THE KASKY-NIKE THREAT TO CORPORATE SOCIAL REPORTING
Implementing a Standard of Optimal Truthful Disclosure as a Solution

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Abstract: In the recent case of *Nike v. Kasky* both sides argued that their standard for distinguishing commercial speech from political speech would create the better policy for ensuring accurate and complete disclosure of social information by corporations. Using insights from information economics, we argue that neither standard will achieve the policy goal of optimal truthful disclosure. Instead, we argue that the appropriate standard is one of optimal truthful disclosure—balancing the value of speech against the costs of misinformation. Specifically, we argue that an SEC-sanctioned safe harbor available under a closely supervised system for social reporting will bring about optimal truthful disclosure. The scheme is intended to enhance stakeholder confidence in corporate social and political commentary, while at the same time encouraging corporations to provide accurate information in a fair playing field of public debate.

I. Introduction

Nike v. Kasky is one of the most important cases bearing on corporate social responsibility ever to reach the United States Supreme Court.[1] The case involved an attempt to impose liability on Nike for allegedly misleading statements made in response to Kasky's criticisms of Nike's sourcing policies. The novel lawsuit could potentially have changed the Constitutional status of corporate speech, which could in turn have had a significant impact on the nature and scope of corporate social reporting. After hearing oral arguments on the case, however, the Supreme Court declared that the *writ of certiorari* allowing the case to be argued was improvidently granted and remanded the case back to the California courts. The Supreme Court's ducking of the issue left confusion regarding firms' potential liability for social disclosures at a time when there is increasing pressure on firms to disclose information about their social and environmental impacts.

Defining the boundaries of Constitutional protection for corporate speech has severely challenged the doctrinal craftsmanship of the United States Supreme Court. The Court's key criterion has been an amorphous distinction between commercial

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and political speech. This "all but unintelligible" distinction has resulted in "unpredictable and confusing decisions at the state, lower federal, and Supreme Court levels" (Earnhardt, 2004: 797–98.). Doctrines originally devised to protect corporate speech against blatantly selective impositions on corporate political involvement (*First National Bank of Boston v. Bellotti*, 435 U.S. 765 [1978]), anticompetitive regulations designed to restrain price competition (*Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 [1976]) and administrative regulations attempting to compel a corporation's advertising to conform to official public policy (*Central Hudson Gas & Electric Corp. v. Public Service Commission*, 447 U.S. 557 [1980]) appear incoherent in the case of straightforward applications of false advertising statutes.

The incoherence of this faltering Constitutional doctrine takes on even greater significance when considered in the context of the controversies over corporate social reporting. In what is viewed by many as an encouraging development in corporate social responsibility, an increasing number of firms are detailing their social initiatives and describing their social and ethical policies in stand-alone reports. By 2001, almost half of the top 250 global companies issued separate reports, while almost all provide comment on social and/or environmental issues (Kolk, 2003; KPMG, 2002).

Some corporations use their social reports to proactively defend and justify controversial practices against the claims of critical stakeholders. Firms also respond directly to public charges made by critics through print and television ads and letters to important stakeholders. Critics in turn allege that companies issuing social and political communications often engage in misinformation campaigns in order to "greenwash" their unethical and harmful actions. The resulting controversies have many of the characteristics of political disputes, but they also involve firms acting in a commercial environment.

The disputes and litigation surrounding Nike's sourcing policies and practices are a defining example. After Kasky sued Nike in California for allegedly false statements about the firm's labor practices, a wide range of stakeholders became involved in the case. The complexity of the issues was reflected in the strange bedfellows the litigation produced. Groups that rarely support global businesses aligned with Nike. For example, the AFL-CIO condemned Nike's labor practices but argued in support of their free speech rights. Major media firms and newspapers and the American Civil Liberties Union filed amicus briefs supporting Nike. In contrast, Public Citizen, the California Labor Federation, and the Sierra Club filed amicus briefs for Kasky. Domini Social Investments LLC, a firm whose social screening activities are dependent on corporate social reporting, participated in an amicus brief for Kasky. Although these briefs raised a wide variety of significant public policy issues, the basis of Kasky's complaint was the standard commercial claim of false advertising.

In this article, our focus is on the potential impact of possible changes in the commercial/political speech doctrine on corporate social disclosure practices. We proceed by evaluating current practices in corporate social reporting and other forms of social disclosures. Next, we summarize the *Nike v. Kasky* case that triggered the renewed controversy over corporate free speech rights. Then we discuss the distinction between commercial and political speech and the policy reasons behind it. With this understanding, we consider the attempts to distinguish the two. We find that a distinction between commercial and political speech is not an appropriate or meaningful standard for the overarching policy goal of ensuring complete and full disclosure on matters pertaining to the social and political implications of corporate activities.

As a meaningful alternative, we present and justify a principle of optimal truthful disclosure. We then use information economics to show that neither the limited liability standard proposed by Nike nor the more expansive standard adopted by the California Supreme Court will result in optimal truthful disclosure. Instead, we argue that an appropriately structured system of social reporting will work best at achieving our policy goals. The scheme is intended to enhance stakeholder confidence in corporate social and political commentary, while at the same time encouraging corporations to provide information in a fair playing field of public debate.

II. The Corporate Social Reporting Phenomenon

The past decade has seen a dramatic increase in the amount of social information firms voluntarily disclose to their stakeholders. Many firms provide this information through their web sites, while others publish formal, glossy reports. Shell has issued a substantial hard copy report since 1997, with recent reports issued in ten languages. In 2001, one-third of the largest 100 U.S. companies issued a social report (KPMG, 2002). NGOs have encouraged and supported the reporting phenomena with efforts directed toward the standardization of reports. In 2003, a leading organization in setting reporting standards, the United Nations–sponsored Global Reporting Initiative, estimated that 300 companies were using its guidelines to some degree (Cowe, 2003). Other organizations, such as London-based AccountAbility, are establishing auditing standards and training auditors to confirm the information provided in social reports.

Despite nascent efforts at standardization, there is wide variation in the quality and scope of information provided. Though we have used the term "social report" to include both social and environmental information, most reports have a more narrow focus limited to environmental issues. In fact, 70 percent of the social reports issued by the Fortune Global 250 are best classified as "pure" environmental reports (Kolk, 2003). Independent verification of the reports to ensure their credibility to stakeholders has yet to become standard practice. Only one-third of the reports issued by the Fortune Global 250 in 2001were externally verified (Kolk, 2003; KPMG, 2002). Thirty-six of the top 100 companies in the United States issued a social report in 2001, but only one of those reports was independently verified (KPMG, 2002). In addition, critics complain that these reports are merely "greenwashing" public relations tools that do not further corporate accountability to society. This claim is bolstered by the fact that many reports simply state the company's policies and intentions toward social and environmental issues, but provide no data (Kolk, 2003).

In addition to social reports, firms use a wide variety of other outlets to provide information to stakeholders. Most major corporate Web sites provide information concerning the ethical policies and practices of the firms. Some firms include this information in their annual reports or other corporate filings. Many corporate speech cases have involved advertising campaigns or "public affairs" ads and statements in newspapers and other media. In some cases, firms responded directly to specific stakeholders by letters or similar communications. This type of activity is much harder to compile, so information concerning the scope of corporate responses through the media to social critics is limited. It may be that firms are more likely to deal with controversial social issues such as child labor and working conditions through the general media than in their formal social reports.

