



By Invitation:

Ethical reporting and the law

Phillip H Rudolph, a corporate social responsibility partner in the Washington DC office of Foley Hoag LLP, provides a brief tour through the legal thicket of CSR reporting for multinationals with US operations

Within the past few years, pressures have increased on companies to disclose and discuss publicly their social and environmental impacts and activities. At the same time, the risks associated with public dialogue and discourse – principally legal risks – have also evolved.

These two parallel developments present companies with a Hobson's choice. They recognise that their stakeholders are expecting – indeed demanding – greater transparency. But their lawyers are hunkered down, wringing their hands and gnashing their teeth over the risks associated with corporate openness.

Lawyers, by training and temperament, tend to be remarkably risk-averse, and the risk of over-communication by their clients can scare them witless. But in fairness to the lawyers, many of the risks associated with transparency are quite real, and potentially quite serious. The mere existence of risk does not alone justify a corporate decision in favour of opacity but it is important for executives making decisions about such issues to comprehend fully what these risks are, and to possess

the tools and the resources necessary to balance the risks of disclosure against the corresponding rewards – in other words to do what business leaders do.

Why are we talking about this?

The legal stakes of corporate transparency were brought into bold relief in 2003. In June of that year, the US Supreme Court let stand a California Supreme Court decision allowing Nike to be sued for statements it made in response to attacks on its labour practices. The rationale of the California court's decision in *Kasky v Nike* was that Nike's status as a commercial enterprise rendered its public statements subject to diminished free speech protections.

The *Kasky* case dramatically raised the profile of social responsibility reports within corporate legal departments. Suddenly an area in which company lawyers had played little if any role became for them a source of agitation. After all, if speech about a public issue – once thought to be protected from attack in the US under the First Amendment to the Consti-

tution – was deemed to be less protected when uttered by a commercial enterprise, the whole notion of corporate social responsibility reporting suddenly seemed to the in-house legal community less than a great idea. Indeed, several companies either stopped reporting, pulled existing reports off of their websites, or put the brakes on initiatives to begin reporting.

Time has passed, however, and there has been no stampede through the court-houses of California by plaintiffs seeking to capitalise on the windfall offered by that state's supreme court. The sky has not, in fact, fallen in on those companies whose lawyers have failed to block publication or dissemination of transparency reports. What explains this? Well, despite much angst among in-house lawyers, the *Kasky* decision was somewhat more limited than has been widely reported. The allegations relied on by the California court to support its ruling (which were never proven to be either true or false because the case was settled before the facts could be established), included the following:

- The statements attacked in the case were specific, targeted, fact-based comments offered by Nike to refute specific, targeted, charges – they were thus different in tone and content from statements offered in the context of a corporate social responsibility report
- The challenged statements were disseminated explicitly to customers (colleges and universities) for whom the criticisms were deemed likely to hurt sales.

On the basis of these allegations, the court concluded that Nike's comments



Big business must tread carefully

were commercial in nature and were thus not deemed to be political speech that would be subject to rigorous free speech protections. Corporate responsibility reports were not at issue in *Kasky*, and the nature of the court's analysis could readily lead one to conclude that carefully drafted reports would not come within the scope of the court's holding.

Some risks presented by corporate responsibility reporting

The litigation silence that has trailed the *Kasky* decision indicates that the California ruling did not ring the death knell for corporate transparency reports. This should not be read to suggest, however, that the publication of such reports is risk-free. The *Kasky* case highlights – and indeed enhances – some risks. Others exist independent of *Kasky*.

California's Unfair Practices Act

When I first sat down to pen this piece, I intended to offer a lengthy discussion of California's Unfair Practices Act (UPA). Because the *Kasky* case arose in California and was based upon the UPA, that seemed a logical place to start. This strange law gave Californians the ability to file suits as "private attorneys general" on behalf of citizens of the state against alleged wrongdoers for acts of fraud perpetrated on these citizens. Perversely, though, the UPA allowed an individual to file a claim regardless of whether he or she had, in fact, suffered any harm as a consequence of the alleged wrongdoing. Marc *Kasky* was thus able to sue Nike for its challenged statements notwithstanding his acknowledgment of having never purchased a Nike product in his life.

