCIAL POLICY (2006), available at <http://tinyurl.com/14ewe5m>; ORG. FOR ECON. CO-OPERATION AND DEVELOPMENT, OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2000), available at <http://tinyurl.com/6z97kv9>; INT'L ORG. FOR STANDARDIZATION, ISO 26000: GUIDANCE ON SOCIAL RESPONSIBILITY (2010); *The Ten Principles*, UNITED NATIONS GLOBAL COMPACT, <http://tinyurl.com/hoojj> (last visited July 24, 2013).

79. See John Entine, *UN Global Compact: Ten Years of Greenwashing?*, ETHICAL CORP. (Nov. 1, 2010), available at <http://tinyurl.com/m9uewne>.

80. See Kinley & Tadaki, *supra* note 76, at 958–60; cf. William S. Laufer, *Social Accountability and Corporate Greenwashing*, 43 J. BUS. ETHICS 253 (2003).

81. John Ruggie, Report of the Special Representative of the U.N. Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, *Draft Guiding Principles for the Implementation of the United Nations “Protect, Respect and Remedy” Framework*, pp. 1–3 (Nov. 1, 2010), available at <http://tinyurl.com/k46gxo>.

82. Kinley & Tadaki, *supra* note 76, at 948.

83. See Kenneth A. Bamberger, *Technologies of Compliance: Risk and Regulation in a Digital Age*, 88 TEX. L. REV. 669, 670–71 (2010).

economic performance.<sup>84</sup> Its guidelines have become the global standard for corporate sustainability reporting. They currently consist of standard disclosures (e.g., organizational profile, stakeholder engagement, and report parameters), reporting principles (e.g., materiality, stakeholder inclusiveness, and accuracy), and, most notably, a set of seventy-nine indicators (sub-divided into fifty core indicators and twenty-nine additional indicators).<sup>85</sup> Many indicators incorporate legal standards on such issues as corporate governance, human rights, anti-discrimination, labor, corruption, and the environment; they also reference a variety of international agreements, including ILO conventions, OECD Guidelines, and U.N. international human rights conventions.<sup>86</sup> The indicators attempt to convert legal norms into quantifiable metrics that are easily compared across corporations and serve as a benchmark for improving performance. While the GRI framework is a voluntary self-regulatory initiative developed by a private, network-based organization, it is moving into the realm of hard law through incorporation into mandatory regulations.<sup>87</sup> The GRI has influenced state governments and stock exchanges to adopt binding and non-binding corporate disclosure standards based on its guidelines. According to a recent study using data from fifty-eight countries, mandatory disclosure of sustainability information has significant consequences on socially responsible managerial practices.<sup>88</sup> This research suggests that regulation based on GRI indicators has the potential to improve corporate behavior.

#### A. Overview of the GRI

“What you cannot measure, you cannot manage. What you cannot manage, you cannot change.”<sup>89</sup> This motto has motivated the GRI since it was founded in Boston by the Coalition for Environmentally Responsible Economies (CERES).<sup>90</sup> Supported by the UN Environment Program, the

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84. GLOBAL REPORTING INITIATIVE, *supra* note 13, at 2.

85. GLOBAL REPORTING INITIATIVE, *supra* note 13.

86. *Id.*

87. In making this assertion, I disagree with a rigid hard versus soft law distinction and instead view the division as a continuum between binding and non-binding rules. See Kenneth Abbott & Duncan Snidal, *Hard and Soft Law in International Legal Governance*, 54 INT'L ORG. 421 (2000); Andrew T. Guzman & Timothy L. Meyer, *International Soft Law*, 2 J. LEGAL ANALYSIS 171 (2010); Gregory C. Shaffer & Mark A. Pollack, *Hard vs. Soft Law: Alternatives, Complements and Antagonists in International Governance*, 94 MINN. L. REV. 706, 712–17 (2010).

88. See Ioannis Ioannu & George Serafeim, *The Consequences of Mandatory Corporate Sustainability Reporting* (Harv. Bus. Sch., Working Paper No. 11-100, 2012).

89. ISOS GROUP, GRI CERTIFIED SUSTAINABILITY REPORTING TRAINING PROGRAM, (June 2010) (on file with author).

90. CERES is a national network of environmental organizations, investors, and other public interest groups with a mission of integrating sustainability into capital markets. See *Who We Are*, CERES, <http://www.ceres.org/about-us/who-we-are> (last visited Apr. 11, 2013).

GRI receives funds from foundations, governments, and corporate sponsors, and also generates income by directly providing services to GRI users (e.g., training programs, executive seminars, and software tools).<sup>91</sup> It aims to empower civil society organizations to seek greater accountability for corporate governance.<sup>92</sup> Following a model of information regulation, a GRI report would presumably “mobiliz[e] its recipients to demand certain performance levels and enabl[e] activists and NGOs to reward practices considered socially responsible and exert pressure on poor performers.”<sup>93</sup> The GRI seeks to raise sustainability reporting to the same status as financial reporting by developing metrics for companies to disclose on intangible assets such as human rights and environmental performance.<sup>94</sup> By presenting this information in a comparable and consistent format through quantifiable measures, the GRI attempts to signal that these intangibles have market value and can affect the financial health of a company.

The GRI bases its legitimacy on a multi-stakeholder consultation process among intergovernmental organizations, businesses, NGOs, and labor unions.<sup>95</sup> It is comprised of four permanent bodies: the Board of Directors, the Secretariat based in Amsterdam (employing more than fifty people), the Technical Advisory Committee, and the Stakeholder Council.<sup>96</sup> The Technical Advisory Committee is responsible for the development and revision of the reporting framework, while the Stakeholder Council deliberates on key strategic and policy issues, and appoints the Board of Directors.<sup>97</sup> The Stakeholder Council’s sixty members are geographically representative and include twenty-two seats for business, sixteen seats for NGOs, six seats for labor, and sixteen seats for so-called “mediating institutions” (which include accounting and consulting firms, foundations, and governments).<sup>98</sup> Most of the members of the Stakeholder Council are elected by a group of Organizational Stakeholders, which include hundreds of organizations and individuals and is dominated by large businesses and international consulting and

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91. Income from direct services represents about 20% of the GRI’s budget. Interview with representative of the Global Reporting Initiative, in Amsterdam, Neth. (Dec. 8, 2010).

92. See David L. Levy et al., *The Contested Politics of Corporate Governance: The Case of the Global Reporting Initiative*, 49 *BUS. & SOC’Y* 1, 8 (2010).

93. *Id.* See also sources cited in *supra* note 18.

94. Although its primary users are corporations, the GRI markets itself to all types of organizations including NGOs and governmental agencies. See GLOBAL REPORTING INITIATIVE, *GRI SUSTAINABILITY REPORTING: A COMMON LANGUAGE FOR A COMMON FUTURE* (2012).

95. GLOBAL REPORTING INITIATIVE, *supra* note 13, at 2.

96. *Id.* at 48.

97. *Id.*

98. GLOBAL REPORTING INITIATIVE, *RULES AND PROCEDURES FOR THE GRI STAKEHOLDER COUNCIL* (2009), available at <http://tinyurl.com/16xgyu6>.

accounting firms, with relatively few NGOs and organized labor associations.<sup>99</sup>

The GRI has formed alliances with a variety of institutional partners and promotes convergence around other corporate social responsibility guidelines and principles.<sup>100</sup> The most notable is between the GRI and the UN Global Compact, which was announced in October 2006.<sup>101</sup> As part of this alliance, the GRI's guidelines incorporate the Global Compact's requirements for signatory companies that annually report a Communication on Progress.<sup>102</sup> The GRI and the Global Compact have also published a draft tool to guide companies in linking the two reporting processes.<sup>103</sup> The GRI has formed linkages with other standards, including the International Finance Corporation's sustainability performance standards, the Carbon Disclosure Project (CDP), ISO 26000, and the OECD's Guidelines for Multinational Enterprises.<sup>104</sup> These alliances serve to deflect competition from similar initiatives such as the CDP, whose climate change reporting framework is used by over 3,000 companies around the world.<sup>105</sup>

The GRI guidelines are voluntary and incremental, and include a high level of flexibility, allowing companies to decide which principles and indicators to adopt.<sup>106</sup> They are designed to improve over time to reflect lessons learned and the changing expectations of companies and stakeholders. The first Sustainability Reporting Guidelines were established

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99. Levy et al., *supra* note 92, at 88, 96.

100. See *Alliances and Synergies*, GLOBAL REPORTING INITIATIVE, <http://tinyurl.com/mh95d68> (last visited July 24, 2013).

101. See GLOBAL REPORTING INITIATIVE & THE GLOBAL COMPACT, MAKING THE CONNECTION: THE GRI GUIDELINES AND THE UNGC COMMUNICATION ON PROGRESS (2007).

102. *Id.*

103. *Id.*

104. See GLOBAL REPORTING INITIATIVE & INT'L FINANCE CORP., GETTING MORE VALUE OUT OF SUSTAINABILITY REPORTING: CONNECTING IFC'S SUSTAINABILITY PERFORMANCE STANDARDS AND THE GRI REPORTING FRAMEWORK (2010); GLOBAL REPORTING INITIATIVE & CARBON DISCLOSURE PROJECT, LINKING UP GRI AND CDP: HOW DO THE GLOBAL REPORTING INITIATIVE REPORTING GUIDELINES MATCH WITH THE CARBON DISCLOSURE PROJECT QUESTIONS? (2010); GLOBAL REPORTING INITIATIVE, GRI & ISO 26000: HOW TO USE THE GRI GUIDELINES IN CONJUNCTION WITH ISO 26000 (2010); Press Release, Global Reporting Initiative, New Partnership to Help Multinational Companies Operate Responsibly (Dec. 13, 2010) (available at <http://tinyurl.com/kpf2tps>).