Although there are a growing number of empirical studies on firms' non-financial disclosure, most focus solely on environmental issues (see Berthelot, Cormier & Magnan, 2003, for a review) and few consider the quality of the disclosures. With respect to the quantity of disclosure, there is growing support that the following factors are associated with greater disclosure of environmental information through corporate communications: firm size, membership in an industry facing significant environmental issues, financial performance, media exposure, and being subject to regulatory proceedings (Berthelot et al., 2003; Adams, 2002).

Many of these studies explain their findings through legitimacy theory (Deegan, 2002; O'Donovan, 2002). Legitimacy is a "socially constructed system of norms, values, beliefs, and definitions" of what society considers "desirable, proper, or appropriate" (Suchman, 1995: 574). If a firm fails to meet society's expectations, then it must act to re-establish its legitimacy to fend off social sanctions (Berthelot et al., 2003). Under this perspective, the driving force behind social reports is not a simple, profit-based cost-benefit analysis, but a response to socio-political factors. In other words, the focus is not on the optimization of resource allocations, but with the justification of those actions (Oliver, 1997). With respect to disclosure, researchers using legitimacy theory hypothesize that firms report information only when needed to maintain or repair their legitimacy within the community. Greater stakeholder awareness of any particular firm's negative social performance leads to the need for that firm to engage in legitimacy maintenance activities, which include disclosure. Thus, firms that receive greater press coverage (e.g., larger firms) or are in industries where environmental issues are prominent (e.g., chemicals or logging), must provide more disclosure to maintain their legitimacy. For example, a recent study by Patten (2002) concluded that the worse a firm's environmental performance, the greater its disclosure.

A different interpretation of these results relies on proprietary information costs (Cormier and Gordon, 2001), where firms compare the costs of keeping this information private versus the benefits of disclosure. In their review of the empirical studies, Berthelot et al. (2003) argued that it is often difficult to distinguish when legitimacy theory explains the findings versus when an information-costs perspective provides a better explanation. For example, if a firm receives negative press coverage, it may strategically choose to increase disclosure to avoid the costs of new regulations (Berthelot et al., 2003). Likewise, Cormier and Magnan (1999) found that the disclosure of negative environmental information depends on the financial well-being of the firm. Financially healthy firms are more likely to disclose negative information than unhealthy firms because they are better able to absorb the costs of disclosure. Cormier and Gordon (2001) also argued that their evidence shows that environmental disclosures are determined more by information costs and benefits, while social disclosures (e.g., diversity goals) are more related to legitimacy. In either case, the firm's motivation for disclosure is strategic, and not in furtherance of the goal of accountability to stakeholders.

Of the few studies that consider the content of the disclosures, most support the role of legitimacy theory. Deegan, Rankin, and Voght (2000) showed that subsequent to events producing significant negative media coverage firms provided greater disclosure on matters directly pertaining to the event (not simply social and environmental information generally), however, that information was overwhelmingly positive. Deegan and Rankin (1996) compared twenty Australian firms that had violated environmental laws to a matched sample of eighty firms that did not have any violations. The firms with regulatory violations clearly had negative information to disclose; however, those firms' "positive" disclosures significantly outweighed any "negative" disclosures. In addition, compared to the matched sample, the violators provided more disclosure during times of their government prosecution. This strategic use of disclosures is consistent with other findings on the quality of disclosure (Deegan, 2002). For example, in a study of oil industry firms' responses to the *Exxon Valdez* accident, Walden & Schwartz (1997: 146) noted the self-interested nature of the firm's environmental disclosures and concluded: "Based on [our] findings, it is doubtful that substantive environmental information adversely affecting future earnings and potential cash flows will be reported voluntarily."

There are several limitations to the existing studies on corporate social and environmental disclosures. First, most of the studies involve social and environmental disclosures through annual reports and press releases rather than through standalone social reports. Second, these studies cover time periods before the increased pressure on corporations to produce social reports. Beginning in the late 1990s, this pressure has created a significant increase in the number of social reports. For the Global Fortune 250, the percentage of firms producing social reports increased from 35 percent in 1999 to 45 percent in 2002 (Kolk, 2003; KPMG, 2002).

Despite the limitations of these studies, the current empirical evidence provides some insights into the nature of corporations' disclosure of social information. First, the impetus behind many corporate disclosures may be a legitimacy-threatening event, such as a crisis faced by the firm or the industry involving negative press coverage, or revelations of poor environmental and social performance. For example, it is not surprising that industries with the highest levels of social reporting include those with a large environmental impact (such as mining, forestry, and chemicals), and pharmaceuticals, which face constant societal pressure over the pricing of drugs (KPMG, 2002). Thus, firms' struggles to maintain legitimacy may drive them to disclose more, but not necessarily complete, information to stakeholders.

Second, when firms disclose information, it may be strategically oriented to repair lost goodwill and not out of a true sense of accountability to the firm's stakeholders (see Deegan, Rankin & Tobin, 2002). Many of the scholars studying social and environmental reporting suggest that stakeholder management is taking precedence over stakeholder accountability (Owen, Swift & Hunt, 2001). The idea of accountability involves the provision of information to company stakeholders to allow them to make informed decisions on matters relating to the company. Owen et al. (2001) argued that accountability should "hurt" (the hurt being the disclosure of information that a firm may wish to conceal). The existing evidence, however, provides significant support for the allegations of corporate critics that the primary purpose of social reporting is greenwashing. For example, Swift argues that social disclosures involve a public relations process where firms are simply "self-reporting on their trustworthiness" (2001: 23). Rob Gray, one of the leading scholars on social and environmental reporting, finds that even audited social reports are of questionable quality, since the quality of attestation is "woefully poor" (2001: 13). At best, Gray considers the current auditing practices a "waste of time and money," or worse, "a deliberate attempt to mislead society" (Gray, 2001: 13). Overall, existing firm disclosure practices appear to be well short of that hoped for by advocates of social reporting, since such information is often disclosed strategically and in a manner designed to cast the firm in a favorable light, rather than show a complete picture of the firm's social performance.

III. The Nike Litigation

The Nike case, which is at the heart of the current corporate speech controversy, involved practically all the above described forms of dissemination. The case began in 1996, when Nike began receiving significant negative press coverage about alleged "sweatshop" conditions in its suppliers' factories in Asia. In response, Nike sent letters to university presidents and athletic directors, issued press releases, took out full-page advertisements in newspapers, and wrote letters to the op-ed pages of newspapers. In these communications, Nike stated that the conditions in its suppliers' plants met all government regulations regarding wage and working conditions. Kasky, a social activist, sued Nike, alleging these communications were business-related fraudulent misrepresentations in violation of California's false advertising laws. Kasky demanded that Nike disgorge the financial benefits it acquired as a result of these unlawful practices and asked for a court-approved public information campaign to correct Nike's alleged misstatements. If the financial benefits to be disgorged would be defined to include all revenues Nike obtained from products indirectly associated with the statements, the impact of a recovery against Nike would be Draconian.

Nike v. Kasky made it all the way to the U.S. Supreme Court before it was finally settled out of court in a deal in which Nike pledged $1.5 million to the Fair Labor Association in turn for Kasky's giving up the suit. Considering the potential scope of the decision, the amount of money pledged was quite small, representing the equivalent of Nike's average media spending for three days (*Footwear News*, 2002). Furthermore, the pledge was given to the labor monitoring organization that many consider most favorable to business interests. Thus, at the end of the case, Nike appeared to have put the suit behind it for a relatively small cost. In the process, however, the California Supreme Court articulated a new test for distinguishing commercial speech from political speech.[2]

This ruling makes it significantly easier for activists in California to sue corporations for misrepresentations for a wide variety of communications. Under the new test, if Nike's statements in the Kasky case (via its letters and press releases) are considered commercial speech—that is, speech directed toward facilitating a commercial transaction—then Nike could be sued for misrepresentation. If Nike's statements are considered political speech, however—that is, speech intended to contribute to the public debate—then Nike could not be sued for misleading statements.

