



Improving the Social Element of a Company's ESG Scores by Addressing Workforce Issues

Corporate, Securities, and Governance

ADDRESSING WORKFORCE ISSUES



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CHEAT SHEET

- **The “S” factor.** Third-party providers consider issues that impact employees, supply chains, human rights, communities, and the company’s stance on social justice issues when evaluating the “social” component for the company’s environmental, social, and governance (ESG) score.
- **Crisis response.** Developing a crisis response and management plan can improve the company’s ESG ranking.
- **Diversity.** There is a direct correlation between ESG scores and diversity. Companies should prioritize hiring, retaining, and promoting a diverse and inclusive workforce.
- **Harassment and discrimination.** Mitigate business and legal risks – and enhance your company’s social component – by responding quickly and adequately to sexual harassment and race-discrimination issues.

In-house counsel play a critical role in shaping a company’s environmental, social, and governance (ESG) strategy and improving its ESG scores. By working with corporate stakeholders, in-house counsel can provide key guidance to the development and implementation of the ESG strategy and enhance ESG ratings. An effective ESG strategy and strong ESG scores enhance market and accounting performance, improve business reputation, and foster employee engagement. Because investors are increasingly focused on ESG issues, in-house counsel must understand how ESG factors are derived and integrated into investors’ review of a company’s financial and reputational health.

Third-party providers evaluate companies on a range of ESG issues including, for example, climate change, natural resources, human capital, product liability, stakeholder opposition, social opportunities, and corporate behavior. While third-party providers consider hundreds of topics related to ESG reporting, generally they divide the topics into one of the three distinct ESG factors. For example, the social or “S” factor in ESG ratings consists of people-related elements, such as issues that impact employees, supply chains, human rights, public stance on social justice issues, and communities. Companies must look to their long-term business strategy, geographic footprint, partnerships, societal impacts and touchpoints, and other factors to determine which issues under the social element of ESG are most salient and impactful. More and more, an important part of staying competitive is a talented workforce.

“[L]ove them or hate them, ESG scores are becoming ever more important in the world of investing and capital markets” and because young investors are driving the trend, ESG scores may be here to stay.

This article focuses on the workforce issues under the social factor and, with respect to workforce issues, provides practical, cost-effective, and proactive strategies in-house counsel may implement to help improve a company’s social factor score in ESG ratings. Companies that focus on workforce

issues as part of their long-term business strategy can utilize the following four strategies to increase their ESG scores via the social component: creating a crisis response and management plan; hiring, retaining, and promoting a diverse and inclusive workforce; mitigating the risk of wage-and-hour litigation; and addressing high-profile sexual harassment and race discrimination issues. This article focuses on these four strategies and explains how the proffered strategies pertain to the current societal environment.

Increasing the company's bottom line

Integrating ESG factors

While a company's financial health is gauged by the ["traditional bottom line,"](#) investors have realized that non-financial factors also "provide useful information about a company's long-term risks and opportunities." ESG factors, for example, ["cover a wide spectrum of issues that traditionally are not part of financial analysis, yet may have financial relevance."](#)

The environmental factor or the "E" in ESG illustrates "whether a company improves the environment or damages it." For example, [environmental topics include](#) climate change policies; energy efficiency; waste management; deforestation; biodiversity; recycling practices; pollution; water scarcity; and green products, technologies, and infrastructure. The social component or the "S" in ESG focuses on "labor relations, including the treatment of workers, the conditions for workers, and worker compensation [and] how a company interacts with the communities in which the company operates." For example, [social topics include](#) employee treatment, pay, benefits, and perks; employee engagement and staff turnover; termination and controversies; employee training and development; employee safety policies, including sexual harassment prevention; risk and crisis management; diversity and inclusion in hiring and retention; supply chain; community relations; adherence to human rights; human trafficking; child labor; migrant labor; policy influence; ethical screens and global sanctions screening; and brand management, including public stance on social justice issues. Finally, the corporate governance component or "G" in ESG "relate[s] to how the company governs itself." For example, governance topics include "executive compensation, internal controls, audits, and transparency for shareholders and the public."

