Corporate Governance Hot Topics

Quarterly Update (November 2020)

Boardroom Buzz

Potential topics for the board's agenda this quarter:

➔ Who should be responsible for overseeing risk at the board-level? Should we delegate certain types of risk oversight to a committee or establish a standalone risk committee?

➔ Do we have a plan to address any ESG vulnerabilities/risks that COVID-19 and other recent events have exposed?

➔ Are the company's public disclosures regarding diversity and inclusion consistent with its policies and practices? Do we need to strengthen or update these disclosures, policies or practices?

➔ How is the company approaching the issue of employee mental health?

1. Regulatory and Legislative Developments

- **SEC Adopts New Rules for Proxy Advisors:** On July 22, 2020, the SEC, in a 3-1 vote, adopted amendments to its proxy solicitation rules to provide that the federal proxy rules and anti-fraud provisions apply to proxy voting advice issued by proxy advisory firms, such as ISS and Glass Lewis, and adopted guidance that clarifies the fiduciary obligations of advisors who rely on proxy advisory firm voting recommendations. Among other changes, the new rules provide that proxy voting advice constitutes a "solicitation" under the federal proxy rules and impose certain requirements that proxy advisors must meet in order to be exempt from the information and filing requirements of the proxy rules, including (i) disclosing conflicts of interest in their voting reports, (ii) adopting and publicly disclosing policies designed to ensure their voting reports are made available to the subject companies at or prior to the time they are sent to the firm's clients and (iii) reporting to their clients any company responses to their voting reports. These new rules come a few months after Glass Lewis announced that any company that purchases a Glass Lewis report will have the right to submit a statement in response to the report at no extra cost, and that it will make these statements available to investors unedited, on the front page of each report. The full text of the amendments is available here and the Sullivan & Cromwell memorandum on the topic is available here.

- **SEC Adopts Amendments to Shareholder Proposal Rules:** At an open meeting held on September 23, 2020, the SEC, in a 3-2 vote, adopted amendments to the shareholder proposal rules under Rule 14a-8. Among other things, these amendments (i) increase the eligibility and resubmission thresholds for shareholder proposals, (ii) add a shareholder engagement component to the eligibility criteria in order to encourage companies and shareholders to meet to discuss the proposal, and (iii) clarify that the one-proposal rule applies to "each person" rather than "each

shareholder." The new rules will become effective 60 days after publication in the Federal Register and will apply to any proposal submitted for an annual or special meeting to be held on or after January 1, 2022. The new rules also provide for a transition period with respect to the ownership thresholds that will allow shareholders meeting specified conditions to rely on the current $2,000/one-year ownership threshold for proposals submitted for an annual or special meeting to be held prior to January 1, 2023. The full text of the amendments is available here and the Sullivan & Cromwell memorandum on the topic is available here.

- **SEC Proposes to Increase the Form 13F Reporting Threshold:** On July 10, 2020, the SEC proposed to amend Rule 13f-1 and Form 13F to, among other things, increase the reporting threshold for filing a Form 13F holding report from $100 million to $3.5 billion and eliminate the *de minimis* threshold for individual securities. The full text of the proposed amendment is available here and the Sullivan & Cromwell memorandum on the topic is available here.

- **SEC Adopts Amendments to Regulation S-K Relating to the Disclosure of an Issuer's Business, Legal Proceedings and Risk Factors:** On August 26, 2020, the SEC adopted amendments to "modernize" the disclosure requirements relating to a company's business description, legal proceedings and risk factors by a 3-2 vote. Among other things, the new rules require companies to include a description of their "human capital resources," including the number of employees and any human capital measures or objectives that the company focuses on in managing their business to the extent they are material to an understanding of the company's business taken as a whole. The new rules do not explicitly define "human capital resources" and acknowledge that the exact measures or objectives that will need to be disclosed will depend on the nature of the company's business and workforce, but it identifies "measures and objectives that address the development, attraction and retention of personnel" as non-exclusive examples of subjects that may be material. The full text of the amendments can be found here and the Sullivan & Cromwell memorandum on this topic is available here.

- **Department of Labor Announces Proposed Rules Affecting Plan Fiduciaries and ESG Investments:** On June 23, 2020, the U.S. Department of Labor released a proposal for a new investment duties rule that clarifies the application of the fiduciary duties of prudence and loyalty under the Employee Retirement Income Security Act of 1974. The proposal would limit the ability of fiduciaries of private-sector retirement plans to select investments based on environment, social and corporate governance ("ESG") factors and would bar 401(k) plans from using a fund with any ESG mandate as the default investment alternative for non-electing participants The full text of the proposed rules is available here and the Sullivan & Cromwell memorandum on the topic is available here.