In the briefs filed with the U.S. Supreme Court by the parties and various *amicus curiae*, both sides discussed the importance of this case for its potential impact on corporate social disclosures. Those arguing in support of Nike claimed the overbroad standard adopted by the California Supreme Court would result in firms being potentially sued for anything said in a social report or other communication. In fact, as a precaution, Nike stopped making public its social report during the litigation (Liptak, 2003). In an amicus brief in support of Nike, public relations firms argued that if the United States Supreme Court upheld the California Supreme Court's decision, then their industry might as well shut down.[3] The Nike argument was further bolstered by an amicus brief filed by forty major newspapers and media outlets claiming the state court ruling would impair the ability of the press to cover important issues.[4]

On the other side, those in support of Kasky argued in favor of the new test for ensuring the truthfulness of corporate communications. A brief filed on behalf of social investors, including Domini Social Investments, argued that overturning the California Supreme Court would make all corporate disclosures on matters relating to public policy "inherently unreliable."[5] Likewise, a brief filed by eighteen states argued that the case is not about providing information to foster the public debate about globalization, rather it "is only about Nike's ability to exploit false facts to promote commercial ends."[6]

Thus, both sides expressed an underlying desire to ensure that the public be fully informed on corporate actions and operations, with Nike and its supporters focusing on the quantity of information and Kasky's supporters emphasizing the quality of information. In the next section, we ask which type of legal regime—the one proposed by Nike or the one adopted by the California Supreme Court—is more likely to lead to a fully informed public. We find that both regimes have their faults and propose, as a better alternative, a system of SEC-monitored voluntary corporate social reporting to solve those problems.

IV. The Commercial-Political Speech Dichotomy

The litigation in the *Nike* case invokes one of the thorniest problems in Constitutional jurisprudence: To what extent do First Amendment protections of the freedom of speech apply to corporate speech, particularly the increasing use of speech that covers social and political issues? The Supreme Court has attempted to answer this question by distinguishing between commercial and non-commercial speech and providing general guidelines to classify any particular corporate communication as one or the other. The scope of protection granted by the Constitution depends upon that characterization. As reflected in the attempts by the majority and dissenting opinions of the California Supreme Court to apply those guidelines to the facts in *Nike*, the current state of the Supreme Court's jurisprudence in this important area is a tangled, conceptual muddle. We believe the failure to find a workable distinction between commercial and political speech in the *Nike* context reflects the fact that the distinction is neither practical nor grounded in reality. In the current environment, one could easily argue that all corporate speech has a commercial dimension. Realistically, most corporate speech of the type at issue in *Nike* is mixed, having both political and commercial intent and impact, but there does not appear to be an easy way to weigh each component. Instead, similar to certain chemical compounds, they are incapable of being dissolved into their component parts. To fully understand the Court's attempts to do just that, however, we must first summarize the legal principles that led to the commercial/non-commercial speech distinction.

The First Amendment to the U.S. Constitution protects each person's right to free speech against government restriction. The Courts have understood the principle behind the First Amendment to mean that "debate on public issues should be uninhibited, robust, and wide-open" (*New York Times v. Sullivan*, 376 U.S. 254 [1964]). This does not mean, however, that the government is categorically prohibited from regulating speech. As a general rule, if the government attempts to regulate the content of speech (as opposed to content-neutral regulations that focus only on the time and manner of speech), the regulation must pass a legal test referred to as "strict scrutiny." This standard considers both the means and ends of the regulation. Under strict scrutiny, the regulation restricting speech content must serve a "compelling government interest" (the ends) through regulation that is "narrowly tailored" (the means) toward achieving that goal. In practice, very few regulations can survive the strict scrutiny test.

However, not all speech is treated equally. Certain types of speech—including obscenities, false statements, and "fighting words"—receive no Constitutional protection, since they do not further the goals of promoting public debate. In addition, speech that is used in commerce—as opposed to public debate—receives a lesser degree of Constitutional protection. When the government attempts to regulate commercial speech, the courts apply an "intermediate scrutiny" test. Under this test, which is easier for the government to satisfy than the strict scrutiny test, the regulation must be "no more extensive than necessary" (the means) to achieve a "substantial interest" (the ends). The court gives less protection to commercial speech than non-commercial (or political) speech because commercial speech is believed to be more easily verified by the speaker, the speaker has a financial incentive to continue speaking (that is, regulation can be expected to have less of a chilling effect on this hearty form of speech), and commercial speech is strongly linked with transactions that government has well-established authority to regulate (*Kasky v. Nike*, 27 Cal. 4th 939 [Cal S. Ct.]).

In addition to the different standards applied to government regulation of speech, the distinction between commercial speech and political speech also is important in situations of false or misleading speech. For political speech, some false or misleading speech is allowed because society does not want to discourage people from participating in public debate. False or misleading commercial speech, however, provides no contribution to public debate and therefore does not receive any First Amendment protection. In fact, the government may entirely prohibit such speech (*In re R. M. J.*, 455 U.S. 191 [1982]), as all states do with their false advertising statutes.

The controversy in *Nike v. Kasky* involved such a false advertising statute. The legal questions focused on how to distinguish between commercial and political speech when applying the statute to corporate statements defending sourcing practices. If the court ruled that Nike's letters and press releases were political speech, then Nike could not be held liable for false advertising. On the other hand, if the court ruled that Nike's statements were commercial speech, then Nike could be held liable for any statements determined to be false or misleading under the state's power to regulate false advertising.

In their one-vote majority ruling in favor of Kasky, the California Supreme Court fashioned a three-part test to determine how to classify any particular statement as commercial speech. Under their approach, the following three questions are determinative of commercial speech: (1) Is the speaker engaged in commerce? (2) Does the intended audience include actual or potential customers? (3) Is the content of the speech of a commercial character "made for the purpose of promoting sales of, or other commercial transactions in, the speaker's products or services"? (*Kasky v. Nike*, 27 Cal. 4th 939, 961). The court defined "commercial character" to include "representations of fact about the business operations, products, or services of the speaker (or the individual or company the speaker represents)" (*Kasky v. Nike*, 27 Cal. 4th 939, 961).

This standard is significantly broader than the test proposed by the dissenting justices. Under their stricter interpretation, commercial speech is limited to that which "does no more than propose a commercial transaction." Any corporate communication that includes information relating to a public debate characterizes the entire communication as protected political speech. The dissenting justices' approach views the political aspects of the speech as being inextricably intertwined with any commercial aspects. This broad protective interpretation is also the standard Justice Breyer advocates in his dissent to the U.S. Supreme Court's dismissal of the *Nike v. Kasky* case.