Because a crisis can hit a business at any time, in-house counsel with other key company stakeholders should proactively strategize and develop a useful crisis response and management plan to help the company react swiftly and appropriately to crisis, which can improve the company's ESG scores.

A 2019 article in *The Economist* noted: ["Using teams of analysts, whizzy software, and data from companies, ratings firms collect ESG information and convert it into a single score."](#) Although a criticism of ESG ratings is that the ["scores are poorly correlated with each other,"](#) the ["idea that investors who integrate corporate environmental, social, and governance risks can improve returns is \[nonetheless\] rapidly spreading across capital markets on all continents."](#) In fact, it is young investors who are ["driving the surge in interest: more than three-quarters of high-net-worth millennial and Generation Z investors have their assets reviewed for ESG impact."](#) ["\[L\]ove them or hate them, ESG scores are becoming ever more important in the world of investing and capital markets"](#) and because young investors are driving the trend, ["ESG scores may be here to stay."](#)

The role of in-house counsel in ESG strategy development

[Companies expect all in-house counsel to offer insight and contribute to key decisions.](#) This increased responsibility presents the opportunity for lawyers to add value and directly contribute to increasing the company's bottom line. In-house counsel can contribute not only to a company's business strategy but also to its ESG strategy and to help a company connect the dots between the two. Where companies can go wrong is failing to thoughtfully craft an ESG strategy that is connected to its overall business strategy. In a rush to publish an ESG report, the development of the company's ESG focus can be disorganized and based on convenience as opposed to strategic importance. In-house counsel are attuned to the big picture, including workforce issues, reputational risks, strategic risk, regulatory issues, ethics, and trends. This places them in a unique position to help ensure that ESG efforts, goals, and disclosures are in-line with the company's operational footprint, societal impacts, employee profile, and the company's long-term business strategy.

Improving your company's social disclosure score

One way in-house counsel can proactively and strategically support a company's financial health as part of its ESG strategy is addressing and executing initiatives related to the social component of a company's ESG score. While there are several strategies in-house counsel may implement to help increase a company's ESG score via the social component, four such strategies applicable to companies focused on human capital — explained below — are creating a crisis response and management plan; hiring, retaining, and promoting a diverse and inclusive workplace; mitigating the risk of wage-and-hour litigation; and addressing high-profile sexual harassment and race discrimination issues.

1. Creating a crisis response and management plan

COVID-19 and the effects resulting from the worldwide pandemic have reinforced that companies must be prepared to minimize risk while addressing a crisis before the crisis happens. Managing risk during a crisis demands consideration of the following social factors related to ESG scores: employee treatment, pay, and benefits; employee engagement and staff turnover; termination and controversies; and attraction and retention of diverse employees, including executives and directors. Because a crisis can hit a business at any time, in-house counsel with other key company stakeholders should proactively strategize and develop a useful crisis response and management plan to help the company react swiftly and appropriately to the crisis, which can improve the company's ESG scores.

Because another crisis may hit at any time, in-house counsel should take a lead role in preparing a crisis response and management plan.

Putting aside the COVID-19 pandemic, crises take many forms. For example, crises may include natural disasters such as hurricanes or tornadoes, data breaches, active shooters on premises, employee boycotts or protests, high-profile sexual harassment or race discrimination claims, criminal activities by executives, and workplace fatalities or injuries. Recommended strategies for creating a crisis response and management plan include the following.

- Prepare a useful and effective crisis response and management plan. The plan may include examples of potential crises and strategies for addressing each crisis. For example, if the crisis is an active shooter on premises, the strategy for addressing the crisis might be identifying the protocol for facility lockdown at other company locations, contacting law

enforcement, and preparing the draft communication to notify employees. The plan also should identify the crisis management team and a procedure for escalating issues to ensure a prompt response.