105. CARBON DISCLOSURE PROJECT, <https://www.cdproject.net/> (last visited Apr. 10, 2013). The GRI is distinct from the CDP because it addresses broader elements of sustainability reporting covering social and governance issues in addition to environmental issues. Yet there is considerable overlap between the GRI's environmental indicators and the CDP's questions on energy consumption and greenhouse gas emissions.

106. Indicator protocols are available to guide organizations as to how to define the relevant terms, compile data, and find potential information sources. In addition, the GRI has produced a variety of sector supplements (e.g., on financial services, electric utilities, and the mining sector) that provide additional guidance and appropriate indicators for companies in that industry. See GLOBAL REPORTING INITIATIVE, *supra* note 13, at 4.

in 2000. The GRI released its second generation of guidelines (G2) in 2002, and then its third version (G3) in late 2006.<sup>107</sup> The G3 guidelines were the product of a two-year development process which involved about 3,000 stakeholders worldwide and provided public comment opportunities.<sup>108</sup> Among the revisions from G2 to G3 are the elaboration of methods for calculating indicators, the requirement of disclosure of an organization's management approach, and broad applicability of the guidelines to private and public actors, including small and large companies, NGOs, and public agencies. The GRI has recently completed updates in the areas of human rights, gender, community impacts, and materiality, which resulted in its G3.1 guidelines (released in March 2011).<sup>109</sup> Finally, in October 2010, the GRI announced that it will begin developing the fourth generation of its guidelines (G4), which are scheduled to be released in 2013.<sup>110</sup> The general aim behind G4 is to increase the robustness of the guidelines in order to further mainstream sustainability reporting and eventually combine it with financial reporting as part of one "integrated report."<sup>111</sup>

In accordance with the quantity (but not quality) of disclosure, companies self-declare their score as A, B, or C, which the GRI refers to as its "application level."<sup>112</sup> Companies at level C have reported on a minimum of ten GRI indicators, including at least one from each of the environmental, social, and economic categories. Level B means that companies have disclosed their management approach (e.g., their goals, monitoring, and relevant policies) and reported on at least twenty indicators, with at least one from each of the environmental and economic categories as well as one from each of the social sub-categories of human rights, labor, society, and product responsibility. Level A means that companies have disclosed their management approach and reported on all fifty core indicators, or alternatively, explained the reason why certain indicators were omitted (such as a lack of materiality for the company). As

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107. Halina Szejnwald Brown et al., *The Rise of Global Reporting Initiative (GRI) as a Case of Institutional Entrepreneurship*, 18 ENVTL. POL. 182 (2009).

108. The GRI follows the same multi-stakeholder consultative approach when developing its sector supplements.

109. See GLOBAL REPORTING INITIATIVE, *supra* note 13.

110. See GLOBAL REPORTING INITIATIVE, G4 DEVELOPMENT PROCESS OVERVIEW, available at <http://tinyurl.com/lpeh7n5>.

111. See Press Release, IIRC, GRI and IIRC Deepen Cooperation to Shape the Future of Global Reporting (Mar. 1, 2013) (available at <http://tinyurl.com/mc7ynuh>). The GRI recently joined a group of professional accounting bodies, auditing firms, international organizations, companies, and non-governmental organizations to form the International Integrated Reporting Committee, whose aim is to promote the adoption of a global standard for integrated reporting among companies worldwide. For more information on integrated reporting, see ROBERT G. ECCLES & MICHAEL P. KRZUS, ONE REPORT: INTEGRATED REPORTING FOR A SUSTAINABLE STRATEGY (2010).

112. GLOBAL REPORTING INITIATIVE, *supra* note 19.

part of this process, companies undergo a materiality test to determine which issues to report on based on such factors as what is important to stakeholders, the existence of relevant laws and regulations, and whether the issue may pose a significant risk. Level A companies must also report on indicators in its sector supplement, if one is available. Finally, companies have the option of adding a “+” to their level (e.g., an A+) if a third-party assurance provider has verified its data. Therefore, if no “+” is present, there has been no external verification of the information in a company’s GRI report.<sup>113</sup>

While companies could choose from over thirty different reporting frameworks in the 1990s, the GRI has now become “the de facto international reporting standard.”<sup>114</sup> According to a 2008 study by the accounting firm KPMG, more than three-quarters of the Global Fortune 250 companies and nearly seventy percent of the 100 largest companies by revenue use GRI guidelines as the basis for their reporting.<sup>115</sup> As of 2013, there were at least 5,470 organizations reporting in eighty-one countries, based on those that submitted their reports to the GRI.<sup>116</sup> What is the motivation for companies to use GRI?

In jurisdictions where there is no mandatory regulation to report on sustainability, there are a variety of reasons why companies nevertheless choose to do so — e.g., gaining competitive advantage through “improved management of ESG [(environmental, social, and governance)] impacts and overall risk, enhancement of company reputation, and a greater ability to attract and retain both customers and talent.”<sup>117</sup> As part of a strategic approach, companies use the GRI guidelines to develop internal metrics that track their social and environmental performance, identify potential risks, and integrate sustainability goals with their overall business objectives. In addition, companies may feel pressure to report because their industry peers are doing so, or in order to deflect civil society pressure after a prominent environmental or human rights incident. In this case, reporting may be part of a public relations exercise and not reflect any real desire to enhance performance.

There have been a number of critiques of the GRI, both by NGOs and companies themselves. NGOs have criticized the GRI for its division of indicators into core indicators and additional ones that are optional and up to the discretion of companies to include, even if they may be important to

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113. *Id.*

114. Richard MacLean & Kathee Rebernak, *Closing the Credibility Gap: The Challenges of Corporate Responsibility Reporting*, 16 ENVTL. QUALITY MGMT. 1, 1 (2007).

115. KPMG INT’L, *supra* note 14.

116. The GRI keeps an updated inventory of reports from 1999 through the present, which is available on their website. See *Reporting*, GLOBAL REPORTING INITIATIVE, <http://tinyurl.com/15rf99q> (last visited Apr. 10, 2013).

117. MacLean & Rebernak, *supra* note 114, at 2–3.



certain stakeholders. Civil society groups have also questioned the credibility of third-party verification services (usually performed by private accounting and consulting firms), given that there are no uniform guidelines to ensure their reliability.<sup>118</sup> At the same time, companies have complained that they are on a “reporting treadmill,” where they spend so much time gathering data that they are left with few resources to implement changes in the organization.<sup>119</sup> Finally, there is a general concern that the GRI ranks reports based on the level of disclosure (e.g., the number of indicators that companies report on) rather than the quality and accuracy of a firm’s sustainability performance.<sup>120</sup> I will expand upon these critiques in Part III in my discussion of the unintended consequences of using indicators like the GRI.

*B. The GRI’s Impact on Domestic Regulation and Financial Markets*

The GRI has moved into the realm of hard law by shaping regulation by regional organizations, states, and stock exchanges. It has recently begun promoting mandatory government regulation on sustainability reporting as well as integrated reporting within the global financial framework, as evidenced by a recent session on the topic at the 2011 World Economic Forum.<sup>121</sup> The primary motivation behind the GRI’s lobbying efforts is that the majority of companies are still not reporting on sustainability. About 4,000 companies are currently issuing CSR reports, which represents a ten-fold increase since the mid-1990s.<sup>122</sup> Just over one-third of those reporters (about 1,400 companies) used the GRI guidelines in 2009.<sup>123</sup> As previously mentioned, three-quarters of the Global Fortune 250 companies use the GRI.<sup>124</sup> That means that many small and medium-sized companies are still not using the GRI, or issuing sustainability reports at all. In an effort to increase participation, the GRI has recently begun encouraging regulation in the disclosure of environmental and social issues.

The GRI’s promotion of regulation represents a significant shift in its role and mission, from an independent organization that encourages companies to voluntarily report on sustainability to a more advocacy-

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118. See David Hess, *The Three Pillars of Corporate Social Reporting as New Governance Regulation: Disclosure, Dialogue, and Development*, 18 BUS. ETHICS Q. 447, 470–71 (2008).

119. Paul Leavoy, *Does CSR Reporting Help the Planet, or Just Help Reporting?*, GREENBIZ.COM (Sept. 30, 2010), <http://tinyurl.com/mst6xl6>.

120. Hess, *supra* note 118, at 463.

121. Press Release, Global Reporting Initiative, World Economic Forum Discusses Integrated Reporting (Feb. 2, 2011) (available at <http://tinyurl.com/n7lb7rg>).

122. CORPORATEREGISTER.COM, CR REPORTING AWARDS ’10: GLOBAL WINNERS AND REPORTING TRENDS 4, (2010).

123. *Id.* at 6.

124. See KPMG, INT’L, *supra* note 14.

oriented organization that is partnering with governments to promote mandatory reporting. While states had historically only provided funding to the GRI and had no direct involvement in its operation, they are now actively participating in its decision making process. In connection with this shift, the GRI established a Governmental Advisory Group in 2008 to provide advice to its Board of Directors and executive team, and suggest ways of increasing GRI participation through regulatory initiatives.<sup>125</sup> The Governmental Advisory Group is also trying to resolve institutional and legislative fragmentation on sustainability reporting.<sup>126</sup> In addition, in 2009 the GRI Board signed the Amsterdam Declaration, which cites the recent global financial crisis and lack of trust in economic institutions as a justification for more transparency in economic, social, and governance (ESG) reporting.<sup>127</sup> The declaration calls on governments to strengthen the global sustainability reporting regime:

[T]he Board of the GRI calls on governments to take leadership by:

1. Introducing policy requiring companies to report on ESG factors or publicly explain why they have not done so.
2. Requiring ESG reporting by their public bodies — in particular: state owned companies, government pension funds and public investment agencies.
3. Integrating sustainability reporting within the emerging global financial regulatory framework being developed by leaders of the G20.<sup>128</sup>

In support of the Amsterdam Declaration, the GRI is working closely with governments to pass regulations on sustainability reporting.

