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Social Accountability in the Boardroom—Good for Business or Just creating New Headaches for Professional Lines Carriers?

I. Introduction

On August 19, 2019, the Business Roundtable, a group of almost 200 executives from some of the largest companies in the world, issued a statement on "the purpose of a corporation."[1] Particularly interesting about the statement, and what received wide-spread attention in the press, was that the executives agreed that the member companies would no longer adhere to the past notion that their first responsibility was to serve their shareholders and maximize profits. Instead, the executives suggested that their respective companies would focus on investing in employees, protecting the environment, supporting outside communities, and dealing ethically with suppliers as their primary business goals.[2] In the current less restrictive regulatory environment in the United States, such positions are not necessarily surprising.

In recent years, companies of all sizes have taken more visible positions on causes impacting their communities, and society. As will be discussed below, there are many benefits to corporations taking more active socially responsible positions. However, in the current era of event-driven corporate securities and derivative litigation, corporations must carefully consider what positions they are taking and when it is appropriate to make public statements about their social responsibility practices. In this regard, there are plenty of instances where these types of positions have backfired, resulting in boycotts or misrepresentations about what a company is doing that can materially impact a given business and potentially ultimately lead to litigation of one form or another.

A recent example was the Houston Rockets' general manager tweeting to "fight for freedom" and "stand with Hong Kong," in support of the recent protests in Hong Kong. However, these tweets resulted in a boycott by China of the NBA and reportedly could cost the Rockets approximately $25 million in sponsorship losses in the near term.[3] While the Rockets attempted to distance themselves from the comments, this is an example of an executive apparently trying to support a social cause that resulted in unintended consequences. In addition, a trial in Manhattan just concluded where Exxon Mobil Corp. was accused of misleading the company's investors and the public about the negative impact carbon regulation would have on the company's future financial position despite its knowledge of global warming.[4] It is also easy to understand the potential future consequences of companies not taking proactive roles on important social issues, such as the environment, as recent polls show that most shoppers would switch, boycott or avoid brands because of their environmental policies.[5]

This article will discuss the concept of corporate social responsibility, and the benefits of companies taking such positions. This article will also discuss corporate accountability when such positions are asserted, including the potential risks given the current litigation climate, as well as the political, economic and social environments. Finally, this article will discuss potential issues underwriters and claims handlers should consider when ensuring companies that take more active social responsibilities.

II. What is Corporate Social Responsibility?

Defining the term "corporate social responsibility" can be a difficult endeavour, with authors and scholars often providing a wide array of interpretations. While there seems to be a consensus that the definition goes beyond adhering to laws and regulations, the breadth of defining the term is where the difficulties often arise since the concept is constantly evolving. Additionally, it can mean different things to different people depending on a variety of factors, such as culture, community, and the environment. The term is also often used interchangeably with other terms such as "corporate accountability," "corporate citizenship," and "social enterprise." One online resource defines corporate social responsibility as "[a] company's sense of responsibility toward the community and environment (both ecological and social) in which it operates."[6] It can be expressed and reflected in an organization's commitment to a wide-variety of factors such as compliance with employment, health and hygiene, safety and environmental laws and regulations, respect for basic civil and human rights, as well as attempting to improve communities and society at varying levels.[7] In this regard, the concept clearly encompasses holding corporations accountable to more than just its shareholders.

Given this background, there are many reasons why companies are now focusing more keenly on corporate social responsibility. One such reason is the public demand for it given the diminished role by government, especially in the U.S. and the U.K. Other reasons include: (1) demands for greater disclosure of a company's business practices by shareholders and the public; (2) increasing customer demands and interest for companies to be active in communities and take proactive roles in improving same; (3) pressure by investors and shareholders through activism due to the perceptions of the benefits a positive corporate responsibility profile can bring to a company; (4) trying to stay competitive in labour markets, especially for purposes of attracting the talent of younger generations who choose to work at companies that are seen to be "making a difference" in terms of social responsibility; and (5) maintaining relationships with suppliers and joint-ventures that require adherence to certain social or legal standards.[8]

III. The Benefits of Corporate Social Responsibility

The benefits of corporate social responsibility can be obvious. For example, a company may take on a more high-profile social role for purposes of increasing its brand, corporate image and/or corporate reputation. This, in turn, may lead to higher sales, stronger customer loyalty, and better supplier relationships, all of which positively impacts a company's bottom line and future financial performance.[9] A company's internal culture and quality of employees can also benefit where employees embrace its social or environmental stance, causing goodwill, lower turnover, and improved employee performance.

