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CORPORATE SOCIAL RESPONSIBILITY: (ESG) a United States Perspective

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(1) The regulatory and socio-political framework

In the US, a corporation's focus on social responsibility is often referred to as "ESG", for the three areas of focus – Environmental, Social, and Governance. In our practice representing executives, we see in principle how these efforts play out, particularly with respect to governance and social responsibility.

Regulatory Governance

In the realm of socially responsible governance, there is relatively little regulatory framework in the US. The Sarbanes-Oxley Act ("SOX"),[1] enacted in 2002 in response to a slew of financial scandals including the Enron scandal, and the Dodd-Frank Act,[2] enacted in 2010 in response to the 2008 financial crisis and economic meltdown, are the two main federal laws governing this area. Among other things, SOX requires CEOs and CFOs of publicly-traded companies to disgorge bonuses and other equity-based compensation, as well as profits from a sale of company stock, within the year following a financial restatement caused by their own misconduct. The Dodd-Frank Act empowered the SEC to implement rules which would require claw-back policies for a broader set of executives of publicly-traded companies with a three-year look-back period. However, in the ten years since its enactment, the SEC has adopted only advisory rules without any mechanism for regulatory enforcement. A key example of this is "Say on Pay" guidance,[3] which requires publicly traded corporations to obtain a shareholder resolution every three years, approving its named executive officers' compensation. This investor oversight encourages "pay for performance" compensation structures and has proven to add some moderation to escalating executive pay. Moreover, while there is no legal consequence to a failed

[1] Pub. L. 107-204, 116 Stat. 745 (2002). The full title is "An Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes."
[2] Pub. L. 111-203, 124 Stat. 1376 (2010).
[3] Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Exchange Act Release Nos. 33-9178; 34-63768; File No. S7-31-10 (Jan. 25, 2011).

say on pay resolution, it puts power behind shareholder activism, and encourages their ESG agendas for change.

Socio-Political Framework

Despite the lack of meaningful regulations in this arena, employees, senior executives and investors are pushing social and governance issues to the forefront. What all of these groups have in common is their desire to make choices and to have their voices heard.

Most influential and vocal in this conversation has been the millennial generation as they enter more senior positions in the workforce and bring their concerns to the boardroom. Generation Z is entering the workforce as well, bringing with them higher expectations around social and governance issues when choosing where to work or to invest. At the same time, the #MeToo and #Time'sUp movements have rocked the country with downfalls of several high-level corporate executives and the ensuing questions around whether their employers ignored, failed to prevent, or even enabled the extreme and often vile misconduct.

A huge driver for this type of social engagement is the digital and social media revolution. Stories can go viral overnight, and, as a result, a company's reputation can be easily damaged in seconds. All of these factors have empowered employees to demand better. For example, in 2019, a group of Google employees successfully pressured the company to cease its practice of requiring forced arbitration for sexual harassment claims through an organized campaign that saw 20,000 workers walk out. Although this was ultimately an employee-led initiative, the walk out was prompted by a New York Times article[4] that revealed Google had given a senior executive a $90 million exit package even after it found he had been credibly accused of sexual harassment. These external and internal pressures for transparency combined with the digital and social media revolution seems to have had a positive impact on ESG resolution efforts in the workforce.

We are also seeing a significant amount of shareholder pressure around ESG issues. Tim Mohin, the Chief Executive of the Global Reporting Index, reported to Forbes that over 90% of the

[4] Daisuke Wakabayashi, *Google Ends Forced Arbitration for All Employee Disputes,* The New York Times (February 21, 2019), https://www.nytimes.com/2019/02/21/technology/google-forced-arbitration.html.

largest companies are now filing sustainability reports and that a recent Oxford University study found that more than 80% of mainstream investors are now considering ESG information when making investment decisions.[5] On a global scale, almost $23 trillion in assets is being managed under so-called responsible investment strategies, which is an increase of 24% between 2014 and 2019. The number is now larger than the GDP of the US economy. With respect to senior executives in particular, major US institutional investors are giving preference to companies that have policies in place to recoup payments to executives when there has been misconduct even after the executive has left the company. For example, BlackRock, one of the largest institutional investors in the country, favors companies that have policies to recoup money from executives whose conduct causes reputational risk or that result in a criminal investigation.[6]

