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June 22, 2021

The Honorable Gary Gensler, Chair
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

RE: Request for Public Input on Climate Change and Other ESG Disclosure

Dear Chair Gensler:

I write in support of the SEC's timely efforts to update the securities disclosure regime to cover climate-related and other ESG topics. My comments focus primarily on conceptual issues related to the statutory basis for SEC rulemaking, the proper construction of the concept of materiality, the optimal design of ESG disclosure rules, and the importance of human capital management (HCM) disclosure as the next step in the Commission's ESG rulemaking efforts. I have studied these topics in my academic work, and some of my comments draw on published and forthcoming research, as noted below. For ease of reference, I have also enclosed my recent article, *The Human Capital Management Movement in U.S. Corporate Law*, as Annex A hereto.[1]

1. The Role of Materiality as an Organizing Principle in Corporate Reporting

Much of the recent debate about climate-related disclosure has focused on the advisability of a so-called prescriptive approach compared to a "principles-based approach grounded in materiality." A comprehensive view of the Commission's longstanding disclosure rulemaking practices suggests that this is an artificial dichotomy, and, moreover, that a narrow and idiosyncratic understanding of materiality is being advanced in an attempt to straightjacket the Commission's ability to promulgate ESG disclosure rules.

By all accounts, the Commission is contemplating the adoption of an ESG disclosure framework that is firmly grounded in financial materiality. Some commenters, however, have set an impossible bar for what such a framework ought to look like by asserting or implying that every individual disclosure item contained therein ought to be material on every occasion and for every firm subject to the framework, or that firms need to test every individual piece of potentially-disclosable information using the resource-intensive process for determining particularized materiality under *TSC Industries/Basic*. This cannot be the right standard for new disclosure rules because, if it were, virtually none of the Commission's existing disclosure rules would meet

[1] George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 TUL. L. REV. 639 (2021), www.ssrn.com/abstract_id=3817747.

it. Nor would the existing system of financial accounting under U.S. GAAP, which relies heavily on "prescriptive" line items.

For a detailed analysis of ESG disclosure and materiality informed by judicial precedent and historical practice, see Part IV.C (pp. 713-727) of the attached article. One key conclusion is that a prescriptive ESG disclosure framework that does not qualify every disclosure item with reference to *TSC Industries* materiality can still be fully consistent with the Commission's longstanding approach to both disclosure and materiality. The Commission's traditional practice has been to identify *general subject areas* that are material to investors and then develop disclosure frameworks for these subject areas; the *specific disclosure items* contained in the disclosure frameworks come last and are subject to the Commission's expert judgment. These specific disclosure items do in many cases include materiality qualifiers or use materiality as a gap-filling device, but in many other cases they do not.[2]

The HCM disclosure rule adopted in August 2020 offers an instructive case study of the limits of open-ended rule design. At the time, the SEC decided against providing detailed materiality guidance or requiring the disclosure of specific HCM metrics; instead, the Commission stated an expectation that the open-ended rule will lead to meaningful disclosure tailored to firms' individual circumstances. This has not happened. Surveys of actual HCM disclosures, discussed in Part 4.A below, observe that "most disclosure is boilerplate" and that the new rule "appears to contribute to the length but not the informativeness of 10-K disclosures."[3] The SEC should avoid following the same approach in the case of climate-related disclosure.

2. Firm Size, Materiality Qualifiers, and ESG Disclosure

Certain individual disclosure rules employ materiality qualifiers.[4] Such materiality qualifiers can be very useful in calibrating disclosure requirements but, as I discussed in a 2017 article, they can also have undesirable effects in the case of very large firms.[5] The Commission should be particularly sensitive to these effects when developing new climate change or other ESG disclosure rules.

Because materiality qualifiers assess the significance of a matter with reference to the size of the particular firm, at large firms even matters that are large or significant in absolute terms can still

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[2] For example, the summary executive compensation table under Item 402(c)(1) of Reg. S-K requires disclosure of the salary, bonus, stock awards, stock option awards, and other specified elements of executive compensation without subjecting the elements or the amounts involved to the *TSC Industries* test. Part IV.C of the enclosed article provides additional examples.

[3] *See infra* Part 4.A.

[4] For example, Item 103 of Reg. S-K requires disclosure of "material pending legal proceedings," while Item 303 seeks disclosure of matters that have had a "material impact" on reported operations or are reasonably likely to have such an impact on future operations. Rule 405 under the Securities Act states that "when used to qualify a requirement for the furnishing of information as to any subject, [materiality] limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered." Rule 12b-2 under the Exchange Act tracks this definition.

[5] *See* George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602 (2017).

escape disclosure. In effect, the larger the firm, the less likely it is that any particular piece of information would be deemed material and required to be disclosed, which leads to what I call "materiality blindspots." The SEC's 2010 Climate Disclosure Guidance placed extensive reliance on a materiality-qualified approach, which likely explains the inadequate levels of disclosure it has elicited.[6]

The materiality blindspots phenomenon is particularly problematic in the case of portfolio investing (whether actively-managed or index-based), which is by far the dominant investment modality nowadays. When large and small firms are part of an investment portfolio, the same risk factor or contingent liability may be disclosed by a small firm (because it is material to it) and not disclosed by a large firm (because it is not material to it). While perfectly legal, this result obscures the total level of risk within the portfolio and it also makes it impossible to compare the large and small firm at issue. This problem is further compounded by the fact that most investment portfolios are market-capitalization weighted, i.e., weighted towards *the largest and non-disclosing firms*.[7]

While it is not feasible to completely avoid materiality qualifiers when designing new disclosure rules, their use should not be automatic and should be informed by the trade-offs noted here. Specific line-item disclosure requirements can help avoid the problem of materiality blindspots. Moreover, where a disclosure threshold is needed, this threshold can be set with reference to a specific dollar amount. (Setting the disclosure threshold using a percentage of a firm-specific metric produces an amount tied to the particular firm's size.) I discuss these possibilities in Part V of the 2017 article.

3. Implementation Approaches and the Role of Comply-or-Explain (Questions 1, 7 & 12)

There are multiple trade-offs to consider when determining how to incorporate ESG information in the disclosure regime. I believe that integrating relevant ESG information in Reg. S-K and, as appropriate, the financial statements should be the end goal of the current process. The SEC should still be sensitive to the possibility that litigation in respect of the validity of any new ESG disclosure rules could block or significantly delay this process.[8] To this end, I propose the following conceptual approach combining comply-or-explain and standard prescriptive mandates:

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[6] *Id.*, at 640-41.

[7] *Id.*, at 608, 643.

[8] The protracted legal proceedings in respect of the Dodd-Frank rules on conflict minerals and resource extraction payments disclosure illustrate this risk. To be sure, these rules involved unique challenges, including the highly-specific language in the congressional mandates. Nevertheless, even though the Commission's broad authority to promulgate disclosure rules has been firmly established for close to nine decades, some have argued that recent Supreme Court case law raises questions about the appropriate standard of review of commercial disclosure requirements. (*See* Letter from Patrick Morrisey, Att'y Gen., West Virginia, to Allison Lee, Acting Chair, U.S. Sec. & Exch. Comm'n (Mar. 25, 2021) (arguing against ESG disclosure rules on First Amendment grounds).) By all indications, any new rules adopted by the SEC will be limited to "purely factual and uncontroversial information" (easily passing judicial review, at least under *Zauderer*); it is nevertheless possible to envision objections on the basis that the rules are "unjustified or unduly burdensome." The comply-or-explain approach suggested here can render such objections moot. With careful design, comply-or-explain rules can meet the majority of investors' informational needs and would represent a decisive first step in the development of an ESG disclosure system.

Step 1—Compliance with Existing Rules: Identify those sections of Reg. S-K that already require disclosure of climate-related information and, by issuing additional guidance, ensure that issuers comply with these existing requirements. Existing disclosure requirements viewed through a climate lens include: Item 105 (identification and assessment of *climate* risk *over varying time horizons*); Item 303 (*climate-related* demands, commitments, events, or uncertainties); Item 402(b) (*climate-related aspects of* compensation discussion and analysis); Item 402(s) (narrative disclosure of compensation practices as they relate to *climate* risk management); and Item 407(h) (the board's role in *climate-related* risk oversight). Work with financial accounting standard-setters to ensure that appropriate climate-related information is reflected in the financial statements and notes thereto.[9]

Step 2—New Comply-or-Explain Mandates: Endorse one or more of the existing disclosure frameworks, or specify additional items likely to be relevant based on the extensive work done by SASB and other international standard-setters, including Scope 1/2/3 emissions and risk scenario modelling. Require disclosure on a comply-or-explain basis for annual reports filed after Dec. 31, 2022. Require that covered issuers provide specific explanations in cases of inability to comply, possibility from a menu of suggested options (e.g., information not relevant (due to particular reasons to be disclosed), information cannot be estimated with sufficient precision, information too burdensome to produce, etc.).

Step 3—New Mandatory Rules: Given that the vast majority of issuers will become comfortable with the information under Step 2 over time, adopt a separate rule to require disclosure of this information on a mandatory reporting basis with a delayed implementation date (e.g., for annual reports filed after Dec. 31, 2025). Delayed implementation will allow the relevant reporting frameworks to evolve. Moreover, any legal challenge to the mandatory rules in Step 3 will not interfere with the implementation of the non-binding comply-or-explain mandates in Step 2, which can remain in effect regardless of the progress or outcome of any litigation.

4. The Need for Enhanced Human Capital Management Disclosure (Question 15)

While the Commission's approach in focusing first on climate-related disclosure is sound, the Commission is also right to solicit stakeholder input on the need to update the disclosure regime to cover additional ESG topics. Information relating to "human capital management" (HCM) represents another urgent area for new disclosure for many of the reasons motivating climate-related disclosure: HCM information is relevant to mainstream investor decisionmaking in connection with investment and voting decisions (i.e., the information is financially material); investors demand consistent, comparable, and reliable HCM information but the information currently available does not exhibit such characteristics; and HCM considerations represent an important vector of competition in capital and other markets (see Part 5 below).

[9] On the role and importance of financial accounting in climate change reporting, see Samantha Ross, The Role of Accounting and Auditing in Addressing Climate Change, Center for American Progress (Mar. 1, 2021), www.americanprogress.org/issues/economy/reports/2021/03/01/496290/role-accounting-auditing-addressing-climate-change. Generally, the financial accounting system represents an unexplored avenue for improving sustainability disclosures in certain areas. Updating financial accounting to reflect quantifiable sustainability information is also important for the continued relevance of financial statements.

A. Lessons from the 2020 HCM Disclosure Rulemaking Process

I analyzed the need for HCM disclosure and the SEC's August 2020 principles-based HCM disclosure requirement in my article *The Human Capital Management Movement in U.S. Corporate Law*, which is attached as Annex A hereto.[10] Based on this research, I believe that the SEC should undertake another round of rulemaking in respect of HCM and seek to correct some of the mistakes from the 2020 rulemaking, which have already become evident.

Specifically, it has already become clear that the August 2020 HCM disclosure rule is not eliciting the type of consistent, comparable, and reliable information that mainstream investors need for purposes of their buy/sell and voting decisions. Upon the rule's adoption, then-Chairman Clayton stated: "under the principles-based approach, I do expect to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs."[11] The following surveys of firms' compliance with the new HCM disclosure rule suggest that the rule is failing to meet Chairman Clayton's stated expectations:

- *Stanford Business School Report:* "We find that while some companies are transparent in explaining the philosophy, design, and focus of their HCM, most disclosure is boilerplate. Companies infrequently provide quantitative metrics. . . . Few provide data to shed light on the strategic aspects of HCM: talent recruitment, development, retention, and incentive systems. As such, new HCM disclosure appears to contribute to the length but not the informativeness of 10-K disclosures." The report also found very limited disclosure of HCM metrics, as follows: diversity-gender (24%), diversity-race/ethnicity (14%), turnover/tenure (14%), safety (12%), engagement (6%), talent development (4%), and other (5%).[12]
- *Intelligize:* Companies "capitalized on the fact that the new rule does not call for specific metrics," and "[r]elatively few issuers provided meaningful numbers about their human capital, even when they had those numbers at hand."[13]
- *Compensation Advisory Partners:* "Most disclosures to date depend heavily on a qualitative description of core values, programs and practices. Very few companies are disclosing actual objectives and/or metrics used to manage the business." The report also noted the absence of any disclosure of productivity metrics.[14]

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[10] See in particular Part III.B (The HCM Movement's Elements and Manifestations), pp. 666-690; Part IV.C (HCM and the SEC), pp. 713-726; and Part IV.D (HCM and Financial Accounting), pp. 727-733.

[11] *See* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Modernizing the Framework for Business, Legal Proceedings and Risk Factor Disclosures (Aug. 26, 2020), www.sec.gov/news/public-statement/clayton-regulation-s-k-2020-08-26.

[12] *See* Amit Batish et al., Stanford Business School, Human Capital Disclosure: What Do Companies Say about Their "Most Important Asset"? (May 5, 2021), www.gsb.stanford.edu/faculty-research/publications/human-capital-disclosure-what-do-companies-say-about-their-most.

[13] *See* Rob Peters, Intelligize, Intelligize Report: Companies Avoid Revealing Human Capital Metrics (Apr. 27, 2021), https://www.intelligize.com/intelligize-report-companies-avoid-revealing-human-capital-metrics.

[14] *See* Margaret Engel, Compensation Advisory Partners, New Human Capital Disclosure Requirements: An Early Read on Developing Best Practices (Jan. 12, 2021), https://s3.us-east-2.amazonaws.com/capartners.production/wp-

- *Bloomberg:* Experts found that "the new SEC workforce disclosures are scant on fresh information."[15]
- *Willis Towers Watson:* "Initial 10-K disclosures provide limited data on human capital metrics." The report found that of the companies in its sample, only 18% disclosed information about health and safety, only 38% disclosed information about workforce compensation and/or other benefits; and only 44% disclosed information about employee engagement. Furthermore, relatively few companies disclosed specific metrics: gender representation (44%), race/ethnicity representation (38%), collective bargaining/union representation (18%), training participation (18%), voluntary attrition rate (15%), employee engagement results (12%), and recordable incidents (12%).[16]

Despite different methodologies and sample sizes, these surveys all paint a consistent picture: the open-ended, "principles-based" HCM disclosure rule adopted in August 2020 has serious shortcomings.

B. <u>Inclusion of Specific HCM Categories and Metrics in Item 101 of Reg. S-K</u>

In light of the shortcomings of the August 2020 HCM disclosure rule, the SEC should launch a new round of HCM rulemaking to consider the inclusion of specific HCM categories and metrics in Item 101(c)(2)(ii) of Reg. S-K. As a starting point, the SEC should revisit the March 2019 recommendations of the SEC Investor Advisory Committee, which contained suggestions for specific metrics.[17] The SEC should also consider the categories and metrics proposed by the Human Capital Management Coalition (HCMC) in its October 2019 comment letter to the SEC.[18] The HCMC's list of categories and metrics is not overinclusive and represents a particularly sensible starting point for SEC rulemaking in this area. Moreover, it has been either endorsed or echoed by a number of the other participants in the 2019-20 rulemaking. In most instances, the SEC should also require workforce-related information to be broken down by segment and geographic region in order to provide a meaningful picture of HCM trends and practices.

In line with the approach outlined in Part 3 above, the new information should be required on a comply-or-explain basis initially. A separate rule should require that the same information be provided on a mandatory basis with a delayed implementation date. The advantage of this two-

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content/uploads/2019/07/15125840/CAPintel-21-01-07-New-Human-Capital-Disclosure-Requirements-An-Early-Read-on-Developing-Best-Practices-v5.pdf.

[15] *See* Amanda Iacone, Bloomberg Law, New SEC Workforce Disclosures Scant on Fresh Information (Jan. 27, 2021), https://news.bloomberglaw.com/securities-law/new-secworkforce-disclosures-scant-on-fresh-information.

[16] *See* Steve Seelig and Lindsay Green, Willis Towers Watson, Initial 10-K Disclosures Provide Limited Data on Human Capital Metrics (Jan. 28, 2021), https://www.willistowerswatson.com/en-US/Insights/2021/01/Initial-10-K-disclosures-provide-limited-data-on-human-capital-metrics.

[17] SEC Investor Advisory Committee, Recommendation on Human Capital Management Disclosure (March 2019), www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf.

[18] *See* Letter from Cambria Allen-Ratzlaff, Chair, Hum. Cap. Mgmt. Coal., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 22, 2019), https://www.sec.gov/comments/s7-11-19/s71119-6322887-194462.pdf.

prong approach is that any legal challenge to the mandatory rule would not interfere with the implementation of the comply-or-explain mandate, which can go into immediate effect.

C. Revisions to Pay Ratio Disclosure—Item 402(u) of Reg. S-K

The SEC's pay ratio disclosure rule deals with one particular dimension of human capital management—workforce compensation. Unfortunately, in its present form the rule suffers from serious deficiencies, which the SEC should address as part of any future HCM rulemaking.

As detailed in an article I coauthored in 2019, the central flaw in the rule's design is that the SEC opted for an idiosyncratic *numbers-only* approach to disclosure: with minor exceptions, firms are required to disclose only the median worker pay figure and the resulting CEO-median worker pay ratio, without any accompanying explanation.[19] As a practical matter, firms provide explanation voluntarily only in cases where their ratio is perceived to be too high, in effect "spinning" the disclosure.[20] In most other cases, firms provide only the minimum required disclosure, without any context or explanation. The 2019 article finds that in its current format the pay ratio information is characterized by low informational integrity, meaning that it fails to meet certain baseline characteristics of securities disclosure, such as accuracy, comprehensibility, and completeness. Due to its high public salience, and despite its low informational integrity, the pay ratio information has received extensive attention and has been subject to misuse.

The article proposes an easy-to-implement intervention: In addition to the median worker figure and the CEO-median worker pay ratio, the SEC should require *"a narrative description of any material factors necessary to an understanding of the information disclosed"*; the SEC should also provide a non-exhaustive list of potential factors. The requirement to provide narrative explanation would make the resulting disclosures more meaningful; it would also conform the pay ratio to the other compensation-related disclosures required by Item 402 of Reg. S-K, all of which eschew the numbers-only approach and instead require appropriate narrative information to place the data in context.[21]

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[19] *See* Steven A. Bank & George S. Georgiev, *Securities Disclosure as Soundbite: The Case of CEO Pay Ratios*, 60 B.C. L. REV. 1123 (2019), ssrn.com/abstract_id=3324882. The rule's design and associated methodological challenges are discussed in Part II of the article; the rule's low informational integrity in the context of the securities disclosure regime is discussed in Part IV; the proposed solution is discussed in Part VI.

[20] *See, e.g.*, Audra Boone et al., Spinning the CEO Pay Ratio Disclosure (Apr. 6, 2020), ssrn.com/abstract=3481540 (finding that firms reporting higher pay ratios tend to also include discretionary narratives portraying their employee relations or compensation practices in a positive light); Sun Moon Jung et al., Why Do Firms Disclose a Supplementary CEO-to-Median Worker Pay Ratio? Initial Evidence from Dodd-Frank Act Section 953(b), at 3 (Dec. 3, 2018), ssrn.com/abstract_id=3234013 (finding that among firms choosing to provide supplemental ratios, 86% reported a supplemental ratio that was *lower* than the main ratio and that firms with CEO compensation and a pay ratio above industry peers were more likely to provide a supplemental pay ratio).

[21] The CD&A rules contained in Item 402 of Reg. S-K require firms to disclose in tabular format the compensation received by their named executive officers. Immediately following the numerical tables, the CD&A rules require firms to provide "a narrative description of any material factors necessary to an understanding of the information disclosed in the tables"; the rules also guide firms by providing a non-exhaustive list of examples of such factors. The CD&A rules follow the same approach with respect to each of the other categories of required quantitative information: any table containing numbers is to be followed by a narrative that discusses the material factors necessary for understanding the information.

Potential examples of material factors necessary to an understanding of the pay ratio information may include the firm's philosophy for determining the pay of the median worker or the workforce in general; a discussion of the structure of the labor force (for example, whether the firm uses contractors/part-time employees/offshore workers, and whether it relies extensively on automation); and an explanation of the reasons for any significant changes from prior years. As with the rest of the CD&A rules, the SEC should come up with basic examples of material factors in consultation with companies and investors. Beyond the proposal contained in the 2019 article, I would also suggest that the SEC consider asking each covered firm to *"explain the links (if any) between its executive and non-executive pay policies"*; on a conceptual level, the pay ratio is intended to illustrate this relationship, but a numerical ratio alone is incapable of communicating a firm's compensation philosophy. Moreover, a number of mainstream investors have expressed an interest in this kind of information in the context of HCM discussions.

D. Financial Information

My research on human capital management also suggests the need to consider certain changes to financial accounting rules and/or Reg. S-X, so that they more accurately reflect firms' investment in human capital. These proposals are discussed in Part IV.D (pp. 727-733) of the enclosed article. As a first and fairly straightforward step, firms should be required to break down *workforce training expenses* and *employee compensation expenses* as separate items. These represent the most significant human-capital-related expenses incurred by firms, but, in both instances, they are lumped together with other expenses on the income statement, which obscures relevant information and makes human capital spending an attractive target during cost-cutting rounds.

Under current rules, workforce training expenses are part of SG&A, a general category that covers overhead items ranging from marketing expenses, to professional services, to office supplies. As a catch-all category, SG&A often contains expenses arising from inefficiencies. Understandably, investors view high SG&A amounts, or year-on-year increases in SG&A amounts, as a negative signal about the firm's current operations and future prospects; conversely, lower SG&A amounts, or year-on-year reductions in SG&A amounts, are viewed as a positive signal. Information about employee compensation expenses presents similar problems. Apart from the median worker pay figure required for the calculation of the CEO pay ratio, neither the accounting rules nor the SEC disclosure rules provide a way for investors to gauge with any specificity what a firm pays its workers. Yet, this information is relevant when investors analyze a firm on its own terms, over time, or in relation to industry peers. Currently, even the total amount spent on worker salaries is not disclosed; it is, instead, lumped into other aggregate figures (COGS for the direct labor costs used to produce a good, and SG&A for all other labor costs).[22]

Employee compensation expenses and workforce training expenses are quantifiable, objective HCM metrics and firms track this information already. The Commission should act to make these metrics a part of firms' reporting obligations.

[22] This is one area of divergence between U.S. GAAP and IFRS. Under IAS 19, firms that follow IFRS are required to disclose the amounts paid in wages, salaries, and social security contributions, among other information.

5. The Promotion of Competition: An Important and Overlooked Additional Justification for SEC-Mandated ESG Disclosure

Comments submitted by investors and other market participants have offered strong evidence of investor demand for consistent, comparable, and reliable information on climate change. In addition to investor protection, the promotion of competition provides an important supplemental basis for SEC rulemaking in this area. This factor can allow the SEC to capture additional benefits as part of its cost-benefit analysis of any new rules. Consider, in turn, the statutory support for incorporating competition in SEC disclosure rulemaking, and the evidence linking ESG information to competition in capital and labor markets.

A. Statutory Authority

When engaging in rulemaking, the SEC is required by statute to consider "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[23] The relevance of this statutory language to ESG disclosure rulemaking is twofold.[24] First, the growing importance of ESG factors as a vector of competition in capital and other markets serves to justify ESG disclosure rulemaking by the SEC. As discussed below, competition based on ESG factors cannot take place without consistent, comparable, and reliable ESG information, and enhancing disclosure is the principal, if not the only, mechanism for facilitating such competition.[25]

Second, the statutory language suggests that the SEC's cost-benefit analysis of any ESG disclosure proposal should take into account the benefits to competition stemming from additional and/or higher-quality disclosure. While this point may appear obvious, my study of the SEC's cost-benefit analysis practices suggests that to the limited extent competition has been considered in the context of disclosure rulemaking in the past, it has been primarily as a *cost* (militating against adopting a particular disclosure rule or imposing disclosure regulation)—and not as a *benefit* (which would militate in favor of disclosure regulation). This approach runs counter to the SEC's own cost-benefit analysis guidance issued in 2012, which states that SEC cost-benefit analyses may consider *the benefits of a rule* in terms of "better information sharing,

[23] *See* Securities Act of 1933, 15 U.S.C. § 77b(b) (2012); Securities Exchange Act of 1934, 15 U.S.C. § 78c(f) (2012); Investment Company Act of 1940, 15 U.S.C. § 80(a)-2(c) (2012).

[24] For an expanded analysis of the relevance of competition to SEC rulemaking in the disclosure context, see George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 658-62 (2017), www.ssrn.com/abstract_id=2894538. In October 2018, then-SEC Commissioner Robert Jackson highlighted the importance of competition to the SEC's overall mission. *See* Robert J. Jackson, Jr., Competition: The Forgotten Fourth Pillar of the SEC's Mission (Oct. 11, 2018), www.sec.gov/news/speech/speech-jackson-101118.

[25] Relatedly, Executive Order No. 13,725 from April 2016 (which remains in effect) provides additional justification for SEC action on ESG disclosure on the basis of promoting competition. The Executive Order directed all "agencies with authorities that could be used to enhance competition" to "use those authorities to promote competition." The Executive Order "strongly encouraged" independent agencies, such as the SEC, to comply with its directives and discussed the importance of the flow of information within the economy. *See* Exec. Order No. 13,725, Steps to Increase Competition and Better Inform Consumers and Workers to Support Continued Growth of the American Economy (Apr. 15, 2016), 81 Fed. Reg. 23,417 (Apr. 20, 2016).

which can result in lower risk premiums and better allocation of capital," and "enhanced competition, which can lead to reduced prices or higher quality."[26]

In short, the SEC's statutory mandate in respect of the promotion of competition can weigh in favor of adopting a disclosure rule. Like all disclosure rules, any new ESG disclosure rules adopted by the SEC will entail some measure of compliance costs; it is important that the SEC's cost-benefit analysis also account for the considerable offsetting benefits to competition stemming from the new rules.

B. The Importance of ESG Information to Competition in Capital and Labor Markets

Empirical and theoretical evidence increasingly suggests that ESG considerations represent an important vector of competition in capital and labor markets. Participants in these markets seek out ESG information and consider it alongside other factors, such as price, when making economic decisions. In many cases, ESG information is also a key input in determining the relevant market price. ESG information cannot adequately serve these purposes, however, unless it is consistent, comparable, and reliable. By all accounts, currently-available ESG information does not exhibit such characteristics.[27] The incorporation of low-quality ESG information in decisionmaking can have distortive effects, thereby not only failing to promote competition but also undermining market efficiency, another aspect of the SEC's statutory mandate.

Capital Markets. Since 2019, the United States capital markets have experienced a sustainable finance revolution. According to a recent Morningstar report, the number of sustainable open-end and exchange-traded funds available to U.S. investors increased to 392 in 2020, up 30% from 2019. Nearly *one out of every four* new dollars invested now goes into a sustainable fund. Sustainable funds attracted a record $51.1 billion in net flows in 2020, more than twice the previous record set in 2019, and the total assets under management invested in sustainable funds stood at close to $250 billion at the end of 2020.[28] According to research from the U.S. SIF Foundation and various surveys of market participants, climate-related issues currently represent the most significant sustainability dimension for investors.

Given the funding volumes at stake, there are multiple competitive dynamics in the markets for sustainable finance. For example, established and new firms compete for "green capital" and a higher ESG rating can translate into a lower cost of capital. Similarly, a firm's inclusion in an ESG fund can lead to a lower cost of capital, whereas exclusion can lead to higher cost of capital. Nevertheless, the lack of consistent, comparable, and reliable ESG information thwarts this

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[26] *See* Memorandum from the SEC Div. of Risk, Strategy, and Fin. Innovation and the Office of the Gen. Counsel, Current Guidance on Economic Analysis in SEC Rulemakings, at 11 (Mar. 16, 2012), www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[27] *See, e.g.*, U.S. Gov't Accountability Off., GAO-20-530, Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them (2020).

[28] *See* Morningstar, Sustainable Funds U.S. Landscape Report (Feb. 10, 2021), at 2, 12. Other sources have reported an even higher number. *See, e.g.,* Debbie Carlson, ESG Investing Now Accounts for One-Third of Total U.S. Assets Under Management, MarketWatch (Nov. 17, 2020), www.marketwatch.com/story/esg-investing-now-accounts-for-one-third-of-total-u-s-assets-under-management-11605626611.

competition. Sustainable firms are unable to differentiate themselves from less sustainable firms because ESG information is not presented in a consistent fashion. Since investment and fund inclusion/exclusion decisions are by their nature comparative, a high-quality firm can only stand apart (and reap the corresponding benefits) if other firms also report their ESG data. Separately, asset managers also need this information because they compete with one another to assemble relevant and high-performing sustainable funds. By all accounts, investors and asset managers currently rely on incomplete and low-quality data, often coming from third-party providers. The solution to these problems is to enhance the quality and availability of ESG information. Doing so would produce competition benefits (in addition to the well-known investor protection benefits), and these additional benefits ought to be taken into account as part of SEC rulemaking.

Labor Markets. ESG information also plays an important role in labor market competition—for both executive and non-executive employees. ESG performance metrics have quietly become commonplace in incentive-based executive compensation plans; recent research suggests that more than half of S&P 500 companies have incorporated ESG metrics as part of executive pay. This includes both climate-related metrics as well as metrics related to HCM.[29] As things currently stand, however, the effectiveness of tying executive compensation to ESG metrics is uncertain at best due to the low quality of the available ESG information. Moreover, the peer-group benchmarking that is a routine part of setting executive compensation cannot take place in the absence of consistent, comparable, and reliable ESG information. The same informational problems also disrupt competition for non-executive employees. There is extensive data suggesting that employees express affirmative preferences for firms that score high on ESG dimensions; a considerable number of employees even report willingness to accept lower wages in order to work for such firms.[30] This sorting process also cannot take place effectively in the absence of high-quality ESG information.

While capital market competition concerns should be paramount for the Commission, the general nature of the "promotion of competition" mandate allows the SEC's cost-benefit analysis to take into account the economy-wide benefits to competition (including in labor and, indeed, other markets).[31] Again, the point here is that competition-related concerns of the kind discussed above provide an additional (and unjustifiably overlooked) basis for SEC rulemaking on ESG disclosure, which supplements the investor protection concerns discussed by other commenters. In this context, it should also be noted that there is a separate competition-related rationale focusing on the international standing of U.S. capital markets and firms, which has been identified by other commenters and which the SEC should also consider.[32]

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[29] *See, e.g.*, Willis Towers Watson, ESG and Executive Pay (2021), at 18, www.willistowerswatson.com/-/media/WTW/Insights/2021/04/ESG-and-Executive-Compensation-Report-2021.pdf.

[30] *See, e.g.*, Adele Peters, Most Millennials Would Take a Pay Cut to Work at an Environmentally Responsible Company, Fast Company (Feb. 14, 2019), https://www.fastcompany.com/90306556/most-millennials-would-take-a-pay-cut-to-work-at-a-sustainable-company.

[31] To the extent consumers increasingly consider a firm's performance on relevant ESG dimensions when choosing among competing products, improving the availability and comparability of ESG information will also have benefits in terms of promoting effective competition in product markets.

[32] *See* Letter from Professor Jill E. Fisch et al. to Gary Gensler, Chair, U.S. Sec. & Exch. Comm'n (June 11, 2021) ("The SEC's failure to regulate in this area could therefore put the U.S. capital markets and U.S. firms at a competitive disadvantage.").

* * *

As evidenced by the Commission's request for input and the comments submitted to date, the incorporation of ESG information in the disclosure regime raises a number of challenging questions. Nevertheless, prior reforms of the disclosure regime have posed challenges of a similar magnitude, which the SEC has been able to resolve successfully through reasoned and iterative rulemaking. I commend the Commission and the Staff for working on this important initiative and I appreciate the opportunity to submit comments for consideration. I would be happy to discuss any of the points raised herein at your convenience.

Sincerely yours,

/s/ George S. Georgiev

George S. Georgiev
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Emory University School of Law

Enclosure

cc: Hon. Caroline Crenshaw, Commissioner, U.S. Securities and Exchange Commission
Hon. Allison Herren Lee, Commissioner, U.S. Securities and Exchange Commission
Hon. Hester Peirce, Commissioner, U.S. Securities and Exchange Commission
Hon. Elad Roisman, Commissioner, U.S. Securities and Exchange Commission

Annex A

George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 TUL. L. REV. 639 (2021) (available at https://papers.ssrn.com/abstract_id=3817747)

The Human Capital Management Movement in U.S. Corporate Law

George S. Georgiev*

Corporations cannot exist without workers, yet workers are not part of the formal or informal governance structures established by U.S. corporate law. Commentators and policymakers have bemoaned this state of affairs for decades, to little avail. Since the mid-2010s, however, a concept related to workers, human capital management (HCM), has become an increasingly prominent part of U.S. corporate governance. HCM is premised on the notion that workers can be viewed as "assets" and ought to be managed just as carefully as firms manage physical and capital assets. In practice, HCM is an expansive concept that has been used to refer to workforce training, compensation and retention issues, gender pay equity, diversity and inclusion, health and safety, matters related to corporate culture, employees' ability to participate in stock purchase programs, and various other matters.

