Shield Yourself from Reputational or ESG-Related Claims

By Nir Kossovsky and Denise Williamee

Listen to article

100

In a litigious environment, directors must go beyond D&O insurance for protection.

Boards of large cap companies beware: If your company's stock price underperforms the market, there's a good likelihood you're going to get sued. The bigger you are, the greater the likelihood. And it's more likely than ever that the lawsuit will claim reputational damage resulting from the board's failure to oversee this mission critical asset.

Large Market Cap Companies Are Vulnerable

According to recent data from *The D&O Diary*, companies with a market cap over $2.8 billion – middle market or larger by most definitions – can expect to be sued 40% of the time following a stock price decline of 20% compared with the overall market. That's more than twice the expected frequency of lawsuits in the second-largest category. For declines in stock price of 15% to 20%, boards of the larger companies can expect quadruple the number of lawsuits compared with those against smaller ones.

This may not come as a shock to

corporate leaders who've been on the receiving end of these lawsuits. It seems safe to assume that the relative frequency of lawsuits against larger companies is driven less by the quality of the claims against them and more by plaintiffs' perceptions about larger targets yielding larger payoffs.

Reputational Damage Claims Are on the Rise

It's like the good old D&O litigation days of the 1980s, but with a new twist: Plaintiffs are increasingly alleging reputational damage in their claims. In two recent examples, a securities class action against electric vehicle manufacturer Rivian notes, "Rivian's focus on its reputation for transparency and devotion to its customers," and claims that price increases tarnished "Rivian's reputation as a trustworthy and transparent company." Also, a lawsuit against technology company Okta cited what it called "a material negative impact on Okta's business, financial condition and reputation."

Of course, it's not just securities litigation where reputation is becoming a more prevalent factor. A Tesla shareholder recently filed a federal lawsuit that alleges, "Tesla's toxic workplace culture has caused financial harm and irreparable damage to the company's reputation."

The likelihood of reputational risk management and oversight becoming an issue in litigation has been heightened in recent years by "stakeholder capitalism" – companies competing for inclusion in ESG investment funds by setting aspirational goals, promoted by marketing and investor relations statements, without the operational or governance processes in place to ensure they are aligned with reality.

As stock prices drop and plaintiffs rise up, those ESG goals and statements – if they turn out to have been misleading – are going to become evidence of reputational negligence.

Questions for the Board

Corporate directors and executives should ask themselves these questions:

- When a lawsuit against your company references reputational damage or ESG, will you have a strong defense?
- Has there been a credible risk-management process built around reputational risk, or has it mainly been considered a marketing function?
- If there is a reputational risk management process in place, has it been validated by authoritative third parties?

This is a crucial time to consider these questions, with an expected surge in securities and derivative litigation on the horizon, fueled by a bear market and plaintiffs alleging corporate reputational loss, unsupported ESG promises and outdated governance models.

Board Best Practices

Directors must mitigate the risk rather than merely indemnify losses. They need more expansive protection than standard directors & officers liability insurance provides.

They should consider reputational coverage that includes in its underwriting a review and authentication of reputational risk management processes – and demonstrates by its presence that an outside entity has put real money behind its assessment of the company’s reputational resilience. They need an insurance solution that can stop litigation in its tracks by making the cost to plaintiffs, and the risk to plaintiffs of an unsuccessful outcome, that much greater.

Corporate directors have a lot to lose. If the current bear market is an indicator of a coming recession, an angry population – and the politicians who represent it – are going to put Corporate America in the hot seat. Board members who are targeted are going to be facing not only shareholder derivative lawsuits, but also political, regulatory and media scrutiny – not to mention judgment in the court of public opinion. That judgment could cause reputational damage to them

personally and cost them millions in lost future income.

Validation through objective underwriting that qualifies a company for reputational or ESG coverage could prove crucial as the company seeks to tell a simple, credible story of diligent and dutiful governance. If it is parametric coverage of first-party losses, it can be used irrespective of any D&O or other indemnity products to offset expenses incurred by the board or the enterprise as a whole, which are beyond the coverage of those other policies.

Take Immediate Action

Boards need to take steps immediately to protect themselves and their companies from what is sure to be an onslaught of litigation – particularly the emerging trend of reputational and ESG-related claims. Validating risk management with respect to operations and governance of reputational and ESG activities will blunt the pitchforks and extinguish the torches with a strategic deterrent.

Nir Kossovsky is CEO and Denise Williamee is vice president of corporate services at Steel City Re.