- **Amendments to Delaware's General Corporation Law Affecting Bylaws, Indemnification and Other Matters:** On July 16, 2020, Delaware's Governor signed House Bill 341 (the "Amendments"), amending key provisions of Delaware's General Corporate Law ("DGCL"). Among other things, the Amendments modify existing statutory provisions governing boards of directors' power to adopt emergency bylaws, address other emergency board powers and effect changes to provisions enabling the indemnification of corporate officers. The full text of House Bill 341 is available here and the Sullivan & Cromwell memorandum on this topic is available here.

2. Litigation Developments

- **Shareholders Seek to Hold Directors and Officers Liable for Lack of Diversity:** Between July and September 2020, shareholders have filed derivative lawsuits against the directors and officers of companies such as Facebook, Inc., Oracle Corporation Qualcomm, Gap Inc., Monster Beverage Corp. and NortonLifeLock, Inc., alleging that they breached their fiduciary duties to the company by, among other things, failing to ensure diversity in the company's leadership and misrepresenting the company's progress towards increasing diversity at all levels. While shareholders are pursuing these claims in court, legislatures are also taking action on the issue of board diversity. For example, on September 20, 2020, California added a new section to its diversity law that will require boards of directors of publicly held companies headquartered in California to include a minimum number of persons from specified historically underrepresented communities on their boards by December 31, 2021. Previously, this law only required companies headquartered in California to include a minimum number of women on their boards. Sullivan & Cromwell's memorandum on the California law is available here.

3. Surveys, Policies and Reports

- **GAO Report Finds Demand for Additional, More Detailed and Consistent ESG Disclosure:** On July 6, 2020, the U.S. Governmental Accountability Office ("GAO") released a report, commissioned by Democratic Senator Mark Warner, evaluating the disclosure practices of public companies related to ESG issues. The GAO reviewed the disclosures of 32 public companies on 33 topics related to various ESG issues in addition to interviewing 14 institutional investors, 18 public companies, 13 market observers and stock exchange and industry association representatives. The report found that most institutional investors use information on ESG issues in their investment decisions and that a majority of the public companies surveyed disclosed information on more than half of the ESG topics reviewed. However, the report also found that more detail and consistency between ESG disclosures is needed to make the information more easily comparable across companies. Following the release of the report, Senator Warner called on the SEC to establish an ESG Task Force to develop a more uniform framework for ESG disclosures that would provide investors with the quantifiable and comparable disclosure regarding ESG issues. However, despite growing pressure from investors, legislators and other key stakeholders to mandate standardized ESG disclosures, the SEC has consistently declined to impose a standardized framework and reiterated a principles-based approach to ESG disclosures. The full text of the GAO's report is available here and Senator Warner's press release on the topic is available here.

- **Ernst & Young Releases Report on Cybersecurity Risk and Oversight Disclosures:** On August 7, 2020, Ernst & Young ("EY") released its annual report on the disclosure practices of public companies in relation to cybersecurity risks and board oversight. EY analyzed disclosures in the proxy statements and Form 10-Ks of 76 Fortune 100 companies from 2018 through May 31, 2020 and found modest year-over-year increases in public disclosure relating to board oversight of cybersecurity, statements on cybersecurity risks and board- and company-level risk management efforts, though the depth and company-specific nature of these disclosures continue to vary widely. The report also highlights certain leading board practices, investor perspectives and SEC guidance with respect to cybersecurity risks. The full text of the report is available here.

- **Trends in U.S. Director Compensation:** On July 28, 2020, Sullivan & Cromwell released a report summarizing director compensation trends over the last 10 years. The report found that average U.S.

public company director compensation has increased steadily, in part due to changes in board composition and governance that have increased the number and significance of board leadership positions held by non-executive directors. Over the same period, the average number of hours of work performed by directors has also increased, while the average number of board meetings and size of boards have remained stable. Future director compensation may be influenced by many variables, including the effects of the COVID-19 pandemic and dynamic regulatory change in certain industries. For example, in its review of the executive and director compensation practices of Russell 3000 companies, CGLytics found that the 57% of the 554 companies that exercised changes in their compensation practices as of May 31, 2020 reduced the compensation of their chief executive officer, their named executive officers, and their board of directors as a result of the effects of COVID-19. For those companies that reduced director compensation, 52% cut director pay by more than 50% and 32% of such companies cut cash fees for directors entirely. While peer company benchmarking can be informative, no single approach to director compensation works for every company. The Sullivan & Cromwell report on the topic is available here.

The entire collection of Sullivan & Cromwell memoranda on corporate governance topics and issues is available here.