The current regulatory landscape reflects a movement towards more government-sponsored legislation, standards, and guidelines on sustainability reporting. According to a 2010 report, there are 142 country standards that include a sustainability-related reporting requirement or guidance.<sup>129</sup> Two-thirds of those regulations are mandatory, and a number of them explicitly cite GRI guidelines.<sup>130</sup>

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125. *See Governmental Advisory Group*, GLOBAL REPORTING INITIATIVE, <http://tinyurl.com/mksqok4> (last visited July 24, 2013).

126. Interview with representative of the Global Reporting Initiative, in Amsterdam, Neth. (Dec. 9, 2010).

127. Press Release, Global Reporting Initiative, The Amsterdam Declaration on Transparency and Reporting (Mar. 10, 2009) (available at <http://tinyurl.com/mvyqetl>).

128. *Id.*

129. U.N. ENVIRONMENT PROGRAMME ET AL., CARROTS AND STICKS—PROMOTING TRANSPARENCY AND SUSTAINABILITY: AN UPDATE ON TRENDS IN VOLUNTARY AND MANDATORY APPROACHES TO SUSTAINABILITY REPORTING 4 (2010).

130. *Id.*

European countries, in particular, are at the forefront of mandatory reporting regulations. France was one of the earliest countries to mandate ESG disclosure. Its 2001 New Economic Regulation requires all listed companies to report on forty social and environmental criteria in their annual reports.<sup>131</sup> The Swedish government requires state-owned enterprises to issue sustainability reports in accordance with GRI's G3 guidelines and subject to external assurance.<sup>132</sup> Spain similarly enacted legislation that requires state-owned companies and businesses with over 1,000 employees to produce sustainability reports beginning in 2012.<sup>133</sup> As of 2009, Denmark requires disclosure of CSR activities in financial statements by both state-owned companies and companies with total assets of more than 19 million euros, revenues more than 38 million euros, and more than 250 employees — totaling about 1,100 companies.<sup>134</sup> In addition, Denmark's mandate extends to institutional investors, investment associations, and other listed financial businesses.<sup>135</sup> The guidance notes to Denmark's amended Financial Statements Act encourages the use of GRI guidelines to fulfill the reporting requirement.<sup>136</sup>

The other EU countries have adopted similar legislation to implement the EU Modernisation Directive on corporate disclosure of non-financial information. Existing EU law mandates private companies to include non-financial key performance indicators in their annual reports “where appropriate” and “[t]o the extent necessary for an understanding of the company's development, performance or position.”<sup>137</sup> The European Commission is considering improvements to this policy because the requirements for disclosure (including indicators) are unclear and EU member states can choose to exempt small and medium-sized enterprises.<sup>138</sup> The Commission hosted a series of workshops to explore

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131. *See* CODE DE COMMERCE [C. COM] art. L. 225-102-1 (Fr).

132. REGERINGSKANSLIET [SWEDISH MINISTRY OF ENTERPRISE, ENERGY, AND COMMUNICATIONS], GUIDELINES FOR EXTERNAL REPORTING BY STATE-OWNED COMPANIES (2007).

133. Ley 2/2011 de 4 de Marzo, de Economía Sostenible (B.O.E. 2011, 55) (Spain) (Spain's sustainable economy law).

134. Financial Statements Act, 2008, § 99A (Den.). The Danish law follows a principle of report or explain, which requires companies to either disclose their CSR activities or give reasons for not having any.

135. *Id.*

136. DANISH COMMERCE & COMPANIES AGENCY, REPORTING ON CORPORATE SOCIAL RESPONSIBILITY: AN INTRODUCTION FOR SUPERVISORY AND EXECUTIVE BOARDS (English Version) 15 (2009).

137. *See* Directive 2003/51/EC, art. 1(14), of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 86/635/EEC, and 91/674/EEC on the Annual and Consolidated Accounts of Certain Types of Companies, Banks, and Other Financial Institutions and Insurance Undertakings, 2003 O.J. (L 178).

138. *European Workshop on Disclosure of Environmental, Social and Governance Information*, at 16 (2010), available at <http://tinyurl.com/n4rv3tr>.

possible policy revisions in 2009 and 2010 and completed its public consultation in late January 2011.<sup>139</sup> Among the recommendations that are being considered is for EU policy to use the GRI guidelines as a reference point for corporate reporting.<sup>140</sup>

In addition to mandatory regulations, governments are issuing voluntary guidelines on sustainability reporting for companies and public agencies, many of which cite the GRI guidelines. For instance, Australia's Department of Economics and Heritage issued a guide to reporting using GRI-consistent environmental indicators, and its Minerals Council (an industry group) recommends public sustainability reporting under GRI's Mining and Metals Sector Supplement.<sup>141</sup> The Canadian government has also endorsed the GRI for CSR reporting by the extractive sector.<sup>142</sup> In 2007, Japan released its Environmental Reporting Guidelines, which cite GRI guidelines and require environmental reporting for specified corporations.<sup>143</sup>

Stock exchanges are another important driving force behind sustainability reporting. They are encouraging companies to be transparent as to their sustainability performance and, in some cases, mandating disclosure. Companies listed on the London Stock Exchange must disclose in their annual reports any non-financial information relevant to their business, although they do not have to file a full-length CSR report.<sup>144</sup> In Australia, companies listed on its national exchange must disclose the extent to which they have followed the Corporate Governance Principles and Recommendations, which include sustainability issues.<sup>145</sup> Emerging market countries are also promoting voluntary standards in CSR reporting through the involvement of local stock exchanges. All companies listed on

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139. See *Public consultation on non-financial reporting, Reporting and disclosure*, EUR. COMMISSION, <http://tinyurl.com/jw9rt9j> (last visited July 24, 2013).

140. *European Workshop on Disclosure of Environmental, Social and Governance Information*, *supra* note 138.

141. AUSTRALIA DEPARTMENT OF THE ENVIRONMENT AND HERITAGE, TRIPLE BOTTOM LINE REPORTING IN AUSTRALIA: A GUIDE TO REPORTING AGAINST ENVIRONMENTAL INDICATORS (2003); MINERALS COUNCIL OF AUSTRALIA: AUSTRALIAN MINERALS INDUSTRY FRAMEWORK FOR SUSTAINABLE DEVELOPMENT "ENDURING VALUE," (2005).

142. THE OFFICE OF THE EXECUTIVE SECTION ESR COUNSELLOR, BUILDING THE CANADIAN ADVANTAGE: A CORPORATE SOCIAL RESPONSIBILITY (CSR) STRATEGY FOR THE CANADIAN INTERNATIONAL EXTRACTIVE SECTOR (2009), available at <http://tinyurl.com/m64vb6w>.

143. GOVERNMENT OF JAPAN: MINISTRY OF THE ENVIRONMENT, ENVIRONMENTAL REPORTING GUIDELINES: TOWARDS A SUSTAINABLE SOCIETY (Provisional Translation) 112 (2007); [Law Concerning the Promotion of Business Activities with Environmental Consideration], Law No. 77 of 2004, <http://tinyurl.com/n2cce89> (Japan).

144. Companies Act, 2006, c. 46, § 417 (U.K.).

145. AUSTRALIAN SECURITIES EXCHANGE, CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS 5, 33–34 (2007). Disclosure under these recommendations is on an "if not, why" basis.

the Johannesburg Stock Exchange are required to follow the King Report on Corporate Governance, which mandates integrated reporting that incorporates financial and non-financial information.<sup>146</sup> China's Shanghai Stock Exchange encourages companies to file annual CSR reports and develop a CSR strategy, and provides incentives for doing so, such as priority election into the prestigious Shanghai Corporate Governance Sector.<sup>147</sup> The Bovespa Stock Exchange in Brazil has played an influential role in raising ESG standards among companies as part of an active national movement for more sustainable investment.<sup>148</sup> Many exchanges have also created socially responsible investing indices.<sup>149</sup> The motivation for this activity includes demand from investors for sustainability-related information and the development of specialized markets for sustainable investment niches, particularly in emerging market countries.<sup>150</sup> Interest in sustainability issues is not restricted to socially responsible investors. In fact, there are more than 1100 asset owners, investment managers, and service providers with \$32 trillion in assets that are signatories to the UN's Principles for Responsible Investment, which promotes incorporation of ESG issues in investment analysis and decision making and disclosure of those issues in annual financial reports.<sup>151</sup>

This brings us to the United States. U.S.-based companies have lagged in participation in the GRI, although there has been a significant increase in recent years.<sup>152</sup> The SEC has been at the center of regulatory efforts to mandate corporate sustainability reporting. Over the past decade, advocacy and investor groups (including some of the largest U.S. pension funds) have successfully engaged with and formally petitioned the SEC to issue guidance on existing rules, increase shareholder rights, and develop new disclosure requirements. On October 27, 2009, the SEC reversed an existing policy (under Rule 14A-8(I)(7)) that had allowed companies to exclude shareholder resolutions requesting information on financial risks

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146. INSTITUTE OF DIRECTORS SOUTHERN AFRICA, KING REPORT ON GOVERNANCE FOR SOUTH AFRICA 10 (2009).

147. See *Investing in a sustainable future*, GLOBAL REPORTING INITIATIVE (Sept. 5, 2012) <http://tinyurl.com/lpwjzsb>; Raising CSR standards and disclosure practices, WORLD FEDERATION OF EXCHANGES (Aug. 2009), <http://tinyurl.com/lqgcv8u>.

148. See KPMG INT'L ET AL., *supra* note 15, at 77.

149. *Id.* at 14.

150. *Id.*

151. UNITED NATIONS, PRINCIPLES FOR RESPONSIBLE INVESTMENT: ANNUAL REPORT 2012, at 2 (2012), available at <http://tinyurl.com/lkz3cw6>.