- Identify a crisis management team. The team may be composed of leadership from different sectors within the company. For example, the team may include in-house counsel, lead outside counsel, chief financial officer, chief risk officer, and the selected corporate spokesperson. Depending on the crisis, other identified team members outside of the core group may include the chief people officer and chief diversity officer (if the issue involves employees), chief sustainability officer (if the issue involves the company's sustainability efforts), or the chief technology officer (if the issue involves a data breach).
- Select a corporate spokesperson that will effectively communicate on behalf of the company during a crisis. The spokesperson should understand the best form of communication based on the audience (e.g., shareholders, board members, employees, the public, etc.) and have pre-vetted communication drafts ready to augment, revise, and disseminate.
- The crisis management team should test the response and management plan, and regularly update it based on new information learned. For example, following government-imposed work-from-home orders related to the COVID-19 pandemic, companies now should have a process for converting workforces to work remotely. The steps taken to move employees to work remotely (e.g., technology testing, employee communications, cybersecurity and data protection, etc.) should be added to the plan in the event another crisis requires remote work.
- Companies should follow the crisis response and management plan when a crisis arises. Adhering to the plan allows companies to quickly and effectively respond, and de-escalate any criticism from stakeholders or the public related to the company's response during the crisis.

ESG in the European Union

In 2018, the [European Union's Non-Financial Reporting Directive](#) came into force, requiring public-interest companies with more than 500 employees ["to disclose how they manage a range of social and environmental challenges."](#) Pursuant to the results of the Alliance for Corporate Transparency analysis of implementation of the EU Non-Financial Reporting Directive, 19 of every 20 companies assessed are complying with the reporting mandate. However, ["results show that the Directive's firm intent to link 'policies, risks, and results' together in the reporting is falling far short."](#) Because the Non-Financial Reporting Directive "stops short of specifying what companies should report," the European Union is ["now assessing the rule's effectiveness and what may need to change."](#)

Because another crisis may hit at any time, in-house counsel should take a lead role in preparing a crisis response and management plan. It is particularly important for plans to be effective and for companies to properly execute their plans to avoid potential business and legal risks. Executing an effective plan also will have the benefit of helping increase your company's ESG scores.

2. Hiring, retaining, and promoting diverse talent

Hiring, retaining, and promoting diverse employees is a priority topic for many companies seeking to improve their bottom line and their ESG ratings. Companies with more gender-diverse workforces

“outperform their less gender-diverse peers.” While “a common objection to such analysis is that ESG is just a proxy for other investment factors such as size or quality, … when controlling for company size, dividend yield, profitability and risk, … gender diverse firms still outperformed.” In addition to gender diversity, companies that increase diversity across the board — for example: race, sexuality, and age — create “a higher likelihood of attracting top talent.” Diversity “impacts the bottom line for businesses of all sizes” in several ways. For example, “[c]ompanies that display ethnic, gender, and age diversity appeal to a broader spectrum of job seekers,” giving those companies “a distinct advantage over companies that do not have a healthy percentage of women and people of color and varying ages on staff.” Different experiences also lead to more innovation.

Listening to the viewpoints of those who have had different experiences engenders richer brainstorming sessions, which foster outside-the-box thinking and higher levels of creativity for today’s companies. These sessions can in turn lead to an idea or invention that will help a firm distinguish itself from its competitors and become more successful.

Jana Turner, *4 Ways Diversity is Directly Linked to Profitability*, ENTREPRENEUR (Feb. 14, 2020), www.entrepreneur.com/article/346229.

Likewise, a “diverse team is more likely to relate to a particular audience’s wants, needs and pain points, creating greater opportunities to resonate with customers [and] reach new demographics in ways that might not have come to light with a homogenous group at the helm.” Finally, diverse clients and customers “want to work with and support diverse people; therefore, these groups seek out companies that actively and openly champion diversity as a pillar of their philosophy.” Because there is a direct correlation between diversity and ESG scores, companies should consider implementing the following strategies for hiring, retaining, and promoting diverse employees.

