Professional Perspective

Impacts of #MeToo on Litigation & DEI

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Social media has come alive in recent years with brave voices sharing stories of workplace sexual harassment, linked by six characters that would change the world: #MeToo. The movement originated with a 2006 MySpace post authored by activist Tarana Burke, who hoped to promote empathy and empowerment among victims of sexual assault.

In October 2017, the movement gained traction. #MeToo began trending on social media as women came forward about the sexual harassment they endured while working with former Hollywood executive Harvey Weinstein. The #MeToo movement has since brought about a sea-change in workplace safety, equity, and accountability.

Securities and corporate governance litigation and investor activism have emerged as legal mechanisms to drive meaningful and lasting social change. This article summarizes key developments in this space, including stockholder suits and securities class actions, investor activism with regards to workplace harassment and diversifying corporate boards, SEC efforts to hold companies accountable for their disclosures, and state and federal legislation.

Stockholder Suits

Under Delaware law, which governs approximately 67% of Fortune 500 companies, "equity capital" means "permanent capital." In other words, Delaware law assumes that stockholders will own their shares forever. Accordingly, a Delaware company's directors and officers have a duty to maximize stockholder value in the long run.

As investors secure victories in suits challenging workplace discrimination and harassment, it becomes increasingly true that directors' and officers' fiduciary duties will require them to address these issues proactively. If they do not, they risk damaging shareholder value by exposing the corporation to significant monetary penalties and reputational harm. Stockholder derivative lawsuits have emerged as a powerful way to obtain significant governance reforms through litigation.

A wave of stockholder suits over the past several years has made it clear that investors will hold company leadership accountable for allowing a toxic culture to develop or persist in the workplace. In November 2017, investors brought the first successful derivative lawsuit involving sexual harassment allegations against the board of directors of Twenty-First Century Fox in the Delaware Court of Chancery, securing $90 million. The settlement required that the company create the "Fox News Workplace Professionalism and Inclusion Council"—a majority independent council of experts charged with remedying the sexual harassment culture at Fox News. The settlement also empowers the council to issue reports that Fox is obligated to make available on its website for investors—and the world—to see.

The Fox council has become a model for other corporations as they confront these difficult issues. In May 2022, shareholders of L Brands—the former parent company of Victoria's Secret— achieved final court approval of derivative claims challenging workplace harassment issues within the company. Like in Fox, shareholders recovered $90 million and implemented a DEI (Diversity, Equity & Inclusion) council designed to reform the culture of the company.

In June 2022, Pinterest's settlement to resolve derivative claims alleging that the company fostered a culture of race and sex discrimination received final approval in the Northern District of California. According to Pinterest's former Chief Operating Officer Francoise Brougher, the complaint alleged that, even at the company's highest levels, Pinterest's female executives "are marginalized, excluded, and silenced." The settlement includes a $50 million workplace reform budget and a commitment not to enforce NDAs.

Securities Class Actions

Investors have accomplished similar feats through securities fraud class actions. Investor suits provide powerful incentives for directors and officers to take proactive steps to prevent workplace discrimination and sexual harassment.

The federal securities class action device is specifically designed to enable and empower hundreds of shareholders under the leadership of a sophisticated financial institution to hold corporations accountable for making false and misleading representations or omissions to investors. Such cases serve a strong remedial purpose as they often resolve for millions or

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even billions of dollars. Stockholders are specifically poised to hold corporations responsible for workplace harassment because the class action device provides a mechanism through which to do so.

In 2020, investors settled the first successful securities fraud class action involving sexual harassment allegations against Signet Jewelers in the Southern District of New York. The case principally alleged that the defendants had made a series of materially misleading statements and omissions about a culture of severe sexual harassment at the company. A media outlet made public excerpts from hundreds of declarations submitted by women in a related employment action alleging, among other things, that Signet's then-CEO, Mark Light, and other senior executives had conditioned promotions on whether women would submit to sexual demands. The company's executives falsely assured investors that their promotion decisions were based on merit. After the court certified a class of Signet investors and held that Signet's statements about gender equality and sexual harassment could be actionable in a securities class action, investors undertook more than a year of hard-fought litigation, ultimately achieving final court approval of a $240 million settlement.