What this meant was that virtually anyone with an axe to grind in California

could theoretically initiate a UPA lawsuit against a company with whose publicly stated positions they disagreed. And as *Kasky's* lawyer gamely acknowledged to the US Supreme Court on this very point, the mere filing of the suit itself – with all of the attendant costs and burdens associated

with it – would be sufficient to chill both legitimate and illegitimate speech. So, an ironic consequence of the application of the UPA in the manner relied upon by *Kasky* was that it discouraged activities that might be thought to benefit the state's citizenry, i.e. greater corporate transparency.

This unique aspect of California law was eviscerated on election day this past November. In a development little noticed outside California, that state's citizens approved a referendum (Proposition 64) requiring that a person bringing a lawsuit in California actually sustain injury of the sort complained of. The referendum also prescribes that only the state's attorney general may file lawsuits on behalf of the citizens of the state. While traditional class action tools are still preserved, the aspects of the UPA that allowed *Kasky* to bring his lawsuit have been eliminated.

Broader free speech concerns

The recent passage of Proposition 64, however, does not overturn the substantive aspect of the California court's *Kasky* holding that the speech in question was subject to lesser First Amendment protection. Thus in California, and in any other state that might be persuaded by plaintiffs' lawyers to embrace the California court's decision, class action claims attacking speech of the sort Nike engaged in are entirely possible.

Note, however, that such enhanced risk cannot be viewed as limited to corporate responsibility reporting. All utterances by companies are subject to similar challenge. So at least in this sense, sustainability reporting does not give rise to any greater risk than any other type of public communication by a corporation, except of course the incremental risk asso-

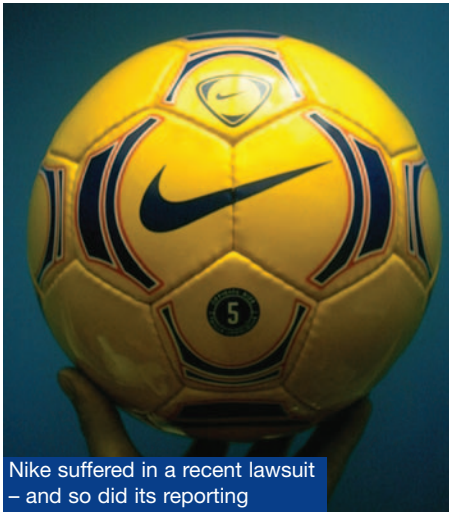
ciated with incrementally more communication. This risk is real – not publishing a report will, in fact, reduce to zero the likelihood of being sued for statements made in such a report. But the mere existence of incremental risk should not alone compel a decision to forego transparency reporting. Rather, this risk should be factored into the broader calculation regarding whether, how, and why a company chooses to communicate with its stakeholders.

Materiality

Materiality is a reporting threshold for filings with US securities regulators and for comparable regulatory filings around the world. US law requires companies to disclose publicly any activities creating a material risk, or having or likely to have a material impact on the company's value. The manner and form of such reporting is fairly clearly prescribed by law in the US.

But what if information that might be deemed material is included in a voluntary transparency report but not in a required regulatory filing? This scenario is not as farfetched as it may sound. It is not uncommon for businesses to achieve something less than perfection in their quest for internal communication. Thus, it would not be surprising for a corporate responsibility report to be produced in the absence of consultation with a company's regulatory lawyers. Would the reporting of arguably material information in public corporate responsibility documents satisfy regulatory disclosure laws? Could disclosure of material information in a corporate responsibility report but not in a filing to the Securities and Exchange Commission give rise to legal or regulatory liability? How might a discussion of global warming in a sustainability report be construed if the company failed to discuss potential global warming financial or liability implications in its regulatory filings?

As interesting as these questions may be as an academic matter, they stray a bit from the central point. While corporate responsibility reporting might, at least theoretically, enhance the risk that material information might not be disclosed properly or consistently, this fact should not decide the question of whether to engage in such reporting. It merely suggests that, as with all activities in which a company engages, corporate responsi-



Nike suffered in a recent lawsuit – and so did its reporting

bility reporting should be done thoughtfully, carefully and with the proper input from all interested parties within the organisation including, of course, the lawyers.