A company that focuses on environmental concerns may also benefit from improved quality, functionality and durability of products and services. Depending on the nature of the business, the use of renewable resources can also improve the environment, and potentially lead to better product safety.[10]

In addition, the benefits of corporate social responsibility do not stop at higher profits for the companies that employ them. Specific communities, and society, often benefit from a company's focus on social responsibility, which can support charitable or holistic endeavours.

IV. The Risks of Corporate Social Responsibility

While the benefits of a company taking a positive and responsible stance on social responsibility are clear, such positions are also potentially fraught with risks on a variety of political, social, environmental, and financial spectrums, among others. One area of risk concerns the level of transparency a company decides to provide regarding its positions on social responsibility. If shareholders do not believe the company's level of transparency is enough or if misrepresentations are made about the positions, shareholder litigation may result. Moreover, the level of authenticity (i.e., the genuineness behind a corporation's intent to implement socially responsible policies) can also lead to litigation. For example, it is easy to contemplate where a company may over-promise certain legal or environmental aspirations, yet under-deliver due to lack of preparation or a failure to fully understand the nature and potential costs of the endeavour.

As will be discussed in more detail below, the costs of trying to implement socially or environmentally responsible positions can cause a company to lose competitive advantages in terms of costs or efficiencies. To the extent a company makes representations to the public about such endeavours and fails to follow through, public backlash in the form of consumer or supplier boycotts can also materially impact a company's bottom line.

V. The Potential Impact to Insurers

In the current era of "event-driven" litigation, it is easy to see how a company could become the subject of a derivative or securities class action due to positions it might take about hot-button social, political, or environmental issues. Often, such corporate positions are taken with a good deal of thought and consideration before implementation. For example, while some people took issue with Nike's decision to use Colin Kaepernick in certain advertising campaigns in 2018, given his controversial "take a knee" protests during the 2016 NFL season, the company's profits increased favourably over the first two quarters of 2019.[11]

On the other hand, even with a good deal of thought and preparation, corporate social responsibility efforts can backfire and lead to boycotts that result in diminished business. Further, even companies that are not seen as taking proactive positions on corporate social responsibility (but tout themselves as being environmentally conscious) can still be the subject of litigation. For example, Volkswagen had a significant marketing campaign in the U.S. touting its diesel cars' low emissions.[12] However, the company continues to deal with litigation arising from allegations that its environmentally friendly vehicles employed software that recognized when the vehicle was being tested and adjust its output accordingly, thus passing emissions tests when the vehicles should have failed. Beyond civil litigation and boycotts, companies may also be exposed to regulatory and criminal investigations. For example, it has been reported that Volkswagen has paid fines, penalties and legal settlements of over $33 billion in 2018 arising from the emissions scandal.[13]

It is important for D&O and other professional lines underwriters to consider whether an insured has historically been an active promoter of socially responsible positions and identify how such positions have the potential to negatively impact business. If an insured has historically taken such positions, the underwriter must also assess whether the company has been transparent with regard to the positions it is taking and carried through with its public representations. Similarly, claims analysts must consider all of these issues when evaluating claims against an insured arising out of its corporate social responsibility positions, especially when faced with allegations of misrepresentations that are alleged to have been made by the insured in an attempt to inure goodwill or other benefits.

VI. Current Corporate Social Responsibility Issues That Could Trigger Litigation

A. Climate Change and Environmental Issues

There are two main potential areas of concern regarding D&O risks associated with corporate social responsibility when it comes to climate change and the environment. First, any company that is more readily identified as being in an industry with environmental concerns (such as fossil-fuel companies) could be the subject of civil or regulatory investigations based on the representations it makes to the public about, for example, its emissions or other policies impacting the environment. Second, and just as potentially concerning, are the wave of "public nuisance" climate change class action lawsuits being filed by states, counties and cities in the U.S. that could lead to significant legal expenses and, depending on the circumstances, substantial settlements or verdicts.