V. Can a Distinction between Commercial and Political Speech Serve as a Sound Basis for Public Policy?

Taken from a point of view that focuses only on the content of the speech (as opposed to the speaker), it is easy to make the argument that all corporate speech could be considered political speech. For example, Greenwood stated:

> Advertising for cars also implicitly promotes other aspects of an automobile-based culture, including military defense of the sources of cheap oil, highway-based transportation, and suburbanization and its ramifications. Similarly, any product advertisement is an intensely political criticism of many traditional religious views, including those that consider riches to be a danger to moral integrity, regard covetousness as a mortal sin, or advocate using national wealth for purposes other than private consumption—promoting the arts, constructing public monuments, parks or sacred buildings or studying sacred texts, for example. (1998: 1001)

Greenwood's statement demonstrates a very broad interpretation of the implicit goals of corporate communications. He shows how advertisements—the most recognized form of commercial speech—also can be characterized as political speech. On the other hand, we can do the opposite and easily impute significant commercial goals for statements that at first glance seem to relate purely to political matters. A statement by corporate managers on government policy, for example, likely has the objective of improving the long-term financial well-being of the firm through favorable regulation. A statement relating to the process of economic globalization and its impact on citizens around the world may have an objective of gaining support for the firm's activities abroad and encouraging the promulgation of favorable free trade policies. Thus, a plausible argument can be advanced that all corporate speech is commercial speech for Constitutional purposes.

When we focus specifically on speakers and their motivations instead of simply the content of the speech, it appears that all corporate speech should be considered commercial; otherwise purely non-commercial speech raises questions of whether management is breaching its duty to the firm. According to the predominant view of corporate law, managers have a primary duty to maximize shareholder value. For example, the ALI's principles of corporate governance state that a "corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain." Thus, all utterances of what might seem to be political speech by management should be done for the purpose of improving corporate profitability, which makes such speech also commercial in nature.

Moreover, a manager using corporate resources for political purposes that do not have the goal of increasing the firm's profits could conceivably be considered to be causing the corporation to act *ultra vires* (beyond its power). Under this hoary doctrine, a corporation can only engage in activities directed toward the stated purpose in its corporate charter. Other activities are beyond the corporation's powers and void. For example, a corporation that stated its purpose as manufacturing a specified type of good could not engage in the business of providing loans unless it amended its corporate charter to include that activity.[7] Today, the *ultra vires* doctrine is primarily a part of legal history, since corporations are allowed to state their purpose as "any lawful business." What remain *ultra vires* are those activities that are either illegal or not directed toward any business goal (Gevurtz, 2000).

Courts have liberally interpreted the concept of a business goal to sustain philanthropic and social activities. For example, in the famous case of *A.P. Smith Mfg. Co. v. Barlow* (98 A.2d 581 [1953], *appeal dismissed* 346 U.S. 861) a shareholder challenged a corporate donation to Princeton University as *ultra vires*. In finding that the donation was within the corporation's powers, the Court relied, in part, on the argument that such donations may increase long-term shareholder value. Although state statutes now permit philanthropic donations, this case shows that if there was not some commercial benefit to the firm, then the activity would be *ultra vires*. Likewise, if we must distinguish between political and commercial speech, then we see that corporate speech without any commercial purpose whatsoever could arguably be considered *ultra vires*. If the senior management of Merck decided to devote all the firm's resources to supporting a campaign for a "national deliberation day" (Ackerman & Fishkin, 2004) that would clearly be political speech, but it would also be unquestionably *ultra vires*. The reality, however, is that most corporate "political" speech turns out to involve a mixture of motives and impacts. Thus, if Merck makes statements concerning animal welfare policies in its research labs, it has both public policy and commercial implications.

In today's business environment, the implicit commercial nature of all corporate communications is more apparent, as even speech that may appear on first impression to be purely political is likely to serve the financial interests of the firm. In fact, if we take a closer look at Justice Breyer's dissent to the U.S. Supreme Court's ruling dismissing the *Nike v. Kasky* case, we see that speech which he identified as political is more appropriately viewed as commercial. Justice Breyer stated that Nike discussed its labor practices in letters to university presidents and athletic directors "because those practices themselves play an important role in an existing public debate." He argues that such statements are significantly different than placing "dolphin-safe tuna" on a product label or "instances of speech where a communication's contribution to public debate is peripheral, not central."

Justice Breyer's analysis ignores the importance of corporate reputation in the marketplace. It is equally plausible to view Nike's statements on its labor practices as peripheral to the public debate and central to the firm's profit motive. For example, in deciding to reform Nike's policies on labor in its overseas supplier's plants, Nike CEO Philip Knight stated, "The Nike product has become synonymous with slave wages, forced overtime, and arbitrary abuse. . . . I truly believe that the American consumer does not want to buy products made in abusive conditions" (Cushman, 1998: D1). Thus, any statements by Nike on factual matters with respect to labor practices likely have as much to do with protecting the Nike brand name in the marketplace as they do with contributing in a general sense to the public debate on the impact of globalization.

Overall, we do not believe that a credible, realistic distinction can be made between the two forms of speech. Virtually every corporate utterance contains a mixture of commercial and political dimensions. At best, the courts might come up with heuristics that frame certain types of speech as one or the other. Inevitably such heuristics will, in certain contexts, have to ignore the reality of the purpose of the speech or its impact in markets and public forums. That is not a very desirable way to deal with an issue that has serious implications for corporate social responsibility and business ethics.

VI. Is There a Better Basis for Public Policy?

The distinction between commercial speech and political speech is fraught with problems and does little to serve the important public policy goals encouraging open political debate and truthful commercial disclosures. Taken as a whole, the Constitutional jurisprudence on free speech under the First Amendment has focused on maximizing speech participation while recognizing the role of incentives for truthful speech. It is philosophically and pragmatically unsound to have a regime in which there are no limits whatsoever on corporate speech. It is equally unsound to prohibit or impose heavy liability for all untruthful corporate speech. Instead, a desirable middle ground is to seek to encourage the optimal amount of truthful speech.

Corporations should be encouraged to participate in public debates, particularly where they have unique information and perspectives. They should not be arbitrarily prohibited from effective participation in political debates merely because of liability based on their identity. The underlying policy goal should be to structure a corporate speech jurisprudence that provides corporations with efficient incentives to produce accurate, useful social reporting. By encouraging an optimal level of truthful disclosure from corporations, public policymakers will be better able to serve society, and market participants will have the information they need to make informed decisions. The achievement of this goal does not hinge on a definition of political or commercial speech, since neither the definition offered by Nike nor the approach utilized by the California Supreme Court will help us achieve this goal.

Public policy should be based on a principle we refer to as Optimal Truthful Disclosure (OTD). The goal is for corporations to produce information up to the point where the marginal costs of production are equal to or less than the marginal benefit provided society (see Franco, 2002). Corporations have information that is both private (or at least very costly for stakeholders to acquire) and is valuable to stakeholders who want the information to make better decisions on investments, consumption purchases, employment choices, and the determination of public policy. It is not optimal to require stakeholders themselves to collect information when doing so would be significantly more costly than disclosure by the firm. In addition, a significant amount of information is proprietary and inaccessible to the firm's stakeholders. Firms provide less than optimal disclosure when liability rules and incentives are not aligned with the value of accurate information on the one hand and the cost of misleading information on the other hand.

Though generally appropriate as a governing principle, the OTD approach becomes even more relevant as stakeholder demand for information expands. For example, social investing fund managers complain about the lack of information available on which to base their screenings (Murray, 2002). In response to the dearth of publicly available information, various parties—including investors, community groups, and consultancies—are flooding corporations with questionnaires asking about the companies' governance and social responsibility practices. One British telecommunications company reports that it has one employee spending two to three days a week responding to demands for such information (Maitland, 2004). This is an inefficient means of gathering information; since it is costly, many firms do not respond, and others only provide selective responses.

