Corporate Culture and the New Landscape of Litigation Facing Directors & Officers
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There has been a paradigm shift in securities litigation. Post-Enron, a primary source of securities litigation was corporate **Financial Restatements**. These restatements caused a drop in the stock price and in turn, plaintiffs filed suit alleging misrepresentations and, often, fraud. However, the frequency and severity of financial restatements has been steadily declining and, in 2018, the number of financial restatements hit a 17-year low attributed to Dodd-Frank oversight and better corporate financial management. In its place, litigation stemming from corporate events, commonly referred to as **“Event-driven” securities litigation**, has emerged as a leading cause of securities claims.

An important distinction with Event-driven securities cases is that they include allegations of mismanagement versus traditional allegations of misrepresentation and are predicated on the often unfounded, but commonly held, perception that bad news is always the result of bad acts. The focus on corporate mismanagement arguably extends the reach of the plaintiff’s bar deeper into the confines of the company and into the roles of the individual directors and officers. Further, the frequency in which **Shareholder Derivative Demands** are brought, either in conjunction with an Event-driven securities claim or separately, is growing, and companies can find themselves defending multiple costly actions in multiple jurisdictions. This new dynamic presents heightened risks for corporate directors and officers and the companies they serve.

A significant contributor to the rise in Event-driven litigation has been the increased scrutiny on corporate culture. Just as good corporate culture can breed innovation, growth, talent attraction and retention, poor corporate culture can reveal underlying deficiencies. These deficiencies, if left unresolved, can manifest themselves in ways companies had not previously considered, including finding themselves at risk of litigation. Finding the right solution for this is not an easy undertaking. The complexities involved in identifying, establishing and fostering good corporate culture are vast and it is increasingly incumbent upon C-Suite Executives and Board members to play an active and transparent role in their organizations. Recent headlines have shown examples of consequences when they don’t. Witness the #MeToo movement, introduced into our verbal lexicon a little over a year ago. As a result of this movement, the volume of litigation against corporate officers alleging different forms of harassment has increased dramatically and the breadth of impacted industries is apparent in these noteworthy cases:

- Harvey Weinstein
- Wynn Resorts
- National Beverage
- Papa John’s
- Teladoc Health, Inc.
A well-known example of C-Suite exposure stems from a Fortune 50 company agreeing to pay a $90 million severance payout to an executive who left the company under allegations of sexual misconduct. This triggered a shareholder lawsuit, citing the co-founders and the Board of Directors participated in a “multi-year scheme to cover up sexual harassment and discrimination...”.

Board members and C-suite executives have a responsibility to foster a workplace environment that is inclusive and safe for all employees. Many have been caught flat footed for not appropriately addressing what were seemingly one-off instances of inappropriate behavior that had either been publicly disclosed and shown to be egregious or, the incident revealed a broader systemic issue. It is incumbent upon today’s board members to ask the tough questions, often of each other, and be prepared to address identified issues with expediency and transparency.

The impact of corporate culture extends beyond #MeToo. Diversity, environmental and social governance (commonly dubbed ESG) and even corporate business transactions are additional measures of corporate culture. Weaknesses can invite unwanted criticism and litigation. BlackRock is just one investment firm that has publicly demanded more transparency and awareness of these issues at a corporate level. From BlackRock CEO Larry Fink, “Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance but also show how it makes a positive contribution to society.” For this reason, the SEC has been called upon by several high-profile investment firms and Pension boards to require uniform disclosures relative to ESG.

Board diversity may be one of the most meaningful indicia of corporate culture. In PwC’s 2018 Annual Corporate Directors Survey, a resounding 94% of respondents agreed that board diversity brings unique perspectives. However, 52% of those respondents felt the motivation for diversity was fueled by political correctness – suggesting the full benefits of diversity are yet to be embraced in their entirety. This has led the state of California to demand increased board diversity by requiring companies headquartered there to have at least one female board member by 2019. Finally, corporate business transactions and the manner in which they are conducted can be bolstered by a good corporate culture of transparency, high ethical standards and awareness.

Corporate responsibility and individual duties have never been as expansive and complex as they are today. A heightened awareness and accountability for perceived mismanagement has resulted in critical dissections of a company’s culture. It is incumbent on Boards to be proactive in identifying and defining the corporate culture, the good, the bad and the ugly. By defining a positive corporate culture and strengthening weaknesses, a company will be better positioned to address shareholder concerns, decrease litigation risk and increase the ability to attract and retain talent. Insightful and honest internal assessment, open lines of communication within various levels of the organization, setting the tone at the top and maintaining transparency can significantly reduce risk for you and your company.

Value of Board Diversity:

“Boards with a diverse mix of genders, ethnicities, career experiences and ways of thinking have, as a result, a more diverse and aware mindset.”

- Larry Fink, CEO BlackRock
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