- Maintain competitive compensation packages. “Compensation is a tangible demonstration of respect, success, and value to the organization.” Compensating up-and-coming diverse talent says: “We’re willing to pay you more because we think you’re worth it.”
- Demonstrate your company’s commitment to diversity and inclusion. Commit to hiring, retaining, and promoting diverse employees by creating “clearly articulated plans for long-term development” of diverse employees. “Hold managers accountable for providing critical development opportunities and high-visibility assignments necessary for advancement.” After implementing goals, benchmark progress and “undertake gap analysis to solve problems.” Foster an inclusive workplace to encourage retention of diverse employees. This may be done through several methods, such as training employees on, among other topics, unconscious bias and conscious inclusion, generational differences, and LGBTQ issues, modeling inclusive behaviors, and encouraging management to champion the company’s commitment to diversity.
- Invest in mentoring and opportunity programs. “A key strategy in keeping diverse talent is ensuring company leaders mentor and champion such talent.” Networking also is “critical to advancement.” “In order for women of color [and other diverse employees] to effectively showcase their professional skills and talents, they must first be recognized.” Implementing high-level internal networking provides the opportunity for diverse employees to “make key connections that can rapidly and positively affect their professional development journey.” Mentoring and other opportunity programs help diverse employees make key connections that facilitate the opportunity for them to receive high-profile projects and responsibilities. If a diverse employee is not “receiving assignments that allow her to effectively demonstrate her range and ability as a potential leader, how can she expect to get noticed or considered for promotion?”

- Implement employee resource groups. Employee resources groups [“are groups created by and comprised of employees focused on a specific commonality that group members share or support.”](#) Organizations can have employee resource groups based on race, sex, sexual orientation, gender identity or expression, generation, or any other underrepresented groups. Employee resource groups [“can foster inclusion and belonging.”](#)
- Offer flexible work arrangements. Because “[m]ore than 75 percent of all caregivers are female,” implementing long-term flexible work arrangements will allow women [“to work schedules that accommodate both their personal and professional demands.”](#)

During the COVID-19 pandemic, employers are balancing customer demand with workplace safety issues, including determining whether it is prudent to require employees to work reduced shifts and, if so, determining the appropriate pay reduction or modification of duties does not affect an exempt employee’s job classification.

3. Mitigating the risk of US wage-and-hour litigation

While wage-and-hour compliance may have been taking a backseat to company survival at the start of the COVID-19 pandemic, company and investor interest has again turned to how current wage-and-hour litigation in the United States is affecting a company’s social factor concerns in ESG ratings. Indeed, employees’ wages and hours worked directly affects several social topics, including employee treatment, pay, engagement, turnover, training, and — particularly during the COVID-19 pandemic — safety. For example, companies that fail to comply with proper minimum wage and overtime laws detrimentally affect a worker’s ability to earn a living wage, damage the company’s internal and external reputation, and impair employee engagement. During the COVID-19 pandemic, employers are balancing customer demand with workplace safety issues, including determining whether it is prudent to require employees to work reduced shifts and, if so, determining the appropriate pay reduction and ensuring any pay reduction or modification of duties does not affect an exempt employee’s job classification. Likewise, while non-exempt employees work remotely, it is paramount for companies to train and regularly communicate the company’s timekeeping procedures so that employees report all hours worked, including overtime.

In the United States, wage-and-hour litigation often involves class actions under Federal Rule of Civil Procedure 23, collective actions under the Fair Labor Standards Act (FLSA), or — in California — Labor Code Private Attorneys General Act of 2004 (PAGA). Generally, employees file such claims to challenge an employment practice or policy that affects a group of employees, which — depending on the size of your company and the scope of the employment practice or policy — could affect employees nationwide. Employment practices liability insurance policies generally do not cover wage-and-hour claims and, thus, companies must pay the tab related to any such actions. Employers face substantial liability from class, collective, and PAGA claims because prevailing employees may be entitled to, among other remedies, unpaid minimum or overtime wages, liquidated damages, and attorney fees.

Because sexual harassment and race discrimination claims are hot-button issues for the media, these issues may immediately rise to the level of a major crisis that must be immediately addressed.

In the United States, wage-and-hour actions may encompass the following types of claims: violations of FLSA or state minimum and overtime laws, failure to provide meal and/or rest breaks,

misclassification of independent contractors, misclassification of employees as exempt from overtime based upon a change in duties during remote work, challenges to the outside sales exemption based on a change in duties, payment related to off-the-clock work, and federal and state pay-equity issues. During the COVID-19 pandemic, employers have been particularly vigilant in keeping abreast of relevant laws concerning remote work, such as reimbursing employees for business-related expenses when employees work remotely. However, as remote work becomes a more long-term consideration for workforces, employers must consider whether they have adequate timekeeping and payroll administration systems to account for all time worked remotely. Recommended strategies for mitigating wage-and-hour litigation, particularly when the economy begins to recover from the effects of the pandemic, include the following.