Returning to a prior example of the legal fallout from representations made about the environment, Volkswagen is still dealing with issues arising from its campaign promoting its cars' low emissions, when in reality it installed software in its vehicles that was allegedly designed to recognize when the car was being tested and alter its emissions so as to improve results. In addition to the fines and penalties Volkswagen has already paid to date, the U.S. Securities Exchange Commission filed litigation in March 2019 against the company alleging that Volkswagen deceived investors who bought more than $13 billion in bonds and other securities from the company in 2014 and 2015, arguing that the company's former chief executive knew about the fraud as early as November 2007.[14]

As noted above, Exxon Mobile has also been the subject of ongoing investigations, by the New York and Massachusetts attorney generals (as well as other civil litigation) arising out of allegations that Exxon Mobil made misrepresentations to investors about the potential future costs related to climate change. The case brought by the New York attorney general recently went to trial and a decision is expected at any time (the Massachusetts Attorney General only recently filed a similar complaint in October 2019).[15] Regardless of the outcome, the fact that the case was allowed to proceed to trial based on theories about what Exxon Mobile represented to shareholders regarding its knowledge of the financial consequences of climate change is significant and could lead to other similar state and private plaintiff litigation against other companies.

As noted above, there are also a growing number of states and local governments, as well as environmental groups bringing climate change lawsuits against energy companies under a "public nuisance" theory.[16] While these types of cases have historically not been successful, there has been an increased prevalence of public nuisance cases being filed in state courts, which are commonly viewed as having lower pleading standards. Further, the plaintiffs' bar has had some recent success in pursuing lead-paint manufacturers in California (resulting in a $305 million settlement)[17] and opioid manufacturers, distributors, and pharmacies in various jurisdictions under this same legal theory. While to date such cases are not specifically based on corporate social responsibility, any statements a company makes about its position on climate change that is viewed as being untruthful could play a role in whether such cases can proceed. Further, these examples show that there is a potential for such cases to succeed under this legal theory. If such litigation is successfully pursued and liability is assessed against these companies based on their social responsibility policies, the financial consequences to investors could be substantial. Moreover, these consequences could lead to separate derivative and securities class actions against the companies for failing to address the issues or making misrepresentations about the impact on the environment.

B. #MeToo

The #MeToo movement has already spawned a good deal of shareholder derivative and securities claims based on corporation's conduct in dealing with allegations related to the movement and negative publicity that often follows.[18] Such litigation has been brought against The Weinstein Company, Wynn Resorts, and Twenty-First Century Fox, and most recently Google, to name a few. The allegations in these cases typically allege that management did not take appropriate steps to address discrimination or harassment in the workplace and/or failed to implement controls enough to prevent a hostile work environment. In this regard, while the focus of the #MeToo litigation to date has been on the failures of management to prevent such conduct, given the sometimes latent nature of these cases, and the apparent increasing cost of resolving sexual harassment claims generally, it is possible that future allegations against companies will be made even after a company adopts and makes socially responsible representations about proactive steps it has taken to address such conduct in the workplace going forward.

C. Social Media

While social media can play a significant role in building a company or brand image in today's marketplace, the way content is created, monitored and published can have a material impact on a company's bottom line. The NBA example in the introduction of this article is just one of many.[19]

While not dealing with a social responsibility issues, another example of the type of risk that can arise via comments made by executives on social media is Elon Musk's August 7, 2018 tweet suggesting that he was considering taking Tesla private at a share price. As a result of that tweet, two securities class actions were filed against Tesla and Musk alleging that Musk's tweets contained material misrepresentations leading to shareholder losses.[20] In addition, the Securities & Exchange Commission not only filed fraud charges against Musk, but also filed charges against Tesla for the failure to have disclosed controls and procedures relating to Musk's tweets.[21] Significantly, the settlement of the charge against Musk included the payment of penalties by Musk, as well as Musk's removal as Chairman of Tesla's Board.[22]

Given the nature of social media generally, and the allegations some have made regarding the controls social media companies have over content, especially in the realm of politics, it is also quite possible that litigation could be pursued against management arising from representations such companies make about the controls put in place regarding such content.

D. Cybersecurity

In today's age of information technology and big data, the protection of an individual's privacy rights could be viewed as an issue that falls within the penumbra of corporate social responsibility. For example, companies such as Facebook, Google, and Twitter often make public statements about maintaining the privacy of user's data. Nonetheless, Facebook has been the subject of privacy investigations by the Federal Trade Commission and the S.E.C. that resulted in penalties of $5 billion and $100 million, respectively, arising out of the misuse of user data.[23] Given the size of these settlements, and the adverse publicity, it is not surprising that Facebook was the subject of securities class actions alleging significant stock drops associated with their involvement with Cambridge Analytica. In this regard, while the securities class action against Facebook involving Cambridge Analytica was recently dismissed without prejudice, the fact of such litigation shows that representations companies make about the security of user data can potentially present significant D&O exposure for companies in the future.[24] Securities class actions and derivative actions have also been filed against credit reporting companies (Equifax) and hotels (Marriot), among others, over the failure to secure private consumer information in the face of representations by those companies about the security of user data.