VII. Why Don't We Have Optimal Truthful Disclosure?

Social disclosure takes place in an environment of information asymmetry between the corporation and its stakeholders. To achieve optimal truthful disclosure, we need to consider both the incentives corporations have to disclose truthful, non-misleading social information about their products and processes, and whether or not the firms' stakeholders will deem corporate disclosures credible and worthy of including in their market decisions.

As a starting point, let us assume that stakeholders believe all firm disclosures are credible. In that case, their determination of a firm's social performance will depend not only on the content of disclosure, but also on what they may infer about a firm that chooses not to disclose. For simplicity, we can divide the market into two types of firms: socially responsible firms (CSR firms) and socially irresponsible firms (non-CSR firms). In addition, we categorize all of a firm's disclosures as collectively indicating either negative or positive social performance. Thus, stakeholders will view a firm that discloses positive social performance as a CSR firm and will view a firm that discloses a negative social performance as non-CSR.

Some firms may choose not to disclose any information to the public. Stakeholders could interpret this silence to mean the firm has something to hide. Thus, the stakeholder will categorize the non-disclosing firm as non-CSR. This interpretation could either be true (a true negative) or there could be some reason for a CSR firm to not disclose unrelated to social performance, which would lead to a false-negative evaluation by the stakeholder. The other potential interpretation mistake by stakeholders occurs when a non-CSR firm discloses information indicating positive social performance. In that case, a stakeholder believing the disclosure will wrongly categorize the firm as CSR (a false positive). If, on the other hand, stakeholders are skeptical of firm disclosures and are risk averse toward making false positive determinations, then all CSR-indicating disclosures will be discounted. Corporate disclosures on social performance will have no use in distinguishing between CSR firms and non-CSR firms.

Overall, in our simplified model, the firm has two choices, either disclose or not disclose. If the firm chooses to disclose, then it must choose between accurate disclosure and misleading disclosure. Next, the stakeholder must interpret this information. The stakeholder can either discredit the information completely due to a fear of relying on false information, or they can take it as a true indication of the firm's social performance.

Next, we consider the possible liability regimes for political speech and the impact of the regimes on the disclosure and interpretation decisions that firms and stakeholders must make. Under the first liability regime, which Nike advocated, a corporation is *not* liable for misleading statements that are considered political speech (using Nike's broad definition of the term). Under the second regime, which essentially follows the ruling of the California Supreme Court, there is liability for false or misleading political speech.[8]

A. No Liability Regime

Under the first regime, there is no liability for false or misleading political speech. A primary concern with this regime is that stakeholders will be less likely to see social disclosures as reliable in circumstances where they have no independent means of verification. Thus, statements such as those commonly referred to as "greenwashing"—where a firm falsely creates the impression that it is environmentally friendly through misleading disclosures—can be readily made to the public. Without risk of liability for false statements, a firm's only *financial* incentive not to mislead the public would be repercussions in the marketplace if it were discovered to be a greenwashing firm. There is some evidence from laboratory experiments that in a multi-stage negotiation game, an individual's willingness to punish an unfair action by the other party is increased if the other party also engaged in deception (Brandts & Charness, 2003; Croson, Boles & Murnighan, 2003). However, context does matter. For example, if the receiving party expects some level of deception, then there is likely to be little or no punishment (see Lewicki & Stark, 1996; see also Bazerman, Curhan, Moore & Valley, 2000). It is reasonable to assume that firms might believe a market's reaction to a non-CSR firm will not be significantly different enough from its reaction to a deception-using non-CSR firm to provide an incentive not to engage in greenwashing-type behavior[9] (not to mention the low risk of detection).

Overall, firms with a certain moral flexibility with regard to the truth have significant financial incentives to engage in "cheap talk." That is, statements any firm could make (both CSR and non-CSR firms) because they will not generate liability, are relatively costless to the speaker and are difficult, if not impossible, for the recipient to verify (see, e.g., Brandts & Charness, 2003; Cason & Gangadharan, 2002; Croson et al., 2003). Aware of the incentives to engage in cheap talk, stakeholders will tend to discount such disclosures. Not knowing if the firm is telling the truth, stakeholders may simply ignore the information rather than taking the risk of making a false-positive assumption. This is known as a "babbling equilibrium," and is expected in situations where the parties' interests conflict, as may be the case between corporations and certain stakeholders (Brandts & Charness, 2003; Crawford, 1998; Wilson & Sell, 1997).

The extent of stakeholder distrust in corporate communications under this regime is supported by the 2002 Cone Corporate Citizenship survey of 1,000 U.S. adults. The survey found that 86 percent of Americans believe corporations should make public their support for social issues (*Business Wire*, 2002). Most respondents, however, did not want to receive that information directly from the corporation. Instead, 51 percent preferred to receive information on corporate citizenship from the news media (*Business Wire*, 2002). Likewise, a recent laboratory experiment found that a market for environmentally friendly goods had better outcomes when sellers were able to have their products certified by a third party than when the products were simply backed by cheap talk (Cason & Gangadharan, 2002).

Signaling and Corporate Disclosures

In a situation where the public is likely to discount most, if not all, corporate disclosures, CSR firms will have to find a way to distinguish themselves from non-CSR firms. The challenge facing CSR firms is how to assure stakeholders that their disclosures are complete and accurate. A common tactic in situations of information asymmetry is to rely on signaling. In game theory, signals are actions that allow actors that possess a certain quality to distinguish themselves from other actors that do not possess that quality. Signals provide value in situations where the identification of that quality is not easily verifiable by others. With limited information on the actor's true type, the other party must infer things about the actor based on the actions they take (Baird, Gertner & Picker, 1994). A classic example involves job applicants that are one of either two types: lazy or hard-working. Although the applicants know their true category, the employer cannot easily verify that information. Instead, the employer must rely on the actions taken by these applicants that signal their true types. For hard-working applicants to demonstrate their true type, they must take actions that lazy workers would be unwilling to take, even though failure to act will signal that they are in fact lazy workers. One way a hard-working applicant could do this is by taking a training program that a lazy worker would not take the trouble to complete (Baird et al., 1994; Pindyck & Rubinfeld, 1995). Thus, the employer only must observe who has completed the training program to make a correct inference on identifying the hardworking job applicants.

Signaling does not require that an actor of high quality take on the highest cost activities available. Instead, the action simply must be too costly for the low-quality actor to find attractive. The most effective strategy is to find a method of signaling that involves higher costs for the lower-quality firm than it does for the high-quality firm. For example, a producer of high-quality goods could offer a money-back guarantee that producers of low-quality goods would find too unattractive to offer. If buyers of televisions, for example, have no way of distinguishing between high quality and undependable sets, the high quality sellers must find a way to somehow signal the good quality of their television sets. Offering a warranty could do this. Since it is a quality television, this is of little cost to the seller since few of its consumers would need to collect on the warranty. However, offering a warranty would be very costly to the seller of low-quality televisions that would require significant repairs. Thus, the presence of a guarantee signals quality (see Pindyck & Rubinfeld, 1995; Varian, 1992).