The speed with which HCM has emerged and the depth and breadth of its reach have been surprising. While broadly fitting within the rubric of environmental, social, and governance (ESG) factors, HCM has quickly surpassed more traditional ESG topics in terms of prominence and uptake. Boards of directors have started to focus on HCM as part of their monitoring and oversight responsibilities, including by amending committee charters to cover HCM matters. Investors are actively engaging with firm management and boards on questions pertaining to HCM. Despite its deregulatory posture at the time, in August 2020 the Securities and Exchange Commission (SEC) adopted a new rule requiring HCM disclosure by public companies. Pending legislation could create HCM disclosure mandates that are considerably more extensive. A variety of private standard-setting organizations have developed detailed frameworks for HCM disclosure, and many firms have started reporting information in accordance with these frameworks. Taken together, these developments represent a powerful and heretofore unprecedented push to incorporate worker-related concerns in corporate governance—a phenomenon I describe as an "HCM movement." This Article is the first to delineate the HCM movement and analyze its origins, development, impact, and normative desirability. In the aftermath of the lingering economic dislocation caused by the 2008 financial crisis and the still-ongoing public health and economic crises unleashed by the COVID-19 pandemic, there is a tangible willingness by policymakers, firms, investors, and others to reconceive institutional arrangements that have been taken for granted for decades. This Article's timely analysis of the HCM movement seeks to inform some of the attendant public and corporate governance policy choices.

Subject to certain qualifications, the Article views HCM as a broadly positive and much-overdue corporate governance development: HCM disclosure contributes to more accurate firm valuation by shining a spotlight on a key driver of success in the modern knowledge-based economy; HCM oversight at the board level ensures that firms focus appropriately on the management of what has come to be referred to as a "mission-critical"

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* © 2021 George S. Georgiev, Associate Professor, Emory University School of Law. For helpful comments and discussions, I thank Miriam Baer, Steven Bank, Jim Barrall, Eric Chaffee, Kevin Collins, Aaron Dhir, Deborah Dinner, Onnig Dombalagian, Mary Dudziak, Martha Fineman, Frank Gevurtz, Tim Holbrook, Kristin Johnson, Jonathan Nash, Alan Palmiter, Kish Parella, Mariana Pargendler, Darren Rosenblum, Hillary Sale, Liza Vertinsky, Verity Winship, and participants in the 2020 AALS Annual Meeting and the other workshops and conferences where this Article was presented.

asset. To realize HCM's full promise, however, participants in the HCM movement should seek to disambiguate the HCM concept by carefully defining it, breaking it down into its appropriate constitutive elements, and, to the extent possible, focusing the relevant discussions on those specific elements. The weight of the empirical evidence and the appropriate policies for corporate boards, the SEC, and private standard-setters will vary depending on which element is under consideration. In addition, boards should resist isomorphic approaches, particularly ones developed by organizations such as large asset managers that are lacking in regulatory legitimacy, accountability, and HCM expertise. The SEC can and should serve as a nexus for coordination among the various participants in the HCM movement. As a first step, the SEC should revisit the HCM disclosure rulemaking process and reject the unstructured, "principles-based" approach reflected in the August 2020 HCM disclosure rule, which is based on an impoverished understanding of the important concept of materiality. In its final part, the Article considers the limits of HCM and sounds a note of caution with respect to HCM's potential to address problems outside corporate law. The rise of the HCM movement has highlighted the need for a governmental human capital development and worker protection agenda; in other words, current socio-economic conditions likely require new measures aimed at the development and protection of human capital, not just its management.

I. INTRODUCTION

One seemingly immutable feature of the U.S. system of corporate governance has long been its focus on the interaction among three constituencies—managers, directors, and shareholders—to the exclusion of other stakeholders, most notably employees. Given that conventional corporations are comprised of workers and cannot exist without workers, this state of affairs is puzzling and, for many, unsatisfactory. In the year 2021, labor's importance to firm success is arguably greater than it has ever been: at many firms, human resources contribute more to total firm value than physical assets such as manufacturing plants, equipment, and machinery; for some firms, human capital is even more scarce than financial capital.[1]

The appropriate role and status of employees in corporate governance, if any, is one of corporate law's evergreen questions. Over the years, scholars have generated a variety of reform proposals aimed at empowering employees and giving them some parity, if not primacy, in corporate governance.[2] These proposals have focused on treating workers more like shareholders by, for example, making it easier for employees to take ownership stakes in firms, arguing for director fiduciary duties to workers, and giving workers various consultation, decision, and litigation rights under corporate law, to name but a few.[3] Public officials have also made regular calls for raising the status of workers. Former Delaware Supreme Court Justice Leo Strine recently proposed an ambitious suite of reform proposals, a "new deal" for workers, which incorporates many of the reform ideas from prior decades and adds a number of new ones.[4] Progressive politicians have made a forceful case for requiring firms to place workers on corporate boards.[5] These worker empowerment proposals have yet to gain serious traction. In August 2019, the Business Roundtable issued a

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1. *See* discussion *infra* subpart III.B.
2. *See* discussion *infra* subpart II.B.1-3.
3. *See* discussion *infra* subpart II.B.1.
4. *See* LEO E. STRINE, JR., TOWARD FAIR AND SUSTAINABLE CAPITALISM, ROOSEVELT INSTITUTE (2020), https://ssrn.com/abstract=3461924.
5. Press Release, Off. of Sen. Elizabeth Warren, Warren Introduces Accountable Capitalism Act (Aug. 15, 2018), https://www.warren.senate.gov/newsroom/press-releases/warren-introduces-accountable-capitalism-act [https://perma.cc/US28-SNXZ] (describing how the bill would require large corporations to obtain a federal charter, require boards to consider the interests of all stakeholders when making decisions, and enable employees to elect at least 40% of the board of directors). *See infra* note 51 and accompanying text (summarizing similar proposals by Senators Baldwin and Sanders).

statement on "redefining" the purpose of the corporation in favor of promoting the interests of constituencies beyond just shareholders, including employees.[6] Commentators have suggested that the statement has not and will not result in changes to corporate policy: many of the CEOs who signed it did so without obtaining board approval for making a potentially sweeping change to corporate policy; at least some firms argued that the statement simply reflected policies already in place.[7]

Nevertheless, workers *are* starting to appear in various important areas of U.S. corporate governance through a new and surprising mechanism: the concept of human capital management (HCM). Since 2017, large institutional investors, including BlackRock, have called for greater attention to HCM in their engagement with public companies.[8] In 2020, the Securities and Exchange Commission (SEC) adopted a new rule requiring HCM disclosure, after overwhelming support for such disclosure from mainstream shareholder constituencies and the SEC's Investor Advisory Committee.[9] A wide range of organizations have been working on frameworks for HCM reporting, while legislators have put forward bills that would mandate extensive HCM disclosure by public firms.[10] And even though workers may not have (yet) entered the boardroom, workers' concerns already have: boards increasingly treat HCM as a "mission-critical" area of oversight and are changing their practices at the urging of legal advisers, big-four accounting firms, and executive compensation consultants, among others. In a development that has gone largely unnoticed, board compensation committees have been expanding their remit beyond matters of executive compensation to consider rank-and-file employee compensation and other HCM matters.[11] Shareholder

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6. Press Release, Business Roundtable, Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans', (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/RE3L-Q3DP] ("Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.").

7. *See* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020).

8. *See* discussion *infra* subpart III.B.1.

9. *See* discussion *infra* subpart III.C.

10. *See* discussion *infra* subpart III.B.6-7.

11. *See* discussion *infra* subpart III.B.2.

engagement agendas, board-level decisionmaking, and the SEC disclosure regime: these are some of the key levers of U.S. corporate governance. HCM has affected each of them in short order, giving rise to what I call an "HCM movement": a broad set of initiatives in support of investor-facing HCM disclosure and board-level oversight of HCM matters. This is an important development in need of academic analysis.

What is human capital management? The term is based on the concept of human capital, popularized by economist and Nobel laureate Gary Becker. Human capital is defined simply as "the knowledge, skills, competences and other attributes embodied in individuals that are relevant to economic activity."[12] Human capital *management*, in turn, has been described in a variety of ways, but they usually share two important elements. First, HCM "addresses the management of a company's human resources (employees and individual contractors) as key assets to delivering long-term value."[13] In other words, HCM views workers as *productive assets*, serving a similar, though of course qualitatively different, function as capital assets, such as machines. The goal of HCM is to maximize workers' ability to deliver long-term value and maximize productivity. For this reason, human capital is often described as an intangible asset, falling in the same category as patents, copyright, franchises, goodwill, trademarks, trade names, computer software, and data.[14]

The second component of the HCM definition relates to the matters that are identified as contributing to workers' ability to deliver long-term value. According to one widely followed standard-setting organization, the Sustainability Accounting Standards Board (SASB), HCM includes issues such as labor practices, employee health and

12. ORG. FOR ECON. COOP. & DEV., HUMAN CAPITAL INVESTMENT: AN INTERNATIONAL COMPARISON 9 (1998). A slightly expanded articulation of this definition states that human capital is "the knowledge, skills, competencies and other attributes embodied in individuals or groups of individuals acquired during their life and used to produce goods, services or ideas in market circumstances." *See* SVEN-ÅGE WESTPHALEN, ORG. FOR ECON. COOP. & DEV., REPORTING ON HUMAN CAPITAL; OBJECTIVES AND TRENDS 10 (1999), https://www.oecd.org/sti/ind/1948014.pdf [https://perma.cc/H94G-ZW2U].

13. *SASB Materiality Map*, SUSTAINABILITY ACCT. STANDARDS BD., https://www.sasb.org/standards-overview/materiality-map [https://perma.cc/AT43-4XHB] (last visited Mar. 20, 2021).

14. According to Accounting Standard Codification 350 (ASC 350) promulgated by the Financial Accounting Standards Board, an intangible asset is an asset, other than a financial asset, that lacks physical substance. *See, e.g.*, BARUCH LEV, INTANGIBLES: MANAGEMENT, MEASUREMENT, AND REPORTING 6-7 (2001).

safety, employee engagement, and diversity and inclusion that "affect the productivity of employees, management of labor relations, and management of the health and safety of employees and the ability to create a safety culture."[15] There is variation among the different definitions with respect to the list of issues and the ways these issues are described and categorized.[16]

The notion of HCM (also referred to as "human resource management") has been around for decades. Over time, it has generated extensive bodies of work in fields such as labor economics, industrial and labor relations, management science, organizational psychology, and sociology.[17] By contrast, law—and corporate law in particular—has generally ignored human capital *management* (though making occasional reference to the concept of human capital), in line with the absence of a formal role for employees in corporate governance noted at the outset.[18]

This Article is the first to focus on the present-day nexus between HCM and corporate governance, and it does so by analyzing the myriad of HCM-related initiatives and developments, which started to emerge in the mid-2010s and had already gained traction by the late 2010s. The Article puts forward new qualitative and quantitative evidence about HCM's integration into the legal and institutional framework for corporate governance. Despite HCM's swift rise and broad uptake, however, to date there has been a relative lack of meaningful coordination among the numerous participants in the HCM movement, which has resulted in often-inconsistent messaging. One notable

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15. *SASB Materiality Map*, *supra* note 13.

16. *See* discussion *infra* subpart III.A.

17. *See, e.g.*, RICHARD DONKIN, THE FUTURE OF WORK (2010); THOMAS O. DAVENPORT, HUMAN CAPITAL: WHAT IT IS AND WHY PEOPLE INVEST IT (1999); ERIC FLAMHOLTZ, HUMAN RESOURCE ACCOUNTING (1974); LESTER THUROW, INVESTMENT IN HUMAN CAPITAL (1970).

18. *See* discussion *infra* subparts II.A-II.B, II.D. Work by corporate law scholars such as Margaret Blair and Marleen O'Connor during the 1990s provides a limited exception and foreshadows some of the HCM developments that have occurred since the mid-2010s. *See, e.g.*, MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY (1995) [hereinafter BLAIR, OWNERSHIP AND CONTROL] (proposing, inter alia, changes in the standard accounting system to measure and reflect the value of human capital); Marleen A. O'Connor, *Rethinking Corporate Financial Disclosure of Human Resource Values for the Knowledge-Based Economy*, 1 U. PA. J. LAB. & EMP. L. 527, 528-29 (1998) (identifying the absence of securities disclosure about "human resource values" and arguing for changes to the disclosure regime). Though persuasive, these proposals did not gain traction at the time. Other areas of law, such as intellectual property, tax, and labor law, have made use of the concept of human capital (though not human capital management) to varying degrees. *See* discussion *infra* Part V.

exception is that virtually all participants in the HCM movement have used the same justification for HCM's importance to corporate governance: workers should be regarded as important productive *assets* and managed accordingly, in the interest of improving productivity and firm performance. This shareholder-focused, workers-as-assets justification stands in contrast to an alternative model for incorporating human capital into corporate governance, which views employees as *human capital investors*, not dissimilar from shareholders who invest financial capital in the firm.[19]

The workers-as-assets vs. workers-as-human capital investors distinction also relates to another important feature of the HCM movement: the way it differs from prior labor-focused reform agendas. These longstanding agendas, which I describe as a worker empowerment agenda, a worker-shareholder agenda, and a stakeholder primacy agenda, have generally sought to *redefine* the existing legal and institutional arrangements, whereas by comparison the HCM movement operates firmly *within* the existing framework.[20] In a related vein, a comparative perspective suggests that the HCM movement is a distinct product of U.S. corporate governance, despite interest and participation from international players. Recent labor-focused reforms in the United Kingdom and the European Union have more in common with the aspirational worker empowerment and stakeholder primacy reform agendas than they do with the shareholder-focused HCM movement.[21]

Subject to certain qualifications, this Article views HCM as a broadly positive and much-overdue corporate governance development: HCM disclosure contributes to better and more accurate firm valuation by shining a spotlight on a key driver of success in the modern knowledge-based economy; HCM oversight at the board level ensures that boards focus appropriately on the management of what has come to be referred to as a "mission-critical asset." To realize HCM's full promise, however, all participants in the HCM movement should seek to disambiguate the HCM concept by carefully defining it, breaking it down into its appropriate constitutive elements, and, to the extent possible, focusing the relevant discussions on those specific elements.[22] The weight of the empirical evidence and the appropriate

19. *See* discussion *infra* subpart II.D.
20. *See* discussion *infra* subparts II.B, III.D.1.
21. *See* discussion *infra* subparts II.C, III.D.2.
22. *See* discussion *infra* subparts IV.A-D.

policies for corporate boards, the SEC, and private standard-setters will vary depending on which element is under consideration.[23] In addition, boards should resist isomorphic approaches, particularly ones developed by organizations such as large asset managers that are lacking in regulatory legitimacy, accountability, and HCM expertise.[24] The SEC can and should serve as a nexus for coordination among the various participants in the HCM movement. As an important first step, the SEC should revisit the HCM disclosure rulemaking process and reject the unstructured, "principles-based" approach reflected in the August 2020 HCM disclosure rule, which is based on an impoverished, and arguably inaccurate, understanding of the important concept of materiality.[25] In its final part, the Article considers the limits of HCM and sounds a note of caution with respect to HCM's potential to address problems *outside* corporate law. The rise of the HCM movement in corporate law has highlighted the need for a governmental human capital development and worker protection agenda; in other words, current socio-economic conditions likely require new measures aimed at the *development and protection* of human capital, not just its *management*.[26]

Viewed through a wide lens, U.S. corporate governance in 2021 is in a state of flux. For the first time since the 1970s, there is a real willingness by policymakers, firms, investors, and others to reexamine questions that only a few years ago had seemed settled, and indubitably so. These questions include: What is the purpose of the corporation? Who should get a say in corporate governance? How should firms navigate the inevitable tradeoffs among economic efficiency, resiliency, and long-term sustainability? How can corporate law engage with the ever-growing social, economic, political, and environmental externalities of the business activities it was designed to enable? For each of these important questions, some of the answers focus on workers and invariably invoke the concept of human capital management. To this end, understanding what HCM is—and what it is not, what it can—and what it cannot do, who it stands to benefit—and at what cost, is a vital part of the future blueprint for capitalism, whether it be stakeholder, shareholder, or enlightened capitalism, that is being written as we stand on the cusp of a new decade and a post-pandemic

23. *See* discussion *infra* subpart IV.A.
24. *See* discussion *infra* subpart IV.B.
25. *See* discussion *infra* subpart IV.C.
26. *See* discussion *infra* Part V.

social and economic order full of both uncertainty and possibility.

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The remainder of the Article proceeds as follows: Part II sets the stage by describing the complex legal and institutional landscape within which the HCM movement has arisen. Part III defines the HCM movement, investigates its manifestations in various corporate governance domains, and describes its key features; Part III also examines the HCM movement in the larger context of corporate governance and offers possible explanations for its swift rise and broad uptake. Part IV presents normative and institutional critiques and offers specific recommendations focused on the role of corporate boards, the SEC, and financial accounting standard-setters. Part V considers the need for a broader human capital regulatory agenda outside corporate law.

II. THE ROLES OF CAPITAL AND LABOR IN THE MODERN U.S. CORPORATION

On a conceptual level, both *human capital* and *human capital management* are hybrid notions created by the fusion of two distinct constructs, capital and labor. To understand the novel HCM movement, it is therefore necessary to first appreciate certain key aspects of the underlying legal and institutional framework as it relates to capital (represented by shareholders) and labor (represented by workers). This Part discusses four background matters: (A) the traditional roles of shareholders and workers in U.S. corporate governance; (B) the history of reform efforts aimed at enhancing the status of workers within the corporation; (C) the idiosyncratic nature of the traditional U.S. arrangements when viewed in a comparative light; and (D) the two distinct models of the nexus between human capital and corporate governance.

A. Corporate Purpose, Theory, and the Mechanisms of Governance

It is a truth (almost) universally acknowledged that shareholders sit at the center of U.S. corporate law—both as participants in the governance process and as the constituency in whose interest most firms are managed—all the while there is vigorous debate on whether it ought to be so.[27] By contrast, employees are neither participants in governance nor the intended beneficiaries of the governance process; indeed, as noted by one commentator, "the 'employee' category is not a meaningful one when it comes to creating, sustaining, or dissolving the corporation."[28]

As a purely descriptive matter, the formal mechanisms of corporate governance accord a variety of rights and powers to shareholders—and none to employees. Under state law, shareholders have the right to vote on important corporate matters, including bylaw and charter amendments, director elections, mergers, and dissolution; inspect the corporation's books and records; and sue directors and officers for fiduciary duty breaches.[29] In public firms subject to the federal securities laws, shareholders also have the right to make and vote on shareholder proposals, express a view on executive compensation, and receive detailed information about the firm on a regular basis.[30] The prevailing view on corporate purpose, at least as it currently stands under Delaware law, is that directors and officers have a duty to "promote the value of the corporation for the benefit of its stockholders,"[31] or, put differently, that "within the limits of their discretion, [they] must make stockholder welfare their sole end."[32] This precept, often referred to as shareholder primacy, serves as the baseline against which corporate law reformers are pushing back when they

27. *See, e.g.*, Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 161 U. PA. L. REV. 2003, 2004 (2013) ("Many, and possibly most, public companies now embrace a shareholder-centered vision of good corporate governance that emphasizes 'maximizing shareholder value' (typically measured by share price) over all other corporate goals."); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859 (2003) (discussing federal and state law mechanisms for shareholder influence in corporate governance).

28. Matthew T. Bodie, *Employees and the Boundaries of the Corporation*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 1 (2011) (capitalization simplified).

29. *See, e.g.*, ALAN PALMITER, FRANK PARTNOY & ELIZABETH POLLMAN, BUSINESS ORGANIZATIONS: A CONTEMPORARY APPROACH 399-536 (3d ed. 2019).

30. *Id.* at 447-541.

31. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010).

32. *See* Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768 (2015). For analyses of corporate purpose affirming this view following the 2019 Business Roundtable Statement, see Edward B. Rock, *For Whom Is the Corporation Managed in 2020?: The Debate over Corporate Purpose*, 76 BUS. LAW. (forthcoming Spring 2021); Stephen M. Bainbridge, *Making Sense of the Business Roundtable's Reversal on Corporate Purpose* (UCLA Sch. of L., L. & Econ., Working Paper No. 20-03, 2020), http://ssrn.com/abstract=3664078; Bebchuk & Tallarita, *supra* note 7.

seek to expand corporate purpose to include the interests of employees and other stakeholders.

The traditional primacy of shareholder concerns in corporate law has also been reflected in the development trajectory of the federal securities disclosure regime. Until 2018, public companies were not required to disclose any specific information about their non-executive workforce apart from a single datapoint—the total number of employees.[33] In 2018, more than eight decades after the inception of the disclosure regime, public companies were for the first time required to disclose minimal information about non-executive compensation through the CEO-median worker pay ratio.[34] This was followed in 2020 by a mandate to disclose certain information about HCM practices, in an open-ended manner and only to the extent deemed material.[35] On the one hand, these are positive signs that workers' visibility in corporate filings is increasing, but, on the other, they also highlight the still-limited nature of workforce disclosure compared to disclosure pertaining to other matters.

The unique status of shareholders in the governance structure is often explained by referencing contractarian theories of the firm, which enjoy substantial, though not universal, acceptance in corporate law. Under the basic contractarian model, the firm is a "nexus of contracts" among the various participants in the corporate enterprise, including shareholders, managers, employees, creditors, suppliers, customers, and others.[36] In the ordinary course, the relevant contracts give each of these parties—except shareholders—a fixed claim on the firm's assets. Shareholders are said to be the only residual claimants, and, hence, they arguably have the right set of incentives to act to maximize the firm's

33. Regulation S-K, Item 101(c)(xiii), 17 C.F.R. § 229.101(c)(xiii) (2018) (requiring firms to disclose "[t]he number of persons employed" by them). To be sure, under particular circumstances workforce information may be captured in other disclosure rubrics of Regulation S-K, such as the MD&A.

34. *See* Steven A. Bank & George S. Georgiev, *Securities Disclosure as Soundbite: The Case of CEO Pay Ratios*, 60 B.C. L. REV. 1123, 1126 (2019). Specifically, Section 953(b) of the Dodd-Frank Act requires public companies to calculate and disclose: (a) the annual total compensation of the median worker; (b) the annual total compensation of the CEO; and (c) the ratio of the two. *Id.* at 1136-37.

35. *See* discussion *infra* subpart III.B.5.

36. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976) (presenting the now-classic formulation of the nexus of contracts model); *see also* Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 656-62 (2006) (summarizing the application of the nexus of contracts model to corporate law).

value.[37] According to contractarian theories, this explains why corporate law gives shareholders—and only shareholders—decision rights, information rights, and litigation rights, and, even more, why it is efficient to do so.[38] In this framework, the relationship between employees and the firm is strictly contractual and thus outside the scope of corporate law. The basic contractarian model has been subject to numerous elaborations as well as numerous critiques, including for its inaccurate (or, at least, oversimplistic) treatment of employees as fixed claimants.[39] Irrespective of its accuracy or normative validity, however, this model remains the most commonplace explanation for workers' absence from the control structures of the firm.

To be sure, the fact that workers are not *formally* embedded in U.S. corporate governance structures does not mean that they could never affect corporate decisionmaking on an ad hoc basis through informal means, including labor strikes, legislative and media advocacy, or litigation. Such mechanisms, however, are diffuse and, generally, ineffectual.[40] Relatedly, there is a distinction between employee participation in corporate governance, which is at issue here, and so-called "operational participation"—a phenomenon whereby employees have a say on various operational issues related to improving productivity and working conditions.[41] Operational participation is not uncommon in the United States, but it is qualitatively different from participation in corporate governance, which pertains to economic and strategic matters.[42] Finally, it is worth

37. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 63-67 (1991).

38. *Id.*

39. *See infra* notes 89-90 and accompanying text (noting argument that employees are best viewed as residual claimants like shareholders).

40. The challenges associated with influencing corporate governance through such mechanisms stem from the well-documented decline of the labor movement over the course of the 20th century. *See, e.g.*, Kate Andrias, *The New Labor Law*, 126 YALE L.J. 2, 5 (2016) (discussing the decline of labor's power). Firms where employees hold disproportionate leverage by virtue of skill scarcity, such as those in the high-tech sector, may offer a limited exception, but even there, employee activism has been driven by specific hot-button issues, without an accompanying push for more formal employee representation in governance. *See, e.g.*, Jennifer S. Fan, *Employees as Regulators: The New Private Ordering in High Technology Companies*, 2019 UTAH L. REV. 973, 977-79, 988 (2019) (discussing the extent and limits of high-tech employee activism).

41. *See, e.g.*, Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 684 (1996) (defining operational participation and noting its widespread nature).

42. *Id.* at 686 (distinguishing between operational participation and strategic participation).

noting that there have been isolated instances of employees (or employee representatives) serving on U.S. corporate boards in the past. Those situations, however, have arisen through private ordering, under unique circumstances, and outside any statutory framework.[43]

B. Labor-Focused Reform Initiatives

The arrangements described in subpart II.A have been subject to regular and intensifying criticism. Over the years—and long before the rise of the HCM movement in the mid-2010s—academics, policymakers, and activists have offered various proposals for refashioning the traditional relationship between labor and capital under U.S. corporate law. Some of these have focused on changing the ends of corporate governance (i.e., corporate purpose) for the benefit of workers, whereas others have sought to change the means of corporate governance by giving workers certain governance rights. Within the large universe of historical reform proposals, it is possible to identify the contours of at least three distinct and coherent labor-focused reform agendas. These include what I call a worker empowerment agenda, a worker-shareholder agenda, and a stakeholder primacy agenda.[44] Despite sharing strong thematic similarities with the novel HCM movement, these older reform agendas differ from it in key respects, which makes them instrumental to understanding what the HCM movement is, and what it is not.[45] As we will see, whereas the reform agendas seek to *redefine* the existing legal and institutional arrangements, the HCM movement operates firmly *within* the existing framework. In addition, the reform agendas remain largely aspirational despite a long history, whereas the brand-new HCM movement has gained significant traction in the span of just a few years.

1. Worker Empowerment Agenda

There have been a variety of proposals over the years to elevate the role of workers in the decisionmaking and oversight structures of the corporation. In effect, these proposals have sought to empower

43. *See, e.g.*, Ewan McGaughey, *Democracy in America at Work: The History of Labor's Vote in Corporate Governance*, 42 SEATTLE U. L. REV. 697, 701-45 (2019) (discussing the history of U.S. experimentation with workers on boards).

44. As with most taxonomies of socio-legal phenomena, there is no absolute separation between categories, and some of the reform agendas discussed here share areas of overlap.

45. *See* discussion *infra* subpart III.D.1 (discussing the HCM movement in historical perspective).

workers by giving them many of the rights currently enjoyed by shareholders alone, such as decision rights (e.g., director appointment rights, consultation rights, veto rights, and other rights),[46] litigation rights (stemming from proposed fiduciary duties owed to workers),[47] information rights (federal disclosure provisions, antifraud protections, and intra-firm information sharing),[48] and economic rights.[49] Many of these proposals arose in the aftermath of the leveraged buyouts of the 1980s, which greatly benefitted shareholders while hurting the economic standing of workers, and which led to a stronger focus on constituent concerns within corporate law discourse.[50] The proposals

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46. *See* BLAIR, OWNERSHIP AND CONTROL, *supra* note 18, at 326-30 (proposing employee representation on boards and other means of facilitating employee participation in governance); Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L., BUS. & FIN. 334, 339-41 (2008) (arguing for employee primacy in corporate decisionmaking and considering different options of employee control); Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 904 (1993) [hereinafter O'Connor, *Reconceptualizing Corporate Law*] (proposing that "[d]irectors [should] owe fiduciary obligations to employees, including the duty to provide information and consult with them about strategic decisions that affect job security and working conditions").

47. *See* Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1189, 1235-46 (1991) (arguing that "directors should owe employees a fiduciary duty to provide adequate severance pay, job retraining, and other benefits to ease the transition dislocated workers face"); O'Connor, *Reconceptualizing Corporate Law*, *supra* note 46, at 954-57 (advocating for broad legally-enforceable fiduciary duties).

48. *See* Cynthia Estlund, *Just the Facts: The Case for Workplace Transparency*, 63 STAN. L. REV. 351, 364-69 (2011) (advocating for a mandatory disclosure regime covering information related to terms and conditions of employment); Kent Greenfield, *The Unjustified Absence of Federal Fraud Protection in the Labor Market*, 107 YALE L.J. 715, 785 (1997) (advocating for antifraud liability for false or materially misleading corporate statements made "in connection with the offering or provision of employment, the negotiation of the terms of an employment relation, or the offering or continuing provision of employment benefits"); Matthew T. Bodie, *Aligning Incentives with Equity: Employee Stock Options and Rule 10b-5*, 88 IOWA L. REV. 539, 543 (2003) (advocating for antifraud protections under Rule 10b-5 for employees who receive stock options through company-wide plans); O'Connor, *Reconceptualizing Corporate Law*, *supra* note 46 (advocating for director duties to provide information to employees in respect of strategic decisions).

49. *See, e.g.*, BLAIR, OWNERSHIP AND CONTROL, *supra* note 18, at 328-30 (recommending that firms give explicit residual income and control rights to employees by replacing part of their fixed compensation with restricted voting stock); Margaret M. Blair, Douglas L. Kruse & Joseph R. Blasi, *Employee Ownership: An Unstable Form or a Stabilizing Force?*, *in* THE NEW RELATIONSHIP: HUMAN CAPITAL IN THE AMERICAN CORPORATION 241, 246-51 (Margaret M. Blair & Thomas A. Kochan eds., 2000) (summarizing theoretical arguments and policy proposals related to employee ownership).

50. *See, e.g.*, William W. Bratton, *The Separation of Corporate Law and Social Welfare*, 74 WASH. & LEE L. REV. 767, 780–81 (2017) (noting the wealth transfer from workers to shareholders during the 1980s and the accompanying shift from general concerns about social responsibility to constituent concerns in progressive critiques of corporate law).

comprising the worker empowerment agenda share an interest in transforming the mechanisms of corporate governance by increasing the relative power of employees vis-à-vis shareholders—with the expectation that this would in turn lead to the reallocation of some of the firm's surplus from shareholders to workers. None of these proposals have come to pass, but some of them, such as the idea of employee representation on corporate boards, garnered renewed political support in the late 2010s.[51]

2. Worker-Shareholder Agenda

The sizeable amount of financial capital represented by workers' retirement savings is another mechanism through which labor can influence corporate governance. Here, workers act in their capacity not as workers but as shareholders, and they use the various powers afforded to shareholders to push for labor-friendly corporate policies. These may include substantive policies aimed at protecting jobs or creating new ones, governance changes that might make such initiatives easier to put forward, or policies believed to maximize the long-term value of the firm in the interest of pension fund beneficiaries.[52] The basic logic underlying this channel for exerting influence is sound and, indeed, intuitive: labor's capital should be used to advance labor's interests.[53] Nevertheless, even though labor union

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51. *See* Press Release, Off. of Sen. Elizabeth Warren, Warren Introduces Accountable Capitalism Act (Aug. 15, 2018), https://www.warren.senate.gov/newsroom/press-releases/warren-introduces-accountable-capitalism-act [https://perma.cc/US28-SNXZ] (proposing that employees be given the power to elect 40% of directors in large public corporations); Press Release, Off. of Sen. Tammy Baldwin, U.S. Senator Tammy Baldwin Reintroduces Legislation to Rein in Stock Buybacks and Give Workers a Voice on Corporate Boards (Mar. 27, 2019), https://www.baldwin.senate.gov/press-releases/reward-work-act-2019 [https://perma.cc/WCK3-2L7F] (proposing the Reward Work Act, which would give employees the power to elect one-third of directors in large public companies); *Corporate Accountability and Democracy*, BERNIESANDERS.COM, https://berniesanders.com/issues/corporate-accountability-and-democracy [https://perma.cc/MZ6F-C3JT] (last visited Mar. 20, 2021) (proposing that employees be given the power to elect 45% of directors in large public companies).

52. The corporate governance tools used to exert influence include say-on-pay voting, shareholder proposals related to executive and non-executive pay, and serving as a lead plaintiff in shareholder lawsuits. *See* David H. Webber & Michael A. McCarthy, *Is Labor's Future in Labor's Capital? A Debate*, LPE PROJECT (June 12, 2019), https://lpeproject.org/blog/is-labors-future-in-labors-capital-a-debate [https://perma.cc/FY5L-CXFN].

53. *See* DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON (2018); *see also* Anne Tucker, *The Citizen Shareholder: Modernizing the Agency Paradigm to Reflect How and Why a Majority of Americans Invest in the Market*, 35 SEATTLE U. L. REV. 1299 (2012) (arguing for the reconceptualization of shareholder identity

pension funds and other labor-affiliated investment funds have long been active in corporate governance, they have traditionally been most successful when making garden-variety corporate governance proposals, which attract support from other shareholders, rather than narrower labor-related proposals.[54] The very availability of SEC Rule 14a-8 has been highly variable over the years, from occasional prohibitions on shareholder proposals concerning employee directors,[55] to the outright prohibition on all "employment-related" shareholder proposals pursuant to the 1992 Cracker Barrel no-action letter (subsequently repealed),[56] to the frequent blocking of individual labor-related proposals (including, for example, recent proposals dealing with minimum wage and occupational health and safety matters),[57] to the successful campaign to raise eligibility and resubmission thresholds for shareholder proposals in 2020.[58] In sum, even though labor advocates have had occasional success when using the tools available to them in their capacity as shareholders, the promise of the worker-shareholder agenda has never been fully realized.