152. Between 2009 and 2010, there was a 30% increase of GRI-based sustainability reporting in the United States although there is still a disproportionately low percentage of assured reporting (i.e., reporting that is verified through a third-party assurance provider). See Mehrdad Nazari, *GRI Reporting Grows by 30% in USA and 50% in Canada*, PRIZMABLOG.COM, (Mar. 9, 2011) <http://tinyurl.com/ketlswv>.

associated with environmental, social, and human rights issues.<sup>153</sup> In January 2010, the agency released an interpretive guidance note on the disclosure of climate change risks in financial filings.<sup>154</sup> The note cited the GRI as a model for sustainability reporting in its 2010 guidance note regarding disclosure related to climate change.<sup>155</sup> The premise behind the interpretation is that a company's 10-K annual report should include discussion of material risks, which may include climate change and other sustainability-related risks. Notably, the guidance note cited the GRI as a model framework for sustainability reporting.

There is current pressure on the SEC to require companies to assess and disclose on not only climate-related risks but also other material environmental, social, and governance risks. A petition to former SEC Chairwoman Mary Schapiro by an association of investment professionals proposed that the agency "require issuers to report annually on a comprehensive, uniform set of sustainability indicators . . . and that the SEC define this as the highest level of the current version of the Global Reporting Initiative (GRI) reporting guidelines."<sup>156</sup>

Consistent with that request, the SEC's Investor Advisory Committee (IAC) took an initial step towards considering ESG disclosure. The IAC was created by Chairwoman Schapiro in 2009 to give greater voice to investors and was regularly attended by several Commissioners as well as senior SEC officials.<sup>157</sup> The Committee was recently codified as a permanent institution under the Dodd-Frank Act and will soon be reconstituted with members appointed by the entire Commission.<sup>158</sup> Among the IAC's priorities was ESG disclosure, which was studied by the Investor as Owner Subcommittee. On May 18, 2010, the subcommittee met with a panel of experts on ESG issues, including the GRI's Director of Sustainability Reporting.<sup>159</sup> Before being temporarily disbanded in light of the Dodd-Frank Act, the subcommittee's final resolution reflects a

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153. Sec. & Exch. Comm'n Div. of Corporate Fin., Staff Legal Bulletin No. 14E (CF) (Oct. 27, 2009). Shareholder activism on environmental and social issues is becoming a significant source of pressure on companies. During the 2010 corporate proxy season, there were a record 100 shareholder-driven proposals related to climate change issues. Lori Pizzani, *Disclosing Environmental Risks*, CFA MAGAZINE, Sept.-Oct. 2010, at 35.

154. See Sec. & Exch. Comm'n, Commission Guidance Regarding Disclosure Related to Climate Change; Final Rule, 75 Fed. Reg. 6290 (Feb. 8, 2010).

155. *Id.* at 6292.

156. Letter from Lisa Woll, CEO of Social Investment Forum, to Mary Schapiro, Chairwoman of the Sec. & Exch. Comm'n (July 21, 2009) (on file with author).

157. See Press Release, Sec. & Exch. Comm'n, SEC Announces Creation of Investor Advisory Committee (June 3, 2009), available at <http://tinyurl.com/pv8822>.

158. See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 911, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank Act].

159. Memorandum from Elizabeth Murphy, Fed. Advisory Comm. Act Comm. Mgmt. Officer, to Michael McTiernan, Div. of Corp. Fin. Staff Member (Sept. 30, 2010) (on file with author).

recognition that ESG disclosure is a priority that should be addressed by the SEC:

The Investor as Owner Subcommittee of the Investor Advisory Committee believes that the SEC should develop dedicated internal resources to monitor and advise on developments regarding the disclosure of corporate social and environmental performance data. Activities could include:

- Monitoring and evaluating the effectiveness of current US disclosure requirements and enforcement measures;
- Monitoring global developments and participating in appropriate fora;
- Serving as a point of contact for investors, issuers and other stakeholders on these issues; and
- Making recommendations to the Commission where appropriate.

The Investor as Owner Subcommittee of the Investor Advisory Committee further believes that periodic public reports on these activities be produced.<sup>160</sup>

The above resolution is not binding on the SEC, and it remains to be seen how much weight will be accorded to it by the yet-to-be constituted new IAC.

There are a variety of obstacles that may prevent the SEC releasing additional guidance or requirements for ESG disclosure. The agency currently does not have the requisite expertise and capacity to make meaningful decisions on the costs and benefits of mandating environmental and social reporting. SEC officials perceive that there is insufficient interest among mainstream investors, as opposed to socially responsible investors.<sup>161</sup> Moreover, while ESG disclosure remains on the SEC's long-term agenda, it has become less of a short-term priority given the resources needed to implement the Dodd-Frank Act.<sup>162</sup>

The Dodd-Frank Act includes three provisions that are particularly relevant to ESG reporting, which suggests the incremental fashion by which sustainability reporting is being mandated in the United States. Section 1502 imposes a new reporting requirement on publicly traded companies that manufacture products using certain conflict minerals.<sup>163</sup> For example, companies must identify whether the sourcing of the

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160. *Id.*

161. Interview with SEC officials, in Washington, D.C. (Nov. 2, 2010).

162. *Id.*

163. Dodd-Frank Act, *supra* note 158, § 1502.

minerals originated in the Democratic Republic of Congo (DRC). If so, they must submit an independent private sector audit report on due diligence measures taken to avoid using minerals that directly or indirectly finance armed groups in the DRC.<sup>164</sup> Section 1503 of the Dodd-Frank Act imposes new disclosure requirements on mine safety.<sup>165</sup> Mining companies must disclose in their annual and quarterly reports to the SEC on the safety and health requirements that apply to mines under the Federal Mine Safety and Health Act of 1977.<sup>166</sup> Finally, section 1504 requires natural resources companies to disclose certain payments made to governments for the commercial development of oil, natural gas, or minerals.<sup>167</sup>

Outside of the SEC, there are notable efforts by federal agencies to incorporate GRI reporting. Under an executive order signed in January 2010 entitled “Federal Leadership in Environmental, Energy, and Economic Performance,” all federal agencies are required to issue a strategic sustainability performance plan.<sup>168</sup> In addition to developing a plan that includes quantifiable metrics and sustainability goals, agencies must also inventory their greenhouse gas emissions and set targets to reduce their emissions by 2020.<sup>169</sup> Each agency must also appoint a senior sustainability officer, and the Chair of the Council on Environmental Quality (CEQ) will report agency results to the President.<sup>170</sup> Since the U.S. Army, U.S. Air Force, and U.S. Postal Service already issue GRI-based reports, GRI representatives are lobbying the CEQ to recommend that all agencies issue their strategic sustainability performance plans under a GRI model.<sup>171</sup>

Efforts to regulate sustainability reporting in the United States are still slow compared to efforts in other countries. In order to raise its U.S. profile, the GRI officially launched a focal point office in New York City on January 31, 2011.<sup>172</sup> The opening ceremony took place at the New York Stock Exchange (NYSE) with a panel discussion on “Why is America Letting the World Lead in Sustainability Reporting?” This event was a clear effort to engage financial leaders and information providers who could then motivate U.S. companies to report on sustainability using the

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164. *Id.*

165. *Id.* § 1503.

166. Federal Mine Safety and Health Act of 1977, Pub. L. No. 95-164, 91 Stat. 1290 (codified as amended in scattered sections of 30 U.S.C.).

167. Dodd-Frank Act, *supra* note 158, § 1504.

168. Exec. Order No. 13,514, 74 Fed. Reg. 52117 (Oct. 5, 2009).

169. *Id.* §§ 2, 8.

170. *Id.* §§ 3, 16.

171. Interview with Mike Wallace, Director of U.S. Focal Point, Global Reporting Initiative, in N.Y.C., N.Y. (Dec. 2, 2010).

172. Press Release, Global Reporting Initiative, GRI Launches its Focal Point USA (Jan. 12, 2011), *available at* <http://tinyurl.com/kaok8l9>.



GRI. Among the participants at the event were Bloomberg and NYSE Euronext, the leading global operators of financial markets and providers of trading technologies.<sup>173</sup>

An essential component of the GRI's strategy in the United States is garnering and publicizing support of the initiative among market data providers. A significant development in this direction came in late 2009 when Bloomberg began providing 120 ESG variables for public companies on its 250,000 data terminals.<sup>174</sup> Users now have access to this data at no additional cost and can manipulate it in the same way as traditional financial metrics. By adding ESG data, Bloomberg recognizes that mainstream institutional investors, not just socially responsible investors, will increasingly consider sustainability performance in their investment decisions. In presentations to business associations and industry groups (including the Business Roundtable, the National Association of Corporate Directors, and the National Investor Relations Institute), the GRI highlights how Bloomberg and other information providers, such as Thomson Reuters, NASDAQ, RiskMetrics, and KLD Research & Analytics, rely on GRI reports when compiling ESG data.<sup>175</sup> According to a Bloomberg representative, "to make our content relevant to the marketplace, we needed to display the information exactly in the format provided by GRI, as this has become the market standard."<sup>176</sup> For instance, when a Bloomberg user selects a company's water consumption variable, she is immediately linked to the company's GRI report. If the company has not issued a report, then the cell will remain blank. The GRI hopes that companies will therefore feel pressure from investors to disclose their social and environmental data and, over time, improve their performance.<sup>177</sup>

Rating agencies and sustainability indices are other potential avenues to pressure companies to report using the GRI. Many rating agencies build their methodologies around GRI indicators although they are not necessarily public about it.<sup>178</sup> One index that explicitly relies on GRI metrics is NASDAQ's Global Sustainability 50 Index.<sup>179</sup> In the fall of

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173. *Id.*

174. See Mindy S. Lubber, *Is ESG Data Going Mainstream?*, HARVARD BUSINESS REVIEW BLOG (May 6, 2009), <http://tinyurl.com/ljcl4nc>; see also *Bloomberg Sustainability*, BLOOMBERG, <http://www.bloomberg.com/bsustainable/> (last visited June 24, 2013).

175. Mike Wallace, Director of U.S. Focal Point, Global Reporting Initiative, *GRI Reporting Trends* (2010) (on file with author).