In a similar manner, CSR firms must lower their costs of signaling or else find a way to raise the costs of signaling for non-CSR firms. Without liability for false statements, there are few costs associated with misrepresenting social performance. One way to raise the costs of signaling to a non-CSR firm is for a CSR firm to voluntarily hold itself up to liability for any false statements in its disclosures. For example, a firm could take the extreme step of issuing a social report and warranting its truthfulness by offering compensation to consumers if a false statement is discovered. The firm also could place certain information directly on its products, similar to "dolphin safe tuna" or "made in the USA" labels, which would put the statements under the jurisdiction of the Federal Trade Commission. For a firm that is honestly representing its social performance, this would be an action of little cost (in terms of liability costs). For non-CSR firms, however, they would have to risk liability if they misleadingly try to hold themselves out as CSR firms. Thus, the issuance of a social report that voluntarily assumes liability for false statements would serve as a signal. This could potentially lead to an unraveling process where once one firm discloses, others will follow due to a fear of wrongfully being considered a non-CSR if they do not. Unfortunately, we do not believe this process will occur, either under a system where firms voluntarily assume liability or under a system where the courts impose liability for all statements with a commercial impact (the liability regime). We discuss the reasons why the unraveling process will not occur in our discussion of the liability regime.

Overall, the no-liability regime is unlikely to attain the goal of optimal truthful disclosure. Although there is the potential for significant amounts of disclosure, this information would provide few benefits to stakeholders due to few legal repercussions for intentional or negligent misrepresentations. Even if a firm provides complete and truthful disclosure, this information would be of little value to stakeholders because they will not be able to distinguish between honest CSR firms and dishonest non-CSR firms and they will discount all information equally. These conclusions are supported by the current state of social disclosure. As indicated above, the latest research indicates that social disclosure is perceived as being presented in a biased manner to build trust, rather than to paint a complete picture of social performance for stakeholders.

B. Liability Regime

Our second liability regime is consistent with the ruling of the California Supreme Court, which expanded the definition of commercial speech to recognize the importance of many different types of information to the firm's stakeholders. The most significant aspect of this regime is to increase significantly the costs to corporations of false and misleading statements on matters that firms previously viewed as touching solely on public policy issues. Nike, the public relations industry, and others argued that this regime would lead to drastically reduced levels of corporate disclosures due to a fear of lawsuits. A game theory perspective using the idea of signaling, however, would suggest that the true CSR firms would actually disclose *more* information because it is less costly to them than to non-CSR firms (due to little risk of liability for making a false statement). Thus, disclosure with liability works as an effective signal because the public will assume that if a firm is not disclosing, then it is because it is a non-CSR firm. Liability for fraudulent statements means stakeholders will be less likely to discount these disclosures. If stakeholders actually use the information, then CSR firms will receive greater benefits from disclosure and more disclosures will ensue. This is unlikely to occur, however, for several reasons.

First, as Nike argued, if a firm is not completely confident in the accuracy of a statement, then it may be unwilling to disclose. In addition, there may be a fear of strike suits by special interest groups that would challenge any corporate statement to further their political goals. To overcome this fear of liability, there must be sufficient pressure on firms to disclose so that the marginal benefits of disclosure are greater than the potential risks of liability. The potential for this to occur is through a process called unraveling, which we mentioned briefly in the previous section. For the following reasons, however, unraveling is unlikely to occur.

Unraveling involves the process of once one actor provides disclosure, others follow until all firms have disclosed. Baird et al. (1994) show how this occurs through the example of stores selling sealed boxes of apples. The boxes can hold up to 100 apples, but only the seller knows how many apples are actually in the box. The buyer will not know the actual number until he gets home, opens the purchased box, and counts the apples. If the seller affirmatively stated that the box contains 100 apples, then the buyer could sue for damages if the box contains less than that number. If the seller remained silent, however, then the buyer has no cause of action for fraud against the seller. An unraveling process occurs if one seller concludes that the only way she can convince a buyer to pay full price for the box of apples is to affirmatively state that the box contains 100 apples. Once a seller has made that representation, buyers will respond in two ways. First, with the seller being liable for false statements and the fact that the buyer can verify the number of apples in the box ex post, the buyer will pay full price for the box. Second, the buyer will not pay full price from a seller that does not affirmatively state how many apples are in the box. In response, a seller with only ninety-nine apples in the box knows that the buyer will not pay full price for the box without an affirmative statement by the seller. Thus, the seller will disclose that the box only has ninety-nine apples and will take the price for ninety-nine apples. Soon, all sellers will recognize that silence is not an effective strategy, since the high-quality sellers will be able to distinguish themselves from low-quality sellers through disclosure. The end result is the voluntary disclosure of private information by actors.

The unraveling process does not seem to work well in practice, however. A recent study of the salad dressing industry provides an example (Mathios, 2000). Prior to the Nutrition and Labeling Education Act (NLEA), manufacturers of salad dressing were not required to disclose information such as their product's fat content and calories. Applying the concept of unraveling would lead to the conclusion that a mandatory disclosure law would not be needed because manufacturers have an existing incentive to disclose. In this market, as in the apple market described above, consumers were aware of the value of this information, and firms faced liability for making false statements on product labels. With both of these conditions met, if a manufacturer does not disclose the nutritional information, then consumers would infer that they are trying to hide unfavorable information. Thus, there are incentives for all firms to disclose, except for the worst performers. Although the study found that the very best performers did provide disclosure, there was little disclosure among the other firms even though they had significant nutritional differences upon which to distinguish themselves (Mathios, 2000). In addition, this was information that consumers were using in their purchasing decisions, as Mathios shows through analysis of the changes in market share of the products immediately after the NLEA went into effect and required all firms to disclose. Overall, the study shows that even in an ideal setting for unraveling, those firms that do not match up with the limited group of the very highest performers will not disclose.

With respect to the disclosure of social information generally, there are additional reasons why an unraveling process is unlikely to occur. First, there are clearly costs to collecting and disclosing the information needed to complete a social report. Acting alone, a firm may decide that the benefits from being identified as a CSR firm do not outweigh the costs of ensuring the information collected is accurate. In addition, if a firm does not disclose, stakeholders will not know if management made that choice because they were attempting to conceal information or because management believed the benefits of disclosure were not worth the costs of collecting and disseminating the information (Berthelot et al., 2003). Thus, stakeholders will not know what the proper inference should be for a non-disclosing firm.

There are also proprietary costs to the information (Cormier & Gordon, 2001; Cormier & Magnan, 1999). There are two types of proprietary costs. First, even firms holding good news may withhold it due to an unwillingness to provide competitors with information that could be used against them. Firms may argue that the marginal costs of the disclosure to their competitors are greater than the marginal benefits from the signal of social responsibility. For example, in the mid-1990s, there was pressure on Nike to disclose the location of its contractor's international factories, which had been accused of human rights violations. Nike initially refused, stating a fear that their competitors might take advantage of that information by attempting to hire away the Nike-trained contractors. Second, stakeholders could use information on corporate irresponsibility to impose costs on the firm, through market boycotts or increased regulation. The greater the public intolerance for corporate irresponsibility, the greater the costs to the firm if it discloses negative information. This leads to the ironic result that the more stakeholders want information and tend to act upon it, the less willing firms are to disclose such information (Li, Richardson & Thornton, 1997).

