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Investor Attempts To Hold Cos. Accountable Are Working

By **Rebecca Boon** (May 17, 2021, 6:50 PM EDT)


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On May 13, new U.S. Securities and Exchange Commission Chairman Gary Gensler announced that in direct response to investor demand, diversity disclosures would be a "top priorit[y]" and "early focus" of his tenure. Gensler said that investors increasingly want to understand information about "one of the most critical components of companies, their workforce."[1]

Indeed, over the past few months, investors have been demanding increased accountability from corporations on diversity and other social issues. The issues are not new, but the investor focus on these issues is. We have already seen institutional investors create meaningful social change in the #MeToo context when they have used their power to compel corporations to fix a broken sexual harassment culture.

Investors continue to demand progress on important social issues and corporations have no choice but to respond to those demands.

Gensler made his comments in connection with the SEC's announcement on March 4 that it had formed an environmental, social and governance, or ESG, task force in the Division of Enforcement to focus on diversity, equity and inclusion disclosures, among others. With public comments due by June 13, the SEC's stated goal is to propose rules to govern ESG reporting and bring consistency to what companies report.

The SEC has a long history of abdicating its responsibilities to investors, essentially doing nothing to proactively protect investors and allowing some of the biggest frauds in history to go unpunished. This latest task force may be no exception, or it could represent a real change brought about by the new administration. It is too soon to say.

But for now, the most significant and noteworthy thing about it is that the SEC is reacting to specific and aggressive demands by investors for social change. And the SEC is not alone.

State Street Global Advisors Inc., The Vanguard Group Inc. and BlackRock Inc., known as the Big Three, manage over $15 trillion in assets, and are the dominant shareholders in 88% of firms listed on the S&P 500. The Big Three have each committed to vote against firms that do not appoint more women directors to their boards.

For example, on Jan. 11, State Street announced that in 2021, it would vote against the chair of the nominating and governance committee at companies in the S&P 500 and FTSE 100 that do not disclose the racial and ethnic composition of their boards, and in 2022, it will vote against them if they do not have at least one director from an underrepresented community.

Similarly, The Goldman Sachs Group Inc. announced that starting in July 2021, it will not take a company public without two diverse board members, one of which must be a woman. And NASDAQ Inc. has proposed that all listed companies disclose board-level diversity statistics and either meet the objective of one to two diverse directors, depending on size, or explain why they have not. The SEC is currently considering comments on the NASDAQ proposal.

Are these initiatives enough? Of course not. But investor pressure works. A recent study from Northwestern University's Kellogg School of Management found that for every additional 8% of a company's stock owned by the Big Three, the number of new women board members increased by 76%.[2]

Critically, the same study found that in response to investor pressure, women on boards get power positions on audit and nominating committees at even higher numbers than companies that were complying with mandatory quotas like California's.

Investors have also taken direct action by filing derivative lawsuits challenging the lack of diversity on boards, and or alleging toxic workplace cultures of discrimination and retaliation against female executives, and racial and gender bias.

Most recently, investors filed a derivative case against the board of directors and certain officers of Pinterest Inc., alleging race and sex-based discrimination and retaliation in Key West Police Officers' & Firefighters' Retirement Plan v. Silbermann.

The Pinterest complaint, filed March 29 in the Delaware Chancery Court, alleges:

> There is no place in today's corporate America for race- and sex-based discrimination and retaliation. But if you are a member of the board of directors of an internet application company that derives the vast majority of its revenues through female users, … the very notion of tolerating gender and racial bias by senior management should be self-evidently anathema, illogical, and unacceptable.

Lawsuits like this one are in early stages, but the pressure is on. Corporations have to address social issues if for no other reason than the fact that investors are demanding it.

We have already seen what investor demands for accountability can accomplish in cases involving #MeToo issues and allegations of sexual harassment. As the #MeToo movement went mainstream in 2017, we saw the first successful securities case addressing sexual harassment allegations: the shareholder derivative lawsuit involving Fox News parent Twenty-First Century Fox Inc.

City of Monroe Employees' Retirement System v. Murdoch arose in the Delaware Chancery Court after prominent Fox News personality Gretchen Carlson went public with her allegations of sexual harassment against longtime Fox News CEO Roger Ailes. While Carlson was the first person to publicly speak out about Ailes' alleged misconduct, she was not the last as dozens of women followed her with their own accounts of alleged abuse by Ailes and other senior executives.

Investors were listening. Following a year of investigation and litigation, the plaintiff uncovered allegedly systemic problems at the network involving multiple senior executives, multiple types of discrimination and harassment, and a toxic workplace characterized by surveillance, retaliation, and fear.

Ultimately, the plaintiff filed a verified complaint and together with the company, simultaneously unveiled a series of governance reforms designed to fix the broken sexual harassment culture at Fox News. The Fox News Workplace Professionalism and Inclusion Council is a landmark council of experts with broad powers and a broad mandate to identify and solve the problems at the company.

A critical component of this relief is investor accountability — the council has the power to issue minority reports that Fox is mandated to post publicly on its website for investors and the world to see. The council also has a mandatory five-year term and if at the end, Fox determines to dissolve the council it must publicly post the reasons why.

After Fox, there were additional derivative lawsuits addressing alleged sexual harassment at public corporations. Most recently, shareholders successfully resolved a derivative lawsuit against the board of directors of Alphabet Inc., Google's parent company.

Like Fox, the In re: Alphabet Shareholder Derivative Litigation complaint alleged in the California Superior Court a long-standing pattern of sexual harassment and discrimination by high-powered male executives that created a workplace "culture of concealment."

As part of the settlement, which received final approval from the court in late 2020, Alphabet established a diversity, equity and inclusion advisory council composed in part of outside experts with a mandatory five-year term.

We also saw the first successful direct securities action certified as a class action involving #MeToo-type allegations of sexual harassment against Signet Jewelers Ltd. In In re: Signet Jewelers Ltd. Securities Litigation, when the market learned that hundreds of women had submitted declarations that described alleged sexual harassment reaching to the company's highest levels, Signet was forced to halt trading to address the allegations and when trading resumed, the company's stock price declined 13%.

Again, investors were listening. The settlement of the Signet case for $240 million was approved by the U.S. District Court for the Southern District of New York in late 2020.

Currently, investors are prosecuting a direct securities action against CBS Inc., Construction Laborers Pension Trust for Southern California v. CBS Corp., which alleges that CBS concealed a history of sexual misconduct and fostered a hostile workplace culture perpetrated by Charlie Rose and Les Moonves.

In sustaining the complaint in part, the Southern District of New York found that the allegation that sexual harassment was pervasive and widespread at CBS was not akin to the allegations that were sustained in Signet because they were too conclusory. But, the court did sustain a statement by Moonves implying that he had not known of workplace sexual harassment problems at CBS earlier, "even though, in truth, he was at that time actively seeking to conceal his own past sexual misconduct from CBS and the public."

On March 19, the investors in the CBS case moved for class certification and that motion is currently pending.

It is too soon to know whether the new cases will be successful or whether the new regulations will have any teeth. But the successful securities cases involving alleged sexual harassment and #MeToo issues demonstrated to the corporate world that investors can use their significant power to fix a broken corporate culture and hold corporations accountable when they fail to act.

Pressure from the Big Three and the corresponding dramatic increase in the number of women on corporate boards confirms that when investors demand diversity, companies respond. Investors have shown that they are and remain willing and ready to compel corporations to act on important social issues.

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[1] https://www.law360.com/environmental/articles/1384626/gensler-says-climate-disclosure-rules-among-top-priorities-.

[2] https://insight.kellogg.northwestern.edu/article/women-company-boards.