In April 2022, Paramount agreed to pay nearly $15 million to settle securities fraud claims alleging that CBS and its CEO, Leslie Moonves, misled investors by issuing public statements in support of the #MeToo movement, while failing to disclose allegations of sexual harassment against Moonves. At the time of this writing, the final approval hearing is scheduled to take place in November 2022.

Though perhaps an unexpected tool, securities litigation has become uniquely powerful in achieving corporate accountability for #MeToo and other critical social justice issues. Large investor classes expose companies to significant liability, which can bring about corporate accountability and deter future misconduct. In the derivative context, the ability of shareholders to impose significant governance reforms through litigation compels corporations to actually change their behavior.

Investor Activism

Activist investors are also directly targeting #MeToo issues in the workplace, and they are uniquely positioned to do so because of the size of their investments and powerful influence in the investor community. BlackRock, known as one of the "Big Three" asset managers, with trillions of dollars in assets under management and ownership of 7% of the S&P 500 index, identified "human capital management" as "one of a company's key drivers of long-term value creation" in its 2021 Annual Stewardship Report. In prior reports, BlackRock emphasized "creat[ing] a positive culture and prevent[ing] unwanted behaviors" as key components of effective human capital management. A coalition of California state pension funds with assets under management totaling $635 billion created "Trustees United" to oppose sexual harassment and other workplace misconduct.

In a rare feat for activist investors, Microsoft shareholders approved a November 2021 proposal requiring the board to publish a report on the efficacy of its policies in preventing workplace sexual harassment. The initiative was led by Natasha Lamb, founder of Arjuna Capital, who continues to advocate initiatives designed to promote workplace equity and inclusion.

These victories are becoming increasingly common. In 2021, shareholders of IBM, Nike, Union Pacific, and Walmart adopted resolutions that require each company to publish data on diverse leadership, including EEO-1 data and annual DEI reports.

Board DEI Efforts

DEI board efforts are specifically designed to compel corporate change because corporate boards are the decision-makers for corporations across the globe. Diverse boards bring diverse perspectives to the board-level. Investors have used their influence to demand that companies pursue DEI efforts and take affirmative measures to prevent workplace discrimination and sexual harassment.

At the beginning of the #MeToo movement, the "Big Three" investment firms—BlackRock, State Street, and Vanguard—used their extensive power and influence to launch a campaign to increase board diversity. Since then, the Big Three have voted against hundreds of incumbent directors of companies with non-diverse boards.

By targeting board diversity, the Big Three recognized that discrimination and sexual harassment do not thrive in companies with diverse leadership. The "Big Three" is uniquely situated to compel board diversity because they dominate

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the passive index investing industry and collectively constitute the largest shareholder in a material number of public companies in the US.

Other major players in the industry have followed suit. In 2020, Goldman Sachs announced that it no longer would underwrite IPOs for companies with all-male boards. And in March 2022, CalSTRS, the second largest pension fund in the US, announced that it would vote against the entire board of directors at any company without at least one female board member and committed to vote against directors on the nominating committee of any board with fewer than 30% female-occupied seats.

But DEI efforts have not gone unchallenged. In an order dated May 13, 2022, the Los Angeles Superior Court invalidated a California statute that required public California companies have at least one woman director on their board, holding that the law violated the equal protection clause of the state's constitution.

DEI Disclosures

DEI disclosures are also uniquely positioned to compel corporate change that are investors are demanding because knowledge is power. When investors know the truth about a company's DEI efforts, they are empowered to demand that corporations do better, make more progress faster, and take specific meaningful steps to improve the DEI composition at their corporations.

Many suspect that the SEC soon will require registered companies to issue disclosures on DEI within the company. The SEC already tackled the "E" of "ESG" investing in March 2022, proposing new rules that would require registered companies to make extensive disclosures about their environmental impact. And in March 2021, the SEC took action to address these critical issues through its ESG task force.

On May 23, 2022, the SEC announced that it had assessed a $1.5 million penalty against BNY Mellon Investment Adviser for misstatements and omissions about its ESG considerations regarding investment decisions for mutual funds that it managed. The penalty is the first that the SEC has assessed based on findings of the ESG task force. If the SEC expands disclosure requirements on ESG issues, the task force will continue to gain traction as a powerful tool in driving corporate progress toward DEI.