VII. Future Corporate Social Responsibility Issues That Could Trigger Litigation

A. Minimum Wage

The federal minimum wage in the United States is currently $7.25 per hour (except in some limited circumstances) and has not been increased since July 2009. Nonetheless, some states, cities, and counties have begun to implement minimum wages higher than those required under federal law, including at least 29 states, 42 municipalities and the District of Columbia. Certain public companies have also implemented a higher minimum wage nationally, such as Amazon, Target, Walmart, and Bank of America.

Labour costs can significantly impact a company's financial position. In this regard, while a company's decision to raise its minimum wage can have a significant impact on employee retention and culture, implementing such policies will have an immediate impact on the company's returns, which could lead to shareholder complaints and potential litigation. Implementing a minimum wage higher than what is required by law could also raise the level of exposure presented by discrimination or sexual harassment litigation, as well as impact liability for any alleged violation of wage and hour laws (especially in certain industries such as retail, or industries active in the "gig" economy). Given these risks, insurers should consider specifically asking about their insureds' plans to raise their employees' minimum wage above that required by law during the application process, and assess the potential impact of same under any director and officer liability, employment practices liability or wage and hour insurance policies.

B. Gun Control

Although it would seem unlikely that that companies and brands not directly tied to gun industry would decide to take positions about gun-control, but there have been a surprising amount of companies doing just that.[25] For example, after the Parkland, Florida mass-shooting, Citigroup adopted a policy that required its retail clients to agree they would: (1) perform background checks on anyone buying firearms; (2) not sell firearms to anyone under the age of 21; (3) not sell bump-stocks; and (4) not sell high-capacity magazines. If its customers did not comply with such requirements, Citigroup announced that it would not offer the customer loans, would not agree to raise capital for the customer, and would refuse to offer the customer store-branded credit cards.

The fallout from these decisions was swift. Citigroup reportedly received several letters from Republican members of Congress asking Citigroup to stop its practices. Corporate representatives were also reportedly chastised by a Republican commission at the S.E.C. for "straying into social policy" and were told not to expect lighter requested regulations on certain types of trading as a result. Further, a Louisiana state board commission barred Citigroup from bidding on certain debt offerings due to its "restrictive gun policies."

While some of the responses to Citigroup's practices may seem insignificant, they are examples of the types of, perhaps unexpected, fallout that may arise when a company decides to take a more proactive position on a more controversial issue, such as gun control. In this regard, although Citigroup was trying to fill a void on gun control, given both the string of mass shootings that have occurred over the past several years and the failure of the U.S. government to take action addressing gun violence, it is a good reminder that well-intentioned social responsibility policies can lead to negative consequence for the company implementing them.

C. Other Areas of Potential Concern

In addition to the areas described in detail above, other potential pivotal social issues that could lead to a material impact on a company's business include, but are not limited to, privacy and security, support for military veterans, immigration, as well as LGBTQ rights. As social responsibility is an evolving concept, this list is by no means exclusive, but is meant to identify those areas where we have already seen corporate policies implicated.

VIII. Conclusion

Companies of all sizes are taking a more proactive role with regard to social responsibility. While taking such positions can have significant benefits to society, as well as those companies implementing these policies (in the form of employee satisfaction and performance, as well as improvements to a company's financial results), it is not without risk. Insurers should be mindful of the propensity of a company and its directors and officers to take such positions. In so doing, underwriters should carefully evaluate whether a prospective insured might otherwise be susceptible to event-driven litigation due to nature of the company's industry and the types of representations it will have to make to the public involving policies that may be closely tied to hot-button social, environmental, or human rights issues. If a company or its directors and officers are prone to taking such positions, or if a company represents itself as having altruistic policies meant to benefit society over the company, litigation or regulatory investigations involving such practices could potentially present significant risks.

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[8] INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT, https://www.iisd.org/business/issues/sr.aspx (last visited Dec. 8, 2019).

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[10] Id.

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