176. *Id.*

177. Client demand has spurred banks like Goldman Sachs to integrate ESG criteria into their investment research. See GOLDMAN SACHS, ENVIRONMENTAL STEWARDSHIP AND SUSTAINABILITY SUMMARY OF 2010 (2010), available at <http://tinyurl.com/m7e9jjo>.

178. Interview with Mike Wallace, Director of U.S. Focal Point, Global Reporting Initiative, in New York, N.Y. (Dec. 2, 2010).

179. See NASDAQ OMX, NASDAQ OMX CRD Global Sustainability Index SM Methodology

2009, the index removed twenty-three firms, including Cisco, Microsoft, and Oracle, for failing to disclose on a minimum of forty percent of core GRI indicators.<sup>180</sup> While indices and rating agencies track reporting based on the indicators, however, they do not track performance or improvement over time.

### III. THE POTENTIAL COSTS OF USING INDICATORS IN GOVERNANCE

Indicators are not neutral instruments that can be applied mechanically. They are normative tools that embed certain values and shape behavior according to a standard.<sup>181</sup> They also carry potential costs. Whether indicators play a beneficial or harmful role in turn can influence the perceived legitimacy of the government agencies and private actors that produce and rely on them.<sup>182</sup> Whether civil society perceives an actor as legitimate will affect the agency's right to govern, its claim to authority, and the likelihood of compliance with its directives.<sup>183</sup> Based on personal interviews with GRI staff in Amsterdam and New York City, and observations at a GRI-certified training session, I will identify potential costs associated with using indicators, which challenge their effectiveness in meaningfully comparing units of analysis and evaluating performance.

#### A. *The Promotion of Box Ticking and Superficial Compliance*

The use of indicators risks producing a box ticking approach to compliance, which entails superficial or cosmetic changes without any substantive effects on behavior. Box ticking refers to a "rigid, mechanical practice involving the use of needlessly detailed 'standardized checklists' and pursued without regard to weighing costs against benefits."<sup>184</sup> The scientific authority of indicators and their focus on transparency can conceal behavioral changes (or the lack thereof) and lead to data gathering

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(Jan. 2012), available at <http://tinyurl.com/mvvhzoy>.

180. Marc Gunther, *Investors Urge More Tech Firms to Follow Intel's Lead and Embrace Green*, GREENBIZ.COM (June 1, 2010), <http://tinyurl.com/2wje9tr>.

181. See Bert-Jaap Koops, *Criteria for Normative Technology: The Acceptability of 'Code as Law' in Light of Democratic and Constitutional Values*, in REGULATORY TECHNOLOGIES: LEGAL FUTURES, REGULATORY FRAMES AND TECHNOLOGICAL FIXES 157 (Roger Brownsword & Karen Yeung eds., 2008).

182. I am primarily interested in procedural legitimacy, which focuses on fair procedures according to principles of transparency, accountability, democratic deliberation, and participation. See THOMAS M. FRANCK, *THE POWER OF LEGITIMACY AMONG NATIONS* (1990); Thomas M. Franck, *Legitimacy in the International System*, 82 AM. J. INT'L L. 705 (1988).

183. See, e.g., Daniel Bodansky, *The Legitimacy of International Governance: A Coming Challenge for International Environmental Law*, 93 AM. J. INT'L L. 596, 602-03 (1999); David D. Caron, *The Legitimacy of the Collective Authority of the Security Council*, 87 AM. J. INT'L L. 552, 558 (1993).

184. MICHAEL POWER, *ORGANIZED UNCERTAINTY: DESIGNING A WORLD OF RISK MANAGEMENT* 153 (2007).

for its own sake, with a preference for precise but not necessarily relevant data.<sup>185</sup> As a result, indicators run the risk of promoting business interests at the expense of public interests, thus drawing regulation away from its primary purpose and not measuring what is important.<sup>186</sup> Organizations that produce indicators may become more preoccupied with perpetuating their existence and raising their status, rather than using the indicators as a tool to shape behavior. In this way, the process of producing more and better indicators becomes an end in itself.

When indicators are used in regulatory governance, there can be a slippage between their initial goals and intended audience, and the goals and audience that evolve over time. For instance, the GRI training session that I attended was exclusively focused on revising indicators and disclosing more information, rather than promoting its original aim of corporate accountability. When the GRI was founded, the intended audience for its reports was communities, consumers, non-governmental organizations, and shareholders who would presumably read the reports, encourage companies to improve their performance on sustainability issues, and thereby shift the balance of power in corporate governance.<sup>187</sup> However, the focus of the GRI's activities has now become the users (the companies) — the GRI devotes significant resources to developing learning tools, training courses, and services for report preparers and users.<sup>188</sup> A GRI official that I interviewed admitted that the GRI's main audience is companies and that its primary motivation is to increase company participation.<sup>189</sup> Here we see a gap between the GRI's stated goal of multi-stakeholder consensus-building and its actual operations.

The GRI is no longer aimed at empowering its original audience to hold corporations accountable. For instance, it is questionable who actually reads the reports. According to one study, “there is widespread agreement that the [GRI] reports are not studied in any detail.”<sup>190</sup> My interviews revealed that GRI officials themselves acknowledge the low readership of GRI reports.<sup>191</sup> Even among those actors that read the reports, many do not find them useful. A major U.S. environmental NGO representative

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185. *Id.* at 167.

186. The process by which regulated firms and special interest groups end up co-opting and manipulating the agencies that are supposed to control them is called “regulatory capture.” See STEVEN P. CROLEY, REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT 17–18 (2008).

187. See Levy et al., *supra* note 92, at 8.

188. See *Reporting Support*, GLOBAL REPORTING INITIATIVE, <http://tinyurl.com/19jqf8e> (last viewed July 24, 2013).

189. Interview with representative of the Global Reporting Initiative, in Amsterdam, Neth. (Dec. 7, 2010).

190. Levy et al., *supra* note 92, at 103.

191. Interviews with representatives of the Global Reporting Initiative, in Amsterdam, Neth. (Dec. 7, 8, 2010).

noted: “We don’t really use GRI reports . . . . [A] single number is not enough; we are interested in [the] strategies and plans behind the numbers.”<sup>192</sup> Others noted that the information “does not give an adequate picture of the impacts on local communities, . . . [and] is too processes oriented, rather than [focused on] performance.”<sup>193</sup> NGOs also do not trust the data, which usually is not verified by a third party. They only pay attention to whether a company releases a report but not its actual content. What becomes important then is simply the procedural exercise of filling out a report or, in other words, superficial compliance.

The GRI’s application levels further reinforce its focus on transparency for its own sake rather than actual improvements in behavior. Recall that the GRI attaches an application level to a report largely based on the number of indicators that a company reports on.<sup>194</sup> A company receives an “A” if it reports on at least fifty indicators, a “B” for twenty, and a “C” for ten.<sup>195</sup> That means that a company that is destroying the environment could nevertheless get an “A” for reporting on fifty or more indicators (as well as disclosing its management approach). Thus, the application levels are based on the level of disclosure, rather than the quality and accuracy of a firm’s actual performance. One GRI official admitted that there is a general misconception that the application levels serve as a ranking based on quality of performance, rather than an objective classification of the level of transparency:

What we’ve seen is that it’s . . . a challenge on the communication side. So often the levels have been presented as being a grade or a quality mark or a performance related statement, which has been quite difficult for us to counteract. I mean, whenever we came across something like that we would contact the company and then ask them to change the statement, but of course, since we’re an international organization you can never ensure that you find everything . . . . That’s also inherent in the system [of] “A,” “B,” and “C” in a U.S. context. It has a completely different connotation in the European context, for instance [where school grades are numeric].<sup>196</sup>

Another GRI official explained that it may be more worthwhile for a company to devote resources to managing change and improving

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192. Levy et al., *supra* note 92, at 103.

193. Halina Szejnwald Brown et al., *Building Institutions Based on Information Disclosure: Lessons from GRI’s Sustainability Reporting*, 17 J. CLEANER PRODUCTION 571, 576 (2009).

194. GLOBAL REPORTING INITIATIVE, *supra* note 19.

195. See *infra* Part II.A for a more detailed description of the application levels.

196. Interview with representative of the Global Reporting Initiative, in Amsterdam, Neth. (Dec. 8, 2010).

performance rather than moving up levels for its own sake.<sup>197</sup> Moreover, external verification is only optional, and a company could add a “+” to its application level even if only a small portion of its report has been externally verified.<sup>198</sup> Third-party verifiers like accounting firms do not have to comply with a uniform assurance standard.<sup>199</sup> Here we see that the motivation behind the producers of the GRI is not that the reports are actually read by NGOs or whether they reflect a company’s good or bad performance, but that more and more companies participate and release reports. As the GRI enhances its profile and perpetuates its status as the market leader in sustainability reporting, it may be undermining its legitimacy and the purported goals behind its indicators.

*B. The Dominance of Technical Experts over Decision Making*

Because indicators rely on numerically-rendered data, technical experts (both within government agencies and private actors) exercise considerable power over decision making and the interpretation of legal norms. While their specialized knowledge and political neutrality can be a benefit for policy making,<sup>200</sup> it is difficult for stakeholders to challenge the power of experts and their methodology and assumptions in producing the indicators. Since indicators carry scientific authority, they mask potential conflicts of interest among technical experts and leave little room for contestation. This is the case for the GRI, where accounting firms are heavily involved in both indicator production and data verification.

Providing assurance for sustainability reports has become a growing business, especially for accounting companies that have been seeking credibility following the Enron scandal.<sup>201</sup> As a result, “[a] large service industry comprised largely of sustainability consultancies and auditing firms has emerged around the revisions of the guidelines, preparations of reports, their verification, stakeholder outreach, and various efforts to standardize and institutionalize the above activities.”<sup>202</sup> These firms arguably derive more economic benefit from the GRI than any other stakeholder. In fact, some firms such as KPMG, PricewaterhouseCoopers, and Deloitte have recently established global sustainability practice groups

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197. Interview with representative of the Global Reporting Initiative, in Amsterdam, Neth. (Dec. 7, 2010).