Second, stakeholders must have knowledge of the information the firm possesses or could collect and be aware of the value of that information (Franco, 2002; see also Dye, 1985). In other words, the stakeholders must know the type of information the firm is trying to conceal (as well as the fact that the seller actually has this information and is concealing it). To return to our salad dressing example, if consumers are not aware of the health benefits of low-fat food, then disclosure of nutritional information by sellers of low-fat salad dressing does not provide them with any advantage (Baird et al., 1994). Because consumers lack the knowledge to make certain inferences about those sellers that provide no nutritional information on their salad dressing labels, producers of high-fat salad dressing have no incentive to provide that information. This argument is supported by research which finds that once the public gains awareness of a firm's irresponsible actions, such as through the media, then such firms are more likely to disclose information on that issue (Li et al., 1997). This suggests that firms will not make disclosures on issues where they are performing poorly unless the public is actually aware that the firm is concealing information.

Third, there are significant incentives for firms to engage in selective disclosure. Without significant search costs, stakeholders will be unlikely to know if a firm is disclosing all available information or only disclosing good information and concealing bad information. In other words, how can the public distinguish between Firm #1 that discloses the good news with the bad, and Firm #2 that discloses only the good news? Does this create an incentive for Firm #1 to also hide bad news for fear the public may think that Firm #2 does not have any bad news to report? Or does this again cause the public to simply discount all disclosures to account for the risk of opportunistic disclosure (Franco, 2002)? Also, consider Firm #3 that engages in fraudulent misrepresentation if there is little risk of being caught or finds other ways to game the system. The end result is that there is little incentive to provide complete disclosure and the total amount of information disclosed is less than optimal.

Finally, even getting the highest performers to begin the unraveling process will be difficult, since firms likely will not know initially how they compare to other firms on certain matters (see Franco, 2002). As the salad dressing study showed, firms only provide voluntary disclosure if they are a leading performer. Without other firms providing information, however, a firm may not know if it is a leader or a laggard. For example, a firm that is an industry leader in preventing abusive labor conditions in developing countries may fear that it is actually a laggard in meeting standards set by the International Labour Organization. The firm will either engage in selective disclosure or simply choose not to disclose at all.

In summary, the liability regime is also unlikely to create optimal truthful disclosure. Even with a way to signal the true nature of their social performance, there are many reasons why firms may still choose not to disclose. In addition, even with disclosure by top performers, a complete unraveling process will not occur, leading to less than optimal disclosure practices. Overall, the liability regime may result in less total information disclosed, but with a higher likelihood that what is disclosed is truthful. However, the incentives to engage in selective disclosure may mean that these truthful disclosures create a misleading picture of a firm's complete social performance.

VIII. Is a Voluntary System of Standardized Corporate Social Reports the Solution?

Neither the legal regime advocated by Nike nor the one established by the California Supreme Court will achieve the goal of optimal truthful disclosure. Under the liability regime, where firms are in essence liable for false or misleading political speech, firms may be more likely to disclose truthful information but they also may reduce the amount of disclosures and engage in strategic disclosure. In a legal regime without liability for political speech, in addition to engaging in strategic disclosure, firms also may provide misleading information. In neither case will there be optimal truthful disclosure.

The way to achieve the goal of optimal truthful disclosure, we argue, is through public policy supporting the production and integrity of corporate social reports. Outside of these reports, firms are subject to the existing legal regime under the First Amendment for any statements they make. To be an effective policy, these reports must overcome the problems of misleading information and strategic disclosure.[10] This can be achieved through greater standardization, third-party assurance, and efficient liability rules for false statements. After a discussion of these factors, we address the issue of voluntary versus mandatory disclosure.

We argue for a government-regulated system of social reporting. The alternative approach would allow private sector organizations, industry associations, or nonprofit organizations to propose different standards and then allow corporations to choose their favored standard. Although this creates flexibility for firms to find a system that matches their needs, it does not solve the problem of selective disclosure. If firms are allowed to choose between different reporting models, and the differences between those models are hard for stakeholders to distinguish, then firms will likely choose the model with the lowest standard for their particular situation (Franco, 2002). Instead, there should be a single standardized format established by a government body, but including sufficient flexibility to be relevant to all firms.

Standardization is necessary to overcome the problem of strategic disclosure. Standardization requires that all social reports contain disclosure on specified matters and be presented in a manner that permits comparability with other firms. Such a reporting form prevents firms from engaging in selective disclosure through incompleteness in any particular year and requires consistent reporting over time. Thus, firms are not allowed to omit information in a time period when it is unfavorable to the company or omit to disclose information now for fear that in the future that information will be unfavorable to the company (Franco, 2002).

To meet these demands, we recommend beginning by using the Global Reporting Initiative (GRI) standards for formal social reports, with the ability to modify those standards over time as experience dictates. The GRI began in 1997 when CERES joined with the United Nations Environmental Programme's Paris Office to develop a set of reporting standards (Willis, 2003). After issuing preliminary standards in 1998, the GRI enlisted twenty-one companies to pilot test the standards. Based on firms' experiences, the GRI updated their standards in 2000 and again in 2002. The GRI estimates that by 2005 more than 600 companies will be using their standards in some form (Global Reporting Initiative, 2003).

The GRI Guidelines are essentially becoming the equivalent of Generally Accepted Accounting Principles for social and environmental reporting. Because they are voluntary, however, not all firms using the GRI guidelines comply with all aspects of them. The GRI specifies that a report should include a statement of the firm's vision and strategy, a statement from the CEO highlighting important aspects of the report, a profile of the organization and its key stakeholders, key indicators for the firm's economic, environmental, and social performance, and an executive summary. The performance indicators include both data (e.g., the number of citations for violation of government safety regulations) and descriptions of the firm's policies and procedures (e.g., programs and monitoring systems to prevent discrimination).

The GRI Guidelines have not gone without criticism. Comments posted on the GRI Web site in 2002 stressed the large number of reporting indicators and expressed concern that their scope and complexity might discourage first-time users and small firms (Investors Responsibility Research Center, 2002). Others criticized the Guidelines for being so inflexible that many organizations would find them irrelevant. Ultimately, the success of the Guidelines will depend on the experience that firms have trying to apply them. So long as the GRI retains a flexible approach with continual updates, time and experience should strengthen the Guidelines and provide clarification for key concepts.

The appropriate government body supervising these social reports should be the Securities and Exchange Commission. Williams (1999) has established that the SEC currently has the power to require firms to disclose information on social and environmental issues. Under this voluntary system, firms choosing to file a report would have to follow the reporting format and procedures established by the SEC. Beyond periodic reviews and enforcement actions, the SEC's role would be limited to updating the standard report format as necessary and providing a general confirmation that reports filed meet the basic requirements.

In addition to overcoming the problem of selective disclosure by corporations, social reports also can solve the problem of misleading disclosures. This is accomplished by establishing liability for intentional or grossly negligent misrepresentations in a social report. There should not be liability for merely negligent statements, however, since that has the likelihood of creating too much of a chilling effect. Although the SEC should have primary enforcement authority, the public also should play some role. Under a purely voluntary system, there would be little incentive for a firm to participate if any special interest organization could bring a private action for misrepresentation (Orts, 1995), especially considering the wide range of topics covered in a social report. Thus, we do not advocate allowing private suits for actionable misrepresentations, but corporate stakeholders should have some formal system to advise the SEC on necessary enforcement actions. In addition, to further protect against strike-type suits, the system should be established so that the federal preemption doctrine prevents any state suits, similar to the false advertising action in *Kasky v. Nike*, being based on the materials filed with the SEC. This limited safe harbor principle protecting corporate filers from state suits should provide a strong incentive for firms to participate in the voluntary filing program.