3. Stakeholder Primacy Agenda

As discussed in subpart II.A, the traditional view with respect to corporate purpose is that corporations, particularly in Delaware, ought to maximize shareholder wealth, which in practice means prioritizing shareholders over other constituencies. Unsurprisingly, some of the efforts to protect and promote labor interests within the firm have

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around the notion of a "citizen shareholder," thereby causing firms to take into account broader societal concerns).

54. *See* Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1082-83 (1998).

55. *See, e.g.*, American Telephone & Telegraph Company, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 79,658 (1974) (permitting exclusion of shareholder proposal concerning employee directors because it conflicts with state law).

56. Cracker Barrel Old Country Stores, Inc., SEC No-Action Letter, [1992–1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,418 (Oct. 13, 1992).

57. *See* Best Buy Co. Inc., SEC Response to No-Action Letter Request (Mar. 8, 2016), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/dominisocialbest030816-14a8.pdf [https://perma.cc/9HDJ-P7XW] (permitting exclusion due to the fact that proposal deals with "general compensation matters"); Pilgrims Pride Corp., SEC Response to No-Action Letter Request (Feb. 25, 2016), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/oxfamamerica022516-14a8.pdf [https://perma.cc/C7CB-BWZL] (permitting exclusion on ordinary business grounds of proposal requesting report on certain occupational health and safety matters).

58. Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Amendments to Modernize Shareholder Proposal Rule (Sept. 23, 2020), https://www.sec.gov/news/press-release/2020-220 [https://perma.cc/T46J-BMCK].

focused on replacing the shareholder primacy view of corporate purpose with an alternative that takes into account the interests of all stakeholders, including workers. These efforts, which can be termed a stakeholder primacy agenda, span many decades and have taken a variety of forms: the adoption of constituency statutes in many jurisdictions (though not Delaware);[59] academic arguments that the shareholder primacy norm is not, in fact, mandated by case law or supported by economic theory;[60] and attempts to redefine corporate purpose, either by statute,[61] or through private ordering.[62] Past efforts in this regard have been unsuccessful in changing the status of workers within firms, and it remains to be seen whether current efforts will fare differently. Like the worker empowerment and the worker-shareholder agendas, the stakeholder primacy agenda is a natural point of comparison for any new corporate governance initiative focused on workers; the surprising lack of overlap between the existing agendas and the HCM movement is an important part of understanding the latter.

C. International Counterpoints

The internal logic and consistency of the U.S. corporate governance arrangements described in subpart II.A and the relative lack of traction of the reform agendas discussed in subpart II.B should not be taken to mean that, by definition, corporate governance must be shareholder-centric. A brief look at non-U.S. systems of corporate

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59. *See, e.g.,* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 26-31 (1992); Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973 (2009).

60. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 300-01 (1999) ("To earn the protection of the business judgment rule, directors must show that a challenged decision satisfied three requirements: . . . (3) the directors acted 'in the honest belief that the action taken was in the best interests of the company.' . . . [C]ase law generally interprets the 'best interest of the company' to include nonshareholder interests, including those of employees, creditors, and the community."); LYNN STOUT ET AL., THE MODERN CORPORATION STATEMENT ON COMPANY LAW 2 (2016), https://ssrn.com/abstract=2848833 (statement of over 50 prominent scholars noting that "[c]ontrary to widespread belief, corporate directors generally are not under a legal obligation to maximise profits for their shareholders").

61. Senator Elizabeth Warren's Accountable Capitalism Act would require large firms to obtain a federal charter, which would obligate directors to consider the interests of all stakeholders—shareholders, employees, suppliers, the communities in which the firms operate, and the local and global environment. *See* Accountable Capitalism Act, S. 3348, 115th Cong. (2018).

62. The August 2019 Business Roundtable Statement on Corporate Purpose represents the most visible attempt to do so. *See supra* note 6.

governance illustrates viable alternatives and shows that the complete lack of labor participation in corporate governance in the United States makes it an outlier, particularly when compared to otherwise-similar market economies such as the United Kingdom and the European Union.[63]

The structure and composition of corporate boards is one prominent area of divergence. About half of the member states of the European Union have laws requiring worker representation on boards of directors.[64] The provisions differ substantially across jurisdictions, but in most cases, worker representatives comprise one-third of the board, and those "employee directors" have the same powers to participate in decisionmaking as shareholder-elected directors.[65] The representation of workers is particularly strong in Germany where, pursuant to the longstanding practice of "quasi-parity codetermination," employee-elected directors comprise half the members of the supervisory board of German companies with more than 2,000 German-based employees.[66] This translates into substantial leverage over corporate policy because supervisory board members have a statutory right to veto nominees for the management board and because of norms favoring consensus at the supervisory board level.[67]

Another example of alternative corporate governance arrangements involves the various consultation, information, and approval rights accorded to "works councils" (institutionalized bodies for representative communication between a firm and its employees). These bodies are distinct from labor unions and represent employees

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63. The discussion of non-U.S. corporate governance systems is abridged due to limitations of scope and space. Importantly, the greater level of worker participation and visibility in non-U.S. corporate governance systems does not obviate the role of shareholders. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001) (discussing the international dissipation of U.S. ideas pertaining to the role and status of shareholders). For a comparative account of corporate governance systems, see MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003).

64. *See* ALINE CONCHON, EUR. TRADE UNION INST., WORKERS' VOICE IN CORPORATE GOVERNANCE: A EUROPEAN PERSPECTIVE 6 (2015). This requirement covers both public and private companies in 13 out of 27 countries in the European Union. *Id.*

65. *Id.* at 24; *see also* Jens Dammann & Horst Eidenmueller, *Codetermination: A Poor Fit for U.S. Corporations*, 2020 COLUM. BUS. L. REV. 870, 880 (2021) (providing a survey of board-level codetermination and board structures in selected European countries).

66. *See* REINER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 90-91 (3d ed. 2017). Companies with fewer than 2,000 and more than 500 employees are subject to codetermination under a different law, which provides that one-third of supervisory board members should be elected by employees. *See* Dammann & Eidenmueller, *supra* note 65, at 885-86.

67. *See* KRAAKMAN ET AL., supra note 66, at 91.

on certain governance matters, strategic decisions, and more routine operational issues. All EU countries mandate that employees should have the right to establish works councils.[68] The applicable statutory frameworks differ across countries and include such powers as the right to formally submit the works council's views on matters under consideration at the annual general meeting (Netherlands),[69] or the right to send works council representatives as observers at board meetings and submit resolutions at the annual general meeting (France),[70] among others. The sources of works councils' powers are fragmented, with some deriving from national law and others from various EU legal provisions.[71] Taken together, provisions relating to board composition and works councils enable EU employees to have a voice in governance matters in ways that are not available to U.S. employees; while EU employees certainly do not enjoy decisionmaking parity with shareholders, they do hold more power vis-à-vis shareholders than is the case in the United States.

The United Kingdom, noteworthy because its corporate governance system is on the whole most similar to that of the United States, has in recent years diverged from the U.S. model in this area by moving to expand the role of employees in corporate governance. The 2018 revision of the U.K. Corporate Governance Code identifies the appointment of an employee-designated director as one of several acceptable methods by which boards can fulfill the requirement to engage with the workforce.[72] Contemporaneous amendments to laws

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68. *See Employee Involvement—European Works Councils*, EUR. COMM'N, https://ec.europa.eu/social/main.jsp?catId=707&langId=en&intPageId=211 [https://perma.cc/AED5-2CPM] (last visited Feb. 17, 2021).

69. CONCHON, *supra* note 64, at 25.

70. *Id.* at 21, 25.

71. *See* AOIFE KENNEDY, EUROPEAN PARLIAMENT, WORKERS' RIGHT TO INFORMATION, CONSULTATION AND PARTICIPATION (2019), https://www.europarl.europa.eu/ftu/pdf/en/FTU_2.3.6.pdf [https://perma.cc/7C88-ZKCD]; CONCHON, *supra* note 64.

72. *See* FIN. REPORTING COUNCIL, THE UK CORPORATE GOVERNANCE CODE 5 (2018), https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf [https://perma.cc/ZQ48-M44M]. In addition to a director appointed from the workforce, possible engagement mechanisms include the establishment of a formal workforce advisory panel, designating a non-executive director focused on the workforce, or "alternative arrangements" determined by the company. *Id.* The Corporate Governance Code operates on a comply-or-explain basis. *Id.* at 2. The accompanying guidance document notes that "[a] director appointed from the workforce will bring a workforce view to the boardroom . . . [but] their role is not solely to represent the views of the workforce." FIN. REPORTING COUNCIL, GUIDANCE ON BOARD EFFECTIVENESS 16 (2018), https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF [https://perma.cc/4NKV-JS9U].

applying to large and medium-sized companies require a statement describing any employee empowerment initiatives pursued by the company,[73] and summarizing "how the directors have engaged with employees" and "how the directors have had regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the financial year."[74] Notably, these provisions apply to all companies (both public and private) with more than 250 U.K.-based employees. The 2018 amendments also require large companies (both public and private) to describe with some specificity how they have complied with their obligations under Section 172 of the Companies Act 2006;[75] this provision had already established a director's "duty to promote the success of the company for the benefit of its [shareholders] as a whole, and in doing so have regard (amongst other matters) to . . . (b) the interests of the company's employees."[76] Finally, listed (i.e., public) companies are required to provide information about the pay received by the 25th, 50th, and 75th percentile employee and report the respective CEO pay ratios.[77] Even though the 2018 reforms in their final form were a retreat from the 2016 Green Paper, which had mooted stronger employee representation modalities,[78] they are nevertheless significant because they stand in stark contrast with numerous similar U.K. reform proposals that had failed in the past,[79] and, most relevant for our purposes, with the U.S. model.

73. The relevant provisions are discussed in greater detail in subpart III.D.2. *See infra* note 244 and accompanying text.

74. *See* The Companies (Miscellaneous Reporting) Regulations 2018, SI 2018/860 (UK). The requirements pertaining to engagement with employees are contained in Regulation 13 and amend Part 4 of Schedule 7 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008. *Id.* at Explanatory Note.

75. *Id.* at Regulation 4. This provision, which is referred to as a "Section 172(1) statement," amends the Companies Act 2006. *Id.* at Explanatory Note.

76. Companies Act 2006, c. 46, pt. 10, ch. 2, § 172 (UK), https://www.legislation.gov.uk/ukpga/2006/46/section/172 [https://perma.cc/MME2-2YP2] (capitalization simplified). The relevant provision uses the term "members" instead of "shareholders"; another section of the Act defines members to mean shareholders. *See id.*

77. *See* The Companies (Miscellaneous Reporting) Regulations 2018, SI 2018/860, Explanatory Memorandum ¶ 7.3 (UK).

78. *See* DEPARTMENT FOR BUSINESS, ENERGY & INDUSTRIAL STRATEGY, CORPORATE GOVERNANCE REFORM, 2016, at 38-42 (UK) (discussing stakeholder advisory panels, designated directors, employee representatives on boards, and enhanced reporting requirements as potential reform options).

79. *See* Brian R. Cheffins, *The Rise of Corporate Governance in the UK: When and Why*, 68 CURRENT LEGAL PROBS. 387, 399-404 (2015).

D. *The Concept of Human Capital in Corporate Governance: Two Models*

The final background matter that deserves consideration relates to the concept of human capital itself. Notwithstanding the novelty of the present-day HCM movement in the United States, the concept of human capital is not entirely new to debates about U.S. corporate governance. During the 1990s, proponents of the worker empowerment and stakeholder primacy agendas described in subpart II.B began referencing studies of human capital in making the case for various corporate governance reforms. By that point, the concept of human capital had already gained significant traction in the fields of economics and management science.[80]

Importantly, the nexus between human capital and corporate governance is not readily apparent—any discussion of the matter must embrace, at least implicitly, a theoretical model. A close look at the academic literature and policy debates since the 1990s discerns two such models: one conceptualizing workers as assets, and one conceptualizing workers as investors of human capital. Even though these models are not mutually exclusive, they differ in how they view the appropriate role and status of workers in the corporate enterprise. As we will see in Part III, participants in the HCM movement have leaned much more heavily on the workers-as-assets model, an insight with important analytical and normative implications.

1. Workers as Assets

This model relies on the analogy between the productive capacity of physical assets, such as buildings, machinery, land, office equipment, furniture, and vehicles (usually referred to as "property, plant, and equipment"), and the productive capacity of the human capital embodied in the firm's employees. Traditionally, physical assets have been the primary focus of board oversight and monitoring, firms'

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80. The figure who most contributed to the early theoretical development of the concept of human capital in economics was University of Chicago economist Gary Becker. Receiving the 1992 Nobel Prize in Economics gave his work on human capital additional recognition and exposure. *See* Press Release, The Nobel Prize, The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 1992 (Oct. 13, 1992), https://www.nobelprize.org/prizes/economic-sciences/1992/press-release [https://perma.cc/Z32B-3YVV] (noting that Becker's "most noteworthy contribution is perhaps to be found in the area of human capital, i.e., human competence, and the consequences of investments in human competence").

internal accounting systems, and their externally facing financial statements and disclosure reports.[81] Structural changes in the economy over time highlighted the importance of employees' skills and knowledge to the success of the firm, which, in turn, contributed to a view that workers (or, more precisely, the human capital embodied in them) should be viewed as assets, similar to other assets of growing importance, such as intellectual property.[82] Despite its somewhat shaky conceptual foundations,[83] the workers-as-assets view appealed to common-sense intuitions and quickly entered policy debates and the broader public domain.[84] It also led even more firms to begin incorporating into their corporate disclosure and broader communication efforts the now-trite proclamation that employees are their "most important" or "most valuable" assets.[85] Corporate governance reform proposals from the 1990s used the workers-as-assets idea in two ways: to argue, broadly, for increased attention to employees as actors within corporate governance because of the

81. The strict distinction between physical capital and what we today call human capital was the result of a fork in the road in the development of economics as a discipline. According to Theodore Schultz, neoclassical economist Irving Fisher's work on economic theory in the late 19th century "clearly and cogently presented an all-inclusive concept of capital," but subsequent dominant approaches, most notably the work of Alfred Marshall and his followers, drew a more formal dividing line, not because of a rigorous theoretical justification but mostly because physical capital was easier to quantify and analyze. *See* Theodore W. Schultz, *Investment in Man: An Economist's View*, 33 SOC. SERV. REV. 109, 111-12 (1959). Marshall wrote: "Regarded from an abstract and mathematical point of view, [Fisher's] position is incontestable. But he seems to take too little account of the necessity for keeping realistic discussions in touch with the language of the marketplace." *Id.* at 111 (quoting ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 787-88 (8th ed. 1930)).

82. *See, e.g.*, Margaret M. Blair & Thomas A. Kochan, *Introduction*, *in* THE NEW RELATIONSHIP: HUMAN CAPITAL IN THE AMERICAN CORPORATION 1, 1-2 (Margaret M. Blair & Thomas A. Kochan eds., 2000) (noting that by 1998 the book value of the physical assets of public corporations represented only 31% of their enterprise value, compared with 83% in 1978, and attributing the difference to the rise of intangible assets).

83. It is true that human capital has a productive capacity, similar to physical assets, but human capital is unlike other assets in that it is not capable of being owned by anyone other than the person in whom it is embodied. Moreover, traditional assets are passive, whereas workers have agency. Human capital also fails the technical definition of an asset employed by financial accounting. *See infra* notes 345-346 and accompanying text.

84. *See* DAVENPORT, *supra* note 17, at 4 ("'Workers are assets' has become the dominant metaphor of late twentieth-century management."). Going even further, *Business Week*, in a special issue on "The 21st Century Corporation" published in August 2000, proclaimed that "[h]uman capital is the only asset." *The 21st Century Corporation*, BUS. WEEK, Aug. 28, 2000, at 278.

85. *See, e.g.*, Teresa Amabile & Steve Kramer, *Valuing Your Most Valuable Assets*, HARV. BUS. REV. (Oct. 10, 2011), https://hbr.org/2011/10/valuing-your-most-valuable ("Corporate leaders often proclaim that their employees are their most valuable asset. For many people, though, this is an empty platitude.").

importance of the human capital they embody,[86] and, more narrowly, to encourage firms to disclose more information about the value of their human capital assets in the interest of maximizing firm performance and shareholder returns.[87]

2. Workers as Investors of Human Capital

Instead of viewing workers as *productive assets* (akin to physical assets), this model views workers as *investors of human capital*, akin to shareholders who invest financial capital in the firm. Just as shareholders make a firm-specific investment when they purchase stock, so, too, do employees make a firm-specific investment when they enter into an employment relationship. In the case of shareholders, the firm-specific investment is induced and protected through the variety of property and control rights embedded in corporate law. As we have seen, employees do not benefit from such rights.[88] The logic behind existing arrangements has been questioned given employees' firm-specific human capital investment and the fact that they can be viewed as risk-bearing residual claimants alongside shareholders.[89]

These theoretical insights were developed primarily by Margaret Blair, who has argued for various corporate governance reforms that treat human capital investors (i.e., workers) more like financial capital investors (shareholders) in order to protect their firm-specific investment.[90] Blair's case for incorporating human capital considerations in corporate governance is strengthened further by recognizing that employees are differently vulnerable compared to shareholders or other stakeholders (including bondholders).[91] Unlike

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86. *See, e.g.*, Margaret M. Blair & Mark J. Roe, *Introduction*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 1 (Margaret M. Blair & Mark J. Roe eds., 1999) (introducing a collection of research papers on the role of employees in corporate governance by noting that "human capital is widely acknowledged to be the most important asset of many firms").

87. *See, e.g.*, BLAIR, OWNERSHIP AND CONTROL, *supra* note 18; O'Connor, *supra* note 18.

88. *See* discussion *supra* subpart II.A.

89. *See* Margaret M. Blair, *Firm-Specific Human Capital and Theories of the Firm*, in EMPLOYEES AND CORPORATE GOVERNANCE 58, 66-67 (Margaret M. Blair & Mark J. Roe eds., 1999).

90. *Id.*

91. Bondholders, also investors of financial capital, are largely absent from the traditional story, but the story's logic can be extended to cover them. Bondholders' firm-specific investments are induced through the promise of a guaranteed return and protected through contractual means. Under the predominant at-will employment model in the United States, workers do not enjoy any income guarantees or meaningful contractual protections in respect of their human capital investment. Both bondholders and employees enjoy certain

shareholders and bondholders, employees are incapable of risk-mitigation through diversification, since they generally invest their human capital in only one firm at a time. Moreover, unlike the return on financial capital, the return on investment of firm-specific human capital is substantially lower outside the firm than within it.[92]

Viewing workers as human capital investors also has other, more modest implications for corporate governance. In a resource-constrained environment, being able to attract and retain human capital is an important part of a firm's competitive strategy.[93] This strategic imperative is sometimes described as a "war for talent."[94] The task then becomes to devise internal governance structures that recognize the importance of making the workplace as attractive to human capital investors as possible. Consequently, the workers-as-human capital investors model appears more normatively appealing, at least at first blush, than the workers-as-assets model. But the model's analytical reach is also potentially more limited. For one, it assumes the existence of competitive labor markets where workers have multiple employment opportunities—an assumption that has been called into question by recent empirical studies.[95] In addition, the model is a much better fit for high-skill workers, who can be conceptualized as high net-worth human capital investors, than it is for lower-skilled workers, whose labor inputs are undifferentiated and more abundant.

III. THE HUMAN CAPITAL MANAGEMENT MOVEMENT

After examining the traditional roles of capital and labor in the modern U.S. corporation, the history of past labor-focused reform efforts, and the use of the concept of human capital in corporate governance, the Article now turns to the HCM movement itself. This Part presents a detailed and original analytical account of the broad set of initiatives in support of investor-facing HCM disclosure and board-

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statutory protections under federal law through, respectively, the Trust Indenture Act and various labor laws.

92. *See, e.g.*, Louis S. Jacobson et al., *Earnings Losses of Displaced Workers*, 83 AM. ECON. REV. 685, 705 (1993) (reporting an approximately 20% drop in long-term earnings of displaced manufacturing and non-manufacturing workers who find new jobs in the same industry and indicating that "a substantial portion of [the] earnings losses result from the loss of some highly firm-specific component of earnings"). The findings of this classic study have been replicated in subsequent research.

93. *See* DAVENPORT, *supra* note 17, at 7-16.

94. *See, e.g.*, ED MICHAELS ET AL., THE WAR FOR TALENT 1-6 (2001) (emphasizing the strategic importance of human capital for firm performance).

95. *See infra* note 255 and accompanying text.

level oversight of HCM matters. The exploration of the HCM movement proceeds in five stages: (A) an overview of the movement and select definitions of the term "human capital management"; (B) a comprehensive account of the myriad of private, regulatory, and legislative initiatives—pulled together for the first time here—that comprise the HCM movement; (C) a discussion of the HCM movement's key features; (D) a discussion of the HCM movement in historical and comparative perspective; and (E) an attempt at explaining the HCM movement's swift rise and broad uptake over the course of just a few years. Relatedly, the Appendix contains a table summarizing the primary HCM categories according to the organizations that have been most active in the HCM space.

A. Overview and Definitions

Human capital management is an expansive concept that can accommodate virtually any issue related to the workforce. This attribute makes HCM a very useful shorthand for the multitude of employee-related matters, both narrow and broad, that arise within modern firms, but it can also render the concept unwieldy and difficult to define. Perhaps conscious of this difficulty, the SEC declined to put forward a definition of HCM during the rulemaking process that resulted in the adoption of an HCM disclosure requirement in August 2020.[96] For us, a useful starting point to understanding HCM would be to look at general definitions as well as the specific mix of categories, issues, and metrics that different organizations include as part of HCM.

As noted in Part I, according to SASB's definition, HCM "addresses the management of a company's human resources (employees and individual contractors) as key assets to delivering long-term value."[97] SASB goes on to note that HCM "includes issues [such as labor practices, employee health and safety, and employee engagement, diversity and inclusion] that affect the productivity of employees, management of labor relations, and management of the health and safety of employees, and the ability to create a safety culture."[98] The Conference Board offers a different articulation that covers similar ground: "HCM is how the organization attracts, hires, develops, retains, enables, and engages the entire workforce, including

96. *See infra* note 177 and accompanying text.
97. *SASB Materiality Map*, *supra* note 13.
98. *Id.*

full-time and part-time employees, contractors, freelancers, and crowdsourced workers. It is how human capital is managed in concert with other resources to execute the organization's business model."[99] These definitions suggest that the introduction of HCM into corporate governance is premised on the ability to improve the firm's economic performance through greater transparency of workforce practices and the appropriate valuation and management of human capital as a strategic resource.

HCM can refer to compensation and employee retention issues, such as workforce pay, promotion opportunities, gender pay equity, and employees' ability to participate in stock purchase programs. In addition, HCM may cover effective employee policies, such as business codes of conduct, whistleblower policies, equal employment opportunity policies, health and safety guidelines, diversity and inclusion, and training and development programs to encourage employee engagement and wellness. HCM also deals with various issues of corporate culture. Some organizations define HCM to include matters of human rights and labor issues within the supply chain. Different organizations generally include a different mix of indicators and metrics; in some cases, these apply across the board, whereas in other cases they are industry-specific. The table in the Appendix summarizes the categories used by the various participants in the HCM movement discussed in the following subpart.

Before proceeding to the detailed presentation of the developments that comprise the HCM movement, a note regarding terminology is in order. In some areas of law, the term "movement" carries specific meaning stemming from the rich literature on law and *social* movements.[100] Labeling a phenomenon as a social movement has certain epistemic consequences, and as a result, there is often debate on whether or not the label fits a particular set of

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99. PAUL WASHINGTON ET AL., THE CONF. BD., BRAVE NEW WORLD: CREATING LONG-TERM VALUE THROUGH HUMAN CAPITAL MANAGEMENT AND DISCLOSURE 3, 5 (2021) [hereinafter CONFERENCE BOARD REPORT], https://www.conference-board.org/research/brave-new-world [https://perma.cc/V36B-LM2F] ("[HCM] is not a passing fad: Boards and management should devote sustained time and attention to evaluating their firm's human capital capabilities, needs, and performance, including developing a human capital strategy that supports the company's broader business strategy.").

100. *See* Angela M. Banks, *Challenging Political Boundaries in Post-Conflict States*, 29 U. PA. J. INT'L L. 105, 133 n.98 (2007) (providing an overview of scholarly understandings of the term "social movement").

developments.[101] To be clear, no argument is made that the HCM movement represents a *social* movement. Instead, I use the term "movement" in its common meaning to denote concerted, loosely-coordinated, and mutually-reinforcing actions by multiple different actors to bring about a particular change in policy and practice. The actors here include institutional investors, board advisors, regulators, legislators, and standard-setters; the change is to incorporate HCM considerations into corporate governance. In this sense, the HCM movement resembles other corporate governance phenomena that have been described as movements by commentators, such as the director independence movement,[102] the shareholder empowerment movement,[103] the pay-for-performance movement,[104] and the corporate social responsibility movement.[105]

B. *The HCM Movement's Elements and Manifestations*

This subpart presents a textured description of the HCM movement drawing on both qualitative and, where available, quantitative evidence. The full suite of distinct, mutually-reinforcing

101. *See, e.g.*, Tomiko Brown-Nagin, *"One of These Things Does Not Belong": Intellectual Property and Collective Action Across Boundaries*, 117 YALE L.J. POCKET PART 280 (2008), http://yalelawjournal.org/forum/qone-of-these-things-does-not-belong-intellectual-property-and-collective-action-across-boundaries [https://perma.cc/H4BR-Y77S] (questioning whether "access to knowledge" is a "[social] movement, mobilization, or interest group"); Amy Kapczynski, *Linking Ideas to Outcomes: A Response*, 117 YALE L.J. POCKET PART 289, 292 (2008), https://www.yalelawjournal.org/pdf/698_sfbju5k9.pdf [https://perma.cc/YC8S-CX8K] (justifying the application of the social movement label to "access to knowledge" activism).

102. *See, e.g.*, Roberta S. Karmel, *Is the Independent Director Model Broken?*, 37 SEATTLE U. L. REV. 775, 780 (2014) (noting that "the independent director movement did not usher in an era of corporate accountability").

103. *See, e.g.*, Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1928 (2013) (identifying a "'shareholder empowerment' movement [that] began to pick up steam" in the early 1990s).

104. *See, e.g.*, Frederick Tung, *Pay for Banker Performance: Structuring Executive Compensation for Risk Regulation*, 105 NW. U. L. REV. 1205, 1217 (2011) ("The pay-for-performance movement of the 1990s led boards of directors and their compensation consultants to adopt equity-based compensation schemes.").

105. *See, e.g.*, John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 1 (2005) (stating that "[o]ne of the most striking developments in the business world over the last decade has been the emergence of a coherent and energetic 'corporate social responsibility' (CSR) movement"); *see also* Omari Scott Simmons, *Chancery's Greatest Decision: Historical Insights on Civil Rights and the Future of Shareholder Activism*, 76 WASH. & LEE L. REV. 1259, 1304 (2019) (setting out questions about shareholder activism and civil rights that ought to be considered with respect to the "ESG movement").

developments that comprise the HCM movement have not been analyzed together in the academic literature or the general corporate governance literature to date. These developments include initiatives by institutional investors and asset managers, various changes in board-level governance, voluntary HCM reporting undertaken by firms, SEC rulemaking in respect of HCM disclosure, legislative efforts seeking to mandate HCM disclosure, private standard-setting initiatives in respect of HCM disclosure from domestic and international organizations, and prescriptive statements from board advisors drawing firms' attention to the importance of board-level HCM oversight.

1. Investor Initiatives: HCM as an Engagement Priority

Firm-shareholder engagement—regularized interactions and exchange of information between firms' management teams and boards, on the one hand, and shareholders, on the other, is an established part of today's corporate governance landscape, even though in its present form it dates back only to the early 2010s.[106] BlackRock in particular has made frequent use of the practice through the annual open letters of its outspoken CEO, Larry Fink, as well as through the periodic release of detailed engagement priorities and proxy voting guidelines.[107] This kind of firm-shareholder engagement constitutes one of the earliest and most visible manifestations of the HCM movement.

HCM first emerged as an area of focus for BlackRock in 2017. In his letter to CEOs released in January 2017, Larry Fink touched on

106. *See* Deloitte, *Shareholder Engagement: A New Era in Corporate Governance*, WALL ST. J.: CFO J. (Oct. 1, 2013), https://deloitte.wsj.com/cfo/2013/10/04/shareholder-engagement-a-new-era-in-corporate-governance [https://perma.cc/4EEQ-HH78] (describing shareholder engagement as the beginning of a "new era" in corporate governance). Initially, firm-shareholder engagement was primarily a tool for dealing with activist shareholders, but the rise of the "big three" asset managers changed that. *See* TREVOR NORWITZ ET AL., LEXIS PRAC. ADVISOR, MARKET TRENDS: PROXY ENHANCEMENTS 7 (2018). According to Equilar, the share of S&P 100 firms disclosing such engagement in their proxy statements rose from 12% in 2012 to 63% in 2016. *See* David McCann, *The Growing Importance of Proxies*, CFO (Feb. 10, 2017), https://www.cfo.com/governance/2017/02/growing-importance-proxies [https://perma.cc/A7MU-SV76].

107. *See* Larry Fink, *Larry Fink's 2012 Letter to CEOs*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2012-larry-fink-ceo-letter [https://perma.cc/E26U-3A9U] (last visited Mar. 20, 2021) (setting out BlackRock's approach to "corporate governance and responsible investing" and highlighting the importance of firm-shareholder engagement); *see also* John C. Wilcox, *Getting Along with Blackrock*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov.6, 2017), https://corpgov.law.harvard.edu/2017/11/06/getting-along-with-blackrock [https://perma.cc/UY79-UBXD] (analyzing BlackRock's approach, focus on sustainability, and significant influence as a global shareholder).

many issues that fall within the scope of HCM.[108] For example, Fink argued that firms must "fulfill their responsibilities to their employees" by improving internal training and education so that employees can leap over the "skills gap" and increase their earnings potential, thereby "helping the employee who once operated a machine learn to program it."[109] In addition, Fink suggested that "companies must lend their voice to developing a more secure retirement system for all workers, including the millions of workers . . . not covered by employer-provided plans," and assist employees in building financial literacy in preparation for retirement.[110] Because of BlackRock's stature and the widespread publicity that accompanies Fink's letters, this was the most prominent worker-focused pronouncement from the mainstream shareholder community in some time. Each of Fink's annual letters since 2017 has maintained the spotlight on HCM topics; in terms of prominence, HCM has ranked second only to concerns related to climate change.[111]

BlackRock's statement of engagement priorities for 2017-2018, released just two months after Fink's 2017 letter, noted that it had added "developing areas like climate risk and human capital management" to the traditional areas of engagement such as governance, strategy, and compensation.[112] This statement provided an insight into BlackRock's early thinking on HCM:

> BlackRock believes creating an engaged and stable workforce is a competitive advantage, particularly given the current talent-constrained environment. BlackRock views a company's approach to human capital management, employee development, diversity and commitment to equal employment opportunity, health and safety, labor relations and

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108. *See* Larry Fink, *Larry Fink's 2017 Letter to CEOs*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2017-larry-fink-ceo-letter [https://perma.cc/8Z8M-9H47] (last visited Mar. 20, 2021).

109. *Id.*

110. *Id.*

111. *See, e.g.*, Larry Fink, *Larry Fink's 2018 Letter to CEOs*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter [https://perma.cc/GLS6-NDMB] (last visited Mar. 20, 2021) ("Are we working to create a diverse workforce? Are we adapting to technological change? Are we providing the retraining and opportunities that our employees and our business will need to adjust to an increasingly automated world? Are we using behavioral finance and other tools to prepare workers for retirement, so that they invest in a way that will help them achieve their goals?").

112. *See* Abe Friedman & Robert McCormick, *BlackRock's 2017-2018 Engagement Priorities*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 17, 2017), https://corpgov.law.harvard.edu/2017/03/17/blackrocks-2017-2018-engagement-priorities [https://perma.cc/W6LB-H987].