198. GLOBAL REPORTING INITIATIVE, *supra* note 19.

199. *Id.*

200. *See generally* JAMES M. LANDIS, *THE ADMINISTRATIVE PROCESS* (1938); David B. Spence & Frank Cross, *A Public Choice Case for the Administrative State*, 89 *GEO. L.J.* 97 (2000).

201. *See* Carol A. Tilt, *Corporate Responsibility, Accounting and Accountants*, in *PROFESSIONALS’ PERSPECTIVES OF CORPORATE SOCIAL RESPONSIBILITY* 11-32 (Idowu & Filho eds., 2009).

202. Levy et al., *supra* note 92, at 97.

that specifically focus on corporate sustainability measurement and reporting.<sup>203</sup>

The role of accounting firms as independent third-parties is dubious given that they are actively governing the same organization that they are presumably regulating. Representatives from large accounting firms occupy key positions in the GRI's governance structure, including the Board of Directors, from which they advise on the methodology and interpretation of indicators.<sup>204</sup> In an informational brochure about its sustainability practice, Deloitte advertises that it:

has been involved in every stage of the GRI's growth and development . . . . Deloitte member firms were involved in the 2002 revision of the GRI guidelines, as well as the 2006 revision at which the current G3 guidelines were drafted. Many Deloitte member firm professionals have played key roles in the GRI governance and stakeholder bodies . . . . Moreover, Deloitte member firm teams both advise clients on reporting and assurance according to GRI guidelines and collaborate . . . on GRI-sponsored training.<sup>205</sup>

The big four accounting firms (Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers) have also recently sponsored the GRI's new U.S. office for the first two years.<sup>206</sup> Yet these same firms also have a stake in increasing the market for their services. Given that the firms may provide other services to their clients, such as financial auditing, they have an interest in trying to package their financial and non-financial services together. More companies using GRI and seeking external assurance represents a significant revenue opportunity for the big accounting firms.

Given the proliferation of performance codes, standards, and other forms of voluntary self-regulation, the "third-party assurance industry" is becoming increasingly influential in the interpretation of legal norms in a variety of areas.<sup>207</sup> Accountants are thus exercising authority over how legal norms are valued, interpreted, measured, and verified.<sup>208</sup> Given their

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203. See Tilt, *supra* note 200.

204. See *Board of Directors*, GLOBAL REPORTING INITIATIVE, <http://tinyurl.com/n4eq328> (last visited July 24, 2013).

205. DELOITTE, SUSTAINABILITY REPORTING: THE EMERGING CHALLENGE 2–3 (2010), available at <http://tinyurl.com/m24e8ka>.

206. Press Release, Global Reporting Initiative, New GRI Focal Point Helps U.S. Companies Improve Sustainability (Nov. 3, 2010), available at <http://tinyurl.com/nx7or7o>.

207. See Margaret M. Blair et al., *The New Role for Assurance Services in Global Commerce*, 33 J. CORP. L. 325 (2008).

208. A handful of law firms are beginning to catch up to accounting firms by opening corporate social responsibility practice groups, but lawyering in this area is still in its early stages. See, e.g., *Corporate Social Responsibility Practice*, FOLEY HOAG LLP, <http://tinyurl.com/lq6pkvf> (last visited June 24, 2013).

conflict of interest, sensitive issues may be left out by assurance providers for fear of upsetting their clients.<sup>209</sup> In the case of the GRI where the verification of data often involves law-related issues such as the application of international human rights and environmental standards, accountants arguably lack the professional competence to conduct a proper evaluation.<sup>210</sup> Surprisingly, there are no legal experts on the GRI's Technical Advisory Committee, so their participation in the production of GRI guidelines and the interpretation of indicators is limited to consultations with Organizational Stakeholders.<sup>211</sup>

### C. *The Distortion of Public Values into Numbers*

When indicators do not accurately represent the social phenomena that they are intended to evaluate, they lose their effectiveness as regulatory tools. This risk particularly applies to the use of indicators to measure public values that are non-instrumental and difficult to translate into numbers. Legal norms may then be interpreted in a managerial way that distorts their original meaning.<sup>212</sup> In the case of the GRI, issues that are easy to quantify, such as greenhouse gas emissions, are prioritized. At the same time, issues such as human rights and community impact are subordinated or even diluted as they are translated into mere business risks. In this way, indicators may lead to better performance on certain issues by relying on the power of numbers, but may neglect those issues that are difficult to quantify. So instead of the maxim “what is measured gets done,” in fact in reality, what is easy to measure may be the only thing that gets done.

While quantification may be appropriate for many environmental or health and safety issues, it is difficult to capture other material information in measurable quantities. For instance, critics argue that the subjection of certain issues to cost-benefit analysis (as it is currently structured) may strip them of their intrinsic value.<sup>213</sup> As the GRI develops its fourth

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209. See Brendan O'Dwyer & David L. Owen, *Assurance Statement Practice in Environmental, Social and Sustainability Reporting: A Critical Evaluation*, 37 BRIT. ACCT. REV. 205, 227 (2005).

210. Giacomo Manetti & Lucia Becatti, *Assurance Services for Sustainability Reports: Standards and Empirical Evidence*, 87 J. BUS. ETHICS 289, 291 (2009).

211. This is particularly problematic because the GRI needs the support of lawyers before companies agree to use the guidelines. Corporate counsel must approve before a company discloses information based on corporate sustainability standards like the GRI.

212. See Lauren B. Edelman et al., *Diversity Rhetoric and the Managerialization of Law*, 106 AM. J. SOC. 1589 (2001) (demonstrating that the use of diversity rhetoric in U.S. management transforms and potentially undermines the legal ideals underlying civil rights law).

213. See DOUGLAS A. KYSAR, *REGULATING FROM NOWHERE: ENVIRONMENTAL LAW AND THE SEARCH FOR OBJECTIVITY* (2010); Maria Green, *What We Talk About When We Talk About Indicators: Current Approaches to Human Rights Measurement*, 23 HUM. RTS. Q. 1062 (2001).

generation of guidelines, there is disagreement over the extent to which indicators can (or should) be solely based on quantitative data:

The challenge is to what extent can we put the sustainability issues into measurable figures. Is that possible? Should we move to that completely or should we also allow for context-related information? So that's going to be a big discussion when we start up G4. But what we've seen is that the information that the investors are looking for are actually these numbers to a large extent.<sup>214</sup>

The debate over quantification emerged most recently over revision of the GRI's human rights indicators.

According to a report by the GRI's Human Rights Reporting Working Group, it has been challenging to develop appropriate performance indicators in this area.<sup>215</sup> For instance, one of the human rights indicators in the G3 guidelines is "total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained."<sup>216</sup> Yet the number of employee training hours does not necessarily correlate with positive human rights outcomes. Another GRI indicator is "total number of incidents of violations involving rights of indigenous people and actions taken."<sup>217</sup> By exclusively relying on a quantitative measure, this indicator does not give information about the seriousness of the violations or the length of time over which they occurred. Good reporting requires more than just quantitative data:

[I]t is necessary to disaggregate performance data . . . . The report should pay adequate attention to both narrative and quantitative data . . . . As a general point, all quantitative indicators have minimal meaning as isolated pieces of information. Numbers can indicate how often events have occurred, but will provide little or no insight into quality (e.g., 100 hours of training does not reflect whether it was effective or ineffective; 1 million Euros of revenue does not describe sources of the revenue or their relative importance to overall strategy). Therefore, all quantitative indicators must be read in the context of other information and the relative value of quantitative indicators must be judged in terms of how

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214. Interview with representative of the Global Reporting Initiative, in Amsterdam, Neth. (Dec. 8, 2010).

215. GLOBAL REPORTING INITIATIVE, REPORT: HUMAN RIGHTS REPORTING WORKING GROUP 7 (2009) (on file with author).

216. GLOBAL REPORTING INITIATIVE, SUSTAINABILITY REPORTING GUIDELINES VERSION 3.0 33 (2000), available at <http://tinyurl.com/d75mkwa>.

217. *Id.*



well it contributes to understanding in combination with the other required disclosures.<sup>218</sup>

In other words, public values such as human rights cannot be captured by numbers alone. Despite the working group's report, the GRI is moving in the direction of more quantification and the translation of all issues into potential financial risks.

As part of its efforts to streamline indicators and mainstream reporting, the GRI recently announced a goal that by 2020, all companies will adopt an integrated report.<sup>219</sup> This means that a company would release a single annual report that includes indicators for both financial and non-financial information.<sup>220</sup> The purpose of an integrated report is to raise the status of non-financial information and demonstrate its relationship to a company's core business strategy. Yet if integrated reporting one day became the norm and ultimately replaced sustainability reports, then the standard for including environmental and social issues would be financial materiality — that is, the same standard used for financial statements under the SEC based on what a reasonable investor would consider important in making an investment decision.<sup>221</sup> Therefore, issues like human rights, which are materially important for communities and NGOs but may not necessarily be financially material, may be left out of an integrated report.<sup>222</sup>

The GRI's progression towards integrated reporting represents an effort to translate public values into financial terms and transform them into business risks. In the case of human rights, what is developing is a risk management approach that defines potential violations as strategic risks, which may damage a company's reputation, threaten its profits, and lead to possible litigation.<sup>223</sup> While risk management has become increasingly common in public and private governance,<sup>224</sup> what are the implications for it being applied to more value-laden issues such as human rights? Translating rights into financial risks and indicators may emphasize their regulatory dimension (including their instrumental, rule-oriented, and administrative qualities) but disregard their sovereignty dimension (which

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218. *Id.* at 7, 8.

219. See sources cited *supra* note 111.

220. See ECCLES & KRZUS, *supra* note 111.

221. See *Basic v. Levinson*, 485 U.S. 224, 231–32 (1988).

222. This is the reason why some advocacy organizations do not recommend that integrated reports completely replace sustainability reports. My discussions with these organizations revealed that they believe that the audiences for the two reports are different — investors would read the integrated reports while NGOs and consumers would read sustainability reports.