- Research the state and city laws in which your company has employees related to wage-and-hour issues. Many states, among other issues, have a higher minimum wage compared to the FLSA, impose liability on employers for failure to authorize and permit rest breaks, and have specific wage-payment laws.
- Evaluate the job duties of all nonexempt employees, particularly for employees who continue to work remotely. This may involve reviewing job descriptions, performance evaluations, and training materials, and interviewing employees or managers. In-house or outside-counsel should be involved in discussions related to employee job duties to trigger the attorney-client privilege.
- Revise company policies and procedures to comply with federal and state laws. For example, company policies must comply with state pay-equity laws that prohibit an employer from asking about an applicant's salary history or restrict employees from discussing their compensation with other employees.
- Establish a timeline for implementing, training (if necessary), and communicating new policies and procedures. This may involve research related to specific issues, revising policies, changing payroll or timekeeping systems, giving notice to employees of changes, and scheduling and conducting training sessions.
- Research and review local and state paid sick leave laws to confirm that policies and protocols related to same are drafted and implemented in compliance with the respective laws. As a result of COVID-19, paid sick leave laws have been implemented at the federal, state, and local levels in the United States. For example, the federal government passed the [Families First Coronavirus Act](#). Several states, including [California](#), [Colorado](#), and [New York](#) have passed paid sick leave laws that fill the gap or add additional requirements for employers not covered by Families First Coronavirus Act. Numerous cities, particularly in California — including [Los Angeles](#), Oakland, [San Francisco](#), and [San Jose](#) — also have passed paid sick leave laws to improve worker safety.
- Review supplemental compensation plans to ensure that overtime, where applicable, is being paid in accordance with federal and state law.
- Analyze additional unique wage-and-hour issues unique to the COVID-19 outbreak (e.g., remote work timekeeping issues) and create requisite policies regarding the same.
- Create a checklist of wage-and-hour issues that could affect your company and review it at least annually to determine whether it needs to be updated or whether more research should be conducted on a specific issue in light of recently-passed legislation.

Each of these recommendations may be proactively implemented to mitigate the risk of litigation, particularly following the effects of the COVID-19 pandemic. Diligently executing these strategies now will substantially reduce the exposure and expense of class, collective, and PAGA actions, and assist in improving your company's social disclosure score for ESG reporting.

An I.D.E.A.L. Workplace

For more diversity and inclusion resources, visit I.D.E.A.L., ACC Foundation's new initiative on race, equity, and social justice: acc.com/ideal.

4. Addressing high-profile sexual harassment and race discrimination issues

Considering the #MeToo era, sexual harassment claims have spurred legislation and numerous lawsuits. Additionally, with the recent events that have [“starkly illuminated the effects of systemic racism and injustice on Black Americans, including threats to physical safety, psychological trauma, and economic disparity.”](#) race discrimination litigation may see similar trends. Other countries too have witnessed demonstrators gathering [“to protest against police brutality in solidarity with the US crowds.”](#) Because sexual harassment and race discrimination claims are hot-button issues for the media, these issues may immediately rise to the level of a major crisis that must be immediately addressed. Sexual harassment and race discrimination claims — which involve a company's treatment, safety initiatives, and diversity efforts for employees — and a company's response to such claims may affect a company's ESG ratings. Recommended strategies for mitigating and addressing sexual harassment and race discrimination claims include the following.