> supply chain labor standards, among other topics, as a window into the company's culture, operational risk management practices and quality of its board oversight. In engagement, BlackRock will ask how boards oversee and work with management to improve performance in these areas.[113]

In a statement of engagement priorities issued in 2018, BlackRock provided a much more extensive treatment of HCM: the asset manager elaborated on why it considers HCM an investment issue and encouraged firms to be more forthcoming with HCM information, both qualitative and quantitative.[114] In addition, the 2018 statement listed a range of HCM topics of particular interest to BlackRock, with a separate set of engagement topics for boards and management teams, which stand out for their detailed and specific nature.[115] Engagement priorities issued in subsequent years have carried on the trend toward greater specificity.[116]

There has been a subtle but important evolution in BlackRock's approach to HCM (and, indeed, corporate governance) between 2017 and 2021. Instead of *encouraging* boards to focus on HCM by putting forward engagement priorities, which are usually framed as questions for discussion, BlackRock now announces its *affirmative expectations* for boards to do so: "Given most companies identify their employees as their greatest asset, we expect boards to oversee human capital management strategies."[117] In addition, BlackRock states that it will "hold members of the relevant [board] committee, or the most senior non-executive director, accountable" for lack of disclosure of the board's role in overseeing the firm's HCM practices.[118] This escalation in BlackRock's position has contributed to consequential changes in

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113. *Id.*

114. *See* Michelle Edkins, *BlackRock Investment Stewardship's Approach to Engagement on Human Capital Management*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 28, 2018), https://corpgov.law.harvard.edu/2018/03/28/blackrock-investment-stewardships-approach-to-engagement-on-human-capital-management/ [https://perma.cc/7MFP-D28Z].

115. *Id.*

116. BLACKROCK, INVESTMENT STEWARDSHIP'S APPROACH TO ENGAGEMENT ON HUMAN CAPITAL MANAGEMENT (2020), https://www.blackrock.com/corporate/literature/publication/blk-commentary-engagement-on-human-capital.pdf [https://perma.cc/69EE-PHCV].

117. *Investment Stewardship*, BLACKROCK, https://www.blackrock.com/corporate/about-us/investment-stewardship#engagement-priorities [https://perma.cc/Q9Q6-KZ2Z] (last visited Feb. 28, 2021).

118. *Id.*

board practices, discussed in subpart III.B.3 below, which in turn comprise another important element of the HCM movement.

While BlackRock remains a leader in terms of emphasis on HCM, its general stance has been copied by State Street and Vanguard, the other members of the "big three" group of asset managers that jointly hold a substantial share of investor capital and exert a powerful influence within corporate governance.[119] State Street discussed HCM in its annual letter to boards in 2019[120] and in 2020 announced that it will vote against the boards of big companies that underperform their peers on ESG matters (including HCM).[121] Vanguard has also noted the importance of HCM engagement.[122] CalPERs, the largest public pension fund in the United States, has made the same point.[123] In a parallel set of developments, HCM issues have also been taken up by a different investor demographic—smaller, pro-social investors who typically seek to influence corporate practices by filing shareholder proposals. An analysis of recent trends indicates that shareholders began to submit a meaningful number of HCM-related proposals in 2018, and that by 2019, those proposals encompassed topics such as

119. Asset managers, or investment managers, hold stakes in companies on behalf of other individual or institutional investors. As such, they are not the ultimate beneficial owners, but they generally exercise the governance and decision rights that are associated with the shares they manage. A study from 2019 found that the Big Three collectively vote about 25% of the shares in all S&P 500 companies; that each holds a position of 5% or more in a vast number of companies; and that the proportion of equities held by index funds has risen dramatically over the past two decades. *See* Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 736 (2019).

120. *See* Cyrus Taraporevala, *2019 Proxy Letter—Aligning Corporate Culture with Long-Term Strategy*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 15, 2019), https://corpgov.law.harvard.edu/2019/01/15/2019-proxy-letter-aligning-corporate-culture-with-long-term-strategy/ [https://perma.cc/5U36-3JFP] (stating that its engagement strategy is focused on corporate culture and that "key issues aligned to corporate culture, such as human capital management; represent important areas for value creation going forward").

121. *See* Robin Wigglesworth, *State Street Vows to Turn Up the Heat on ESG Standards*, FIN. TIMES (Jan. 28, 2020), https://www.ft.com/content/cb1e2684-4152-11ea-a047-eae9bd51ceba. Notably, State Street views SASB's disclosure framework (discussed in subpart III.B.7 *infra*) as "a minimum set of standards that companies should reach." *Id*.

122. *See* Brian Tomlinson & Mark Tulay, *Investor Letter to CEOs: The Strategic Investor Initiative*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 8, 2018), https://corpgov.law.harvard.edu/2018/03/08/investor-letter-to-ceos-the-strategic-investor-initiative [https://perma.cc/N2TK-6MGK] (asking companies to address, as part of the engagement process, how they manage "human capital requirements over the long-term" and how they communicate future HCM efforts to investors).

123. *See, e.g.*, CALPERS, CALPERS' GOVERNANCE & SUSTAINABILITY PRINCIPLES (2019), https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf [https://perma.cc/Y63J-X4LJ] (noting importance of engagement and listing human capital management as a priority).

disclosure of HCM metrics, gender pay equity, and workplace diversity.[124]

2. Investor Initiatives: HCM Rulemaking Petition

Another early and prominent manifestation of the HCM movement appeared in July 2017, just a few months after BlackRock began highlighting the issue. The Human Capital Management Coalition (HCMC), a group of public pension funds with $2.8 trillion in assets under management led by the UAW Retiree Medical Benefits Trust, submitted a rulemaking petition to the SEC asking it to consider adopting disclosure rules related to the knowledge, skills, and engagement of the workforce.[125] The HCMC rulemaking petition stated that "human capital is a company's most valuable asset" and that "stewarding human capital with that in mind will help to preserve and add value."[126] In addition, the HCMC noted a "broad consensus that human capital management is important to the bottom line" and pointed to "a large body of empirical work [showing] that skillful management of human capital is associated with better corporate performance, including better risk mitigation."[127] This, the HCMC argued, rendered HCM "essential to long-term value creation and therefore material to evaluating a company's prospects."[128]

The rulemaking petition focused on several potential topics for disclosure, including workforce demographics, workforce stability, workforce composition, workforce skills and capabilities, workforce compensation and incentives, workforce culture and empowerment, workforce health and safety, workforce productivity, and human rights.[129] It received support from the Council of Institutional Investors,

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124. *See* Marc Treviño, *2019 Proxy Season Review: Part 1—Rule 14a-8 Shareholder Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 26, 2019), https://corpgov.law.harvard.edu/2019/07/26/2019-proxy-season-review-part-1-rule-14a-8-shareholder-proposals [https://perma.cc/MQ76-VCHV]. Interestingly, more than half (55.6%) of the submitted proposals were voted on, meaning that firms either did not attempt to obtain or, more likely, were unsuccessful in obtaining SEC no-action relief that would have allowed them to exclude the proposals from the proxy statement. *Id*.

125. *See* Letter from Meredith Miller, Human Capital Mgmt. Coal., to William Hinman, Dir. Corp. Fin., U.S. Sec. & Exch. Comm'n (July 6, 2017) [hereinafter HCMC Petition for SEC Rulemaking], https://www.sec.gov/rules/petitions/2017/petn4-711.pdf [https://perma.cc/VGF9-J2S3].

126. *Id*. at 2.

127. *Id*. at 1.

128. *Id.*

129. *Id.* at 26-27.

a group representing the broad investor community,[130] as well as from a number of large institutional investors.[131] An ESG rulemaking petition submitted in October 2018 by law professors Jill Fisch and Cynthia Williams referenced the HCMC petition and reiterated the case for HCM disclosure.[132]

The HCMC rulemaking petition played an important part in the expansion of the HCM movement. It did not appear in a vacuum: in comment letters submitted in response to the SEC's 2016 Concept Release, some investors had mentioned the importance of disclosure on certain workforce-related topics, alongside a host of other ESG topics.[133] The HCMC petition, however, presented a particularly detailed case for HCM's importance while separating HCM disclosure from disclosure on other ESG topics, thereby prompting more focused consideration of the issue. This gave the SEC's Investor Advisory Committee an occasion to study HCM disclosure and to put forward recommendations, which ultimately contributed to the adoption of the SEC's HCM disclosure rule in August 2020, as discussed in subpart III.B.5 below.

3. Changes in Board-Level Governance

The HCM movement is also reflected in several consequential changes in board governance practices that have occurred since the mid-2010s. To place these changes in context, it is worth remembering that the baseline governance frameworks under both state and federal law make no specific mention of HCM issues.[134] Boards' *Caremark*

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130. *See* Letter from Jeffrey P. Mahoney, Council of Institutional Invs., to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (Oct. 1, 2017), https://www.sec.gov/comments/4-711/4711-2638207-161248.pdf [https://perma.cc/LYQ2-83RH].

131. *See Comments on Rulemaking Petition to Require Issuers to Disclose Information About Their Human Capital Management Policies, Practices and Performance*, SEC. & EXCH. COMM'N, https://www.sec.gov/comments/4-711/4-711.htm [https://perma.cc/UY6E-KQ56] (last visited Mar. 20, 2021).

132. *See* Letter from Cynthia A. Williams, Professor, Osgoode Hall L. Sch., and Jill E. Fisch, Professor, Univ. of Pa. L. Sch., to Brent J. Field, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 1, 2018) [hereinafter 2018 ESG Rulemaking Petition], https://www.sec.gov/rules/petitions/2018/petn4-730.pdf [https://perma.cc/XT4P-K2B8].

133. *See* Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Release No. 33-10668, Exchange Act Release No. 34-86614, 84 Fed. Reg. 44,358, 44,369-70 nn.166-182 (proposed Aug. 23, 2019) (discussing investor feedback in response to the 2016 Concept Release).

134. To be sure, this has never absolved boards from having to consider important issues related to the workforce when such issues arise: a large-scale labor strike, for example, would certainly command board attention, but it would likely do so on a time-limited basis, until the

duties under Delaware law are framed in a general way,[135] and, until recently, the question of whether these duties require oversight of HCM had not been explored. Relatedly, federal corporate governance obligations have traditionally focused the board's attention on corporate executives and executive compensation, not on matters related to rank-and-file employees, through requirements pertaining to the compensation committee and the compensation discussion and analysis (CD&A) section of annual reports.[136]

This blank regulatory backdrop notwithstanding, recent evidence suggests that HCM has emerged as a mainstream board concern through voluntary changes in board practices. The Conference Boards' HCM Oversight Working Group, which includes more than 100 C-suite executives, among others, has identified HCM oversight as an emerging best practice.[137] External board advisors have been sending the same message.[138] The 2021 proxy voting guidelines issued by ISS and Glass Lewis contained expanded references to board oversight over ESG (and, by extension, HCM).[139] Even though board deliberations are confidential and thus unobservable, a survey of 378 public company directors conducted in the fall of 2019—when the HCM movement was well underway but before it had peaked—found that at 40% of covered companies, HCM oversight was a focus of board discussions "regularly (e.g., every board meeting)"; at 30% HCM was "considered in a more embedded way throughout numerous

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issues are resolved. This stands in contrast to a matter such as executive pay, which is structurally embedded in the governance framework through the mandated compensation committee.

135. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (imposing an obligation on directors to implement and oversee "information and reporting systems . . . that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance"). A recent line of *Caremark*-related cases discussed the need for reporting systems focused on "essential and mission critical" compliance risks. *See* Marchand v. Barnhill, 212 A.3d 805, 824 (Del. 2019); *In re* Clovis Oncology Derivative Litig., No. 2017-0222-JRS, 2019 WL 4850188, at *13-15 (Del. Ch. Oct. 1, 2019).

136. *See* Executive Compensation and Related Person Disclosure, Exchange Act. Release Nos. 33-8732A, 34-54302A, 71 Fed. Reg. 53,158 (Sept. 8, 2006) (setting out compensation committee responsibilities for the CD&A report); *Listed Company Manual: § 303A.05 Compensation Committee*, NYSE, https://nyse.wolterskluwer.cloud/listed-company-manual [https://perma.cc/FT5L-QPEG] (last updated Nov. 25, 2009).

137. *See* CONFERENCE BOARD REPORT, *supra* note 99, at 2-3.

138. *See* discussion *infra* subpart III.B.8.

139. *See* Brian V. Breheny et al., *ISS and Glass Lewis Release Updated Proxy Voting Guidelines*, SKADDEN (Dec. 7, 2020), https://www.skadden.com/insights/publications/2020/12/iss-and-glass-lewis-release [https://perma.cc/JN6W-XTAP].

board discussions and decisions"; and at the remainder of the covered companies, it was considered "ad hoc or on an as-needed basis."[140] It appears, therefore, that boards are heeding demands for board oversight of HCM, which may not be surprising given the advice coming from third parties and BlackRock's admonition that it will "hold [boards] accountable" if they fail to do so.[141] Presumably, board oversight of HCM also gives board members familiarity with HCM issues, which enables them to engage with shareholders on HCM matters, another BlackRock demand.

Whereas at least some of the preceding developments have garnered attention, several more technical changes in board practices related to HCM have remained largely under the radar. Two studies shed light on these practices: a 2019 Willis Towers Watson study of the largest 100 public companies by revenue ("Willis study")[142] and a 2020 Shearman & Sterling study of the 100 largest non-controlled public companies ("Shearman study").[143] Five broad trends emerge. First, approximately 40% of the companies analyzed by either study have changed the name of the compensation committee by adding words such as "human resources," "people resources," "personnel," or "talent" in order to reflect a broader scope of responsibilities.[144] Second, firms have been amending their compensation committee charters to reflect an expansion of the committee's remit beyond executive compensation. According to the Willis study, 58% of the charters of the companies in the sample included responsibility for oversight of broad-based compensation and benefit programs, 33% included responsibility for diversity and inclusion programs, and 14%

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140. *See* ERNST & YOUNG, HOW THE GOVERNANCE OF HUMAN CAPITAL AND TALENT IS SHIFTING 1-2 (2020), https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-human-capital-white-paper.pdf [https://perma.cc/CV2Y-EVR3] (capitalization simplified). A question that arises with respect to this and other studies relates to the extent we can discuss trends on the basis of data that in many cases presents board practices as of a single point in time. This is a natural limitation of the survey evidence that is available. What we know about the status quo ante, as well as multiple commentators' observations that practices are "shifting" or "evolving," should serve to allay this otherwise legitimate concern.

141. *See supra* notes 117-118 and accompanying text.

142. *See* Robert Newbury et al., *Compensation Committees & Human Capital Management*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 27, 2019) [hereinafter *Willis Study*], https://corpgov.law.harvard.edu/2019/08/27/compensation-committees-human-capital-management [https://perma.cc/8GS6-KBPM].

143. *See* SHEARMAN & STERLING, CORPORATE GOVERNANCE & EXECUTIVE COMPENSATION SURVEY 2020 (2020) [hereinafter SHEARMAN STUDY], http://digital.shearman.com/corporate-governance/shearmancorpgov-2020 [https://perma.cc/X5U7-MVSF].

144. *Id.* at 29; *Willis Study*, *supra* note 142. Both studies identify this as a new trend.

included responsibility for culture, employee relations, and engagement.[145] The Shearman study analyzed descriptions of the compensation committees' responsibilities (rather than their charters) and found similar trends.[146] Third, in many cases, board committees other than the compensation committee are tasked with "ESG oversight"—an umbrella term, which in a number of companies covers HCM oversight.[147] Fourth, HCM expertise is increasingly sought and valued at the board level. According to the Shearman study, 35% of companies in the sample expressly identify "human capital management" as a skill or area of expertise that is important in the selection of directors.[148] Finally, a significant number of companies now include ESG metrics in the incentive compensation plans for corporate executives, which is noteworthy because traditionally such plans have focused almost exclusively on stock price performance. According to the Shearman study, 32% of incentive plans consider performance in the area of "talent and succession," 31% indicate that "increasing diversity is part of the talent and succession analysis," and 5% include a metric that relates to employee health and safety.[149]

The five trends identified in the preceding paragraph suggest that HCM is becoming hard-wired into a wide array of board practices. To be sure, both the Willis study and the Shearman study have limitations, including a fairly small sample size as well as classification and specification challenges stemming from the inherently broad nature of the HCM concept. Even if some of the precise data points are open to question, however, the studies represent a useful supplement to the qualitative evidence presented throughout this subpart. And, taking all into account, the general direction of travel is unmistakable: whereas

145. *Willis Study*, *supra* note 142.

146. Specifically, the Shearman study found that 13% of companies mentioned talent development or talent management, 10% mentioned human capital or human capital management, 8% mentioned culture, 5% mentioned retention, and 3% mentioned pay equity. SHEARMAN STUDY, *supra* note 143, at 30.

147. According to the Shearman study, 51% of the companies in the sample assign ESG oversight responsibility to the nominating and governance committee, 26% to a public policy/regulatory and compliance/sustainability committee, 7% to a corporate social responsibility committee, and 2% to the audit committee. *Id.* at 60.

148. *Id.* at 55 (capitalization simplified). Pursuant to SEC rules, firms are required to provide information in their proxy statements about "the specific experience, qualifications, attributes or skills" of persons nominated to serve as directors. *See* Proxy Disclosure Enhancements, Exchange Act Release No. 34-61175, 74 Fed. Reg. 68,334, 68,343 (Dec. 23, 2009); Regulation S-K, 17 C.F.R. § 229.401(e) (2017).

149. SHEARMAN STUDY, *supra* note 143, at 25. By comparison, only 6% of incentive compensation plans refer to environmental sustainability. *Id.*

as recently as the early-2010s oversight of HCM issues used to be primarily a management concern, boards are now embracing HCM oversight as one of their core responsibilities.

4. Voluntary Disclosure by Public Companies

In addition to information that is strictly required by SEC disclosure rules, public companies routinely disclose large amounts of additional information. The only legal constraint on such disclosure is that the voluntarily disclosed information should not be materially false or misleading by itself or render any of the required disclosure materially false or misleading.[150] As a general matter, voluntary disclosure usually entails aspirational statements, discussion of positive developments that may not be sufficiently material to make them required disclosures, and information requested by investors, such as sustainability information. In the run up to the adoption of the SEC HCM disclosure rule in August 2020, public companies were disclosing more and more HCM-related information on a voluntary basis. These voluntary disclosures represented another important early manifestation of the HCM movement.[151]

Studies analyzing the proxy statements of large companies in 2019 and 2020 indicated that voluntary HCM disclosures were increasing but that they were still at an "early stage." Ernst & Young found that within its sample of 100 large companies, 50% disclosed information about workforce diversity, 34% disclosed information about workforce compensation, and 22% disclosed information about culture initiatives, workforce health and safety, and workforce skills

150. The antifraud provisions of the federal securities laws apply to both voluntary and mandatory disclosure. *See generally* THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION §§ 7.1, 12.19 (6th ed. 2009) (discussing the various SEC disclosure requirements and consequences of violations).

151. Consistent with the approach followed by other commentators, this Article considers HCM-related information disclosed before the SEC's HCM disclosure rule went into effect as "voluntary disclosure"; this is due to the lack until 2020 of any disclosure requirements pertaining to HCM topics (except for the total number of employees and the median worker pay figure). It is possible, however, that some of the HCM disclosure in question was not voluntary but instead required under one of the more general disclosure requirements (e.g., description of business, risk factors, material trends and uncertainties, among others). The fact that these disclosures started appearing in the late 2010s but had been previously absent suggests either that they were, indeed, voluntary at that point in time, or that firms had failed to fully comply with their obligations with respect to required disclosure in prior years.

and capabilities.[152] White & Case observed similar trends, noting that there was an increase in both the number of companies providing HCM disclosure in their proxy statements and in the topics covered between 2019 and 2020.[153] An analysis of sustainability reports contained in the Shearman study discussed above found that all but one of the companies in the sample released sustainability reports and that the vast majority of reports covered topics related to the workforce.[154]

As with most voluntary disclosure, the quality of voluntary HCM disclosure has been problematic. The Ernst & Young study noted that the HCM disclosures it analyzed varied in depth and clarity and often did not identify and report key performance indicators.[155] An analysis by the Government Accountability Office (GAO) released in July 2020 found the overall quality and comparability of ESG disclosures, including those on HCM, to be poor. For example, GAO identified "instances where companies defined terms differently or calculated similar information in different ways."[156] A lack of consistency was observed even among companies that used the same ESG standards or the same reporting framework.[157] As concerns the rise of the HCM movement, the most relevant aspect of the voluntary HCM disclosures is their growing ubiquity in corporate filings. Looking to the future, however, the low quality of voluntary HCM disclosures is likely to presage problems with the quality of the disclosures elicited by the SEC's new open-ended HCM disclosure rule, which we turn to next.

5. SEC Disclosure Rulemaking

In August 2020, the SEC adopted a disclosure requirement whereby a public company must provide "a description of [its] human capital resources, including any human capital measures or objectives

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152. *See* ERNST & YOUNG, HOW AND WHY HUMAN CAPITAL DISCLOSURES ARE EVOLVING 3 (2019), https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-how-and-why-human-capital-disclosures-are-evolving.pdf [https://perma.cc/G2PF-DTP3].

153. *ESG Disclosure Trends in SEC Filings*, WHITE & CASE (Aug. 13, 2020), https://www.whitecase.com/publications/alert/esg-disclosure-trends-sec-filings [https://perma.cc/S8SH-8VFY].

154. SHEARMAN STUDY, *supra* note 143, at 56, 59.

155. *See* ERNST & YOUNG, *supra* note 152, at 2.

156. U.S. GOV'T ACCOUNTABILITY OFF., GAO-20-530, PUBLIC COMPANIES: DISCLOSURE OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCE FACTORS AND OPTIONS TO ENHANCE THEM 32 (2020).

157. *Id*. at 33. In this respect, GAO's findings echoed prior research on the quality of voluntary sustainability disclosure. *See, e.g.*, Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 414-23 (2018); Barnali Choudhury, *Social Disclosure*, 13 BERKELEY BUS. L.J. 183, 212 (2016).

that [it] focuses on in managing the business"; the information is required "to the extent such disclosure is material to an understanding of the [company's] business taken as a whole."[158] The SEC's HCM disclosure rule was the culmination of a multi-stage process, which started with investor demands for HCM disclosure in 2016 and 2017, gained momentum after the SEC's Investor Advisory Committee issued recommendations in favor of HCM disclosure in 2019, and was bolstered further by strong support for HCM disclosure in comment letters on the SEC's rule proposal in 2019 and 2020. Despite general agreement that some form of HCM disclosure is warranted, however, the various participants in this process expressed different views on the purpose, scope, and format of the new disclosure requirement. Due to the open-ended nature of the HCM disclosure rule and the absence of guidance from the SEC, many of these questions remain unresolved. The exposition that follows provides a chronological overview of key steps in the rulemaking process; Part IV offers an assessment of the SEC's approach to HCM disclosure as part of a comprehensive analysis and critique of the HCM movement.

Even though most SEC rulemaking petitions do not prompt any agency action, the HCMC petition on HCM disclosure was an exception. In March 2018, less than a year after the petition was submitted, SEC Chairman Jay Clayton noted in testimony to the House Appropriations Subcommittee on Financial Services and General Government that he "would like to see more disclosure from public companies on how they think about human capital."[159] The same year, the SEC Investor Advisory Committee (IAC), a quasi-independent body attached to the agency, launched a study of the idea of HCM disclosure.[160] The process moved swiftly, and in March 2019, the IAC produced and formally adopted a detailed "recommendation" in

158. *See* Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Release No. 33-10825, Exchange Act Release No. 34-89670, 85 Fed. Reg. 63,726, 63,739 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239, and 240) [hereinafter Reg. S-K 2020 Modernization Release].

159. *See Financial Services and General Government Appropriations for 2019: Hearing Before the Subcomm. on Fin. Servs. & Gen. Gov't of the H. Comm. on Appropriations*, 115th Cong. 222 (2018) (statement of Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n).

160. The IAC was established by the Dodd-Frank Act of 2010 and has been operational since 2012. It is tasked with representing the interests of investors in various matters before the Commission. The IAC has emerged as an effective voice in debates about the regulation of the securities markets. *See Spotlight on Investor Advisory Committee*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/spotlight/investor-advisory-committee.shtml [https://perma.cc/ED2V-PBHV] (Feb. 14, 2017).

support of HCM disclosure.[161] The IAC recommendation noted estimates that the implied intangible asset value of the S&P 500 had grown from an average of 20% in the 1970s to an average of 84% by 2015—evidence that the economy is transitioning from one "based almost entirely on industrial production to one that is becoming increasingly based on technology and services."[162] As a result, the IAC suggested that the disclosure system should also evolve to include information about intangible assets, such as intellectual property and human capital. The IAC noted that whereas human capital is increasingly conceptualized as an investable *asset*, the SEC's traditional disclosure approach has been to treat human capital as a *cost*. As a result, the SEC's disclosure framework, in both its qualitative and quantitative aspects, has not kept pace with the shift toward viewing HCM as a primary source of value.

The IAC discussed two different approaches to remedying these deficiencies in the disclosure regime. First, the IAC suggested that a principles-based disclosure requirement could ask firms to describe their HCM policies and strategies for competitive advantage and comment on their progress in meeting their corporate objectives. The IAC also discussed a second possibility—mandating disclosure of specific HCM metrics, since many such metrics are a routine part of financial due diligence, including basic valuation models in M&A transactions. According to the IAC, these metrics could include standardized human capital-related key performance indicators (KPIs), such as the stability of the workforce, including voluntary and involuntary turnover and internal hire and promotion rates; the safety of the workforce—including frequency, severity and lost time due to injuries, illnesses, and fatalities—and percent of first-tier suppliers that were audited for safety and health compliance; average hours of training per employee per year; race/ethnicity and gender diversity data; and standardized survey measures of employee satisfaction.[163]

The IAC suggested an extensive, multi-party consultative process to decide on any new disclosure requirements.[164] SEC Chairman Jay

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161. SEC INV. ADVISORY COMM., RECOMMENDATION ON HUMAN CAPITAL MANAGEMENT DISCLOSURE 3-5 (2019) [hereinafter IAC Recommendation], https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf [https://perma.cc/SBE2-P5VY].

162. *Id.* at 1.

163. *Id.* at 4.

164. *Id.* at 3 ("We encourage the Commission to learn more from investors, issuers and the academic community through its customary processes, such as roundtables, concept

Clayton, who had been skeptical of expanding disclosure requirements on prior occasions, supported the HCM disclosure initiative by noting that human capital is the source of economic strength and, for some firms, "a mission-critical asset."[165] Six members of the IAC voted against the recommendation and issued a short dissenting statement.[166] Because the IAC recommendation called for a departure from traditional ways of thinking about firm value, and, at least notionally, came from within the SEC, it attracted much attention in the corporate governance community.

The SEC took up HCM disclosure in August 2019, only a few months after the IAC recommendation.[167] Whereas the IAC had suggested that the rulemaking process should start with concept releases and broad-based roundtables that include investors, firms, and the academic community, the SEC skipped those steps and included HCM disclosure as part of a lengthy Proposing Release covering changes to a number of disclosure items that had been under consideration for most of the 2010s.[168] The formulation of the HCM disclosure proposal was open-ended and "principles-based"—placing heavy reliance on the complex and contested concept of materiality—

releases, and proposed rules for public comment, including information about what kinds of HCM disclosures are already required under other regulatory regimes . . . .").

165. *See* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at Meeting of the Investor Advisory Committee (Mar. 28, 2019), https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-032819 [https://perma.cc/FG5L-KCQQ]. Interestingly, this formulation echoes the test for whether the board would have *Caremark* oversight duties with respect to HCM matters. *See supra* note 135 and accompanying text. This point is analyzed further in subpart IV.B.1 *infra*.

166. The dissenting IAC members expressed concern that HCM disclosure could be used to pressure companies to adopt pro-social policies and that the new HCM information would not be consistent with traditional accounting principles such as conservatism. *See* SEC INV. ADVISORY COMM., DISSENT BY MEMBERS OF THE INVESTOR ADVISORY COMMITTEE RE: HUMAN CAPITAL DISCLOSURE RECOMMENDATION (2019), https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-recommendation-dissent.pdf [https://perma.cc/YM5H-R7DD].

167. Modernization of Regulation S-K Items 101, 103, and 105, Exchange Act Release No. 34-86614, 84 Fed. Reg. 44,358 (Aug. 23, 2019) (proposing amendments to Regulation S-K to modernize the description of disclosure requirements for businesses, legal proceedings, and risk factors).

168. Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, Testimony on "Examining the SEC's Agenda, Operations, and FY 2018 Budget Request" (Nov. 15, 2016), https://www.sec.gov/news/testimony/white-testimony-sec-agenda-fy2018-budget-request.html [https://perma.cc/645J-BDNC] (summarizing SEC actions as part of the Disclosure Effectiveness Initiative).

in line with the SEC's overall approach to disclosure under Chairman Clayton and his predecessor, Mary Jo White.[169]

The Proposing Release generated an extensive comment file consisting of 98 individual comment letters (alongside 2,847 form letter submissions).[170] The file reflected a broad acknowledgment of the importance of human capital, and, with the notable exception of three large public companies,[171] support for some form of HCM disclosure. Even the U.S. Chamber of Commerce's Center for Capital Market Competitiveness, a longstanding and unwavering opponent of any proposal to expand the SEC disclosure regime, indicated that it was "cautiously supportive."[172] The comment letters contained disagreement on the format of HCM disclosure, with a number of commenters arguing in favor of a "hybrid" or "dual" approach combining principles-based and prescriptive (or "rules-based") requirements.[173] The prescriptive requirements would call for the disclosure of specific metrics or categories of information (sometimes referred to as "line items"—a term borrowed from financial

169. *See* discussion *infra* subpart IV.C.1.

170. *See Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/comments/s7-11-19/s71119.htm [https://perma.cc/B9SV-578Z] (Aug. 26, 2020).

171. These public companies were General Motors, Chevron, and UnitedHealth Group. *See* Letter from Christopher T. Hatto, Vice President, Controller & Chief Acct. Officer, Gen. Motors, and Rick E. Hansen, Assist. Gen. Couns. & Corp. Sec'y, Gen. Motors, to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 3-4 (Oct. 22, 2019), https://www.sec.gov/comments/s7-11-19/s71119-6324040-194699.pdf [https://perma.cc/D35P-VTU3]; Letter from David A. Inchausti, Vice President & Comptroller, Chevron Corp., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 3 (Oct. 22, 2019), https://www.sec.gov/comments/s7-11-19/s71119-6323234-194676.pdf [https://perma.cc/G49F-M54R]; Letter from Thomas E. Roos, Senior Vice President & Chief Acct. Officer, UnitedHealth Grp. Inc., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 2 (Oct. 14, 2019), https://www.sec.gov/comments/s7-11-19/s71119-6288238-193380.pdf [https://perma.cc/5PTQ-YSZP].

172. Letter from Tom Quaadman, Exec. Vice President, Ctr. for Cap. Mkts. Competitiveness, to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 4 (Oct. 22, 2019), https://www.sec.gov/comments/s7-11-19/s71119-6324038-194710.pdf [https://perma.cc/6J4C-X8SS].

173. *See, e.g.*, Letter from Cambria Allen-Ratzlaff, Chair, Hum. Cap. Mgmt. Coal., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 22, 2019) [hereinafter HCMC Letter], https://www.sec.gov/comments/s7-11-19/s71119-6322887-194462.pdf [https://perma.cc/75VA-4BA2]; Letter from Marcie Frost, Chief Exec. Officer, CalPERS, to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 22, 2019) [hereinafter CalPERS Letter], https://www.sec.gov/comments/s7-11-19/s71119-6324067-194727.pdf [https://perma.cc/FK62-BPE4]; Letter from Brandon J. Rees, Deputy Dir. of Corps. & Cap. Mkts., AFL-CIO, to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 22, 2019) [hereinafter AFL-CIO Letter], https://www.sec.gov/comments/s7-11-19/s71119-6324055-194715.pdf [https://perma.cc/D776-TMG6].

accounting), in order to make firm-specific information more useful and promote some degree of comparability across firms.[174]

When it came time to finalize the HCM disclosure rule, the SEC hewed closely to the principles-based approach outlined in the Proposing Release. Like the rule proposal, the final rule contained language noting that "depending on the nature of the registrant's business and workforce," relevant HCM information potentially subject to disclosure may include "measures or objectives that address the development, attraction and retention of personnel."[175] The Final Rule Release emphasized that these are not disclosure mandates but rather represent non-exclusive examples of subjects that may be material.[176] The Final Release also refused to adopt a definition of the term "human capital," reasoning that its meaning "may evolve over time and may be defined by different companies in ways that are industry specific."[177] The two Democratic SEC commissioners criticized the SEC's approach and voted against the Regulation S-K amendments containing the rule, despite agreeing in principle that HCM disclosure is needed.[178]

Given the SEC's overall reluctance to provide specific guidance, it remains to be seen whether the new HCM disclosure rule will elicit any new and meaningful information. Preliminary evidence, which became available as this Article went to print, suggests that the new HCM disclosures are fairly brief and contain information that is already available to analysts from other sources, including voluntary sustainability reports.[179] In addition, most new disclosures entail

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174. *See, e.g.*, HCMC Letter, *supra* note 173; CalPERS Letter, *supra* note 173; AFL-CIO Letter, *supra* note 173.

175. Reg. S-K 2020 Modernization Release, *supra* note 158, at 63,760.

176. *Id.* at 63,739.

177. *Id.*

178. *See* Allison Herren Lee, *Regulation S-K and ESG Disclosures: An Unsustainable Silence*, U.S. SEC. & EXCH. COMM'N (Aug. 26, 2020), https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26 [https://perma.cc/J93D-LQSW] (noting that she would have supported the final rule "if it had included even minimal expansion on the topic of human capital to include simple, commonly kept metrics such as part time vs. full time workers, workforce expenses, turnover, and diversity"); Caroline Crenshaw, *Statement on the "Modernization" of Regulation S-K Items 101, 103, and 105*, U.S. SEC. & EXCH. COMM'N (Aug. 26, 2020), https://www.sec.gov/news/public-statement/crenshaw-statement-modernization-regulation-s-k [https://perma.cc/QLA9-CK2D] (criticizing the rules as "generic and vague" and noting that they fail to provide investors with "critical and useful information about key corporate metrics").