223. A prominent example of this approach is the Voluntary Principles on Security and Human Rights, which promote human rights risk assessments in the extractive industries sector. *Introduction, VOLUNTARY PRINCIPLES ON SECURITY & HUM. RTS.*, <http://voluntaryprinciples.org/principles/introduction> (last visited Apr. 11, 2013)

224. See MICHAEL POWER, *THE RISK MANAGEMENT OF EVERYTHING: RETHINKING THE POLITICS OF UNCERTAINTY* (2004), available at <http://tinyurl.com/18cbzgq>.

invokes their universal character, symbolic valence, and emancipatory power).<sup>225</sup> As a result, human rights indicators that rely exclusively on quantitative measurement may distort the legal norms on which they are based and challenge the usefulness of these tools to effectively evaluate performance.

#### IV. HOW TO ENHANCE THE PROMISE AND MINIMIZE THE PERILS OF INDICATORS

Given the potential costs of using indicators in legal governance, how can we enhance their effectiveness as regulatory instruments? I argue that indicators are useful tools that provide important benefits to the policymaking process. But they are not ends in themselves. Their ultimate goal should be improving performance and changing long-term behavior. Towards that end, I draw upon my case study of the GRI to propose the following recommendations. These prescriptions apply to both regulatory actors such as government agencies that incorporate indicators into decision making, as well as private actors such as the GRI that produce indicators and shape regulation.

##### *A. Design Meaningful Indicators and Rankings*

In order to avoid box ticking and superficial compliance, regulators should design meaningful indicators that measure information that is relevant to stakeholders, can be reasonably collected, and addresses issues on which change is most needed. A meaningful indicator would be one where an improvement in the number implies that things actually got better on the ground. Towards that end, it is important to balance structure-based and process-based indicators with outcome-based indicators.<sup>226</sup> Structure-based indicators focus on the legal and institutional framework and organizational inputs, such as the adoption of a policy or equipment type. Process-based indicators measure the efforts made to meet obligations and achieve performance outcomes, such as levels of spending on female primary education or the percentage of employees trained in an organization's anti-corruption policies. Outcome-oriented indicators measure how well one's initiatives are accomplishing the intended results, such as total greenhouse gas emissions or an increase in

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225. See GALIT A. SARFATY, *VALUES IN TRANSLATION: HUMAN RIGHTS AND THE CULTURE OF THE WORLD BANK* (2012); Galit A. Sarfaty, *Why Culture Matters in International Institutions: The Marginality of Human Rights at the World Bank*, 103 AM. J. INT'L L. 647 (2009).

226. I follow here the division of rights-based indicators proposed by Paul Hunt, the former U.N. Special Rapporteur on the Right to Health. Special Rapporteur of the Commission on Human Rights, *Interim Report on the Right of Everyone to Enjoy the Highest Attainable Standard of Physical and Mental Health, transmitted by note of the Secretary General*, ¶¶ 14–29 U.N. Doc A/58/427 (Oct. 10, 2003).

literacy rates. These last indicators are the most critical type because they track progress over time and assess whether or not performance is improving or worsening. In contrast, process indicators frequently do not track changes from year to year and do not focus on the extent of implementation of processes.<sup>227</sup>

The relevance of the GRI indicators is a primary concern for NGOs, community groups, and consumers, many of whom are currently not reading the GRI reports in depth and do not trust the GRI application levels.<sup>228</sup> Until recently, the GRI indicators (particularly those on human rights) were primarily structure- and process-based. Yet in an effort to address stakeholders and make their indicators more meaningful, the GRI has added additional outcome-based indicators.<sup>229</sup> For instance, the new indicators on human rights are: (i) percentage of operations that are subject to human rights impact assessments; and (ii) number of grievances related to human rights that were filed and resolved through formal grievance mechanisms.<sup>230</sup> These metrics will measure the degree to which policies are being implemented and ultimately whether rights are being progressively realized.

It is also critical to design meaningful rankings that reflect a company's quality of performance and its improvement over time, rather than simply its level of transparency. Not only is the GRI's grading system only based on the number of indicators reported by a company, but it also prioritizes "core" indicators over "additional" ones that may nonetheless be materially important to stakeholders. For instance, the GRI's only indicator on indigenous rights (which measures the total number of incidents of violations involving the rights of indigenous people and actions taken) is categorized as "additional."<sup>231</sup> As a result, companies with an "A" application level do not have to report on an indicator that is critical for affected communities and certain civil society organizations.

But how does one overcome the difficulties of translating value-laden issues like human rights into numbers? Measuring human rights is worthwhile given that it provides a number of benefits: "(1) contextual description, monitoring, and documentation of violations; (2) classification of different types of violations; (3) mapping and pattern recognition of violations over space and time; and (4) secondary analysis that provides explanations for violations and policy solutions for reducing them in the

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227. See Rosga & Satterthwaite, *supra* note 45, at 295–96.

228. See *supra* Part III.A.

229. See GLOBAL REPORTING INITIATIVE, GRI G3 AND G3.1 UPDATE: COMPARISON SHEET, available at <http://tinyurl.com/kbyesmg>.

230. GLOBAL REPORTING INITIATIVE, INDICATORS PROTOCOL SET HUMAN RIGHTS (2011), available at <http://tinyurl.com/mezyl3>.

231. *Id.*

future.”<sup>232</sup> However, quantitative measurement is insufficient to capture the full meaning of human rights. Therefore, producers of indicators should rely on both quantitative data and qualitative information (in textual or descriptive form) when measuring public values. These methods are complementary and interdependent ways of understanding a phenomenon. Quantitative metrics can provide evidence of whether a violation is widespread or systematic, while qualitative information can contextualize the problem, establish causal relationships, and clarify why a situation has arisen.

*B. Avoid Data Overload*

When identifying meaningful indicators, one must be careful of data overload as a result of having too many indicators. Having more data does not necessarily mean facilitating better decision-making. As I observed with the GRI, there is a tendency to think that technology is the answer. Alan Knight, the Associate Senior Partner of AccountAbility (a global non-profit organization that provides advisory services and creates standards on sustainability) expressed his concern over the reliance on technology to produce effective corporate reporting: “Technology is very good with data. But data must be debated, analyzed, and considered. Technology can help this process of analysis and consideration but should not be relied on to provide ready-made answers. Technology is only a tool. The buck can never stop at a tool.”<sup>233</sup> Simply focusing on information disclosure through indicators may actually be counterproductive because it may appear as greenwashing. The ultimate goal should be embedding certain norms into company culture. Telefónica, S.A., a Spanish company that has effectively used the GRI indicators towards changing behavior states:

CR [(Corporate responsibility)] reports provide a management platform similar to an iceberg structure. On top, we have indicators as the piece of information that is visible in the report. Second, we have systems and processes implemented in the company, not visible to stakeholders, that help to produce and collect all information within the company. And finally, we verify both indicators and processes to make sure CR issues are implemented properly. So finally, CR reports are a driver to speed up the CSR implementation within the company.<sup>234</sup>

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232. Todd Landman, *Measuring Human Rights: Principles, Practice, and Policy*, 26 HUM. RTS. Q. 906, 909 (2004).

233. Alan Knight, *Think Different, in THE LANDSCAPE OF INTEGRATED REPORTING: REFLECTIONS AND NEXT STEPS* 38, 38 (Robert G. Eccles et al. eds., 2010).

234. Alberto Andreu, CR and Environmental Director, Telefónica, S.A., Spain, *quoted in* GLOBAL

Indicators are just the tip of the iceberg that includes a larger strategy for change.

The GRI's focus on disclosing more and more information (resulting in as many as seventy-nine performance indicators) has led to a deviation from its goals. The large number of indicators discourages companies from adopting the GRI, especially U.S. companies whose corporate counsel fear the litigation risk attached to too much disclosure. On the part of investors and government officials in the SEC, there is a concern that GRI reports are not sufficiently streamlined and not focused on performance outcomes.<sup>235</sup> Some regulatory bodies argue that before mandating any kind of corporate sustainability reporting, they first need a much smaller set of key performance indicators that are clearly linked with financial materiality.<sup>236</sup> What is currently under debate is which key performance indicators are the most appropriate for each industry.<sup>237</sup>

### C. *Require Third-Party Verification*

Indicators are not meaningful if there is little confidence in the information that they provide. It must be costly for actors to disclose false information, which they are arguably more prone to doing under self-monitoring systems. In order to ensure the quality and reliability of the data that feeds into indicators, regulatory agencies should require verification by an independent third party. Possible third parties include NGOs or auditing firms, as long as they are not directly involved in the production or governance of the indicators.

The lack of a third-party assurance requirement affects the trustworthiness of GRI reporting, as viewed by investors and NGOs. Third-party assurance (where a firm will certify whether a company conforms to a relevant standard) is currently optional under the G3 guidelines, and there is not a uniform auditing standard that the GRI requires when an audit is carried out.<sup>238</sup> Due to the possibility that companies may be tempted to misrepresent data so as to enhance their public reputation, the public and NGOs frequently do not trust the

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REPORTING INITIATIVE, GRI SUSTAINABILITY REPORTING: HOW VALUABLE IS THE JOURNEY? 27 (2008).

235. See Levy et al., *supra* note 92, at 105.

236. The GRI is currently responding to these concerns by developing a 4th generation of guidelines to include more streamlined indicators that will be "standard-ready," i.e., ready to be incorporated into future regulations on corporate disclosure. See GLOBAL REPORTING INITIATIVE, *supra* note 110.

237. See STEVE LYDENBERG ET AL., FROM TRANSPARENCY TO PERFORMANCE: INDUSTRY-BASED SUSTAINABILITY REPORTING ON KEY ISSUES (2010). See also the work of the SUSTAINABILITY ACCOUNTING STANDARDS BOARD, <http://www.sasb.org/> (last visited July 24, 2013).