To further assure stakeholders that firms are not engaging in selective disclosure or misrepresentation, third-party assurance is also necessary. Obviously, simple assurance by the corporation is not sufficient (Dando & Swift, 2003), since it does not add any additional source of credibility. On the other hand, third-party gatekeepers, such as independent auditors who have their own reputation to protect, provide a signal to stakeholders about the quality of the disclosures (Franco, 2002). As noted above, the percentage of social reports that are independently audited is quite low. In addition, the quality of attestation that is done is questionable (Kolk, 2003; Gray, 2001). Some causes of this low quality include a lack of clear standards for auditing (Dando & Swift, 2003) and verifications done by auditors who lack independence from the firm. Many auditors are not independent due to their role as a consultant for the same social report they are auditing, which may be more financially significant than their auditing role (Ball, Owen & Gray, 2000). The auditors are providing value to the firm to identify internal problems with their control systems or potential risks, but they are not significantly contributing to external accountability (Ball et al., 2000). Thus, the SEC should determine auditing standards, as well as specify standards for social auditor independence.

To further the development of such standards, greater support should be placed behind initiatives such as the Institute of Social and Ethical AccountAbility's AA1000 standards (though we are not necessarily endorsing their exact method [see Owen et al., 2001 for a critique]). Such standards should provide clear guidance to auditors on their roles and responsibilities, and increase the credibility of reports. Currently, many of the major auditing firms provide social auditing services, and one could envision the development of a recognized, certified social auditing profession specializing in these types of reports.

A final issue is whether these reports should be mandatory or voluntary. As indicated above, there are many incentives for firms to refuse to disclose social information. For example, we can safely assume the initial response from the corporate community will be that complying with the required format will be too costly and time consuming. A key question, then, is if a standardized social report format with liability for false information will allow the unraveling process to occur. As we noted above, two reasons that prevent the unraveling process from occurring include the ability of firms to selectively disclose and stakeholders' lack of knowledge with respect to what information a corporation has or could acquire. Both problems are lessened with a standardized format, since all firms must disclose the same information. In addition, the standard format sets out what information firms should be able to disclose. The other incentives not to disclose remain, however, such as fear of liability and loss of proprietary information. In addition, there must be sufficient action by some leading corporations to begin the unraveling process in the first place.

To overcome these obstacles to voluntary disclosure, there must be either a significant benefit in disclosure or a strong belief in the notion of accountability. As indicated above, in the current environment most firms seem to view social reports as tool of stakeholder management rather than for stakeholder accountability (Owen et al., 2001). Though more and more firms are finding some motivation for disclosing social information as seen by the trend in increased reports, it is not clear if that motivation will remain if they lose control over the format and content of those reports. It remains to be seen if there will be sufficient pressure from consumers, investors, or government regulators, for example, to continue that trend. The current evidence on unraveling is not promising, however, and a mandatory approach may be necessary.

Several European countries are moving away from a voluntary model and are experimenting with limited forms of mandatory social reporting. Denmark, Norway, and Sweden have required corporations to report on their environmental impacts since the late 1990s (Environment Policy Centre, 2004). The United Kingdom is considering legislation that would require approximately the largest 1,000 companies to annually report on their "material" social and environmental impacts (Cowe, 2003). In 2002, France passed a law requiring all listed companies to annually report on certain aspects of their social (which includes human resources, community, and labor standards) and environmental impacts (PricewaterhouseCoopers, 2002).

Even under a mandatory system, however, managers are able to engage in selective disclosure. For example, under U.S. environmental laws, many firms face potentially large liability expenses under Superfund liability. Due to securities laws requiring disclosure on matters having a material impact on the firm's financial situation, firms typically should disclose these potential costs. Several studies have found, however, that firms rarely provide detailed information on their Superfund liability. Instead the firms either do not provide any disclosure or provide only non-specific, qualitative information (see Berthelot et al., 2003, for a review of the studies).

As a practical matter, mandatory reporting is probably not a politically viable idea in the United States at this time. Therefore, the most pragmatic and practical approach would be to take an initial step with the regulated voluntary reporting scheme described in this article. This allows time to see whether CSR firms take advantage of the process and if the unraveling begins. It also would allow time to evaluate the experiments currently underway in Europe.

IX. Conclusion

We believe that with respect to corporate social reporting, the distinction between commercial and political speech has little value. Instead, the principle of optimal truthful disclosure is a sound basis for setting public policy with respect to social reporting, in dramatic contrast to the arbitrary and awkward commercial/political speech dichotomy. The approach we describe does away with the possibility of a safe harbor for fraudulent speech by corporations under the legal regime advocated by Nike, thereby reducing the level of misinformation directed toward stakeholders. On the other hand, the ability to file reports with the SEC enhances the credibility of firms, such as Nike, when they choose to be involved in debates on matters that affect not only public policy but also their performance in consumer and financial markets. Under this voluntary system, firms are free to make statements based on information that is not included in a social report. Stakeholders are, of course, free to discount these statements and rely only on social reports. Over time, we hope the incentives will be sufficient for nearly all firms to engage in social reporting and the policy goal of optimal truthful disclosure will be achieved.

Notes

1. The authors thank Mariko Tran for extraordinary research assistance on this project.

2. The doctrine applies only to future suits under California's false advertising law and to other California litigation where commercial speech is an issue.

3. Brief of Amici Curiae on behalf of the Arthur W. Page Society, the Council of Public Relations Firms, the Institute for Public Relations, the Public Affairs Council, and the Public

Relations Society of America in support of Petitioners, *Nike, Inc., et al., Petitioners, v. Marc Kasky, Respondent*, 123 S. Ct. 2554 (2003) (No. 02-575).

4. Brief of Amici Curiae of Forty Leading Newspapers, Magazines, Broadcasters, Wire-Services, and Media-Related Professional and Trade Associations in Support of Petitioners, *Nike, Inc., et al., Petitioners, v. Marc Kasky, Respondent*, 123 S. Ct. 2554 (2003) (No. 02-575).

5. Brief of Amici Curiae of Domini Social Investments LLC, KLD Research & Analytics, Inc., and Harrington Investments, Inc. in Support of Respondent, *Nike, Inc., et al., Petitioners, v. Marc Kasky, Respondent*, 123 S. Ct. 2554 (2003) (No. 02-575).

6. Brief of Amici Curiae of the states of California, Alaska, Arizona, Connecticut, Florida, Illinois, Louisiana, Maine, Maryland, Minnesota, New Mexico, New York, North Dakota, Ohio, Oklahoma, South Dakota, Vermont, and West Virginia, and the Commonwealth of Puerto Rico in Support of Respondent, *Nike, Inc., et al., Petitioners, v. Marc Kasky, Respondent*, 123 S. Ct. 2554 (2003) (No. 02-575).

7. If an action is found to be *ultra vires*, there are several possible results including holding the officers liable for harm suffered by the shareholders, the attorney general dissolving the corporation, or the action being enjoined (Gevurtz, 2000).

8. This second regime essentially follows the ruling of the California Supreme Court, but we have changed the terminology for purposes of this paper. Under that Court's ruling, corporations continue to have First Amendment protection for political speech, but what may be considered political speech is so significantly reduced as to render the "protection" meaningless. Thus, to simplify matters, we represent the California Court's ruling as permitting liability for political speech.

9. Cason and Gangadharan (2002) provide limited support that this assumption is true through a laboratory experiment.

10. The process of collecting the information required for a social report—if structured appropriately—also can serve other public policy goals beyond the provision of information. These policy goals are based on the idea of reflexive law and involve improving the decision-making process of firms (see Hess, 2001; Orts, 1995).

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