179. *See* Amanda Iacone, *New SEC Workforce Disclosures Scant on Fresh Information*, BLOOMBERG L. (Jan. 27, 2021), https://news.bloomberglaw.com/securities-law/new-sec-workforce-disclosures-scant-on-fresh-information.

qualitative descriptions of core values, programs, and practices, with very few covering objectives or metrics used to manage the business.[180]

6. Legislative Efforts

The HCM movement has also encompassed legislative efforts, such as the introduction of bills seeking to mandate detailed and highly-specific HCM disclosure for public companies, as well as advocacy by members of Congress in connection with the SEC's rulemaking process discussed above. The HCM disclosure bill was first proposed by Representative Cynthia Axne, Democrat of Iowa, in May 2019,[181] and it was approved by the House Financial Services Committee in February 2020.[182] Senator Mark Warner, Democrat of Virginia, introduced a Senate version of the bill shortly thereafter.[183] Though the bill has not been taken up by either the full House of Representatives or the Senate as of March 1, 2021, it is noteworthy for its expansive scope and highly-specific disclosure mandates. It covers all information categories generally included as part of HCM: workforce demographics, workforce stability, workforce composition, skills and capabilities, culture and empowerment, health and safety, compensation and incentives, and recruiting.[184] Within these categories, the draft bill mandates disclosure of 20 specific metrics or groups of metrics,[185] as well as 9 more general narrative topics.[186] The

180. See Cydney Posner, *Early Trends in Human Capital Disclosure*, COOLEY PUBCO (Feb. 10, 2021), https://cooleypubco.com/2021/02/10/trends-human-capital-disclosure [https://perma.cc/H3MN-2TW4].

181. *See* Hearing before the Subcomm. on Investor Protection, Entrepreneurship, and Capital Markets (May 15, 2019), https://financialservices.house.gov/calendar/event single.aspx?EventID=403651 (providing link to draft version of the HCM bill).

182. *H.R. 5930—Workforce Investment Disclosure Act*, CONGRESS.GOV, https://www.congress.gov/bill/116th-congress/house-bill/5930 [https://perma.cc/4SN4-ZCES] (last visited Mar. 21, 2021).

183. Press Release, Sen. Mark R. Warner, Financial Services Committee Advances Axne-Led Legislation to Boost Transparency of U.S. Workforce Development Investments (Feb. 28, 2020), https://www.warner.senate.gov/public/index.cfm/2020/2/financial-services-committee-advances-axne-led-legislation-to-boost-transparency-of-u-s-workforce-development-investments [https://perma.cc/2V84-WP5V].

184. S. 3361, 116th Cong. § 2 (as referred to the Comm. on Banking, Hous., & Urb. Affs., Feb. 27, 2020).

185. These include, for example, metrics such as voluntary turnover or retention rate, involuntary turnover rate, internal hiring rate, internal promotion rate, and the frequency, severity, and lost time due to injuries, illness, and fatalities, among others. *Id.*

186. These include, for example, topics such as "policies or practices relating to subcontracting, outsourcing, and insourcing" and "policies and practices . . . relating to freedom of association and work-life balance initiatives," among others. *Id.*

bill's scope exceeds the scope of the already-detailed HCMC Rulemaking Petition, and it reflects an approach that stands in contrast to that of the SEC's HCM disclosure rule. A separate House bill, introduced in July 2020, sought to impose various obligations, including HCM disclosure obligations, on firms receiving federal aid under the Coronavirus Aid, Relief, and Economic Security (CARES) Act.[187]

In addition to championing their HCM disclosure bill, Senator Warner and Representative Axne also wrote to SEC Chairman Clayton in May 2020 and urged the SEC to finalize the HCM rulemaking process, particularly in light of the workforce-related business disruptions caused by the COVID-19 pandemic.[188] Senator Warner had sent two prior letters to the SEC on HCM disclosure: first in July 2018, drawing attention to the importance of the topic (which had not yet become an area of focus for the agency),[189] and then in October 2019, urging the SEC to require disclosure of specific metrics in the interest of standardization and comparability instead of relying exclusively on a principles-based approach.[190] Senator Warner was also the driving force behind GAO's July 2020 report highlighting the inadequacies of public companies' voluntary disclosures related to HCM and other ESG topics.[191]

Almost exclusively, the rhetoric employed by Senator Warner and Representative Axne has reflected an investor-focused, workers-as-assets justification for HCM. For example, Warner's July 2018 letter noted that "human capital is among a company's most valuable assets" and that "without [this] information, investors do not have the ability to adequately assess the current performance and future prospects of a company."[192] When the House Financial Services Committee

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187. MAJORITY STAFF OF H. COMM. ON FIN. SERVS., 116TH CONG., MEMORANDUM 5 (July 14, 2020), https://www.congress.gov/116/meeting/house/110888/documents/HHRG-116-BA16-20200714-SD002-U3.pdf.

188. *See* Letter from Mark R. Warner, U.S. Sen., and Cynthia Axne, U.S. Rep., to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (May 19, 2020), https://axne.house.gov/sites/axne.house.gov/files/Warner Axne Letter to SEC.pdf [https://perma.cc/6ZTM-LL3Z].

189. *See* Letter from Mark R. Warner, U.S. Sen., to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (July 19, 2018) [hereinafter Warner 2018 Letter], https://www.sec.gov/comments/s7-06-16/s70616-4186935-172772.pdf [https://perma.cc/VAN6-W5ES].

190. *See* Letter from Mark R. Warner, U.S. Sen., to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (Oct. 22, 2019), https://www.sec.gov/comments/s7-11-19/s71119-6323056-194575.pdf [https://perma.cc/P7AF-8VDX].

191. *See supra* notes 156-157 and accompanying text.

192. Warner 2018 Letter, *supra* note 189, at 1 (capitalization simplified).

considered the HCM disclosure bill, Axne similarly noted that investors "have extremely limited information about a company's workforce, even though it is their greatest asset."[193] As with the statements of other participants in the HCM movement, however, there has been some incongruity. For example, despite the focus on investor interests, the HCM disclosure bill was introduced and discussed at a congressional hearing whose subject was a "review of proposals to strengthen the rights and protections for workers."[194]

7. Private Standard-Setting Initiatives

Private standard-setting organizations, including the Sustainability Accounting Standards Board (SASB), the International Organization for Standardization (ISO), the Global Reporting Initiative (GRI), the Embankment Project for Inclusive Capitalism (EPIC), and the World Economic Forum (WEF), have done considerable work in the area of HCM disclosure, making them an important part of the HCM movement.

SASB's efforts have been particularly extensive and are likely to remain so in the future.[195] A young but well-resourced organization, SASB has developed detailed disclosure standards intended to "identify and standardize disclosure on the most business-crucial sustainability issues for companies in each of 77 industries."[196] The standards represent comprehensive and narrowly-tailored disclosure frameworks, and a number of companies have reported following the standards in their sustainability reports.[197] Human capital is one of five primary sustainability dimensions addressed by the standards,

193. Bill Flook, *House Financial Committee Advances Political Spending, Workforce Disclosure Bills*, THOMSON REUTERS TAX & ACCT. (Mar. 2, 2020), https://tax.thomsonreuters.com/news/house-financial-services-committee-advances-political-spending-workforce-disclosure-bills [https://perma.cc/5KCA-VHYD].

194. MAJORITY STAFF OF H. COMM. ON FIN. SERVS., 116TH CONG., MEMORANDUM 1-2 (2019), https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-20190515-sd002-u2_-_memo.pdf [https://perma.cc/HL5S-RP3J] (capitalization simplified).

195. SASB will operate as the Value Reporting Foundation upon the completion of its planned merger with the International Integrated Reporting Council, which was announced in November 2020. *See* Press Release, Sustainability Acct. Standards Bd., IIRC and SASB Announce Intent to Merge in Major Step Towards Simplifying the Corporate Reporting System (Nov. 25, 2020), https://www.sasb.org/wp-content/uploads/2020/12/IIRC-SASB-Press-Release-Web-Final.pdf [https://perma.cc/W4KF-RELL].

196. SUSTAINABILITY ACCT. STANDARDS BD., HUMAN CAPITAL BULLETIN 3 (2020) [hereinafter SASB HUMAN CAPITAL BULLETIN], https://www.sasb.org/wp-content/uploads/2020/12/HumanCapitalBulletin-112320.pdf [https://perma.cc/P6GC-ESQ9].

197. *Id.*

alongside environment, social capital, business model and innovation, and leadership and governance.[198] According to SASB, 48 out of its 77 industry standards already contain at least one human capital-related metric, and so the standards, finalized in 2018 after a stakeholder consultation process, already cover HCM to a considerable degree.[199] Nevertheless, in September 2019, SASB launched a new research project dedicated solely to human capital with the goal of designing "an evidence-based framework to support the identification of financially material impacts related to [HCM]."[200] This project is collecting input from a variety of stakeholders and it is likely to have a significant effect on HCM's future development.[201]

Despite the SEC's lack of interest in SASB's work during Chairman Clayton's leadership of the agency between 2017 and 2020, one of SASB's stated goals is for the SEC to ultimately acknowledge SASB's narrowly-tailored standards as an accepted way of meeting public companies' disclosure obligations under the federal securities laws.[202] The SASB standards have been endorsed by various corporate governance actors, including BlackRock.[203]

SASB has adopted an expansive conception of HCM across four broad categories: labor practices, employee health and safety, employee engagement, diversity and inclusion, and supply chain management. Each of these categories contains various general and

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198. *Id.*

199. *Id.* at 4-5.

200. *Id.* at 10.

201. *See, e.g.*, SUSTAINABILITY ACCT. STANDARDS BD., PRELIMINARY FRAMEWORK ON HUMAN CAPITAL AND THE SASB STANDARDS (2020), https://www.sasb.org/wp-content/uploads/2020/12/Human-Capital_Preliminary-Framework_2020-December_FINAL.pdf. [https://perma.cc/9ZBQ-YUZG]. This draft document, spanning 125 pages and released in December 2020, further expands SASB's conception of HCM.

202. Letter from Thomas L. Riesenberg, Dir. of Legal & Regul. Pol'y, Sustainability Acct. Standards Bd., to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n 2 (Oct. 17, 2019), https://www.sec.gov/comments/s7-11-19/s71119-6313644-193668.pdf [https://perma.cc/K7WA-4PH3] ("[W]e urge that, if the SEC adopts this principles-based rule, the Adopting Release state that issuers should consider using the SASB standards as a means of complying with the rule . . . ."). Paradoxically, this may well happen in the future precisely because of the vacuum created by the SEC's inaction on ESG reporting and its principles-based approach to disclosure. While the SEC was dismantling specific disclosure requirements as part of its Regulation S-K modernization program, SASB was building up detailed disclosure frameworks in consultation with investors, firms, and other stakeholders.

203. Larry Fink, *Larry Fink's 2020 Letter to CEOs*, BLACKROCK, https://www.blackrock.com/us/individual/larry-fink-ceo-letter [https://perma.cc/B46D-7BC4] ("While no framework is perfect, BlackRock believes that [SASB] provides a clear set of standards for reporting sustainability information across a wide range of issues, from labor practices to data privacy to business ethics.").

industry-specific topics and metrics. A comprehensive overview of the topics and metrics is beyond the scope of this Article, but the following examples provide some indication of the truly granular nature of SASB's approach to HCM. Under the category of employee health and safety, the disclosure standards for the construction materials industry include reporting the number of reported cases of silicosis; the standards for the waste management industry include reporting of the number of road accidents and incidents; and the standards for the casinos and gaming industry include reporting the percentage of the gaming floor where smoking is allowed.[204] To be sure, the SASB standards also cover HCM metrics with a broader appeal, such as voluntary and involuntary turnover, training expenses, and others.

Alongside their highly-specific nature, another important feature of the SASB standards is that, according to SASB, they are grounded in the exact same standard of financial materiality that the SEC has cited extensively during the Regulation S-K modernization program.[205] (SASB is currently considering adopting its own definition, also grounded in financial materiality.[206]) As in other areas, SASB's work on HCM reflects an investor-focused approach premised on financial materiality. According to SASB, "the concept of human capital itself re-frames people as assets rather than as costs," and "it is clear that high-quality information about how companies are managing some of their most important assets can facilitate more robust financial analysis and more efficient price discovery in markets around the world."[207]

In addition to SASB, at least four other organizations have also been active in setting HCM reporting standards. For example,

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204. SASB HUMAN CAPITAL BULLETIN, *supra* note 196, at 7.

205. SASB's 2017 Conceptual Framework, under which the original 77 industry standards were developed, notes: "In identifying sustainability topics that are reasonably likely to have material impacts, the SASB applies the definition of 'materiality' established under the U.S. securities laws." SUSTAINABILITY ACCT. STANDARDS BD., SASB CONCEPTUAL FRAMEWORK 9 (2017), https://www.sasb.org/wp-content/uploads/2020/02/SASB_Conceptual-Framework_WATERMARK.pdf [https://perma.cc/NCP2-NQA7]. The Conceptual Framework then goes on to cite the 1976 United States Supreme Court case *TSC Industries v. Northway, Inc. Id.*

206. *See* SUSTAINABILITY ACCT. STANDARDS BD., PROPOSED CHANGES TO THE SASB CONCEPTUAL FRAMEWORK & RULES OF PROCEDURE 7 (2020), https://www.sasb.org/wp-content/uploads/2020/08/Invitation-to-Comment-SASB-CF-RoP.pdf [https://perma.cc/VPV5-2XAF] ("For the purpose of SASB's standard-setting process, information is financially material if omitting, misstating, or obscuring it could reasonably be expected to influence investment or lending decisions that users make on the basis of their assessments of short-, medium-, and long-term financial performance and enterprise value.").

207. SASB HUMAN CAPITAL BULLETIN, *supra* note 196, at 2.

the International Organization for Standardization has formulated standards for both external and internal HCM reporting, which were released in 2018 following extensive consultations.[208] The ISO standards call on companies to publicly report on 23 specific metrics split across 9 categories and to report internally on 36 additional metrics.[209] The Global Reporting Initiative has also included in its Global Reporting Standards various detailed topics related to HCM; the standards form the basis for the sustainability reports prepared by a number of companies.[210] The Embankment Project for Inclusive Capitalism, formed by the Coalition for Inclusive Capitalism and Ernst & Young, released a report in 2018 identifying HCM as one of four drivers of long-term value,[211] and recommended HCM reporting by way of metrics and narrative information along five different dimensions.[212] Finally, in September 2020, the World Economic Forum released a report delineating a core set of "stakeholder capitalism metrics," including HCM metrics, intended to ensure "consistent reporting of sustainable value creation."[213] Notably, WEF's standards rely on a compilation of metrics released by other organizations.[214] The main HCM categories and topics used in the standards put forward by these organizations are summarized in the Appendix.

The standard-setting landscape is highly dynamic: SASB and GRI have announced an initiative to develop joint standards.[215] SASB has

208. *See* David McCann, *Human Capital Reporting Standards Finally Arrive*, CFO (Dec. 18, 2018), https://www.cfo.com/people/2018/12/human-capital-reporting-standards-finally-arrive [https://perma.cc/9LRK-8478].

209. *Id.*

210. *See* GLOB. REPORTING INITIATIVE, CONSOLIDATED SET OF GRI SUSTAINABILITY REPORTING STANDARDS (2020), https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/. Early-generation sustainability initiatives, such as the UN Principles for Responsible Investment and the OECD Guidelines for Multinational Enterprises, can be viewed as the progenitors of the current GRI standards.

211. Press Release, Ernst & Young, Embankment Project for Inclusive Capitalism Releases Report to Drive Sustainable and Inclusive Growth (Nov. 16, 2018), https://www.ey.com/en_gl/news/2018/11/embankment-project-for-inclusive-capitalism-releases-report-to-drive-sustainable-and-inclusive-growth [https://perma.cc/9DZ7-F5BH].

212. *See* COAL. FOR INCLUSIVE CAPITALISM, EMBANKMENT PROJECT FOR INCLUSIVE CAPITALISM 44 (2018), https://assets.ey.com/content/dam/ey-sites/ey-com/en_ca/topics/transaction-advisory-services/ey-the-embankment-project-for-inclusive-capitalism-report.pdf [https://perma.cc/Z5VJ-YDHK].

213. *See* WORLD ECON. F., MEASURING STAKEHOLDER CAPITALISM: TOWARDS COMMON METRICS AND CONSISTENT REPORTING OF SUSTAINABLE VALUE CREATION 3 (2020), http://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf [https://perma.cc/ZW5X-MPX6] (capitalization simplified).

214. *See id.* at 6-10.

215. *Id*. at 41.

also announced that it will merge with the International Integrated Reporting Council and form the Value Reporting Foundation in 2021.[216] The IFRS Foundation, in charge of formulating international financial reporting standards, has issued a preliminary consultation paper on sustainability reporting and may also enter this already-crowded field.[217] Separately, a number of organizations incorporate the HCM information released pursuant to the various standards into ESG scoring and ESG rating systems, which are proliferating and gaining greater prominence.[218] Among others, both ISS and Glass Lewis issue ratings that take into account ESG factors, including HCM factors.[219] These organizations further amplify the reach of the HCM reporting frameworks, albeit in nebulous ways due to the proprietary nature of most rating methodologies.

8. Board Advisors' Focus on HCM Best Practices

The last element of the HCM movement relates to the work of board advisors—the corporate governance practice groups of law firms, big-four accounting firms, and executive compensation consulting firms, among others. By highlighting HCM as an emerging area of board oversight and commenting on changes in board practices, advisors have played a considerable part in transforming emerging practices into best practices. For example, one of the early mentions of HCM in its present iteration came in a report by the Ernst & Young Center for Board Matters titled *2017 Board Priorities*, published in late 2016; under the caption "questions for the board to consider," the report

216. *See* discussion *supra* note 195.

217. *See* IFRS FOUND., CONSULTATION PAPER ON SUSTAINABILITY REPORTING (2020), https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf?la=en [https://perma.cc/NS35-RUU5]. The IFRS Foundation fulfills its standard-setting function through the International Accounting Standards Board. *See id.* at 7.

218. *See, e.g.,* Betty Moy Huber & Michael Comstock, *ESG Reports and Ratings: What They Are, Why They Matter*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 27, 2017), https://corpgov.law.harvard.edu/2017/07/27/esg-reports-and-ratings-what-they-are-why-they-matter/ [https://perma.cc/TZ26-UPGY] (describing various ESG rating providers and their methodologies).

219. *See ESG Ratings & Rankings*, ISS, https://www.issgovernance.com/esg/ratings [https://perma.cc/2SV2-9AZX] (last visited Mar. 21, 2021); *ESG Profile Overview*, GLASS LEWIS, https://www.glasslewis.com/understanding-esg-content [https://perma.cc/KHX3-28LQ] (last visited Mar. 8, 2021).

presented specific HCM topics that boards ought to focus on.[220] Publications by prominent law firms, such as Wachtell Lipton, Weil Gotschal, and Cleary Gottlieb, among others, have used similarly prescriptive language about the need for boards to focus on HCM issues.[221] So have executive compensation consultants.[222] The Conference Board, an organization that commands authority in corporate boardrooms, also endorsed HCM as a core board concern in early 2021.[223] In sum, by including HCM as part of various best practices for boards, these advisors have both contributed to the substantive development of the HCM movement and enabled it to gain and sustain momentum.

9. Antecedents: Public Pension Funds and Labor Unions' Interest in HCM

Even though BlackRock's identification of HCM as an engagement priority in 2017 was the most visible early manifestation of the HCM movement, it did not pioneer firm-shareholder engagement framed around the notion of "human capital management." Instead, it appears that such engagement originated a few years earlier with a group of public pension funds, the Human Capital Management Coalition (HCMC), which subsequently gained

220. *See* Steve Klemash & Ann Yerger, *2017 Board Priorities Report* (Dec. 31, 2016), HARV. L. SCH. F. ON CORP. GOVERNANCE, https://corpgov.law.harvard.edu/2016/12/31/2017-board-priorities-report [https://perma.cc/7YQ6-HBMC] (capitalization simplified).

221. *See, e.g.*, Martin Lipton, *Spotlight on Boards*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 3, 2020), https://corpgov.law.harvard.edu/2020/12/03/spotlight-on-boards-8 [https://perma.cc/33UJ-V88R] (writing that "[b]oards should . . . [r]ecognize that ESG and sustainability are major mainstream governance topics that encompass a wide range of issues . . . [including] human capital management"); WEIL, GOTSHAL & MANGES LLP, BOARD PRIORITIES FOR 2019: LOOKING INWARD AND OUTWARD TO MEET STAKEHOLDER EXPECTATIONS 2 (2019), https://www.weil.com/~/media/mailings/2019/q1/201935pcag-alert.pdf [https://perma.cc/E7PP-8DCX] ("Directors should embrace oversight of culture as a key board responsibility . . . [and] consider how various components of corporate culture, such as human capital management, can create opportunities to manage risk and drive results."); *Human Capital Management Moves to the Front Lines*, CLEARY GOTTLIEB (Jan. 16, 2019), https://www.clearygottlieb.com/news-and-insights/publication-listing/human-capital-management-moves-to-the-front-lines-bod-2019 [https://perma.cc/7ETG-8J9K] (stating that HCM can no longer be viewed as an issue solely within the purview of management and that it has become a board-level issue).

222. *See, e.g.*, Rusty O'Kelley & Anthony Goodman, *Is Your Board Accountable?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 16, 2019), https://corpgov.law.harvard.edu/2019/09/16/is-your-board-accountable [https://perma.cc/C78D-DHU4]. Many of the reports cited in subparts II.B.3 and II.B.4 also fall in this category.

223. *See* CONFERENCE BOARD REPORT, *supra* note 99.

prominence for its 2017 rulemaking petition on HCM disclosure.[224] According to an article in the *Wall Street Journal*, the HCMC had been engaging with firms on HCM issues "with little fanfare" since its founding in 2013.[225] The HCMC was focusing on "information on pay, budgets for training, and whether boards of directors have oversight on HR matters"—themes that would come to define the HCM movement.[226] Around the same time, the AFL-CIO issued a report entitled *Valuing America's Greatest Asset: Corporate Disclosure of Human Capital Management*; the report was notable in that it read as if it came from an organization focused on shareholder wealth maximization and not one organized expressly for the purpose of protecting and empowering workers.[227]

This evidence suggests that the roots of the present-day HCM movement—a mainstream corporate governance phenomenon with manifestations across the entire governance landscape—lie with public pension funds and labor unions. (Incidentally, it also suggests an expansion of these actors' approach to corporate governance to include softer engagement and lobbying for *shareholder*-oriented disclosure, in addition to the more heavy-handed engagement through formal shareholder proposals and litigation, which had been their traditional focus.[228])

C. Summation: Key Features

The discussion above shows that the HCM movement is a multi-faceted phenomenon. For our purposes, three features deserve particular attention: (1) the movement's swift rise and broad uptake within the corporate governance community, (2) the relative lack of meaningful coordination among the numerous participants in the movement, and (3) the fact that despite a general lack of consistency in messaging, virtually all participants in the movement have used a

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224. *See supra* notes 125-131 and accompanying text.

225. *See* Lauren Weber, *Why Top Fund Managers Want Better HR*, WALL ST. J. (Sept. 8, 2015), https://www.wsj.com/articles/why-top-fund-managers-want-better-hr-1441749764 (capitalization simplified).

226. *Id.*

227. *See* AFL-CIO, VALUING AMERICA'S GREATEST ASSET: CORPORATE DISCLOSURE OF HUMAN CAPITAL MANAGEMENT (2016), *reprinted in* Letter from Heather Slavkin Corzo, Dir., Corps. & Cap. Mkts., AFL-CIO, to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n app. B. (Sept. 22, 2017), https://www.sec.gov/comments/4-711/4711-2596141-161123.pdf [https://perma.cc/9QC9-6KMY].

228. *See supra* note 54 and accompanying text.

workers-as-assets justification for HCM's importance to corporate governance.

Corporate governance is a field in a perpetual, even frenetic state of motion, but even by these standards, the rise of the HCM movement in the late 2010s has been remarkably swift. As we saw in the preceding subpart, HCM went mainstream in 2017 with BlackRock's adoption of HCM as an engagement priority and the HCMC's submission of an HCM disclosure rulemaking petition to the SEC. Just three-and-a-half years later, the SEC had already adopted an HCM disclosure rule, and many boards of directors were making changes to longstanding practices in order to incorporate HCM. In the short time period since the movement's inception, the list of participants in the discourse on HCM has grown to include not just investors and public companies but also legal advisors, accounting firms, executive compensation consultants, regulators, legislators, and numerous domestic and international standard-setting organizations. Analyzing the content of the *Harvard Law School Forum on Corporate Governance*, a de facto clearing house for corporate governance developments, yields data that provides a rough quantitative illustration of these trends. In each of the years between 2007 (the Forum's inception) and 2016, Forum posts mentioning "human capital" were in the single digits; the term was then mentioned 31 times in 2017, 61 times in 2018, 117 times in 2019, and 167 times in 2020.[229] In addition to this near-universal interest in HCM, the near-universal support for HCM, discussed above, also stands out. Other sustainability topics, such as climate change, had been an area of focus for parts of the corporate governance community for much longer without generating the same level of interest or support.[230]

229. Author's survey of posts appearing on the *Harvard Law School Forum on Corporate Governance*. Search Results for "Human Capital," HARV. L. SCH. F. ON CORP. GOV., https://corpgov.law.harvard.edu/?s=%22human%20capital%22&is_v=1 [https://perma.cc/6F6V-WPMZ] (last visited Mar. 21, 2021). The total number of posts generally held steady over time, which makes year-on-year comparisons meaningful.

230. *See* Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 33-9106, Exchange Act Release No. 34-61469, 75 Fed. Reg. 6,290, 6,292 (Feb. 8, 2010) (affirming the applicability of existing disclosure requirements to climate change risk without adopting new requirements). A number of rulemaking petitions have been filed over the years in respect of environmental and climate change disclosure but have failed to yield any new disclosure requirements. *See id.* at 6,291 n.20 (listing shareholder petitions submitted before 2010); 2018 ESG Rulemaking Petition, *supra* note 132. (There is indication that the SEC is changing its approach under new leadership in 2021. *See* Sylvan Lane, *SEC to Update Climate-Related Risk Disclosure Requirements*, THE HILL (Feb. 24, 2021), https://thehill.com/policy/finance/540377-sec-to-update-climate-related-risk-disclosure-requirements [https://perma.cc/8X5V-XGB9].)

The HCM movement's swift rise goes some way to explaining the observed lack of coordination among participants in the movement. But, until recently, there also does not appear to have been much interest in broad coordination, and multiple organizations and groups of organizations have been working on the same questions in parallel. Whether or not this was due to deliberate efforts to compete to showcase thought leadership or claim ownership of a highly salient issue, the result is a crowded and fragmented field—many different voices making relatively similar, though not identical, pronouncements, and pursuing relatively similar, though not identical, goals. The entity that is perhaps best suited to serve as a natural nexus for coordination, the SEC, has not been interested in doing so to date: the HCM disclosure rule was adopted as part of a much larger disclosure modernization package, and HCM received little sustained attention within the agency beyond the IAC's initial recommendations. The Financial Accounting Standards Board (FASB), another organization with the capacity to coordinate at least some aspects of HCM, has also avoided this area despite launching a project on the accounting treatment of intangible assets.[231] The result of the lack of broad coordination has been conceptual uncertainty—both about the overall scope of HCM and about the specific content of the various HCM categories. The table contained in the Appendix illustrates this point in a systematic way.

Despite the inconsistent messaging, a close study of the HCM movement reveals one common thread: the need for HCM disclosure and oversight has been justified by emphasizing that employees' human capital represents an important asset that ought to be managed in the interest of shareholders. Recall from subpart II.D that there are two distinct theoretical models of the role of human capital in corporate governance: the workers-as-assets model and the workers-as-investors of human capital model. The focus on the former model represents one of the defining features of the HCM movement: its primary stated purpose is shareholder wealth maximization rather than improving the role and status of workers in the corporate enterprise. To be sure, the two approaches need not be mutually exclusive—workers can and likely do benefit in a collateral way when firms take up HCM

231. *See Project Update: Identifiable Intangible Assets and Subsequent Accounting for Goodwill*, FIN. ACCT. STANDARDS BD., https://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdateExpandPage&cid=1176171566054 [https://perma.cc/EG2W-9UJ2] (Jan. 6, 2021).

disclosure and oversight. When participants in the HCM movement talk about corporate culture and a firm's ability to "compete for talent," as they sometimes do,[232] there is an implication that workers have a choice where to invest their human capital. In some cases, therefore, the distinction between "assets" and "investors" may be more rhetorical than substantive. On the whole, however, the workers-as-assets model derives from an entirely different management philosophy than the workers-as-investors of human capital model. It is also noteworthy that the HCMC (representing public pension funds), the AFL-CIO, progressive legislators, and others have adopted a rhetoric that portrays workers as objects to be managed in the interest of investors, rather than the direct beneficiaries of the relevant initiatives.

D. *The HCM Movement in Historical and Comparative Perspective*

Examining the HCM movement in historical and comparative perspective by revisiting the background matters discussed in Part II offers further insight into its nature.

1. Historical Perspective

There are obvious thematic similarities between the HCM movement and the three labor-focused reform initiatives discussed in subpart II.B—they each focus on workers. The similarities, however, are not as deep as they may appear, and there are important differences. Figure 1 presents a comparison across two crucial dimensions—the initiatives' intended beneficiaries and the governance roles they assign to workers—and suggests that the HCM movement operates on a different plane from the reform efforts that have come before it.

232. *See, e.g.*, Fink, *supra* note 108 ("America's largest companies, many of whom are struggling with a skills gap in filling technical positions, must improve their capacity for internal training and education to compete for talent in today's economy and fulfill their responsibilities to their employees.").

Reform Initiative	Workers as Beneficiaries	Role of Workers
HCM Movement	Indirect	Passive
Worker Empowerment Agenda	Direct	Active
Worker-Shareholder Agenda	Direct	Active
Stakeholder Primacy Agenda	Direct	Passive

Figure 1: Comparison Between the HCM Movement and Prior Labor-Focused Reform Initiatives

As Figure 1 shows, each of the three labor-focused reform initiatives were framed with workers serving as the primary and direct beneficiaries, and two out of the three envision a direct role for workers in corporate governance. The worker empowerment agenda encompasses proposals to give employees various governance rights akin to those presently enjoyed by shareholders, which would, in turn, lead to a more equal allocation of the firms' surplus between shareholders and employees.[233] The worker-shareholder agenda seeks to encourage workers to make more active use of the financial capital they hold in their savings and to use the governance rights embedded in that capital to advocate for labor-friendly reforms, again leading to a greater share of the firm's surplus being allocated to workers.[234] The stakeholder primacy agenda urges a redefinition of corporate purpose to encompass stakeholder (and, by extension, employee) interests while holding the means of corporate governance relatively intact.[235] The HCM movement, by contrast, changes neither the means nor the ends of corporate governance and, instead, seeks to raise awareness of the fact that the appropriate management of human capital assets is as important to firm performance and shareholder returns as the appropriate management of physical assets. It remains to be seen whether the HCM movement will end up being a substitute for other labor-focused reform initiatives, effectively absorbing the energy of reform advocates, or serve as a precursor to further reforms by generating additional energy.

233. *See* discussion *supra* subpart II.B.1.
234. *See* discussion *supra* subpart II.B.2.
235. *See* discussion *supra* subpart II.B.3.

2. Comparative Perspective

Viewing the HCM movement in comparative perspective suggests that it is a distinct product of U.S. corporate governance, despite interest and participation from international players. As regards disclosure, the EU's approach differs both in timing and in relative emphasis. International Accounting Standards as applied in the European Union have long required some information about workforce costs and spending, so the dearth of workforce information has not been quite as pronounced as in the United States.[236] In 2014, the EU directive on non-financial reporting mandated enhanced disclosure of sustainability information, including workforce information.[237] Consultations on potential amendments to address inadequate reporting were launched in 2020 but were driven primarily by demands for better environmental and climate disclosure as part of the European Green Deal.[238] While it has not given up on improving employee-related disclosure within the larger framework of sustainability disclosure, the European Union has been more focused on substantive corporate governance. A 2020 report on directors' duties expressed concern that "the social norm of shareholder primacy and short-term pressures from the financial markets" cause directors and executives to "maximise shareholder value and distribute earnings through dividends and buybacks, at the same time sacrificing investments (in R&D, CapEx, employee development, etc.) that are much needed for a transition to sustainable value creation."[239] The report discussed various policy options, some of them far-reaching.[240] In the United

236. *See infra* note 342 and accompanying text.