238. GLOBAL REPORTING INITIATIVE, *supra* note 13, at 41.

reports.<sup>239</sup> The GRI has been thus far reluctant to require independent audits, likely because the cost of doing so may dissuade companies from participating. Thus many private actors rely on self-monitoring regimes rather than external assurance. In such cases, I recommend an evolutionary strategy whereby verification would be required only after there is a critical mass of participants. I argue that the GRI has already achieved that level and is now suffering from a credibility deficit for not requiring third-party assurance. Another alternative is to institute a probabilistic auditing model, whereby companies would contribute to a GRI-managed fund that would pay for auditing of approximately 10% of participating companies.<sup>240</sup>

Independent verification is also critical for indicators that are produced for, or used by, regulatory agencies. Since agencies have limited resources to conduct direct oversight, the costs of verification should be spread among program participants.<sup>241</sup> While self-monitoring is cost-effective, the absence of verification has led to under-compliance in such programs as Responsible Care and the Toxics Release Inventory (TRI).<sup>242</sup> In contrast, such initiatives as the EPA's Environmental Leadership Program, the European Union's Eco-Management and Audit Scheme, and California's greenhouse gas cap-and-trade program do rely on third-party verification entities that are certified by the government.<sup>243</sup> Any government program that incorporates indicators should similarly require assurance because "[w]ithout verification, self-reporters will become lax, and likely lean towards underreporting if that is in their self-interest."<sup>244</sup>

Assurance providers should follow standardized and transparent criteria and procedures that are publicly disclosed.<sup>245</sup> They should avoid, or at least disclose, conflicts of interest with the reporting company — for instance,

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239. Neil Gunningham, *Environmental Management Systems and Community Participation: Rethinking Chemical Industry Regulation*, 16 UCLA J. ENVTL. L. & POL'Y 319, 428 (1997–1998).

240. I thank Ian Ayres for this suggestion.

241. See Lesley K. McAllister, *The Enforcement Challenge of Cap-and-Trade Regulation*, 40 ENVTL. L. 1195, 1208 (2010); Eric W. Orts & Paula C. Murray, *Environmental Disclosure and Evidentiary Privilege*, 1997 U. ILL. L. REV. 1, 52 (1997).

242. See Jody Freeman, *Private Parties, Public Functions, and the New Administrative Law*, 52 ADMIN. L. REV. 813, 851 (2000) ("It would significantly enhance Responsible Care's credibility were auditing independently performed by, or at least subject to, independent verification by third parties."); McAllister, *supra* note 241, at 1209 (noting widespread under-compliance with TRI reporting requirements as there is no required verification of the accuracy of data).

243. See Eric W. Orts, *Reflexive Environmental Law*, 89 NW. U. L. REV. 1227, 1306–07 (1994–1995); Freeman, *supra* note 242, at 851; McAllister, *supra* note 241, at 1228–29.

244. McAllister, *supra* note 241, at 1210.

245. One of the most prominent standards for auditing of sustainability reports is AccountAbility's AA1000 assurance standard, which was developed through a multi-stakeholder consultation process and is based on the three principles of inclusivity, materiality, and responsiveness. See ACCOUNTABILITY, <http://www.accountability.org/standards/index.html> (last visited July 24, 2013).

an auditing firm should not serve as verifier for a company if it has designed the company's CSR policies or processes.<sup>246</sup> In addition, the same firms that provide assurance should not be concurrently involved in the governance of the indicators, as is currently the case for the GRI. Finally, governments should regulate the third-party assurance providers through certification or accreditation, or delegate oversight to an independent entity.<sup>247</sup>

*D. Expand Participation by Citizens and a Broad Group of Experts*

Given the technical nature of indicators, experts should naturally play a role in their design and verification. However, there is a risk that they may exercise undue influence over decision making, exhibit conflicts of interest, and leave little room for public contestation. The dominance of experts (especially accounting professionals) can undermine the legitimacy of the institutions that produce the indicators. Ensuring citizen participation in rulemaking is an important goal in administrative law.<sup>248</sup> It is especially critical in the use of indicators, whose scientific appearance makes them less open to being challenged by external parties. By broadening public participation and including a broad group of experts, regulatory entities can avoid capture by technical experts and the promotion of industry interests at the expense of public interests.

Private actors and government agencies should expand participation by the public and NGOs in the design of indicators and engage them in the reporting process. The GRI exhibits several important mechanisms in this regard that other actors should adopt — for instance, its multi-stakeholder consultation process for the design and governance of indicators; its evolutionary approach that allows periodic review and revision of indicators by interested parties; and transparency in the methods used to produce indicators. Yet despite these praiseworthy procedures, the organization has strayed from its goal of empowering civil society organizations to make informed decisions and seek greater accountability for corporate governance. Since it was founded,

[c]onsiderable attention [has been] . . . paid to ensuring collaboration from major multinational corporations and propounding the business case for social reporting, while activists and labor [have] received less attention. These strategic choices and compromises

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246. See Penelope Simons, *Corporate Voluntarism and Human Rights: The Adequacy and Effectiveness of Voluntary Self-Regulation Regimes*, 1/1/2004 RELATIONSIND. 101, 126–27 (2004).

247. See Gabriela Llobet, “Trust but Verify”: *Verification in the Joint Implementation Regime*, 31 GEO. WASH. J. INT’L L. & ECON. 233, 263–64 (1997–1998).

248. For a comprehensive review of the literature on this topic, see Cary Coglianese, *Citizen Participation in Rulemaking: Past, Present, and Future*, 55 DUKE L.J. 943 (2005–2006).

[have] shaped the path of the emerging institution, so that the corporate sector plays an increasingly prominent role, while activists find themselves somewhat marginalized.<sup>249</sup>

According to one study, the low readership of GRI reports by civil society organizations is due to inadequate outreach by the GRI secretariat, the uneven quality and trustworthiness of reports, and the information that is too process-oriented to be useful for activist tactics.<sup>250</sup> As the latter two issues have already been addressed above, it is important to address the need to balance representation among experts and civil society within the GRI's governance system. Corporate interests currently exert considerable influence over the design of indicators and reporting requirements. Therefore, the GRI should set guidelines to ensure that large businesses and international consulting and accounting firms do not continue to dominate the group of Organizational Stakeholders, who vote for members of the Stakeholder Council and approve nominations for Board of Directors.<sup>251</sup> The challenge will be how to select the most representative civil society groups to participate in the GRI governance bodies.

In addition to civil society participation, experts from a variety of disciplines should contribute to the indicator production and verification processes. In the case of the GRI, accounting professionals have been overly representative in these processes although they lack the professional competence to evaluate all types of indicators. Since many of the GRI indicators draw from legal norms, lawyers should be involved in their design through representation on the Technical Advisory Committee. International human rights, labor, and environmental lawyers would not only provide needed expertise, but they could also facilitate greater company adoption of GRI guidelines. In the United States, a lack of support by corporate counsel has been a significant obstacle towards participation in the GRI by U.S. companies.<sup>252</sup> Inside counsel are frequently hesitant to publicly disclose their companies' social and environmental impacts for fear of future litigation.<sup>253</sup> Another possible

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249. Levy et al., *supra* note 92, at 91.

250. Brown et al., *supra* note 193, at 575–76.

251. Levy et al., *supra* note 92, at 96.

252. Mike Wallace, Director of GRI's U.S. Focal Point, observed, "I would say it would be very worthwhile for us to have more legal involvement going forward, because [the obstacle posed by U.S. corporate counsel] is getting very serious." Interview with Mike Wallace, U.S. Focal Point, Global Reporting Initiative, in N.Y.C., NY (Dec. 2, 2010). Interestingly, the obstacles posed by lawyers is uniquely American as lawyers in Europe are much less concerned about possible risks attached to non-financial disclosure and have supported the GRI at much higher rates.

253. This is particularly true after a 2003 case, *Kasky v. Nike*, where Nike was sued for allegedly deceptive public statements about its labor practices. *Kasky v. Nike*, 45 P.3d 243 (Cal. 2002) (affirming that the company's "commercial speech" was entitled to only minimal free speech protection under the First Amendment). Fearing similar lawsuits, many inside counsel are cautious



litigation concern involves a company disclosing “material” information in a voluntary sustainability report that has not been included in a regulatory filing under federal securities law.<sup>254</sup> Since corporate counsel are usually the ones to decide whether a company will participate in the GRI, lawyers should be more involved in the GRI in order to appropriately design the indicators and promote the guidelines to companies. Moreover, assurance providers should include a broad group of experts in their teams of verifiers, including not only lawyers but also environmental scientists and anthropologists with knowledge of the local cultural context.<sup>255</sup>

### CONCLUSION

What are the unintended consequences of using metrics in decision making? Are indicators measuring what is critical towards changing behavior? How can we more effectively use these tools to minimize their costs and enhance their benefits?

In this Article, I have sought to answer these questions by drawing on an empirical study of the Global Reporting Initiative. I demonstrate that indicators do not just serve as instruments to regulate behavior; they themselves have normative authority and may be fraught with problems. Indicators are playing an important role in governance given their ability to simplify and translate social phenomena into a numerical representation that is easy to understand and comparable across actors. They have become particularly prevalent in international law as a mechanism to increase compliance and operationalize global norms. Yet as indicators hide behind a veil of scientific truth and neutrality, they mask potential problems: the promotion of box-ticking and superficial compliance; the dominance of technical experts over decision making; and the distortion of public values into numbers.

Like all tools, indicators can be misused and manipulated in a way that strays from their purported goals and intended audiences. Their costs threaten to outweigh their benefits if they are not designed meaningfully and if there is little confidence in the information that they provide. Therefore, regulatory bodies should not treat indicators as ends in and of themselves, but rather as a means towards evaluating performance and ultimately improving behavior.

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about public communications such as sustainability reporting.

254. See Phillip H. Rudolph, *By Invitation: Ethical Reporting and the Law*, ETHICAL CORP. (Feb. 3, 2005), <http://tinyurl.com/mg5vu9v>.

255. See Simons, *supra* note 246, at 127–28.

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