- Research the country, state, and city laws in which your company has employees related to sexual harassment training. For example, several US states require a private employer to provide sexual harassment prevention training and education to its employees. The state laws vary with respect to coverage, frequency, and content requirements. Even if your employees are not employed in a location that requires such training, proactively training your employees will help prevent sexual harassment in the workplace and allow human resources or in-house counsel to effectively investigate and address it when it occurs.
- Revise anti-harassment policies to include: the definition for unlawful sexual harassment and the company's commitment to prohibiting discrimination based on protected characteristics; conduct that constitutes sexual harassment and harassment based on protected characteristics; the obligation to report sexual harassment, discrimination, and harassment based on protected characteristics; and identification of the internal complaint process, and anti-retaliation protections.
- Provide sexual harassment prevention and diversity and inclusion training and education to employees. For example, sexual harassment training may include information on the company's anti-harassment policy; relevant statutory provisions and case-law principles; supervisors' obligation to report sexual harassment and related retaliation; appropriate remedial measures to correct harassing behavior, such as reporting mechanisms; steps to take if a supervisor is personally accused of harassment; remedies available for victims in civil actions; and potential employer and individual exposure and liability.
- Create and regularly update a written crisis-management plan directly related to sexual harassment and race discrimination. A crisis-management plan may identify specific risks that could happen at your company and methods for addressing those risks. For example, depending on your company's industry, specific risks may include an executive's personal suggestive text messages to a subordinate employee that become public or an industrial supervisor making sexual comments to a worker that is caught on video. Race discrimination risks may involve electronic messages, videos, or images involving racial or ethnic slurs

asserted against an employee. The plan also may include a response team, escalation procedures, and draft communications that have been vetted by key stakeholders to quickly respond to public inquiries.

- Adhere to your company's sexual harassment and race discrimination policies and crisis management plan should a sexual harassment or race discrimination issue arise, particularly when those issues becomes high-profile. Adherence to your company's sexual harassment and race discrimination policies may assist in asserting the Faragher/Ellerth affirmative defense should litigation arise. Following the company's crisis-management plan will allow the company to quickly respond to media inquiries, social media allegations, and mitigate other business risks.
- Delegate anti-racism, racial justice, and equality issues to a board-level committee. The “committee should, together with management, regularly monitor the company’s progress [on such issues] and report to the full board.” The “relevant committee and the full board should understand how these priorities align with strategy and planning, how the company measures, assesses and drives progress, and what is done in response to shortfalls.”

Create and regularly update a written crisis-management plan directly related to sexual harassment and race discrimination.

Planning for high-profile sexual harassment and race discrimination issues can mitigate business and legal risks. Quickly responding and adequately addressing the issue also will help improve the social factors related to your company's ESG score.

Conclusion

In-house counsel may take concrete steps to shape the company's ESG strategy and drive initiatives to support ESG. This will further protect the company's financial and reputational health and help improve the company's ESG scores. For companies focused on their human capital, it is prudent to implement the best practices discussed above as soon as practically possible to mitigate business, legal, and reputational risks. Proactively strategizing will help contribute to factors that improve your company's fiscal health and mitigate against negative media exposure as well as expensive litigation.

ACC EXTRAS ON... Addressing workforce issues

ACC Docket

[3 Ways Companies Can Achieve Inclusivity at All Levels](#) (July 2020).

[Protecting Continuity, Workforce, and Physical Assets During the Pandemic](#) (May 2020).

[8 Tactics to Roll Back Racial Bias at the Office](#) (June 2020).

ACC HAS MORE MATERIAL ON THIS SUBJECT ON OUR WEBSITE. VISIT [WWW.ACC.COM](#), WHERE YOU CAN BROWSE OUR RESOURCES BY PRACTICE AREA OR SEARCH BY KEYWORD.

References

Susan N. Gary, *Values and Value: University Endowments, Fiduciary Duties, and Esg Investing*, 42 J.C. & U.L. 247, 260 (2016).

Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and Esg Integration*, 90 U. COLO. L. REV. 731, 734 (2019).

Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and Esg Integration*, 90 U. COLO. L. REV. 731, 746 (2019).

See e.g., 29 U.S.C. § 216(b) (allowing a prevailing employee to recover unpaid minimum or overtime wages, liquidated damages, and attorney's fees and costs); Cal. Lab. Code § 2699 (with respect to Labor Code provisions that do not specify the penalty amount, allowing default civil penalties at \$100 for every employee for every pay period for the first violation and \$200 for each violation thereafter).

See Fisher Phillips' Pay Equity Interactive Map (www.fisherphillips.com/equity#Main) to determine whether your company has employees in a state that has enacted a pay equity law.

See DOL Families First Coronavirus Response Act: Questions and Answers, www.dol.gov/agencies/whd/pandemic/ffcra-questions#32; DOL Families First Coronavirus Response Act: Employee Paid Leave Rights, www.dol.gov/agencies/whd/pandemic/ffcra-employee-paid-leave.

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