237. *See* Directive 2014/95, of the European Parliament and of the Council of 22 October 2014 Amending Directive 2013/34/EU as Regards Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups, 2014 O.J. (L 330). The reporting regime was slow getting off the ground, which required the European Union to issue non-binding guidance in 2017. *See* Guidelines on Non-Financial Reporting (Methodology for Reporting Non-Financial Information), 2017 O.J. (C 215).

238. *See Review of the Non-Financial Reporting Directive: Towards an EU-wide ESG Reporting Standard*, ALLEN & OVERY (Mar. 6, 2020), https://www.allenovery.com/en-gb/global/news-and-insights/publications/review-of-the-non-financial-reporting-directive [https://perma.cc/Z6LA-DPUZ] (noting that "the Commission considers that disclosed information does not adequately detail how non-financial issues . . . impact companies and how companies themselves impact society and the environment").

239. EUR. COMM'N, STUDY ON DIRECTORS' DUTIES AND SUSTAINABLE CORPORATE GOVERNANCE vi (2020), https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en (capitalization simplified).

240. The report's evidence and analysis have attracted criticism. *See* Mark J. Roe, Holger Spamann, Jesse M. Fried, & Charles C.Y. Wang, *The European Commission's*

Kingdom, too, corporate governance reforms pertaining to the workforce extend much further than non-financial reporting.[241] The corporate governance reforms adopted in 2018 include several provisions focused on employees, which, somewhat paradoxically, moved the U.K. closer to the European model at the same time as the U.K. was preparing to separate from the European Union. Of the provisions mentioned in subpart II.C, three deserve particular attention for the way they implement measures that resonate with the worker empowerment and shareholder primacy agendas in the United States. These provisions apply to both listed (i.e., public) and unlisted (i.e., private) U.K. companies, whereas the U.S. HCM disclosure rule applies only to public companies.

First, and most notably, the U.K. Corporate Governance Code now requires board engagement with the workforce and identifies the appointment of an employee-selected director as one acceptable means of fulfilling this mandate.[242] This resembles proposals for giving employees the right to elect a share of the board, which sit at the center of the U.S. worker empowerment agenda.[243]

Second, any company with more than 250 U.K.-based employees needs to include in its statutorily-mandated directors' report a statement "describing the action that has been taken during the financial year to introduce, maintain or develop arrangements aimed at (i) providing employees systematically with information on matters of concern to them as employees, (ii) consulting employees or their representatives on a regular basis so that the views of employees can be taken into account in making decisions which are likely to affect their interests, (iii) encouraging the involvement of employees in the company's performance through an employees' share scheme or by some other means, and (iv) achieving a common awareness on the part of all employees of the financial and economic factors affecting the

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Sustainable Corporate Governance Report: A Critique (Eur. Corp. Governance Inst. Working Paper, Paper No. 553/2020, 2020), https://ssrn.com/abstract=3711652.

241. With respect to non-financial reporting (including of HCM information), the U.K. is pursuing a consultation similar to that in the EU. *See* DEPT. OF BUSINESS, ENERGY & INDUSTRIAL STRATEGY, FRAMEWORKS FOR STANDARDS FOR NON-FINANCIAL REPORTING (2020) (UK), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935097/frameworks-for-standards-for-non-financial-reporting.pdf.

242. *See supra* note 72 and accompanying text.

243. *See supra* note 51 and accompanying text (summarizing bills by Senators Warren, Baldwin, and Sanders).

performance of the company."[244] This is a disclosure provision, which does not *require* companies to pursue any of these policies, but it does focus directors' attention on the role employees could play and, as a result, could serve a behavioral function by influencing corporate governance practices.[245] Whereas some of the policies it references are commonplace industrial relations measures that fit within the definition of operational participation,[246] others, such as provisions (ii) and (iii), resemble proposals that are part of the U.S. worker empowerment agenda and relate to employee participation in corporate governance.

Finally, large U.K. companies are required to include in their statutorily-mandated strategic report a so-called "Section 172(1) statement" explaining how directors have considered the interests of stakeholders in decisionmaking.[247] Again, this is only a disclosure requirement, but one that can be expected to serve a behavioral function. The regulatory guidance provided in respect of this provision states that companies "will probably want to include" information about "the issues, factors and stakeholders the directors consider relevant" in complying with their obligation to have due regard for stakeholder interests, as well as "information on the effect of that regard on the company's decisions and strategies."[248] Taken seriously, this provision pries open the black box of director decisionmaking and requires directors to explain how they weigh shareholder interests against stakeholder interests—a move that is somewhat consonant with the U.S. stakeholder primacy agenda.

In sum, the comparative examples illustrate that even though other market economies have been incorporating employee-related provisions in their corporate governance regimes contemporaneously

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244. *See* The Companies (Miscellaneous Reporting) Regulations 2018, SI 2018/860 (UK), at Regulation 13 (amending Part 4 of Schedule 7 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008).

245. In addition to their standard informational function, disclosure requirements can also serve a so-called behavioral function by influencing corporate decisionmaking in substantive ways. *See* Bank & Georgiev, *supra* note 34, at 1146-49.

246. Operational participation is discussed in subpart II.A. *See supra* notes 41-42 and accompanying text.

247. *See* discussion *supra* note 75. A similar requirement applies to all companies with more than 250 U.K.-based employees as part of the "employee engagement" disclosure in the directors' report. *See supra* note 74 and accompanying text.

248. DEPT. OF BUSINESS, ENERGY & INDUSTRIAL STRATEGY, CORPORATE GOVERNANCE—THE COMPANIES (MISCELLANEOUS REPORTING) REGULATIONS 2018 Q&A 8 (2018) (UK), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/755002/The_Companies__Miscellaneous_Reporting__Regulations_2018_QA_-_Publication_Version_2__1_.pdf (capitalization simplified).

with the rise of the HCM movement in the United States, the U.S. and non-U.S. developments are fundamentally different. In the EU and the U.K., we are seeing a concerted push against shareholder primacy through the incorporation of measures that resonate with the worker empowerment and stakeholder primacy agendas; by comparison—and notwithstanding its novelty, ambition, and importance—the U.S. HCM movement exists within the traditional shareholder primacy realm.

E. Explaining the Rise of the HCM Movement

A final part of understanding the HCM movement involves an inquiry into its rise. Seasoned observers of corporate governance may find the swift ascendance of the HCM movement in the late 2010s puzzling, and not without reason. The concept of human capital is not new to U.S. corporate governance, and there have been many unsuccessful efforts over the years to improve the role and status of workers within the corporate enterprise. Moreover, even though the need for HCM disclosure and oversight is usually justified with reference to the transition to a knowledge-based economy, this development is not new either; indeed, the knowledge-based economy has been part of public discourse for at least three decades.[249] We have also known for decades about the inadequacy of financial accounting when it comes to capturing the value of intangible assets, including human capital.[250] Even the specific idea of mandating HCM disclosure has been on the table since the 1990s.[251] So what was different this time around, and why did HCM succeed where other reform initiatives failed? In light of the analysis presented thus far, and subject to the qualification that any discussion of the determinants of a phenomenon as complex as the HCM movement is by its nature subjective and somewhat speculative, I identify several relevant factors—the broader socio-economic environment of the 2010s, the important changes in

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249. *See, e.g.*, SHOSHANA ZUBOFF, IN THE AGE OF THE SMART MACHINE: THE FUTURE OF WORK AND POWER (1988).

250. *See, e.g.*, LEV, *supra* note 14; MARGARET M. BLAIR & STEVEN M. H. WALLMAN, UNSEEN WEALTH: REPORT OF THE BROOKINGS TASK FORCE ON INTANGIBLES (2001); *see also* Donald C. Langevoort, *Technological Evolution and the Devolution of Corporate Financial Reporting*, 46 WM. & MARY L. REV. 1, 26 (2004) ("Another strong complaint against GAAP is that it penalizes 'knowledge'-based firms by excluding measures of intellectual and human capital, wherein real comparative advantages lie.").

251. *See, e.g.*, BLAIR, OWNERSHIP AND CONTROL, *supra* note 18; O'Connor, *supra* note 18.

the corporate governance ecosystem occurring at the same time, and the malleable and non-disruptive nature of the HCM concept.

The economic devastation wrought by the 2008 financial crisis and the slow pace of the subsequent recovery placed much stress on workers during the 2010s. This included growing economic insecurity, pay disparities, and wealth inequality, problems exacerbated at least in part by inadequate workforce training, job obsolescence due to automation, and a U.S. worker skills gap.[252] By 2013, labor's share of income, a measure of the part of national income allocated to wages relative to the return on financial capital, was the lowest it had been since World War II.[253] This was accompanied by a growing gap between relative increases in productivity and wages.[254] Scholars also documented a lack of labor market competition, even in labor markets characterized by a scarcity of talent.[255] A comprehensive study of human capital covering 195 countries and territories between 1990 and 2016 found that the United States fell from 6th to 27th place in human capital investment, the only industrialized country to experience such a drop.[256] Divided government, government shutdowns, and an overall state of political paralysis made regulatory solutions hard to come by,

252. *See, e.g.*, *In the Past, America Was Not as Unequal as It Has Become*, ECONOMIST (Oct. 24, 2019), https://www.economist.com/books-and-arts/2019/10/24/in-the-past-america-was-not-as-unequal-as-it-has-become (reviewing three books by leading social scientists discussing present socio-economic trends related to low economic growth, income and wealth inequality, worker displacement due to automation, and inadequate levels of workforce training, among others).

253. *See* Michael W. L. Elsby et al., *The Decline of the U.S. Labor Share*, BROOKINGS PAPERS ON ECON. ACTIVITY, Fall 2013, at 1.

254. *See, e.g.*, *The Productivity-Pay Gap*, ECON. POL'Y INST., https://www.epi.org/productivity-pay-gap (July 2019) [https://perma.cc/U4C7-4QN7] (showing that net productivity rose 69.6% between 1979 and 2018, whereas inflation-adjusted typical worker pay increased only 11.6%).

255. *See, e.g.*, Alan B. Krueger & Eric Posner, Opinion., *Corporate America Is Suppressing Wages for Many Workers*, N.Y. TIMES (Feb. 28, 2018), https://www.nytimes.com/2018/02/28/opinion/corporate-america-suppressing-wages.html (suggesting that practices such as non-compete clauses in employment contracts are suppressing worker wages); Suresh Naidu, Eric Posner & Glen Weyl, *More and More Companies Have Monopoly Power over Workers' Wages. That's Killing the Economy.*, VOX (Apr. 6, 2018), https://www.vox.com/the-big-idea/2018/4/6/17204808/wages-employers-workers-monopsony-growth-stagnation-inequality (linking depressed worker wages and income inequality to firms' monopoly power).

256. *See* Stephen S. Lim et al., *Measuring Human Capital: A Systematic Analysis of 195 Countries and Territories, 1990–2016*, 392 LANCET 1217 (2018). During the same time period, China rose from 69th to 44th place. Other developed countries, including France, Germany, Japan, and the United Kingdom, all stayed within four spots of their original rank. *Id.* at 1222-26.

and some of the attention shifted to firms' treatment of their workers.[257] The proposition that firms should pay close attention to the workforce—one of many ways to communicate HCM's essence—had broad appeal and generated organic support for the HCM movement in its early days.

Other societal developments played a part as well. These include the focus on workplace sexual harassment as part of the MeToo movement launched in the fall of 2017, the focus on workforce resilience and health and safety as part of the COVID-19 crisis starting in the spring of 2020, and the renewed focus on corporations' efforts to promote diversity and inclusion following the protests for racial justice in the summer of 2020. These developments resonated deeply with participants in the insurgent HCM movement who referenced them on multiple occasions when making the case for HCM disclosure and oversight.[258] This gave the HCM movement, by then already in progress, an extra measure of momentum.

In addition to the particular socio-economic conditions of the 2010s, the rise of the HCM movement was likely boosted by the growing power of BlackRock and other asset managers in corporate governance. By virtue of the concentration of holdings, a limited number of players have come to hold considerable voting power and even greater soft power,[259] which they have willingly exercised in the service of various causes. Some commentators have explained large asset managers' advocacy on climate change and social justice issues as an effort to appeal to younger and more socially conscious

257. *See, e.g.*, Rana Foroohar, *Plans for a Worker-Led Economy Straddle America's Political Divides*, FIN. TIMES (June 9, 2019), https://www.ft.com/content/31b843b2-8938-11e9-a028-86cea8523dc2.

258. *See, e.g.*, *supra* note 188 and accompanying text (referencing the COVID-19 pandemic in connection with HCM); Lee, *supra* note 178 ("There is ever-growing recognition of the importance of diversity from all types of investors. . . . What's more, since [the HCM disclosure] rule was proposed, we've seen protests regarding racial injustice that have brought about an unprecedented national conversation on this subject."); David A. Katz & Laura A. McIntosh, *Corporate Governance Update: Shareholder Activism Is the Next Phase of #MeToo*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 28, 2018), https://corpgov.law.harvard.edu/2018/09/28/corporate-governance-update-shareholder-activism-is-the-next-phase-of-metoo (discussing how various HCM initiatives specifically incorporate measures to prevent workplace sexual harassment).

259. BlackRock, Vanguard, and State Street control approximately 25% of voting power in S&P 500 companies. *See* Bebchuk & Hirst, *supra* note 119, at 736; *see also* John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harv. Pub. L. Working Paper, Paper No. 19-07, 2018), https://ssrn.com/abstract=3247337 (presenting a critical perspective on the transformation of corporate governance as a result of the concentration of power in the hands of asset managers).

investors.[260] Regardless of motivation, the assertiveness displayed by large asset managers represents a structural change in corporate governance. As the head of an investing machine with close to $10 trillion in assets under management, BlackRock's Larry Fink commands the attention of the broad corporate governance community and, in particular, of public firm CEOs, since those firms are all part of BlackRock's broadly diversified investment portfolio.[261] And, unlike other players with considerable power to set governance standards (such as proxy advisory firms, for example), BlackRock does not shy away from publicity. As we saw in subpart III.B.1, HCM has been a prominent topic in Fink's annual letters, BlackRock's engagement agenda, and in statements from other asset managers.

Lastly, framing and context have likely played a part as well. HCM is intuitive and non-threatening as a reform agenda, and it appears positively anodyne next to some of the transformational proposals coming from progressive politicians[262] and from prominent corporate governance commentators.[263] HCM was an easy cause for BlackRock to champion and also one that the corporate establishment could get behind at a relatively low cost. In addition to improving firm performance and, particularly for BlackRock, positive publicity, the potential upsides also included improving employee relations and deflecting government-mandated reforms that would be more costly and intrusive.

IV. CRITIQUES AND RECOMMENDATIONS

Building upon the evidence and insights developed thus far, this Part offers a critical assessment of the ways in which HCM is being incorporated into corporate governance as well as specific recommendations focused on the roles played by corporate boards, the SEC, and financial accounting standard-setters. One common

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260. *See, e.g.*, Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1301 (2020); ERNST & YOUNG, SUSTAINABLE INVESTING: THE MILLENNIAL INVESTOR (2017), https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/financial-services/ey-sustainable-investing-the-millennial-investor.pdf [https://perma.cc/GQ75-KA7U].

261. *See About BlackRock*, BlackRock, https://www.blackrock.com/sg/en/about-us [https://perma.cc/NZ8F-SVAH] (last visited Mar. 21, 2021).

262. *See supra* note 51 and accompanying text (summarizing corporate reform bills by Senators Warren, Baldwin, and Sanders).

263. *See* STRINE, *supra* note 4 and accompanying text.

takeaway relates to the need to disambiguate HCM by carefully defining the concept, breaking it down into its appropriate constitutive elements, and, to the extent possible, focusing the relevant discussions on those specific elements. The weight of the empirical evidence and the appropriate policies for boards, the SEC, and standard-setters will vary considerably depending on which element is under consideration; in short, both context and specificity are crucial if the promise of HCM is to be fully realized. Beyond the need for disambiguation, this Part highlights the possibility of strategic use and misuse of empirical studies linking HCM to firm performance, HCM's status as a "mission-critical" area of board oversight (including the meaning and legal consequences of this observation), the flaws in the SEC's open-ended, principles-based approach to HCM disclosure, which ought be revisited, and the importance of involving financial accounting standard-setters (or a suitable substitute body) in developing disclosure policies in respect of workforce training and compensation and human capital valuations.

A. HCM and Firm Performance

The conventional case for HCM in corporate governance is built on the idea that "better" HCM practices contribute to "better" firm performance. There have been numerous empirical studies that lend support to this notion, and they are cited regularly and with authority by participants in the HCM movement.[264] Three related points about the empirical case for HCM disclosure and oversight deserve

264. A comprehensive report published in 2015 analyzed 92 relevant studies and concluded that "in aggregate the literature offers considerable empirical evidence that human capital policies can be material to corporate performance." AARON BERNSTEIN & LARRY BEEFERMAN, INV. RESP. RSCH. INST., THE MATERIALITY OF HUMAN CAPITAL TO CORPORATE FINANCIAL PERFORMANCE 2, 5 (2015), https://lwp.law.harvard.edu/files/lwp/files/final_human_capital_materiality_april_23_2015.pdf. The report focused on studies that used as proxies for firm financial performance indicators widely adopted by institutional investors, including total shareholder return, return on assets, return on earnings, return on investment, return on capital employed, profitability, and Tobin's Q; this was intended to address "a common misunderstanding that the materiality of [HCM information] is not yet backed up by research pertinent to mainstream investors." *Id.* at 4, 6. A different meta-analysis, which reviewed 66 studies, concluded that human capital characteristics, such as education, experience, and training, have positive effects on firm performance. *See* T. Russell Crook et al., *Does Human Capital Matter? A Meta-Analysis of the Relationship Between Human Capital and Firm Performance*, 96 J. APPLIED PSYCH. 443, 443–56 (2011). HCM advocates and the SEC have cited various other studies. *See, e.g.*, Mark A. Huselid, *The Impact of Human Resource Management Practices on Turnover, Productivity, and Corporate Financial Performance*, 38 ACAD. MGMT. J. 635, 643-44 (1995); Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, 101 J. FIN. ECON. 621 (2011).

equal emphasis. First, the empirical studies suffer from various methodological, conceptual, and definitional limitations.[265] Second, most of these limitations are not unique to the HCM area but are, instead, common to the empirical literature on the determinants of firm performance.[266] Third, the studies' limitations are not sufficient reason to dismiss the links between HCM practices and firm performance.

Given that by some estimates there are hundreds if not thousands of relevant studies,[267] it is ultimately impossible to adjudicate the strength of the general empirical case in support of HCM. Disambiguating HCM and examining specific categories is likely to offer better payoffs. In light of the limitations of empirical research on firm performance, however, policymakers and corporate decisionmakers should be wary of making empirical support either a necessary or a sufficient condition for proceeding with HCM-focused reforms in corporate governance. There also needs to be careful consideration of how firm performance is measured and resistance to using one-dimensional metrics. Relatedly, some data-driven research on firm performance is based at least in part on doctrines of scientific management, also known as Taylorism, which have been criticized for their single-minded focus on maximizing worker productivity.[268] The

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265. A recent working paper by Adam Badawi and Frank Partnoy offers a compelling analysis of various problems with the design of ESG metrics and their actual use in academic research. *See* Adam B. Badawi & Frank Partnoy, *Measuring How Corporations Impact Society: The Relationship Between ESG Metrics and Securities Litigation* 9-17 (Oct. 26, 2020), https://insights.truvaluelabs.com/hubfs/Academic%20Research%20Network/ARN_Partnoy_ESGandLitigation.pdf [https://perma.cc/F8MU-TRQU].

266. Some mainstream researchers have uncharitably described this literature as a "factor zoo." *See* Campbell R. Harvey & Yan Liu, A Census of the Factor Zoo 1 (Feb. 25, 2019) (unpublished manuscript), https://ssrn.com/abstract=3341728 ("The rate of factor production in the academic research is out of control. We document over 400 factors published in top journals. Surely, many of them are false."). One of the principal ways of measuring changes in firm value over time, Tobin's Q, does not withstand close scrutiny. *See* Robert Bartlett & Frank Partnoy, *The Misuse of Tobin's* q, 73 VAND. L. REV. 353, 354 (2020) ("Our message for corporate law scholars is straightforward: view with suspicion the large body of empirical law and finance scholarship that misuses Tobin's *q*.") The problems with the metric are further compounded at firms with a large share of intangible assets. *Id.* at 396-98.

267. *See* BERNSTEIN & BEEFERMAN, *supra* note 264, at 4 (reporting that a 2013 paper found 248 articles on the links between "HR policy" and indicators of firm operational performance, whereas a 2009 paper estimated that employee job satisfaction had been studied in approximately 10,000 articles).

268. *See, e.g.*, BRETT FRISCHMANN & EVAN SELINGER, RE-ENGINEERING HUMANITY 59 (2018) (discussing the tenets and applications of Taylorism and noting that "[t]he Taylorist vision of efficient management is focused on minimizing costs associated with misallocated or wasted human capital, effort, and attention"). Frischmann and Selinger also note: "Taylorism and Fordism are famous both for their underlying *objective*, namely, to increase efficiency,

widespread implementation of tools of workforce surveillance in the name of optimizing performance offers new possibilities for scientific management with troubling implications.[269] If the growing emphasis on HCM by boards and investors is fomenting a return to, or the entrenchment of, Taylorism—and this is an important research question for management scholars—then HCM should attract more critical scrutiny as a firm management phenomenon. Such scrutiny can benefit from and enhance the analysis of HCM as a corporate governance phenomenon presented here.

B. HCM and Corporate Boards

Some of the most prominent manifestations of the HCM movement involve changes in board-level governance. As discussed in subpart III.B.3, these have included adding HCM as an area of board oversight, discussing HCM topics as part of board-shareholder engagement, expanding the remit of the compensation committee to cover HCM matters, highlighting HCM as an important area of expertise for director nominees, and even incorporating HCM as a factor in setting incentive-based executive compensation. These extensive changes happening over a short period raise questions about the scope of directors' fiduciary duties, the allocation of decisionmaking authority within the corporation, and the appropriate boundaries of board autonomy.

1. HCM as a "Mission-Critical" Oversight Area

Both the statements and the actions of participants in the HCM movement imply that there is now a presumption that oversight of matters related to the workforce is mission-critical for many modern firms: proper HCM is viewed as an important component of business success, and inadequate HCM could be a source of business risk. When discussing the topic of mandatory HCM disclosure in March 2019, then-SEC Chairman Jay Clayton stated that he "believe[s] that the strength of our economy and many of our public companies is due, in significant and increasing part, to human capital, and for some of those

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quality, and productivity for the ultimate benefit of managers, owners, and capitalists, and *means*, specifically by managing factory workers in various ways that get them to behave like machines." *Id.* at 55.

269. *See Digital Taylorism*, ECONOMIST (Sept. 10, 2015), https://www.economist.com/business/2015/09/10/digital-taylorism (suggesting that "[a] modern version of 'scientific management' threatens to dehumanise the workplace").

companies human capital is a *mission-critical asset*."[270] It is logical to ask, therefore, whether directors' fiduciary duties under state law *require* HCM oversight? Can a board's lack of HCM oversight constitute a breach of fiduciary duties, and, if so, under what circumstances? Fiduciary duties related to oversight are invariably nuanced and contextual, and any liability analysis would depend on the particular facts of the case. The baseline standard for director conduct set by *Caremark* is considered permissive,[271] and for a long time, the case law offered little guidance on the specific subject areas requiring board oversight, speaking broadly of "compliance with law" and "business performance."[272]

Two Delaware cases from 2019, *Marchand v. Barnhill* and *In re Clovis Oncology, Inc. Derivative Litigation*, offered some additional guidance. In *Marchand*, the Delaware Supreme Court overturned the Court of Chancery and allowed a *Caremark* complaint to proceed because, inter alia, the company had "no system of board-level compliance monitoring and reporting" in respect of food safety, which, crucially, was "essential and *mission critical*" for the company.[273] In *Clovis*, the Court of Chancery allowed a *Caremark* complaint to proceed because the board "consciously ignored red flags that revealed a *mission critical* failure to comply with . . . FDA regulations."[274] Interpretations of these cases differ, with the term "mission critical" attracting particular attention.[275]

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270. *See* Clayton, *supra* note 165 (emphasis added).

271. A corporation's board may be liable for breach of fiduciary duty if "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." Stone *ex rel.* AmSouth Bancorp. v. Ritter, 911 A.2d 362, 370 (Del. 2006) (restating and applying the *Caremark* standard). *Caremark* duties fall under the duty of loyalty and not under the duty of care. This is notable because the now-widespread charter exculpation provisions are limited to claims for monetary damages under the duty of care and cannot exculpate directors and officers from liability for breaches of the duty of loyalty. DEL. CODE ANN. tit. 8, § 102(b)(7) (2020).

272. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

273. Marchand v. Barnhill, 212 A.3d 805, 822, 824 (Del. 2019) (emphasis added). The court pointed out that there was "no committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments." *Id.* at 809.

274. *In re* Clovis Oncology Inc. Derivative Litig., No. 2017-0222-JRS, 2019 WL 4850188, at *15 (Del. Ch. Oct. 1, 2019) (emphasis added).

275. After a detailed analysis of the two cases and the various interpretations, Adam Badawi and Frank Partnoy note that "the 'mission critical' standard could support a conclusion

It is worth noting that in addition to "mission critical failure to comply," the *Clovis* court also referenced "'mission critical' regulatory compliance risk," "'mission critical' operations," "mission-critical regulatory issues," and a "mission critical product."[276] This raises the question: Is the key to oversight liability the mission-critical nature of the company's compliance failure, its regulatory compliance risk, its operations, its regulatory issues, its product, or some combination thereof? It is left to future cases to answer this question.

Despite uncertainty with respect to the meaning of the mission-critical standard, HCM's demonstrated importance suggests that HCM oversight failures could result in *Caremark* liability. Actionable failures would look differently at different companies depending on the business model, operations, and the attendant regulatory compliance risks—beyond abiding the law, "the mission" at each company is different, and, hence, what is deemed mission-critical would also be different. As we have seen, some companies identify specific HCM topics they consider important; those that do not would do well to disambiguate "HCM" because the catch-all term covers a wide array of topics, as well as different populations such as non-employee contractors and those employed within the supply chain.[277] Fiduciary duty breaches could potentially result from (1) failures to identify HCM factors (and, hence, failures to implement a system of board-level compliance monitoring and reporting in respect of those factors); (2) failures to implement a system that corresponds to the identified factors; or (3) failure to monitor and oversee the system that has been implemented.

2. The Optimal Locus of Expertise and Control over HCM

Discussions of the need for board oversight of HCM are often based on the unstated premise that moving from the traditional structure where HCM is a management-only issue to a structure where HCM is a strategic issue that commands the attention of both firm management and the board of directors will improve firm performance and risk management. In other words, board involvement and board oversight are indicia of better corporate governance. But involvement and oversight alone are insufficient, and, moreover, could quite

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that oversight standards are related to ESG and sustainability." Badawi & Partnoy, *supra* note 265, at 43.

276. *See Clovis*, 2019 WL4850188, at *12-15.

277. *See* discussion *supra* subpart III.B; discussion *infra* Appendix.

possibly be counterproductive in the absence of adequate expertise and bandwidth. HCM encompasses a host of complex matters; depending on the circumstances, effective board oversight thereof can—with equal legitimacy—reach down to the lower levels of the organizational hierarchy or stop at a more general level. It may well be that full-time management, rather than the part-time boards of directors, would be better placed to oversee HCM policies once they reach a certain level of technical specificity. There is likely to be a different set of optimal arrangements at each firm, which would depend on various attributes of the business, the level of expertise of the board, and other factors. As a result, participants in the HCM movement ought to pay considerably more attention to designing the right oversight structures and determining which matters deserve board time, rather than viewing board oversight as an unalloyed good. Recall that *Caremark* requires boards to implement reporting and information systems and controls and then monitor and oversee these systems and controls. Overloading the board with oversight responsibilities in respect of non-essential and non-mission-critical matters in an overbroad effort to satisfy the first part of the *Caremark* standard of conduct may prevent the board from meeting the second part of the standard due to limitations of either expertise or bandwidth.

In a related vein, it is necessary to carefully consider the appropriate allocation of responsibility for HCM *within* the board. Tasking an already-existing board committee with HCM oversight represents one possible approach, and many boards have selected the compensation committee.[278] Commentators have even urged for the compensation committee to be "reconceived" to focus on employee-related matters.[279] A strong argument in favor of this approach is that by considering both executive and non-executive compensation matters, the committee can ensure broad internal consistency of compensation practices and appropriate "gainsharing" among executives and rank-and-file employees.[280] For example, it may be more difficult for compensation committee members to sign off on below-average employee pay if they have just considered and approved

278. *See* discussion *supra* subpart III.B.C.

279. *See* Leo E. Strine, Jr. & Kirby M. Smith, *Toward Fair Gainsharing and a Quality Workplace For Employees: How a Reconceived Compensation Committee Might Help Make Corporations More Responsible Employers and Restore Faith in American Capitalism*, 76 BUS. LAW. 31 (2020-2021).

280. *Id.* at 51-56.

CEO pay at 75% of the firm's peer group, or to oppose employee unionization if they have just paid for a negotiation lawyer to assist the CEO in bargaining against the firm.[281] In a nutshell, forcing cognitive dissonance on the compensation committee might cause it to make different decisions. It bears noting, however, that boards as a whole have—for decades and without discomfort—presided over decisions that do not reflect gainsharing. In addition, this line of argument in support of vesting HCM oversight with the compensation committee is based on desired changes in substantive decisionmaking, which may be more controversial than arguments with a more neutral normative cadence.

Procedural and institutional considerations militate against assigning most or all HCM oversight responsibility to the compensation committee. First, the compensation committee already has a host of statutory responsibilities related to executive compensation and the CD&A report.[282] Second, even though the compensation committee would be a natural fit for matters related to workforce compensation, such matters comprise a relatively small part of HCM's overall scope, as illustrated by the discussion in Part III. Here again it would be beneficial to disambiguate the various aspects of HCM, spell out oversight duties, and allocate oversight responsibility accordingly. It might be worth considering the merits of a dedicated HCM committee, which can be modeled after the audit and compensation committee.[283] If HCM reporting becomes more detailed, either voluntarily or as a result of new SEC mandates, the need for an HCM committee is likely to become more prominent because of the oversight demands associated with internal and external reporting mechanisms. One of the main responsibilities of the audit committee, generally considered the most important board committee, is to ensure the integrity of financial reporting and the internal systems and controls related to financial reporting. An ESG or sustainability committee covering HCM, in addition to environmental oversight and reporting, presents another possible model of allocating responsibility for HCM within the board. The evolution of boards and board structures is

281. *Id.* at 54.

282. *See* Regulation S-K, Item 402, 17 C.F.R. § 229.402 (2018).

283. Possibilities include giving this committee the power to hire HCM consultants directly and requiring that at least one HCM or HR expert sit on such a committee, much like the Sarbanes-Oxley Act requires the audit committee to have a financial expert.

subject to active academic debate,[284] and the optimal locus of board expertise and control over HCM should be considered as part of this debate.

3. The Dangers of Coercive and Mimetic Isomorphism in Corporate Governance

At their core, firms are complex organizations, and much of corporate governance deals with organizational processes and structures. According to neo-institutional theories, organizations can evolve either as a result of competitive dynamics (e.g., competition in product, capital, or labor markets), or for institutional reasons.[285] There are several different kinds of convergence in organizational processes and structures (termed isomorphism) due to institutional factors: coercive isomorphism, resulting from the imposition of external pressures or mandates;[286] mimetic isomorphism, resulting from organizations copying one another, often under conditions of uncertainty and in a quest for legitimacy;[287] and normative isomorphism, representing convergence stemming from the development of best practices, often in a professional context.[288] This

284. *See* Ronald J. Gilson & Jeffrey N. Gordon, *Boards 3.0: An Introduction*, 74 BUS. LAW. 351, 353 (2019) (advocating a model of "thickly informed, well-resourced, and highly motivated directors who could credibly monitor managerial strategy and operational skill" in the place of "the present board model . . . [of] thinly informed, under-resourced, and boundedly motivated" directors); Faith Stevelman & Sarah C. Haan, *Boards in Information Governance*, 23 U. PA. J. BUS. L. 179, 180-81 (2020) (highlighting the board's role in "knowledge synthesis, reporting oversight, and institutional deliberation constitutive of the firm's identity"); Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401 (2020) (arguing that sustainability oversight can help boards obtain information from internal and external constituencies and mitigate social risk).

285. *See* Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOCIO. REV. 147 (1983).

286. *Id.* at 150 (noting that coercive isomorphism "results from both formal and informal pressures exerted on organizations by other organizations upon which they are dependent and by cultural expectations in the society within which organizations function").

287. *Id.* at 151 ("When organizational technologies are poorly understood . . . when goals are ambiguous, or when the environment creates symbolic uncertainty, organizations may model themselves on other organizations. The advantages of mimetic behavior in the economy of human action are considerable; when an organization faces a problem with ambiguous causes or unclear solutions, problemistic search may yield a viable solution with little expense . . . .").