As a result of these employee, social media and investor-driven initiatives, corporations are responding and reacting to ESG pressures. In particular, we are seeing more pronounced (or more easily accepted) activism in regard to diversity in particular sectors. In the healthcare and medicine, technology, and higher education industries, we are seeing companies take active steps to attract, promote and hire diverse talent, hire dedicated executives for the ESG function, and publish diversity reports. Additionally, many major consumer goods and technology corporations (including Starbucks, Adobe, Salesforce, Nike, and Apple) are adopting ESG initiatives, such as banning salary history data even for internal applicants to narrow the gender wage gap, proactively looking for and discussing unexplained salary differentials along gender or racial lines, improving family leave policies, and internal rules to promote diversity and inclusion.

Even in the legal community, the status quo is changing. Corporations that are taking up the call for real Diversity & Inclusion initiatives, gender equity, proper governance and more performance related compensation are also demanding that their chosen law firms reflect their changing culture and principles. General Counsels are looking at who represents the company and what the gender and racial make-up is on litigation teams and corporate transactions. In

[5] Susan McPherson, *Corporate Social Responsibility: What To Expect in 2019*, Forbes (January 14, 2019), https://www.forbes.com/sites/susanmcpherson/2019/01/14/corporate-responsibility-what-to-expect-in-2019/#258ae934690f.

[6] Jonathan M. Ocker, Justin Krawitz, Benjamin T. Gibbs, *The State of Play on Clawbacks and Forgeitures Based on Misconduct*, Pillsbury (June 7, 2019) ,https://www.pillsburylaw.com/en/news-and-insights/state-of-play-on-clawbacks-and-forfeitures-based-on-misconduct.html.

effect, the "power of the purse" is choosing who represents the company's interests in legal representation.[7] For example, in 2017, Facebook announced a policy requiring at least 33% of the lawyers on a litigation or deal team to be female or racially or ethnically diverse. As a result, law firms bidding for Facebook's legal work must demonstrate their active efforts to provide meaningful opportunities for women and other diverse lawyers.

(2) Activist shareholder litigation

We have also seen shareholders use derivative suits to hold companies accountable for their roles in tolerating sexual harassment at high levels. The largest suit was filed by the City of Monroe Employees' Retirement System ("CMERS"), a shareholder in Twenty-First Century Fox, against the company's directors in connection with allegations against Fox News CEO Roger Ailes.[8] The matter initially began with Gretchen Carlson's lawsuit against Fox for sexual harassment and wrongful termination, which included allegations of sexual harassment by Mr. Ailes and retaliation. Following Mr. Ailes' departure from the company, CMERS filed a books-and-records request. Several more employees came forward in the following months with sexual harassment allegations against Mr. Ailes, as well as Fox News commentator Bill O'Reilly. CMERS then filed shareholder derivative claims: against the board for breach of fiduciary duty, and against Mr. Ailes for unjust enrichment. The case settled in 2017 for a $90M payment in favor of the victims, as well as corporate governance reforms.

A similar case against Wynn Resorts settled in November 2019 for $41M, just less than half of which was paid by Steve Wynn, the former CEO whose alleged pattern of forcing employees to have sex with him was at the center of the lawsuit. Similar cases are ongoing against Alphabet (Google's parent company), and the Weinstein Company, among others. Harvey Weinstein, the co-founder and former chief executive of the Weinstein Company, was convicted of rape and sexual assault in New York on February 24, 2020, and still faces rape and sexual battery charges in California.

[7] American Bar Association Commission on Women in the Profession (2020). Retrieved from https://www.americanbar.org/groups/diversity/women/#b.

[8] *City of Birmingham Relief & Ret. Sys. v. Hastings*, No. 18-cv-02107-BLF, 2019 WL 3815722 (N.D. Cal. Feb. 13, 2019).

(3) Drafting trends

In light of the social responsibility initiatives described above, changes to executive agreements, equity plans, handbooks and other employment related obligations are front and center in our practice. There is an increased focus on behavioral and economic accountability in terms of what constitutes "Cause", a bad leaver, and other potential negative behaviors which trigger an executive's departure. In particular, definitions around Cause are now robust and the threshold itself has been lowered from what most courts considered a high standard of extreme misconduct and bad behavior,[9] to now what is seen as unsatisfactory performance. Beyond the effect a "For Cause" termination may have on a senior executive's career, these broad behaviors also trigger severe economic consequences, such as clawbacks and/or forfeiture of incentive compensation, vested benefits and severance. Following the initial enactment of SOX and Dodd-Frank, we saw a trend of employers including Cause and Clawback triggers for financial misreporting, but we are now seeing far greater punitive actions for other forms of behavioral misconduct that corporations consider antisocial or culturally misaligned.

