By Julia Gavrilov

Corporate Diversity and Inclusion Efforts Grow with Data Transparency

STUDIES HAVE CONSISTENTLY SHOWN that increased diversity and inclusion often leads to increased corporate profitability. The demand for diversity is partly driven by the vast body of empirical evidence demonstrating that greater diversity and inclusion efforts lead to better team decision making, work product and results.

Recently, regulators and investors have prodded companies to make voluntary disclosures detailing data in their corporate diversity profiles, including a new U.S. Securities and Exchange Commission (SEC) regulation enacted in August 2020 requiring companies to disclose information about their "human capital resources," prompted by last year's nationwide protests over racial discrimination and inequity.

Although a number of public companies have made progress in diversifying their boards, other companies slower to diversify their board membership and executive leadership teams are now faced with increased pressure to move beyond verbal commitments and incremental progress. In fact, litigation is now being leveraged to increase public companies' commitments to diversity, disclose their diversity data and make significant financial investments in diversity initiatives.

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For example, on July 2, 2020, a shareholder derivative suit was filed in the United States District Court for the Northern District of California against 14 members of the board of directors for a large American multinational computer technology corporation (the "Corporation"), as well as against the Corporation itself as a nominal defendant. The complaint (and amendments thereafter) alleged that the Corporation's failure to appoint racially diverse directors and officers—while simultaneously making public statements avowing a commitment to racial diversity, including, but not limited to, claiming to have a multitude of policies, internal controls and processes designed to ensure diversity both at the management level and within the board itself—constitutes, among other things, securities fraud.

The complaint further alleges that, as a result, the Corporation's directors breached their duty of candor and violated federal proxy laws, resulting in irreparable harm and severe financial and reputational damage to the Corporation. To support the claims of irreparable harm suffered as a result of the board's actions and inactions, the complaint references: (i) two Congressional inquiries into the lack of diversity on the Corporation's board; (ii) a 2017 lawsuit filed by the U.S. Department of Labor seeking $400 million in damages against the Corporation on the grounds that the company purportedly engaged in pay discrimination—specifically, that the Corporation paid Caucasian male employees more than female, African-American and/or Asian employees with the same job titles, and that the Corporation favored the hiring of Asian employees for technical roles; and (iii) a class-action pay discrimination lawsuit by several female employees against the Corporation.

The complaint further alleged that the defendants "knew of, but failed to disclose, fraudulent business practices at [the Corporation] that put [the Corporation] at material risk—namely, discriminatory hiring and compensation practices" and seeks various relief, including: (i) the resignation of at least three directors prior to the Corporation's annual meeting; (ii) the Corporation's nomination of three new director appointees, with the applicants to include two African-American appointees

and one other minority appointee; (iii) the defendants' return of all 2020 compensation; (iv) a requirement that the Corporation's board receive annual diversity training; (v) the creation of a $700 million fund to hire, promote and mentor minority workers over the next five years; and (vi) a requirement that the Corporation publish an annual "diversity report."

Similar shareholder derivative suits have since been filed against a U.S. multinational social networking service company and an American multinational wireless technology company, in California federal courts, to name a few. While the Court in two of these lawsuits recently granted motions to dismiss on similar grounds—namely that the respective plaintiffs did not sufficiently demand futility and that the state law claims must be asserted in the Delaware Court of Chancery, with leave to amend the federal claim under Section 14(a) of the Exchange Act—the mere commencement of these actions and the nature of the relief sought therein reflect a growing trend that litigation may now serve as a tool to leverage some degree of corporate change.

Privately held companies will not be held to any lower standard. While companies often focus their diversity and inclusion efforts at the hiring level, this methodology falls short as the internal promotion system fails to advance diverse individuals over time through corporate ranks. One of the many measures that each company can take to diversify its workforce at every organizational level—and minimize the likelihood of litigation being used as a means to drive that change—is by implementing a proper internal mentorship and sponsorship program. Senior mentors can advise and provide guidance to junior minority employees with similar backgrounds. Having these same senior mentors in a position to sponsor, or advocate for, such employees should necessarily lead to the advancement of diverse talent and, in turn, increased profitability.

The data-driven metrics measuring corporate diversity and inclusion efforts are largely playing out in publicly traded companies at the moment, but the efforts will not stop there. In due course, this required level of transparency will permeate every organization, including privately held companies and nonprofits, and will become the gold standard in establishing how clients, investors and society alike will perceive any organization.

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