288. *Id.* at 152 (noting that normative isomorphism stems primarily from professionalization, which is described as "the collective struggle of members of an occupation to define the conditions and methods of their work, to control 'the production of producers' . . . and to establish a cognitive base and legitimation for their occupational autonomy" (quoting

theoretical framework has not been applied to corporate governance before, and it offers particularly useful ways of thinking about the changes being brought about by the HCM movement.

The conditions giving rise to the HCM movement, discussed in subpart III.E, have triggered both uncertainty as to the appropriate level of oversight and disclosure of workforce-related matters and a quest for legitimacy whereby firms seek to demonstrate to external stakeholders, such as investors, proxy advisors, and society at large, that they are doing right by workers. In addition, BlackRock and, to a more limited extent, certain other market players have exerted both formal and informal pressures on firms to comply with a new HCM rulebook that is highly prescriptive with respect to disclosure, engagement, and oversight. Taking this into account, the adaptive behaviors displayed by firms, i.e., the various changes to board-level governance we have observed, bear the characteristics of both mimetic and coercive isomorphism. There have also been processes at play that suggest some degree of normative isomorphism, since various third parties have engaged in the development of best practices. But given the fragmentation of the field, the broad scope of HCM, and its novelty as a corporate governance concern, it is questionable whether these deliberative processes have, thus far, resulted in much guidance that is specific enough to be usable. The other possible explanation for the observed degree of convergence in board practices—competitive dynamics—also seems less likely.[289]

There are serious downsides to both mimetic and coercive isomorphism, which firms and participants in the HCM movement should bear in mind during the next stages of HCM's integration into corporate governance. As far as mimetic isomorphism is concerned, there is little reason to believe that firms will improve their performance in a consistent manner by copying from one another in response to external pressure; to be sure, actual outcomes would depend on the nature and extent of the copying, but the substantial degree of heterogeneity in firm business models and structures suggests caution. In the realm of coercive isomorphism, many of the recommendations for incorporating HCM in board governance follow

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MAGALI SARFATTI LARSON, THE RISE OF PROFESSIONALISM: A SOCIOLOGICAL ANALYSIS 40 (1977)).

289. We can expect that one of the prerequisites for competition on the basis of HCM practices would be adequate information about each firm's practices. To date, such information has been both scarce and low-quality. *See* discussion *supra* subpart III.B.4.

generic checklists formulated by BlackRock. As we have seen, BlackRock actively transmits these recommendations to the firms in its portfolio.[290] The pressure to comply is both implicit given BlackRock's market power and explicit by virtue of BlackRock's declaration that it will hold boards accountable.[291] Perhaps unsurprisingly, recent evidence points to a high degree of compliance with BlackRock's mandates.[292] It is nevertheless doubtful that BlackRock has the legitimacy and accountability to determine the parameters of what constitutes desirable HCM and to set policies that are, in effect, mandatory.

In addition to questions about the propriety of BlackRock's power and influence, there are questions about its resources and expertise, as well as about its incentives. By its own account, BlackRock employs (only) about 45 analysts in its investment stewardship team; these analysts cover approximately 16,000 companies across 85 markets worldwide and an ever-expanding array of subject areas on which BlackRock takes a position.[293] The number of analysts compares unfavorably with the numbers employed by proxy advisors and rating agencies.[294] This lack of capacity can lead to low-quality

290. BlackRock and commentators occasionally refer to these firms as "[BlackRock's] portfolio companies," which is both misleading and telling. BlackRock does not own or formally control these companies, but it often acts as if it does. *See, e.g.*, BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP 6 (2020) [hereinafter BLACKROCK STEWARDSHIP PRACTICES], https://www.blackrock.com/corporate/literature/publication/blk-profile-of-blackrock-investment-stewardship-team-work.pdf [https://perma.cc/5EY8-SU6V] (referencing "our portfolio companies"); Amy Whyte, *Evidence Shows That Larry Fink's Annual Letters Actually Work*, INSTITUTIONAL INV. (Feb. 25, 2021), https://www.institutionalinvestor.com/article/b1qqdhmzgrwbb3/Evidence-Shows-That-Larry-Fink-s-Annual-Letters-Actually-Work [https://perma.cc/QK6J-55J5] (discussing effects of Fink's "public letter[s] to the CEOs of his firm's portfolio companies").

291. *See supra* note 118 and accompanying text.

292. *See* Andrea Pawliczek et al., A New Take on Voice: The Influence of BlackRock's "Dear CEO" Letters (Jan. 2021) (unpublished manuscript), https://ssrn.com/abstract=3763042 (finding that firm disclosures issued immediately following Larry Fink's annual letters echo themes from the letters and that BlackRock rewards compliance by more often siding with management of compliant firms than non-compliant firms in votes on annual shareholder proposals).

293. *See* BLACKROCK STEWARDSHIP PRACTICES, *supra* note 290, at 5, 16. BlackRock claims that its team is the largest in the industry, which implies that other asset managers have an even greater expertise and capacity problem. For prior criticism of asset managers on such grounds, see Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPS. 89 (2017).

294. For example, ISS, which focuses predominantly on issuing corporate governance recommendations, has approximately 2,200 employees across 29 global offices in 15 countries; Moody's Investor Services has approximately 11,400 employees in more than 40 countries. Undoubtedly, many of these employees cover administrative functions, but given

recommendations and the introduction of harmful practices, or, at the very least, to shallow recommendations and pro forma compliance. Finally, due to its status as a universal investor/universal owner, BlackRock has rational incentives to maximize the value of its entire portfolio rather than the value of individual firms within the portfolio.[295] While this approach would not be problematic from the point of view of investors who are fully diversified, some of BlackRock's portfolio-maximizing recommendations may have a negative effect on the value of individual firms within the portfolio and, consequently, result in welfare losses for investors who are either undiversified or differently diversified.

As is often the case in corporate governance, these problems do not have easy solutions, but awareness of them makes it more likely that they can be solved. The push to incorporate HCM oversight in board practices, while well underway, is still in its early stages. By accelerating the development of best practices (and doing so in a coordinated and deliberative manner), participants in the HCM movement can still prevent mimetic and coercive approaches from setting in. In theory, the availability of enhanced information about each firm's HCM policies, the topic to which we turn next, can also facilitate competitive evolution via capital markets (investors evaluating and rewarding firms that display good HCM practices) or labor markets (prospective employees doing the same), which may counterbalance the institutional factors that have dominated thus far.

C. HCM and the SEC

The SEC's adoption of an HCM disclosure rule in August 2020 represented a milestone in the development of the SEC disclosure regime: for the first time, firms were called on to disclose broad information about their workforce. As discussed in subpart III.B.5, however, the HCM disclosure rule reflects an open-ended, principles-based approach. The rule does not prescribe specific information or

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the nature of ISS's and Moody's business, we can also expect that a substantial number of them are analysts. *See About ISS*, ISS, https://www.issgovernance.com/about/about-iss (last visited Mar. 26, 2021) [https://perma.cc/X5BN-X3MM]; *Investor Relations*, MOODY'S, https://ir.moodys.com/home/default.aspx (last visited Mar. 25, 2021) [https://perma.cc/GT89-E7YC].

295. Since BlackRock's aggregate equity portfolio is roughly weighted by market capitalization, focusing on strategies tailored to the largest firms, which represent the largest share of the portfolio, would have a more beneficial aggregate effect than focusing on strategies tailored to smaller firms. The large-firm strategies, however, are likely inappropriate for smaller firms and may hurt these firms and their investors.

metrics subject to disclosure, and, instead, calls for "a description of [the company's] human capital resources, including any human capital measures or objectives [it] focuses on in managing the business"; the information is required "to the extent such disclosure is material to an understanding of the [company's] business taken as a whole."[296] The SEC's approach was not entirely unreasonable, but it was nevertheless inadequate. This subpart critiques the HCM disclosure rule as it currently stands and offers recommendations for a potential future round of HCM rulemaking.

1. From HCM Materiality to HCM Disclosure Rulemaking

As a preliminary matter, it is worth emphasizing one important outcome from the SEC rulemaking process: The work of the SEC's Investor Advisory Committee (IAC) and the extensive feedback from numerous investors, including investors with different profiles, demonstrated the significance of HCM as a mainstream investor concern. Moreover, the SEC was unanimous in its judgment that an HCM disclosure requirement was warranted. The two Republican commissioners and the SEC Chairman voted in favor of the rule, whereas the two Democratic commissioners voted against it on the grounds that it did not go far enough.[297] This agreement about the materiality of HCM as a disclosure area is notable because virtually all new disclosure requirements adopted during the 2010s—including congressionally-mandated requirements pursuant to the Dodd Frank Act—were opposed by Republican SEC commissioners on the grounds that the topics they covered were not material to investors.[298]

296. *See supra* note 158 and accompanying text.

297. *See supra* note 178 and accompanying text (quoting statements of SEC Commissioners Allison Herren Lee and Caroline Crenshaw).

298. *See, e.g.*, Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at the 34th Annual Current Financial Reporting Issues Conference (Nov. 16, 2015), https://www.sec.gov/news/speech/piwowar-current-financial-reporting-issues-conference.html [https://perma.cc/XX5U-P5BS] (criticizing the SEC's adoption of congressionally-mandated pay ratio and conflict mineral disclosure rules and arguing that "[t]he focus on non-material, special interest disclosure provisions is a deplorable corruption of our mission to protect investors, to ensure fair, orderly, and efficient markets, and to facilitate capital formation"); *see also* Business Roundtable, BRT Letter on the Core Principles for Regulating the U.S. Financial System (Sept. 1, 2017), https://www.businessroundtable.org/brt-letter-on-the-core-principles-for-regulating-the-usfinancial-system [https://perma.cc/BMS2-EKSF] (arguing that certain Dodd-Frank disclosure rules are in conflict with "the materiality standard for public company disclosure"). Setting aside the substantive merits of these assertions of non-materiality, the legal logic motivating them is flawed. Contrary to arguments made in the context of Dodd-Frank rule implementation, when a disclosure rule is mandated by Congress, there is no

In short, the SEC rulemaking process served to reveal the materiality of human capital as an investor concern.

But how do we go from a broad finding of materiality to crafting a rule that elicits material information? And what does "material" mean in this context? Note that throughout the HCM rulemaking process (and the much-lengthier process of disclosure regime modernization during the 2010s) the SEC invoked the formulation of materiality stemming from the 1976 Supreme Court case *TSC Industries v. Northway*.[299] Materiality is one of the required elements for establishing securities law liability resulting from a misstatement or omission of information. As part of its explication of the liability test, the *TSC Industries* court noted that information is material if there is a "substantial likelihood that a reasonable [investor] would consider it important" in making an investment or voting decision; in other words, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[300]

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requirement that it meet a test of materiality before it is required to be implemented by the SEC. Congress's determination that a particular disclosure rule is warranted renders the information covered by the rule presumptively material. Materiality is not a constitutional requirement, and, moreover, no act of Congress has ever limited the SEC's general authority to promulgate public company disclosure rules by requiring that such rules be material. The Supreme Court has never taken a case challenging the validity of an SEC-adopted disclosure rule (much less a congressionally-mandated disclosure rule) on materiality or any other grounds. When the D.C. Circuit has struck down SEC rules, it has been for failure to carry out adequate cost-benefit analysis; the D.C. Circuit has not found that cost-benefit analysis requires an assessment of materiality. *See, e.g.*, Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011); Chamber of Com. v. SEC, 412 F.3d 133 (D.C. Cir. 2005). The closest the D.C. Circuit has come to considering materiality in the context of SEC disclosure rulemaking has been to rule that the SEC is entitled to deference in its determination on the materiality (or lack thereof) of particular topics. During the 1970s, the National Resources Defense Council challenged the SEC's refusal to pursue disclosure rulemaking in response to its petition, which the SEC had justified on the grounds that the requested information was not material; the D.C. Circuit sided with the SEC. *See* Nat. Res. Def. Council, Inc., v. SEC, 606 F.2d 1031 (D.C. Cir. 1979). These points are important because it is likely that any expansion of the SEC's HCM disclosure rule along the lines advocated in subpart IV.C.3, as well as any new ESG or climate change disclosure rules, will be criticized and potentially challenged on materiality grounds.

299. Former SEC Chairman Jay Clayton has repeatedly cited the *TSC Industries* definition as the test for whether a new disclosure requirement is warranted, and other SEC Commissioners have done the same. *See, e.g.,* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, *Remarks on Telephone Call with Investor Advisory Committee Members*, SEC. & EXCH. COMM'N (Feb. 6, 2019), https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-call-020619 [https://perma.cc/5ZX9-B32G] (setting out requirement for "materiality—as so well defined by Justice Marshall [in *TSC Industries*]").

300. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (defining materiality in the context of a proxy fraud action under Rule 14a-9); Basic Inc. v. Levinson,

In making the determination of materiality in the context of securities fraud cases, courts apply a variety of judge-made heuristics, and, for practical purposes, require evidence that a particular misstatement or omission had an impact on the company's stock price.[301] If the investor-plaintiff cannot show stock market impact, then the misstatement or omission in question is deemed not material, and hence there is no legal liability. This process may work reasonably well in the context of adjudicating liability ex post, but it is of little utility in setting disclosure requirements ex ante.

Before analyzing the SEC's open-ended, principles-based approach to HCM disclosure, which uses the *TSC Northway* formulation of materiality as its sole guidepost, consider how the SEC has approached similar problems in the past. On multiple occasions when it has decided (or been directed by Congress) to incorporate into the disclosure regime a requirement pertaining to a new asset class or a new disclosure topic, the SEC has set out to develop an information-generating framework containing specific guidance; these processes have often taken years of sustained work to complete. For example, during the 1970s, the SEC developed a framework for the disclosure of oil and gas assets with input from relevant stakeholders.[302] Following the global financial crisis, the SEC developed a framework for the disclosure of statistical information about asset-backed securities.[303] There is also a dedicated framework related to

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485 U.S. 224, 231–32 (1988) (adopting the *TSC Industries* materiality formulation in the context of securities fraud actions under Rule 10b-5).

301. *See* George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 620-25 (2017) (examining the content of the materiality standard, various approaches to applying it, and the associated challenges).

302. *See* Modernization of Oil and Gas Reporting, Securities Act Release No. 33-8995, Exchange Act Release No. 59192, 74 Fed. Reg. 2158, 2159 (Jan. 14, 2009) (discussing the history of the oil and gas disclosure framework). The disclosure requirements were introduced pursuant to a directive in the Energy Policy and Conservation Act of 1975, which required the SEC to "take such steps as may be necessary to assure the development and observance of accounting practices to be followed in the preparation of accounts by persons engaged, in whole or in part, in the production of crude oil or natural gas in the United States." *See* 42 U.S.C. §§ 6201–6422. In formulating and refining the oil and gas accounting framework, the SEC worked with the Department of Energy, the Society of Petroleum Engineers (a global organization), and other expert agencies; in addition, it outsourced some of the work to FASB. This model of multi-stakeholder involvement can be deployed in any future round of HCM disclosure rulemaking.

303. *See* Asset-Backed Securities Disclosure and Registration, Securities Act Release No. 33-9638, Exchange Act Release No. 72982, 79 Fed. Reg. 57,184, 57,186 (Sept. 24, 2014) (adopting new rules because "the financial crisis highlighted that investors and other participants in the securitization market did not have the necessary information and time to be

information about executive compensation.[304] With respect to financial information, Regulation S-X sets out detailed disclosure rules, whereas the staff accounting bulletins, the SEC's financial reporting manual, and other documents provide extensive guidance.[305] Finally, the SEC spent more than two decades developing the MD&A disclosure framework to ensure accurate and comparable reporting, even though in theory the goal of MD&A is simply to allow the investor to see the firm's performance and results of operations "through the eyes of management."[306] In each of these cases, the disclosure rules use the concept of materiality in a targeted way—to qualify specific disclosure items in order to prevent the overdisclosure of information. Cognizant of the difficulties firms encounter in making materiality determinations, the SEC has also issued materiality guidance applicable in specific circumstances, such as Staff Accounting Bulletin 99 (qualitative materiality of financial information)[307] and Item 303 of Regulation S-K (disclosure of forward-looking information).[308]

Contrary to its historical approach and despite HCM's complexity and novelty as a disclosure area, the SEC did not find it necessary to develop an HCM information-generating framework or offer any guidance for making HCM materiality determinations. Instead, the SEC placed its full faith behind the *TSC Industries*

able to fully assess the risks underlying asset-backed securities and did not value asset-backed securities properly or accurately").

304. *See supra* notes 136, 282 and accompanying text.

305. *See Staff Interpretations*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/interps.shtml [https://perma.cc/2P6J-LR9A] (last updated Jan. 8, 2021).

306. *See* Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48960, 68 Fed. Reg. 75,056 (Dec. 29, 2003) (providing supplemental guidance on key topics and summarizing prior guidance since 1980).

307. *See* SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 19, 1999). The SEC noted that SAB 99 "is not intended to change current law or guidance in the accounting or auditing literature." *Id.* at 45,155. The wording of the accounting definition of materiality does not track *TSC Industries*, and stakeholders disagree on whether the two definitions are identical in substance.

308. *See* Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 6835, Exchange Act Release No. 26831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427, 22,430 n.27 (May 24, 1989) ("[Item 303] mandates disclosure of specified forward-looking information, and specifies its own standard for disclosure—i.e., reasonably likely to have a material effect. . . . The probability/magnitude test for materiality approved by the Supreme Court in *Basic* . . . is inapposite to Item 303 disclosure."). This statement further contradicts assertions that materiality as defined in *TSC Industries* (from which *Basic* derives) is the universal "touchstone" of the public company disclosure regime.

formulation of materiality, in effect trusting it to serve as an automatic, self-executing disclosure criterion. This was part and parcel with the SEC's repeated emphasis on "principles-based disclosure requirements rooted in materiality" between 2016 and 2020.[309] But can such an open-ended, principles-based approach to HCM disclosure elicit information about the many different HCM topics that investors have attested are material to their decisionmaking?

2. The Missing Principles for "Principles-Based HCM Disclosure"

The principles-based approach reflected in the August 2020 HCM disclosure rule is inadequate for several related reasons: it gives firms too much discretion and not enough guidance about what to disclose; it fails to produce a baseline "mix of information" that could enable firms to make the extensive materiality judgments it requires; and it fails to elicit information that is comparable, standardized, and decision-useful for investors. The question of adequacy is in part an empirical one. Preliminary evidence from the first round of HCM disclosure, as well as prior evidence about voluntary HCM disclosure (discussed in subparts III.B.5 and III.B.4, respectively), suggests that the quality of disclosure provided by firms has been low so far, which validates the theoretical and practical concerns raised below. It bears

309. Indeed, a review of public statements and speeches by SEC commissioners during this period suggests that if an observer who knew nothing about securities regulation set out to read these public statements and speeches, the observer would come away thinking that there is little more to the disclosure regime than the *TSC Industries* formulation of materiality; the observer would learn nothing about the specialized disclosure rules and materiality guidance discussed above. *See, e.g.*, Clayton, *supra* note 299 (emphasizing that the SEC's disclosure requirements must be rooted in the principle of materiality as defined in *TSC Industries*)*;* Elad L. Roisman, Comm'r, U.S. Sec. & Exch. Comm'n, Keynote Speech at the Society for Corporate Governance National Conference (July 7, 2020), https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020 [https://perma.cc/RJH7-S94Q] ("Materiality is the touchstone of our public company disclosure regime . . . a standard that has been defined by the Supreme Court [in *TSC Industries*] and followed for decades. I am a proponent of the SEC's principles-based materiality standard now more than ever."). Yet, the brief statement of Commissioner Hester Peirce upon the conclusion of the Regulation S-K rulemaking process in August 2020 gives away the fact that instead of ensuring conformity with a longstanding "touchstone"—a rather uncontroversial proposition—the SEC's open-ended, principles-based approach moves the goalpost. *See* Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Statement at Open Meeting on Modernization of Regulation S-K 101, 103, and 105, U.S. SEC. & EXCH. COMM'N (Aug. 26, 2020), https://www.sec.gov/news/public-statement/peirce-reg-s-k-2020-08-26 [https://perma.cc/HFQ4-5X9U] (noting that she "would have preferred to eliminate *the remaining vestiges of a prescriptive approach*, such as the requirement to disclose the number of employees" (emphasis added)).

noting that most of these concerns also apply to ESG disclosure areas beyond HCM, including climate-related disclosures.

A principles-based approach to HCM disclosure can work only if the SEC supplies principles that are sufficiently clear to guide firms' disclosure decisions. The *TSC Industries* formulation of materiality—while elegant and superficially intuitive—cannot in and of itself serve as such a principle. It asks firms to step into the shoes of a fictional "reasonable investor" and make predictive judgments about the significance the reasonable investor would ascribe to information about each of the many broad categories that fall within the domain of HCM.[310] Notably, because HCM information is unlike any of the other types of information currently part of the disclosure regime, existing materiality guidance in respect of the latter is of little help. Moreover, whereas many disclosure areas have a financial component covered by the accounting regime, which can aid in making difficult materiality and disclosure determinations, HCM information is not covered by the accounting regime, which means that it, too, cannot be a source of guidance. In the absence of guidance, firms can be expected to take advantage of the discretion afforded by the rule and avoid disclosure when it makes rational sense to do so.

The decision whether or not to disclose information is binary by necessity, but materiality itself is not—it often exists in a gray, probabilistic space where an argument can be made both that something is material and that it is not. In practice, this means that in many cases the disclosure decision is not the result of a conclusive finding of materiality, but, rather, of the weighing of the costs of disclosure against the risk of liability for non-disclosure. With an open-ended HCM disclosure rule and no prescribed disclosure categories, the risk of both detection and liability are substantially lower.

Relying on the *TSC Industries* formulation of materiality to elicit all relevant disclosure also sets a very high bar in terms of significance and administrability. Consider the difference between the information-generating frameworks described in subpart IV.C.1 and the HCM disclosure rule. The information-generating frameworks relate to *matters* that have been deemed broadly material; the *specific items* included in the frameworks are either not subject to a separate materiality test or, when they are, are subject to a materiality test in a

310. *See* Georgiev, *supra* note 301, at 624 (discussing the concept of the reasonable investor as used in the context of materiality determinations under *TSC Industries*).

very targeted way. For example, Item 1202 of Regulation S-K requires disclosure of various types of natural resource reserves (proved, probable, possible, developed, undeveloped) by continent for oil, natural gas, synthetic oil, and synthetic gas.[311] The rule does not require the materiality of each individual item to be tested using the *TSC Industries* test, and for good reason. The summary executive compensation table required by Item 402(c)(1) of Regulation S-K takes the same approach: it requires disclosure of the salary, bonus, stock awards, stock option awards, and other specified elements of executive compensation without subjecting the elements or the amounts involved to the *TSC Industries* test. By contrast, the HCM disclosure rule is designed in a way that subjects every single piece of information to the *TSC Industries* test. In addition to being difficult and potentially unreliable, as discussed above, these materiality judgments are also costly in terms of management time and input from legal and other advisers. The SEC extolled the benefits of the flexibility afforded by an open-ended, principles-based approach, but it failed to take into account the costs associated with putting all HCM-related information through the dense and resource-intensive sieve that is the *TSC Industries* materiality test.

Another problem with the SEC's open-ended approach premised on *TSC Industries* is that it is arguably inconsistent with a close reading of the *TSC Industries* case itself. Recall that *TSC Industries* applies materiality in the context of an ex post inquiry into securities fraud liability. Notably, the case uses the concept of "the total mix of information made available": this is the baseline against which courts are to test the materiality of any misstatement or omission in order to determine whether it can support a finding of liability. As such, *the case pre-supposes the existence of a "total mix" of relevant information*; without a total mix, there is no baseline against which to test—and the materiality test itself does not work. To be sure, part of the total mix comes from voluntary disclosure, but voluntary disclosure alone cannot produce a balanced picture of the underlying reality that would serve as a baseline for determining liability.[312] Implicitly, then, it is the SEC's job to design an

311. *See* Regulation S-K, Item 1201 (Disclosure of Reserves), 17 CFR § 229.1202 (2019).

312. *See, e.g.,* Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999) (discussing the inadequacy of a voluntary disclosure approach to securities regulation).

information-generating framework that produces the appropriate total mix. Seen this way, *TSC Industries* does not prohibit the SEC from mandating disclosure items that eschew the *TSC Industries* test for materiality; instead, *TSC Industries* practically requires the SEC, as the regulator in charge of securities markets, to mandate such disclosure items.[313] Without a proper total mix of information, the enforcement structure of securities regulation would simply struggle to work.

In a related vein, the total mix needs to include consistent information about other firms, so that investors can compare firms for purposes of making investment decisions. Without comparable information, even individual materiality and disclosure judgments may be difficult. The first part of the *TSC Industries* formulation, which is the part the SEC most often alludes to, obscures the reality that materiality is a contextual judgment and that the relevant context often transcends the individual firm. Consider a firm with a particular rate of workplace health and safety accidents. For purposes of determining the materiality of this HCM information and, hence, the existence of a duty to disclose, the *TSC Industries* test requires the firm to discern (1) whether there is a substantial likelihood that the reasonable investor would consider this information important in making an investment decision, or, in other words, (2) whether there is a substantial likelihood that the reasonable investor would view this information as significantly altering the total mix of available information.[314]

To make this judgment, the reasonable investor would almost certainly need to know how the firm's rate of workplace health and safety accidents compares to the rate at other firms. If it is significantly above the norm, the information would be material and the firm would have a duty to disclose it. The problem, of course, is that even though the firm in question cannot judge the materiality of its own information without also knowing the same information about other firms, those

313. It is possible to argue that the total mix itself should only contain material information, but then the *TSC Industries* test would suffer from an endogeneity problem. On a conceptual level, materiality is both contextual and relative—significant information takes on the property of materiality by comparison to information that is less significant and hence not material. The total mix therefore should contain information of various levels of significance in order to enable such comparative judgments.

314. *See supra* note 300 and accompanying text (stating the *TSC Industries* formulation of materiality). While courts have elided this question, the right way to think about the two parts of *TSC Industries* is as alternative methodologies for testing for materiality, either one of which should be sufficient to render a piece of information material.

other firms do not have an absolute obligation to disclose their own information; under the principles-based approach, their disclosure obligations are also contingent on a materiality determination. Firms' materiality judgments, in other words, are inextricably linked, but the unstructured, open-ended HCM disclosure rule does not take this reality into account.[315] And even if different firms end up releasing the same types of information, which would in theory make comparisons possible, the absence of standardized metrics would render such comparisons meaningless or, worse, misleading.[316] Carrying on with the example of the rate of workplace health and safety accidents, this rate needs to be standardized so that it is comparable across firms, which involves using the same definition of an accident in terms of severity and covering the same employee base.

In its release adopting the HCM disclosure rule, the SEC acknowledged investors' concerns about the lack of comparability under a principles-based approach but then quickly dismissed those concerns by simply stating: "we do not believe that prescriptive requirements or a designated standard or framework will ensure more comparable disclosure given the variety in registrant operations as well as how registrants define, calculate, and assess human capital measures."[317] This statement is illogical on its face—the purpose of imposing any standard or framework would be to ensure that firms with different operational profiles define and calculate information in a consistent way. Comparability will come about only *after* a standard or framework is put in place; to say that comparability is not possible because there currently isn't any comparability makes little sense. The only reasonable inference that can be drawn from the SEC's strained justification for going with a principles-based approach is that the SEC believes that HCM information cannot be standardized in the same ways that other types of information have been standardized. Yet, the SEC offers no support for this bold assertion, and the assertion is contradicted by the available evidence discussed in subpart III.B of this

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315. For a general discussion of the interfirm effects of securities disclosure, see Georgiev, *supra* note 301, at 652-54.

316. The GAO report on voluntary ESG disclosure practices, discussed in subpart III.B.4, illustrates this point. The GAO report also noted that even firms purporting to use the same disclosure frameworks sometimes end up presenting information differently. This may be seen as a problem with the frameworks as they exist today, but it is likely to be at least as much a problem with firms' diligence and expertise in applying the frameworks.

317. Reg. S-K 2020 Modernization Release, *supra* note 158, at 63,739.

Article.[318] To be sure, some HCM measures will be easier to standardize than others; some may even be impossible to standardize. But there are plenty of measures that would be easy to standardize: in addition to the rate of workplace accidents discussed above, such easy-to-standardize measures include voluntary and involuntary turnover (discussed in subpart IV.C.3 below), annual amounts spent on workforce training and compensation (discussed in subpart IV.D.1 below), and others.

3. HCM Disclosure Rulemaking Round Two

In light of the foregoing critique, it would be advisable for the SEC to engage in a second round of rulemaking with a view to expanding the August 2020 HCM disclosure rule. This should be a dedicated and deliberative process involving multiple stakeholders.[319] Even though it has fairly limited experience with HCM to date, the SEC is still best placed to serve as a nexus for coordination among the many participants in the HCM movement described in subpart III.B, as well as any new participants such as financial accounting standard-setters (as recommended in subpart IV.D).[320] Developing an information-

318. This includes the detailed HCM disclosure frameworks developed by SASB, GRI, ISO, and others. There is also an entire academic subdiscipline of human resource accounting, dating back to the 1960s, which neither the SEC nor the private standard-setters have engaged. *See* FLAMHOLZ, *supra* note 17; *see also infra* notes 341 & 346 and accompanying text.

319. This is in line with the process envisioned in the March 2019 recommendations of the SEC Investor Advisory Committee; the SEC did not follow these recommendations. *See supra* note 164 and accompanying text.

320. The mission of the SEC includes promoting capital formation. Though it is frequently invoked, particularly as a counterweight to imposing new investor-protection measures, the term "capital formation" does not have a statutory definition. It is generally understood to refer to firms' ability to raise financial capital. Evidence suggests, however, that firms in certain industries have a much harder time attracting human capital than financial capital and that human capital is much more important to these firms' success. *See, e.g.*, Vijay Govindarajan et al., *Why We Need to Update Financial Reporting for the Digital Era*, HARV. BUS. REV. (June 8, 2018), https://hbr.org/2018/06/why-we-need-to-update-financial-reporting-for-the-digital-era (noting that "[f]inancial capital is assumed to be virtually unlimited, while certain types of human capital are in short supply"); Eric Ries, *Foreword*, *in* SCOTT KUPOR, SECRETS OF SAND HILL ROAD: VENTURE CAPITAL AND HOW TO GET IT, at xi (2019) (observing that "[p]ossibly for the first time in history, we're talent-constrained instead of capital-constrained"). If certain firms do not need help with raising financial capital but do have a problem attracting human capital, then there is at least an argument to be made that in today's economy the reference to capital formation in the SEC's mission should be understood to encompass *human capital* formation in addition to financial capital formation. The SEC can promote human capital formation with the tools that have traditionally been at its disposal: mandated disclosure (adding information that would help firms attract human capital) and oversight of equity issuances (since the employees of start-ups often receive various equity instruments in exchange for their investment of human capital).

generating framework for HCM disclosure involves both formulating specific disclosure items and deciding on larger conceptual issues; whereas the former can be delegated to a third party, the latter often involve complex policy judgments, which require a decisionmaker with both regulatory expertise and democratic legitimacy. Based on the analysis presented in this Article, the following conceptual issues and recommendations deserve consideration as part of any future HCM rulemaking initiative.

Disambiguating HCM. An important challenge to formulating specific disclosure rules stems from the broad nature of the notion of HCM. As illustrated in Part III and the Appendix, stakeholders have included a wide variety of general categories under the catch-all umbrella of HCM, and there is no complete overlap among these different conceptions of HCM. There is even less overlap among the specific information items and metrics that fall within the different general categories. To this end, any future SEC rulemaking should seek to disambiguate HCM and promote a focused discussion of individual categories, such as training and development, diversity and inclusion, workforce compensation, etc. It should be much easier to argue that a metric within a particular category, such as the rate of voluntary and involuntary workforce turnover or total compensation expense, for example, is material and should be disclosed, than to make the same argument for one of the highly-detailed HCM disclosure frameworks discussed in subpart III.B.7. Relatedly, the SEC can consider mandating the disclosure of a limited set of information categories and metrics at first and then revisit the matter on a periodic basis.[321]

Standardization and Comparability. Not all HCM information lends itself to standardization and comparability across firms, but important categories that can be standardized should be. As discussed above, the materiality of a particular piece of firm-specific information often depends at least in part on information provided by other firms. For an investor, the rate of voluntary turnover at a given firm is likely to mean little on its own—to interpret the information, the investor would need to know both the historical trends at the particular firm and, importantly, how the firm compares to its peers. In order for investors to make such inter-firm comparisons for purposes of investment or

321. In its October 2019 comment letter, the Human Capital Management Coalition proposed a set of basic disclosure categories, which in its view are fundamental to human capital analysis. These disclosure categories will be a particularly sensible starting point for any expansion of the HCM disclosure rule. *See* HCMC Letter, *supra* note 173, at 26.

voting decisions, firms should disclose the same types of information, and this disclosure needs to have informational integrity (i.e., be accurate, comprehensible, and complete).[322]

The Comply-or-Explain Option. A comply-or-explain approach to disclosure may offer a middle ground between highly-prescriptive line items and the existing open-ended, principles-based HCM disclosure rule. The SEC could come up with specific HCM metrics that would be required, but, importantly, allow firms to opt out of disclosure so long as they state a valid reason for doing so.[323] Under this approach, a firm would be able to avoid the disclosure of an ill-fitting metric, but it should not be able to avoid disclosure of otherwise relevant information for opportunistic reasons. Another way to think of the comply-or-explain approach is as a system of pre-set defaults, a favored approach in corporation and other entity statutes at the state level.[324] The comply-or-explain approach has been used effectively in the United Kingdom and elsewhere.[325] An affirmative representation that a particular metric or type of information is not material for a particular firm is much more helpful to investors than the observed absence of the metric or type of information from the unstructured HCM narrative; such an affirmative representation also makes public and private enforcement for disclosure violations much easier than it otherwise would be.