Effective disclosures, however, will require companies disclose more than the "what." To address ballooning executive compensation, Congress and the SEC twice have mandated that registered companies disclose executive compensation—once in the '33 and '34 Acts and again in the Dodd-Frank Act. Empirical studies have concluded that neither set of mandated disclosures resulted in lower executive compensation—instead, data shows that executive compensation increases accelerated after mandatory pay disclosures took effect.

Nasdaq's Board Diversity Rule offers a helpful framework for disclosures that require the "why." Nasdaq announced a requirement that by August 2023 each company listed on its exchange must have one diverse director or provide an explanation why it does not. Requiring companies to disclose the "why" is powerful, providing the investor community with insight into companies that still exclude women and other underrepresented groups.

Does the company disproportionately reject qualified candidates who belong to underrepresented groups? How much effort did the company invest in diversifying its board? Equipped with the answers to these questions, activist investors can continue to push corporations to fundamentally change how they do business—and to demonstrate with specific data points that the corporations did in fact change. What gets measured gets done.

A major concern with these kinds of mandated disclosures that many DEI advocates share is tokenism—will companies appoint diverse directors to positions with less responsibility just to satisfy the requirement? Ensuring meaningful change while avoiding tokenism will require the SEC to find creative solutions. Instead of requiring board diversity disclosures, the SEC instead could encourage boards to retain DEI consultants and require disclosure of the consultants' recommendations. If a board does not retain DEI consultants, the SEC could require it to justify why they chose not to.

Ample data makes clear that companies with diverse boards outperform their nondiverse peers. In a corporate system driven primarily by profit, incentivizing companies to hire DEI consultants to educate the board could encourage reticent directors to embrace diversity instead of taking a check-the-box approach. Consultants can employ tools such as company-wide DEI audits and periodic anonymous surveys to access whether the measures that the company has in place are working and compel data-backed improvements.

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As employees are freed from confidentiality restrictions and disclosure mandates take effect, we will gain better insight into the issues that continue to pervade workplaces and harm diverse employees. The extensive corporate reforms that have resulted from shareholder litigation and activism are a great first step—but much more work remains.

Governmental Action

Congress, regulators, and state legislatures have also acted. In March 2022, President Joe Biden signed into law the Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021. The Act, introduced in 2017 in response to the #MeToo movement, voids any mandatory arbitration clause as applied to allegations of sexual harassment or assault.

Now that the Act has become law, survivors of sexual harassment and assault will have unfettered access to litigate their claims in court, which means that allegations and evidence in their cases will be public. The Act will offer this protection to an estimated 60 million workers in the US who are bound by mandatory arbitration clauses in their employment contracts. This, in turn, will enable and empower employees to come forward publicly about their experiences and expose bad actors who to-date have been protected by the secrecy that mandatory arbitration clauses afford.

Numerous state legislatures have enacted laws to prevent employers from enforcing nondisclosure provisions against employees for disclosing discrimination, sexual harassment, or retaliation. In March 2022, Washington state enacted a law—informally called "Do Speak!"—that voids any such nondisclosure provision and imposes liability of $10,000, plus attorneys' fees and costs, on any employer that attempts to enforce such a provision.

The liability provision of Washington's "Do Speak!" law recognizes the reality that employers are likely to have more resources than their employees. By including the liability provision, the law ensures that employers cannot use the threat of legal fees to coerce employees into abiding by illegal nondisclosure provisions.

Conclusion

The combination of shareholder activism through derivative and securities class action lawsuits, activist investors who are demanding change at the board-level and through increased corporate disclosures, and governmental action that has removed protections that have previously been automatically afforded to those who discriminate and harass employees has provided a powerful and effective tool to redress and remedy corporate wrongdoing.

In the aftermath of the #MeToo movement, shareholders have demonstrated not only that these changes are here to stay, but that their demands for change at the corporate level have only increased and continued to gain momentum over time. In a post #MeToo world, corporations must confront and remedy systemic harassment and discrimination cultures because shareholders simply will not allow it.

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