In some respects, it all seems rational in the # MeToo era to punish those that violate internal policies and victimize other employees by clawing back compensation and benefits when there is proof of extreme misconduct, including sexual or other harassment. The purpose is generally borne out of the desire to avoid payouts to sexual predators and others who have engaged in similar gross misconduct, and the need to satisfy shareholders and protect against bad publicity. However, these clauses are being applied to far lesser types of misconduct often so broadly drafted that a breach and the consequences that follow may be predicated on mere accusations, denying employees an impartial investigation or minimal due process before a termination or clawback occurs, and giving the company complete discretion to determine when there has been a breach.

[9] Cause has traditionally been limited only those serious acts or omissions committed by an employee that adversely affect the company's business in a material respect (i.e. fraudulent behavior, commission of a felony; material violation of company policy, etc.) Black's Law Dictionary (2nd ed. 1910).

These observations are in line with what was revealed by a 2019 survey of Silicone Valley employers, which found that Clawbacks and other punitive policies go further than the minimum mandated by SOX, and many include triggers for breaches of restrictive covenants, as well as detrimental activity.[10] While senior executive contracts are a great resource for furthering ESG initiatives, adding subjective performance triggers, overly broad restrictive covenants or "catch-all" provisions gives corporations a blank check to exploit their power over employees and fails to actually move the needle as it relates to ESG efforts. Of course, on the sexual harassment front, balancing the needs of victims in the workplace against the rights of their alleged predators remains challenging.

(4) Looking forward – what to expect

Major corporate governance advisers aware of these pressures are guiding companies to change bloated pay practices. In its annual policy update for 2020 in the US, Glass Lewis recommends that companies focus on governance steps to reduce corporate waste by removing what it terms "poor pay practices," including by lowering severance settlements, awarding smaller bonuses to executives, tying compensation and equity to performance, and eliminating single-trigger change in control payments (which entitle executives to large payouts when there is a qualifying acquisition, merger or IPO, even if they will continue to be employed at the same level with the new employer, as opposed to double-trigger clauses requiring both a change in control and an involuntary termination).[11]

On the regulatory front, observers disagree on whether any Dodd-Frank regulations are forthcoming.[12] Regardless of whether the SEC releases rules, however, the practices of US

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[10] Jonathan M. Ocker, Justin Krawitz, Benjamin T. Gibbs, *The State of Play on Clawbacks and Forfeitures Based on Misconduct*, Pillsbury (June 7, 2019) ,https://www.pillsburylaw.com/en/news-and-insights/state-of-play-on-clawbacks-and-forfeitures-based-on-misconduct.html.

[11] *See* Jonathan M. Ocker, Jessica Lutrin, Keith E. Ranta and Jeremy D. Erickson, *Winning Say-on-Pay: Top Five Supplemental Tipd for 2020*, Pillsbury (January 21, 2020), https://www.pillsburylaw.com/en/news-and-insights/winning-say-on-pay-top-five-supplemental-tips-for-2020.html.

[12] *Compare* Jesse Hamilton, *Wall Street Pay Proposal Being Negotiated by SEC, Bank Regulator*, BLOOMBERG (May 16, 2019), https://www.bloomberg.com/news/articles/2019-05-16/wall-street-pay-proposal-being-negotiated-by-sec-bank-regulator (reporting that regulators are close to a final draft) *with* John Heltman*, Don't hold your breath for an executive compensation rule*, AMERICAN BANKER (Mar. 13, 2019), https://www.americanbanker.com/opinion/dont-hold-your-breath-for-an-executive-compensation-rule ("Even now, regulators seem pretty lukewarm, at best, about whether there has been any progress.").

publicly-traded corporations are changing in regard to ESG, largely in response to public, employee, and investor pressure. As millennials continue to enter into the management and executive levels in the workplace and become bigger players as consumers and in the investment field, we think we will continue to see significant pressure for companies to make continued efforts with respect to ESG.