Regulatory Choice About False Positives vs. False Negatives. In determining its overall approach to HCM disclosure and the need to disclose particular types of information, the SEC should consider the relative costs of false positives (disclosure of immaterial information) and false negatives (non-disclosure of material information), also known as Type I and Type II errors, respectively. Assuming that disclosure requirements cannot be calibrated with precision, which kind of imprecision is worse: overdisclosure or underdisclosure? While the issue deserves systematic analysis, there is reason to believe that the cost of false negatives would be greater than the cost of false positives; this, in turn, suggests that the SEC should seek to avoid rules

322. *See* Bank & Georgiev, *supra* note 34, 1180-89 (discussing the notion of informational integrity—the accuracy, comprehensibility, and completeness of information subject to mandatory disclosure).

323. *See* Virginia Harper Ho, *"Comply or Explain" and the Future of Nonfinancial Reporting*, 21 LEWIS & CLARK L. REV. 317 (2017) (describing the "comply or explain" approach).

324. *See* Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391, 1396-97 (1992).

325. *See* Harper Ho, *supra* note 323.

that elicit too little information, even if this comes at the expense of occasional overdisclosure. The costs of requiring the disclosure of immaterial information would include increasing the regulatory burden on firms, and arguably exposing investors to "information overload." The first concern is mitigated by the fact that firms already possess at least some of the information that may be mandated for disclosure,[326] whereas the second concern stems from a model of investor information gathering and processing that does not fully reflect present-day reality.[327] Given the resource-intensive nature of materiality determinations and the potential for strategic nondisclosure due to the low likelihood of detection and liability, as discussed above, the argument that certain basic information items should not be prescribed for disclosure because they may not be universally material seems particularly unpersuasive.[328] Relatedly, even requiring the disclosure of clearly material information is sometimes called into question on the grounds that the required information may be commercially sensitive;

326. Such is the case, for example, with the Equal Employment Opportunity Commission's EEO-1 Report, which requires most firms to provide a record of their employment data categorized by ethnicity, race, gender, job category and designated salary bands. *See EEO-1 Frequently Asked Questions and Answers*, U.S. EQUAL EMP. OPPORTUNITY COMM'N, https://www.eeoc.gov/employers/eeo-1-survey/eeo-1-frequently-asked-questions-and-answers [https://perma.cc/VS4Z-GJJE] (last visited Sept. 29, 2020); *see also* Edkins, *supra* note 161 ("Investors recognize that most companies are already in possession of HCM data on their workforce, but are cautious of disclosing this information."); SEC INV. ADVISORY COMM., *supra* note 161, at 3 ("Companies use many metrics to evaluate the success of their HCM strategies and investments.").

327. *See* Georgiev, *supra* note 301, at 670-72 (presenting a critical assessment of the information overload hypothesis and the associated evidence); Erik F. Gerding, *Disclosure 2.0: Can Technology Solve Overload, Complexity, and Other Information Failures?*, 90 TUL. L. REV. 1143 (2016) (suggesting that the information overload hypothesis is overstated and that technical solutions can ameliorate most information overload problems).

328. During the HCM rulemaking process, the concern that the SEC might accidentally mandate disclosure of some piece of information that is not universally material, and thereby dilute the dubious purity of the principles-based approach, reached extreme proportions: the SEC's 2019 proposing release suggested abolishing the "number of employees" disclosure requirement, which until 2018 was the lone workforce-related disclosure item, and leaving the disclosure decision to firms' materiality calculus. It is unclear under what circumstances the reasonable investor would not wish to know the number of employees, how supplying this information might contribute to information overload, or what would be saved by deleting the requirement to provide it from Regulation S-K. The SEC reversed course in the final release but did not offer a justification for treating the number of employees differently than, say, information about turnover, workforce compensation expense, or workforce training expense. *See* Reg. S-K 2020 Modernization Release, *supra* note 158, at 63,739, 63,755 n.333 (citing empirical studies about financial materiality of both annual growth in employee count and employee turnover but failing to explain why a prescriptive rule is warranted for the former and not the latter).

this objection appears less persuasive in the context of HCM because of the difficulty in replicating a firm's success by copying its HCM policies.[329]

D. HCM and Financial Accounting

Financial accounting standards are central to corporate disclosure and reporting and play an important, albeit sometimes ignored, role in corporate law.[330] Financial accounting has received little attention from participants in the HCM movement: as discussed in Part III, the focus has been, instead, on developing new disclosure frameworks centered around HCM. Relatedly, FASB has been conspicuously absent from the ongoing HCM discourse. One explanation for this is the inability of generally accepted accounting principles (GAAP) to account for any type of intangible asset (and not just human capital), a decades-long problem that remains unresolved despite its growing urgency.[331] This subpart highlights inadequacies in the current state of affairs and suggests that financial accounting has an important part to play if human capital concerns are to be effectively incorporated in corporate governance.

The focus is on two issues: (1) the undifferentiated presentation of firms' human capital spending on firms' income statements, and (2) the absence of any accounting for the value of human capital assets

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329. *See, e.g.*, Alden M. Hayashi, *HR Information Disclosure*, MIT SLOAN MGMT. REV. (Apr. 15, 2003), https://sloanreview.mit.edu/article/human-resources-hr-information-disclosure (suggesting that human capital, unlike traditional resources such as land and equipment, is difficult to replicate successfully). Separately, as I have argued elsewhere, any competitive costs may in fact be offset by competitive benefits that accrue to other firms. When engaging in rulemaking, the SEC is required by statute to consider "in addition to the protection of investors, whether the [rulemaking] will *promote* efficiency, competition, and capital formation." *See* Georgiev, *supra* note 301, at 659 (emphasis added) (quoting 15 U.S.C. § 77b(b), § 78c(f)). A number of empirical and theoretical studies have shown that disclosure can promote competition, which suggests that disclosure rules may offer an added benefit, which the SEC should consider when engaging in cost-benefit analysis. Nevertheless, the SEC generally uses competition in the opposite way, as an argument against imposing additional disclosure requirements. *See id.* at 658-62.

330. *See, e.g.*, A. A. Berle, Jr., *Accounting and the Law*, 13 ACCT. REV. 9, 9 (1938) (stating that "rules of accounting have become, in large measure rules of law").

331. *See, e.g.*, WAYNE S. UPTON, JR., FIN. ACCT. STANDARDS BD., PUB. NO. 219-A, SPECIAL REPORT: BUSINESS AND FINANCIAL REPORTING, CHALLENGES FROM THE NEW ECONOMY (2001), http://www.cs.trinity.edu/~rjensen/Calgary/CD/fasb/uptonApril01.pdf [https://perma.cc/ET6L-SPYT] (summarizing challenges with the accounting treatment of intangibles from FASB's perspective); BLAIR & WALLMAN, *supra* note 250. An ongoing, multi-stage FASB project examining intangibles does not cover human capital. *See supra* note 231 and accompanying text.

on the asset side of firms' balance sheets. Whereas questions of board oversight over HCM and HCM disclosure have dominated conversations about HCM, the more technical issues discussed below have received very little attention. The discussion is framed with reference to FASB and the traditional financial accounting regime, but most of the information in question can also be elicited through disclosure rules put in place by the SEC.

1. Human Capital Spending

The most significant human capital-related expenses incurred by firms relate to employee compensation (salaries, bonuses, and benefits, including retirement benefits) and firm-sponsored workforce training. In both instances, these costs are lumped together with other expenses on the income statement, which obscures relevant information and makes human capital spending an attractive target during cost-cutting rounds.[332]

Under current rules, *workforce training expenses* are part of selling, general, and administrative expenses (SG&A), a general category that covers overhead items ranging from marketing expenses, to professional services, to office supplies. As a catch-all category, SG&A often contains expenses arising from inefficiencies. Understandably, investors view high SG&A amounts or year-on-year increases in SG&A amounts as a negative signal about the firm's current operations and future prospects; conversely, lower SG&A amounts or year-on-year reductions in SG&A amounts are viewed as a positive signal.[333] A firm can therefore improve its bottom line in the short term by foregoing productivity-enhancing workforce training or cutting existing training, even though such actions would be damaging in the longer term. Notably, this treatment of workforce training spending stands in contrast to the treatment of R&D spending, which

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332. In line with accounting conventions, I refer to spending on human capital as an *expense* and not an *expenditure*, even though the term expenditure more accurately reflects the long-term productive capacity of human capital. Under current accounting rules, spending on human capital is treated as an accounting expense, whereas spending on physical assets such as manufacturing plants, equipment, and machinery is treated as an accounting expenditure. In other words, spending on human capital is accounted as a cost, whereas spending on physical assets is accounted as an investment in the firms' productive capacity, which is subject to capitalization and depreciation or amortization over time.

333. *See* Angela Hanks et al., *Workers or Waste? How Companies Disclose—or Do Not Disclose—Human Capital Investments and What to Do About It*, CTR. FOR AM. PROGRESS (June 8, 2016), https://www.americanprogress.org/issues/economy/reports/2016/06/08/138706/workers-or-waste [https://perma.cc/6EGN-XLSN].

is listed as a separate line item on the income statement. If a firm cuts R&D spending under pressure from activist shareholders, this would show up in the financial statements, putting all investors on notice; when a firm does the same with workforce training spending, investors only see a decrease in the SG&A amount.[334]

Information about *employee compensation expenses* presents similar problems. Setting aside the median worker pay figure required for the calculation of the deeply-flawed CEO pay ratio,[335] neither the accounting rules nor the SEC disclosure rules provide a way for investors to gauge with any specificity what a firm pays its workers. Yet, this information is quite likely to be relevant when investors analyze a firm on its own terms, over time, or in relation to industry peers. Even the total amount spent on worker salaries is not disclosed. Instead, it is lumped into other aggregate figures presented in the financial statements: cost of goods sold (COGS) for the direct labor costs used to produce a good, and SG&A for all other labor costs.[336] (To be sure, in certain cases the presentation of non-recurring items, such as a one-time restructuring charge, or information contained in other parts of the financial statements or the MD&A discussion, may provide some additional information about employee compensation on an ad hoc basis.[337] Stock-based employee compensation expenses are

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334. Spending on R&D and human capital is expensed and does not show up on a firm's balance sheet as an asset. (Acquired R&D is a limited exception and can be shown on the balance sheet.) Expensing reduces taxable income, providing a tax incentive for firms to spend on R&D. But expensing also ensures that these investments look like operating expenses without capturing the potential future value firms recoup from that initial investment. Expensing implies that a dollar spent on research or on workforce training in one year will not increase the firm's future value. This may produce a disincentive for firms to invest in R&D—one that does not exist for physical capital which is capitalized; the disincentive is mitigated by the fact that R&D is broken down separately. The same disincentive also exists for human capital spending, but, unlike R&D, it is not mitigated because there is no separate breakdown of human capital expenses. *See id.*

335. *See* Bank & Georgiev, *supra* note 34.

336. *See generally* Chris B. Murphy, *Operating Expenses vs. SG&A*, INVESTOPEDIA, https://www.investopedia.com/ask/answers/101314/what-are-differences-between-operating-expenses-and-sga.asp [https://perma.cc/748Y-5QLK] (May 31, 2020) (examining administrative expenses, operating expenses, and SG&A).

337. With respect to employee compensation expenses, data suggests that only 15% of firms in the S&P 500 index report this information on a voluntary basis. *See* Letter from Anthony Hesketh, Lancaster Univ. Mgmt. Sch., to Anne Sheehan, Chairman, SEC Inv. Adv. Comm. 3 (Mar. 21, 2019), https://www.sec.gov/comments/265-28/26528-5180428-183533.pdf [https://perma.cc/KN8V-FQAV].

also disclosed as a separate line item under SFAS 123, but such expenses generally apply only to executive-level employees.[338])

This undifferentiated treatment of human capital-related spending is clearly a problem if investors wish to understand a firm's approach to training and compensation. But it is a problem even if investors are not interested in these matters because human capital-related expenses influence important line items, such as SG&A and COGS. These line items are key components of a number of financial ratios used to analyze and compare firms, such as gross margin, profit margin, operating margin, earnings per share, price-earnings ratio, and return on stockholders' equity.[339]

In light of the foregoing, FASB should consider changes to financial accounting standards to require the disclosure of workforce training expenses and employee compensation expenses. This represents another form of disambiguation—disaggregating existing accounting line items to present specific and decision-useful information. In the case of workforce training expenses, FASB can use as a reference point expense classification methodologies developed by the U.S. Bureau of Labor Statistics in its surveys of employer-provided training during the 1990s,[340] as well as existing human resource accounting methodologies and ISO standards.[341] In the case of employee compensation expenses, there is already international precedent for disclosure, which can serve as a partial model. Pursuant to International Accounting Standard 19, Employee Benefits (IAS 19), firms that follow IFRS are required to disclose the amounts paid in wages, salaries, and social security contributions, among other information.[342] As a general matter, the presentation of human capital-

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338. *See Summary of Statement No. 123: Accounting for Stock-Based Compensation (Issued 10/95)*, FIN. ACCT. STANDARDS BD., https://www.fasb.org/summary/stsum123.shtml [https://perma.cc/BH2N-24HF] (last visited Mar. 21, 2021).

339. *See generally What Are the Main Income Statement Ratios?*, INVESTOPEDIA, https://www.investopedia.com/ask/answers/102714/what-are-main-income-statement-ratios.asp [https://perma.cc/7QRQ-BKS5] (Mar. 21, 2021) (providing an overview of financial ratios that appear in common income statements).

340. *Survey of Employer-Provided Training*, U.S. BUREAU OF LAB. STAT., https://www.bls.gov/ept/overview.htm [https://perma.cc/SG82-QLFM] (last visited Mar. 21, 2021).

341. *See generally* Eric G. Flamholtz et al., *Human Resource Accounting: A Historical Perspective and Future Implications*, 40 MGMT. DECISION 947 (2002) (surveying the development of human resource accounting systems since the 1960s).

342. *See IAS 19 Employee Benefits*, IFRS, https://www.ifrs.org/issued-standards/list-of-standards/ias-19-employee-benefits [https://perma.cc/Z4C3-7UBX] (last visited Mar. 10, 2021). This information is disclosed under captions such as "personnel expense," "personnel costs," and "salaries [and] wages," among others. *See, e.g.*, EUR. DIRECTORIES GRP.,

related spending on the income statement is straightforward in that it does not raise any serious valuation issues.[343]

2. Human Capital Valuations

By contrast, valuation is a major challenge to including human capital as an asset on firms' balance sheets. This is due to the expansive nature of the concept. Recall that any firms' stock of human capital is comprised of the acquired knowledge, skills, competencies, and other attributes embodied in its employees and used in productive ways by the firm.[344] Quantifying the value of "knowledge, skills, competencies, and other attributes" presents obvious difficulties. Moreover, human capital does not fit the current technical definition of assets ("probable future economic benefits *obtained or controlled by* a particular entity as a result of past transactions or events").[345] Even though firms exert control over their employees, this control is fundamentally distinct from the control firms have over physical assets such as machines or more traditional intangible assets such as intellectual property. The employer-employee relationship is a voluntary relationship grounded in principles of contract and agency law. These considerations explain

CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2019 (2020), https://www.europeandirectories.com/uploads/p9WhjAk1/ConsolidatedFinancialStatements31.12.2019EDMidcoS.r.l.pdf [https://perma.cc/VLQ2-JLV4].

343. Though they lie outside the scope of the present discussion, pensions and other post-retirement benefits can be viewed as future human capital-related expenses. They do present valuation challenges, but those have already been addressed by the system of financial accounting. *See* PWC, PENSIONS AND EMPLOYEE BENEFITS (2019), https://www.pwc.com/us/en/cfodirect/assets/pdf/accounting-guides/pwc-guide-pension-and-employee-benefits.pdf [https://perma.cc/DA9J-KTF9].

344. *See supra* note 12 and accompanying text.

345. FIN. ACCT. STANDARDS BD., ELEMENTS OF FINANCIAL STATEMENTS, STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS NO. 6 ¶ 25 (2008) (emphasis added). The Concepts Statement goes on to say that an asset "embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows . . . . [A] particular entity can obtain the benefit and control others' access to it, and . . . the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred." *Id.* ¶ 26. IFRS defines an asset as "[a] resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity." IFRS, CONCEPTUAL FRAMEWORK OF FINANCIAL REPORTING 8 (2018), https://www.ifrs.org/-/media/project/conceptual-framework/fact-sheet-project-summary-and-feedback-statement/conceptual-framework-project-summary.pdf [https://perma.cc/39UX-5C7U].

why FASB has long been reluctant to even consider the inclusion of human capital in financial statements.[346]

Two factors suggest that a change in approach may be advisable. First, if financial accounting continues to exclude intangible assets, the value of financial statements to investors will continue to decrease. Leading accounting scholars have estimated that between the 1950s and the 2010s, the relevance of the information contained in financial statements decreased twofold, a trend largely tracking the rise of intangible assets.[347] Second, if firms and investors view human capital as a mission-critical productive asset—and that indeed is the key message of the HCM movement—then it is necessary to explore ways to bring human capital within the accounting framework and its depiction of assets. These two factors go to the dual role of accounting policy: to prescribe information structures and individual items that have to be disclosed in financial reports in order to make such reports useful to investors and, also, to establish standards for the preparation and presentation of this information.[348]

There is a deep and extensive literature on human resource accounting dating back to the 1960s, which has not been referenced by the present-day HCM movement. This can be explained in part by the technical nature of the literature—its objective has been to overcome the specific valuation, measurement, and definitional challenges associated with incorporating human capital into the existing framework of financial accounting.[349] This work is clearly relevant to the HCM movement, and as an expert body with standard-setting authority, FASB is best placed to engage with it. Doing so could enrich the HCM movement and help overcome its somewhat acontextual nature. The impetus need not come from within FASB: despite its substantial autonomy, regulators and policymakers do have the ability

346. *See* Ingrid Smithey Fulmer & Robert E. Ployhart, *"Our Most Important Asset": A Multidisciplinary/Multilevel Review of Human Capital Valuation for Research and Practice*, 40 J. MGMT. 161, 171-72 (2014).

347. *See* BARUCH LEV & FENG GU, THE END OF ACCOUNTING AND THE PATH FORWARD FOR INVESTORS AND MANAGERS 31 (2016). This trend is even more pronounced in the case of new firms entering the market: the accounting relevance for firms that went public in the 1950s was over 85%, whereas the same for firms that went public in the 2000s was approximately 25%. This decrease in accounting relevance can be linked to the rise of intangibles, since each decade's new firms have new business models, which are much more likely to depend on intangible assets in line with the overall economy's shift from traditional to intangible assets. *Id.* at 89.

348. *See* LEV, *supra* note 14, at 120-21.

349. *See* Flamholtz et al., *supra* note 341; Fulmer & Ployhart, *supra* note 346.

to direct FASB's attention to human capital accounting should they wish to do so.[350] There could also be opportunities for collaboration with FASB's international counterpart, the International Accounting Standards Board, which has traditionally been more active in the area on intangible assets and which launched a consultation on sustainability reporting in 2020.[351]

FASB may need to be prompted to act because, in line with its historical reluctance to consider human capital, FASB's current early-stage project on intangibles, launched in 2019, does not cover human capital assets.[352] Indeed, references to human capital on FASB's website, a repository of information about its activities, are largely limited to a handful of third-party comment letters urging FASB to consider human capital assets at various times over the years.[353] Yet, FASB is capable of executing complex projects that focus on the treatment of assets. For example, it revised accounting principles as recently as 2016 to add a major new item, operating leases, to firms' balance sheets; previously, those leases were not capitalized and were treated solely as expenses, similar to the current treatment of human capital expenses.[354] An employment contract in respect of human capital shares basic conceptual similarities with an operating lease in respect of a physical asset: in both cases, a firm enters into a contract that allows for the temporary use of a productive asset without conveying an ownership right. If operating leases belong on the balance sheet, then it may be easier to make the case that human capital assets do as well.

350. It is worth noting that even though FASB has enjoyed substantial autonomy and independence since its establishment in 1973, the SEC exercises informal oversight and provides some input into its agenda; Congress has also periodically taken an interest in influencing FASB's work. *See, e.g.*, Mark Maurer, *U.S. House Subcommittee Scrutinizes Accounting Rule Maker*, WALL. ST. J. (Feb. 19, 2020), https://www.wsj.com/articles/u-s-house-subcommittee-scrutinizes-accounting-rule-maker-11582150442.

351. *See supra* note 217 and accompanying text.

352. *See* FIN. ACCT. STANDARDS BD., INVITATION TO COMMENT: IDENTIFIABLE INTANGIBLE ASSETS AND SUBSEQUENT ACCOUNTING FOR GOODWILL (2019), https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176172950529 [https://perma.cc/6D59-BRA5].

353. *See, e.g.*, Letter from Bill Patterson, Dir., Off. of Inv., AFL-CIO, to Timothy S. Lucas, Dir. of Rsch. & Tech. Activities, FASB (Oct. 5, 2001), https://www.fasb.org/jsp/FASB/CommentLetter_C/ViewCommentLetter&cid=1175803143035.

354. *See* FIN. ACCT. STANDARDS BD., ACCOUNTING STANDARDS UPDATE 2016-02, LEASES (TOPIC 842) (2016), https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176167901010 [https://perma.cc/B6W2-LZR5].

V. BEYOND CORPORATE LAW: A HUMAN CAPITAL PROTECTION AND DEVELOPMENT AGENDA

The analysis presented in this Article has highlighted HCM's status as an important corporate governance phenomenon; in the process, it has also revealed that HCM resonates well beyond the corporate governance realm. Even though HCM has been offered as a solution to corporate law problems (inadequate disclosure of and oversight over critical firm resources), it has also drawn strong support from actors focused on much bigger problems (wealth inequality, economic insecurity, inadequate workforce training, and others), which at best have an attenuated nexus to the core concerns of corporate law.[355] This observation suggests that the rise of the HCM movement is not only a quest for solutions but also a symptom of regulatory vacuums in various other areas of law. It is important to ask, therefore, whether HCM, a privately-coordinated corporate law phenomenon, can serve to fill those regulatory vacuums. If firms optimize various HCM metrics in an effort to improve corporate performance, would this contribute in a material way to solving larger societal problems related to the workforce? Put simply, does HCM's promise transcend corporate law?

While broadly supportive of the HCM movement in corporate law, this Article sounds a note of caution with respect to HCM's potential to address problems outside corporate law. It is important to remember that, notwithstanding its broad and intuitive appeal, the HCM movement—much unlike past labor-focused reform initiatives—is grounded in traditional notions of shareholder wealth maximization and investor protection. The HCM movement certainly has a role to play in improving the visibility and standing of workers within firms, and it may also contribute to illuminating some of the broader social and economic problems related to workers. But it would be unrealistic to expect that it could solve those problems. Moreover, even if the conditions are now ripe for a move away from the longstanding shareholder wealth maximization paradigm of corporate governance—as argued by policymakers, scholars, and the Business Roundtable—the HCM movement is ill-suited to take a central role under a new stakeholder-centered regime because its core rationale derives from the shareholder wealth maximization paradigm. Certain HCM initiatives may even be detrimental to workers since,

355. These actors include, for example, the AFL-CIO, legislators, and others.

especially when it comes to the allocation of surplus within the firm, the interests of employees and shareholders are not always congruent. Overemphasis and overreliance on HCM will thus put undue pressure on existing corporate governance systems and may crowd out other, more targeted policy interventions. This would also render the HCM movement akin to various initiatives to use corporate governance tools to solve non-corporate governance problems that have drawn critical attention from scholars.[356]

Acknowledging these realities suggests the need for a governmental human capital development and worker protection agenda focused on the bigger problems that the privately-coordinated HCM movement is incapable of solving. Put differently, the HCM movement has highlighted that current socio-economic conditions require new measures aimed at the *development and protection* of human capital, not just its *management*. If workers are firms' most important assets, as is so often asserted, then surely a nation's workforce ought to be its most important asset as well. A national human capital agenda is also needed because shareholder wealth maximization initiatives do not always translate into total welfare maximization. Reducing employee turnover, for example, may be viewed as a desirable outcome from the point of view of shareholders because it protects the firm's human capital investments. The same, however, may not be optimal from a societal point of view if it is achieved through means that hinder employee mobility and stymie the dissemination of knowledge across the economy.

The menu of policy options for a national human capital development agenda is extensive, and it is beyond the scope of this Article to define the agenda's contours. Possibilities include a variety of public or public-private initiatives, from new government

356. *See, e.g.*, Jeffrey N. Gordon, *Addressing Economic Insecurity: Why Social Insurance Is Better Than Corporate Governance Reform*, CLS BLUE SKY BLOG (Aug. 21, 2019), https://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-is-better-than-corporate-governance-reform [https://perma.cc/7ZPD-FRK3]; Bebchuk & Tallarita, *supra* note 32; Ronald J. Gilson & Curtis J. Milhaupt, *Shifting Influences on Corporate Governance: Capital Market Completeness and Policy Channeling* (Eur. Corp. Governance Inst., L. Working Paper No. 546/2020, 2020), https://ssrn.com/abstract=3695309.

programs;[357] to changes in labor law,[358] tax law,[359] and antitrust law;[360] to a new body of human capital law;[361] to more fundamental reforms of corporate law,[362] among others. As ever, formulating an effective agenda will entail difficult policy choices. From the vantage point of corporate law, however, implementing a broader national human capital development agenda will improve the HCM movement by modulating the expectations for what firms' management, boards, and the SEC can realistically achieve with the tools at their disposal.

VI. CONCLUSION

The rise of the HCM movement—the broad set of initiatives in support of both investor-facing HCM disclosure and board-level oversight of HCM matters—is a singular moment in the development of U.S. corporate governance. After several decades of successive and ultimately unsuccessful attempts to increase the prominence of workers

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357. *See, e.g.*, STEPHEN STEIGLEDER & LOUIS SOARES, CTR. FOR AM. PROGRESS, LET'S GET SERIOUS ABOUT OUR NATION'S HUMAN CAPITAL: A PLAN TO REFORM THE U.S. WORKFORCE TRAINING SYSTEM (2012), https://cdn.americanprogress.org/wp-content/uploads/issues/2012/06/pdf/workforce_training.pdf [https://perma.cc/2G39-84FS] (offering proposals for various government initiatives to improve workforce training).

358. *See, e.g.*, SHARON BLOCK & BENJAMIN SACHS, CLEAN SLATE FOR WORKER POWER, HARV. L. SCH., CLEAN SLATE FOR WORKER POWER: BUILDING A JUST ECONOMY AND DEMOCRACY (2020), https://assets.website-files.com/5ddc262b91f2a95f326520bd/5e28fba29270594b053fe537_CleanSlate_Report_FORWEB.pdf [https://perma.cc/TAF4-C2W8] (proposing a comprehensive suite of labor law reforms in the interest of worker empowerment).

359. *See, e.g.*, Michael Simkovic, *The Knowledge Tax*, 82 U. CHI. L. REV. 1981 (2015) (demonstrating how the current tax regime contributes to underinvestment in education and offering potential solutions); ERICA YORK, TAX FOUND., TAX TREATMENT OF WORKER TRAINING (2019), https://files.taxfoundation.org/20190320180040/Tax-Treatment-of-Worker-Training-FF-644.pdf [https://perma.cc/J4FK-GF9R] (reviewing proposals to improve the tax treatment of firms' investment in human capital).

360. *See, e.g.*, Zoe Willingham & Olugbenga Ajilore, *The Modern Company Town*, CTR. FOR AM. PROGRESS (Sept. 10, 2019), https://www.americanprogress.org/issues/economy/reports/2019/09/10/474336/modern-company-town [https://perma.cc/GT75-ZYJN] (proposing various ways to address the monopsony power of employers vis-à-vis workers); Sanjukta M. Paul, *The Enduring Ambiguities of Antitrust Liability for Worker Collective Action*, 47 LOY. U. CHI. L.J. 969 (2016) (demonstrating how antitrust law acts as a constraint on low-wage workers' ability to organize and offering reform suggestions).

361. *See, e.g.*, Orly Lobel, *The New Cognitive Property: Human Capital Law and the Reach of Intellectual Property*, 93 TEX. L. REV. 789, 793 (2015) (calling for "reform [of] human capital law from a nebulous set of harmful doctrines to a body of law committed to the promotion of innovation, knowledge flow, and economic growth").

362. *See, e.g.*, STRINE, *supra* note 4; Grant M. Hayden & Matthew T. Bodie, *The Corporation Reborn: From Shareholder Primacy to Shared Governance*, 61 B.C. L. REV. 2419 (2020) (proposing a shared governance model to replace shareholder primacy).

in corporate governance, firms' employees are finally gaining visibility in corporate disclosure reports and attention in corporate boardrooms. But, as this Article has pointed out, such visibility and attention does not mean that employees have taken a seat at the board table or that directors have started to treat employee concerns on par with shareholder concerns; this is a crucial, yet heretofore overlooked, aspect of HCM's introduction into corporate governance. The analytical rationale at HCM's core is to treat workers as assets—firms' "most important" and "most valuable" assets—but assets nonetheless. This approach can yield collateral benefits in terms of employees' economic status and working conditions, but it need not necessarily do so. The workers-as-assets justification for HCM is an investor-focused justification. It differs from a justification conceptualizing employees as "investors" of the human capital embodied in them. If the focus were on firms competing for talent (i.e., the investment of human capital by employees) just like they compete for the investment of financial capital by shareholders and bondholders, the attendant legal protections, including governance rights, would have to look different.

These important distinctions notwithstanding, HCM is a positive and much-overdue corporate governance development: HCM disclosure can contribute to better and more accurate firm valuation by shining a spotlight on a key driver of success in the modern knowledge-based economy; HCM oversight at the board level can ensure that boards focus appropriately on the management of what has come to be referred to as a "mission-critical asset." There is much work, challenging yet highly consequential, that lies ahead. Corporate governance actors need to determine the proper scope of HCM, establish context-specific links between HCM indicators and firm management, develop effective and narrowly-tailored frameworks for HCM disclosure and HCM oversight, and identify the optimal ways to address worker-related concerns in firms' institutional structures. This Article has sought to lay the analytical, theoretical, and normative foundations for these real-world decisions and for future academic inquiries into the HCM movement and the incorporation of ESG concerns into U.S. corporate law.

APPENDIX: PRIMARY HCM CATEGORIES ACCORDING TO SELECT ORGANIZATIONS

The following table presents the primary HCM categories and dimensions identified by core participants in the HCM movement. (Source: Compiled by the author based on the latest available information as of March 1, 2021.)

Organization	**Primary HCM Categories & Dimensions**	**Discussed in:**
SEC – Reg. S-K Amendment (Aug. 2020)	Number of employees; any material "measures or objectives that address the development, attraction and retention of personnel"	Subpart III.B.5
SEC – Recommendations of Investor Advisory Committee (IAC)	Workforce demographics; workforce stability; workforce training; health and safety; workforce diversity; compensation and incentives [Note: categories derived from IAC's examples of KPIs]	Subpart III.B.5
U.S. Congress (Rep. Axne & Sen. Warner) – Proposed "Workforce Investment Disclosure Act"	Workforce demographics; workforce stability; workforce composition; workforce skills and capabilities; workforce culture and empowerment; workforce health and safety; workforce compensation and incentives; workforce recruiting	Subpart III.B.6
Human Capital Management Coalition (HCMC)	Workforce demographics; workforce stability; workforce composition; workforce skills and capabilities; workforce culture and empowerment; workforce health and safety; workforce productivity; human rights; workforce compensation and incentives	Subpart III.B.2
BlackRock	Employee development; corporate culture; compensation; diversity & commitment to equal employment opportunity; health and safety; labor relations; supply chain labor standards	Subpart III.B.1
Sustainability Accounting Standards Board (SASB)/Value Reporting Foundation	Labor practices; employee health & safety; employee engagement, diversity & inclusion; supply chain management	Subpart III.B.7

International Organization for Standardization (ISO)	Compliance and ethics; costs; diversity; leadership; organizational culture; organizational safety, health, and well-being; productivity; recruitment, mobility, and turnover; skills and capabilities; succession planning; workforce availability	Subpart III.B.7
Global Reporting Initiative (GRI)	Employment; labor and management relations; occupational health and safety; training and education; diversity and equal opportunity; non-discrimination; freedom of association and collective bargaining	Subpart III.B.7
Embankment Project for Inclusive Capitalism (EPIC)	Workforce costs; attraction, recruitment and turnover; workforce composition and diversity; training, learning and development; engagement and wellbeing; employee health; organizational culture	Subpart III.B.7
World Economic Forum (WEF)	Dignity and equality; health and well-being; skills for the future	Subpart III.B.7