Lawyer-client privilege

Research undertaken by non-lawyers while preparing a corporate responsibility report may lead to the disclosure of information that had previously been the subject only of attorney-client communications. Disclosure of such information could be argued to be a waiver of the attorney-client privilege. This privilege – which protects parties from having to make public the details of their discussions with their lawyers – is far more robust in the US than elsewhere. In the US it is a jealously guarded protection that can readily be lost in its entirety through even the inadvertent disclosure of only small portions of attorney-client communications. But as with the previous discussion of materiality, avoidance of this eventuality simply requires care – nothing about corporate responsibility reporting gives rise to privilege-waiver issues that don't already exist. It just heightens the possibility of unintentional waiver. Once again, the involvement of lawyers in the preparation of the report can help identify these risks and minimise them.

Roadmap issues

There is always the possibility that a corporate responsibility report might be used as a roadmap for people or groups with axes to grind. For example, the acknowledgment in a report of labour challenges in certain markets might result

in disclosures that trigger lawsuits or legal actions by trade unions or others. Similarly, disclosure of child labour violations in overseas production facilities could give rise to a US Customs investigation. Or discussions of the challenges of operating facilities in markets with oppressive political regimes could trigger Alien Tort Claims Act litigation. The mere fact of reporting should not independently give rise to legal exposure. It might, however, increase the universe of people who become aware of issues on which they may wish to assert legal claims. Again, though this risk exists, it is just one of many factors that must be evaluated in deciding whether and how to report.

Legal and other risks of not reporting

Balanced against these legal issues is an array of business drivers that motivate companies to prepare and publish corporate responsibility data. Compelling issues relating to brand management and stakeholder management can and often do line up strongly in favour of corporate transparency. Readers of this publication are more than familiar with all of the arguments and constituencies supporting the publication of social responsibility reports.

Beyond these pragmatic, stakeholder-driven motivators, however, are evolving legal and regulatory developments that create potentially enhanced risks of not engaging in CSR reporting.

Several countries have begun to mandate some form of “triple bottom line” reporting by companies doing business within their jurisdiction. In 2001, for example, the French parliament enacted a law calling for mandatory disclosure of social and environmental issues in companies' annual reports. Similar legislation has been proposed elsewhere. And beyond these developments is the evolution – discussed earlier – of rigorous regulations governing the definition of materiality for purposes of financial disclosure laws. These laws may be read to mandate greater disclosure and transparency, at least with respect to matters deemed material.

These are examples of a growing trend towards mandatory reporting or towards strongly encouraged voluntary reporting (as has been promoted within the European Union). These developments create interesting issues for multinationals trying to reach a balance between fulfilling local

reporting expectations and managing broader or more global legal risks.

Walking the line

As noted, legal risk is only one of several factors to evaluate in assessing the pros and cons of corporate responsibility reporting. But how does one define legal risk? From a lawyer's perspective, risk is not limited to the prospect of losing a lawsuit or claim, but includes also the prospect of being sued or of being investigated in the first instance. The potential outcome of lawsuits is obviously important but is not the only concern of company lawyers. Even frivolous lawsuits can be costly and distracting. For this reason company management must always think carefully about taking action – even legitimate action – that might enhance legal risks, regardless of the merits of the potential underlying claims. The Kasky case helps underscore this point. Ultimately Nike settled the case by paying \$1.5 million to a labour rights non-governmental organisation, notwithstanding that there was never a legal finding that Nike had done anything wrong.

We have seen that many legal risks exist to the same degree with or without corporate responsibility reporting. Such risks should not be used to justify a decision to forego reporting. But some risks are almost certainly enhanced by corporate responsibility reporting. Does the enhanced risk justify avoidance of reporting? At risk of sounding like a lawyer, the answer can be yes, no or maybe. Legal risks are important, but their existence should not be the single deciding factor (except in rare instances, such as preventing the commission of a crime or preventing actions that would constitute a breach of fiduciary duty). As with all other types of risks (and subject to the referenced exceptions), legal risks need to be balanced against other legitimate business considerations.

This article does not pretend to offer a definitive answer to the question posed in the title. At risk again of sounding like a lawyer, such an answer cannot be given other than on a case-by-case basis. The best general advice I can offer those confronted with Mr Hobson's dilemma is to paraphrase former New York Yankee catcher and linguistic gymnast Yogi Berra: “When you come to a fork in the road, take it – and bring your lawyer with you.” ■