

Corporate Governance Hot Topics

Quarterly Update (February 2021)

Boardroom Buzz

Potential topics for the board's agenda this quarter:

- What steps, if any, should we take to advance diversity, equity, and inclusion across the organization?
- Do our corporate political contribution and lobbying policies need updating? Are our disclosures about our policies clear?
- What are our material ESG risks? Have we disclosed these risks adequately to our investors? What are our ESG goals for 2021? Have we disclosed these goals adequately to our investors?

1. Proxy Advisory and Institutional Investor Updates

- **Proxy Advisory Firms Heighten Focus on Board Diversity and Related Disclosures:** On November 12, 2020, ISS announced a new board diversity policy in its “Proxy Voting Guidelines Updates for 2021” effective for shareholder meeting on or after February 1, 2021. Under the new policy for 2021, which applies to companies in the Russell 3000 or the S&P 1500, the absence of racial or ethnic diversity will not be a factor in voting recommendations, but ISS will highlight those boards that lack racial or ethnic diversity “to help investors identify companies with which to engage.” For 2022, the policy further states that ISS “will issue adverse vote recommendations, generally voting against or withholding from the chair of the nominating committee where the board has no apparent ethnically or racially diverse members.” Similarly, on November 24, 2020, Glass Lewis released its “2021 U.S. Proxy Paper Guidelines,” which focus on board diversity, board tenure, and related disclosures. Beginning in 2021, for S&P 500 companies, Glass Lewis’s report will reflect how a company’s proxy statement discloses: (1) the board’s current percentage of racial or ethnic diversity; (2) whether the board’s definition of diversity explicitly includes gender and race; (3) whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees, otherwise known as the “Rooney Rule”; and (4) board skills disclosure. Glass Lewis also reaffirmed its commitment to board gender diversity and will now generally recommend voting against the nominating committee chair of a board that has more than six members of which fewer than two are women, starting with shareholder meetings held after January 1, 2022. For 2021, Glass Lewis will apply its existing guideline of a minimum of one female board member for meetings held in 2021 and will flag companies if their boards have fewer than two female directors. Beginning in 2021, Glass Lewis will also note instances where the average tenure of non-executive directors is 10 years or more, and no new independent directors have joined the board over the past five years. The full text of the ISS policy is available [here](#). The full text of the Glass Lewis policy is available [here](#).

- **BlackRock’s 2021 Proxy Voting Guidelines Prioritize ESG Actions:** On January 3, 2021, BlackRock released its “2021 Stewardship Expectations,” coupled with its traditional annual “Proxy Voting Guidelines” update. Both documents are effective as of January 2021 and reflect BlackRock’s continued commitment to integrate environmental, social and corporate governance (“ESG”) throughout its investment and stewardship functions. Most notably, BlackRock showed an increased willingness to vote against companies in the coming year, both in shareholder proposals and in director elections. BlackRock writes: “We see voting on shareholder proposals playing an increasingly important role in our stewardship efforts around sustainability. Accordingly, where we agree with the intent of a shareholder proposal addressing a material business risk, and if we determine that management could do better in managing and disclosing that risk, we will support the proposal.” Other key changes in BlackRock’s policies address board quality; the transition to a low-carbon economy; key stakeholder interests; diversity, equity and inclusion; alignment of political activities with stated policy positions; and shareholder proposals. On January 26, 2021, BlackRock CEO Larry Fink released his annual letter to CEOs reiterating BlackRock’s commitment to ESG actions. In the letter, Larry Fink called on companies to disclose a plan for how their business model will be compatible with a net-zero economy, defined as one where global warming is below two degrees Celsius and greenhouse gas emissions have reached net zero by 2050. Further, Fink warned that companies without a clear plan to address this transition will “see their valuations suffer” as customers, shareholders, policymakers and employees lose confidence in the business. The full text of the “2021 Stewardship Expectations” is available [here](#). The full text of the “Proxy Voting Guidelines” is available [here](#). The full text of Larry Fink’s 2021 Letter to CEOs is available [here](#).
- **State Street’s CEO Announces Climate Change and a Lack of Racial Diversity as the Main Stewardship Priorities for 2021:** On January 13, 2021, President and CEO of State Street Global Advisors Cyrus Taraporevala announced that State Street’s main stewardship priorities for 2021 are the systemic risks associated with climate change and a lack of racial and ethnic diversity. Simultaneously, State Street also released “Guidance on Enhancing Racial & Ethnic Diversity Disclosures.” Under this new policy, in 2021, State Street “will vote against the Chair of the Nominating & Governance Committee at companies in the S&P 500 and FTSE 100 that do not disclose the racial and ethnic composition of their boards.” The policy further stated that starting in the 2022 proxy season, State Street will vote against the Chair of the Compensation Committee if a company in the S&P 500 does not disclose its EEO-1 report. Taraporevala’s letter is available [here](#). The new “Guidance on Enhancing Racial & Ethnic Diversity Disclosures” is available [here](#).
- **Vanguard Makes a Continued Call for Boardroom Diversity:** On December 19, 2020, Vanguard released its “Investment Stewardship Insights” for 2021 which exclusively focus on increasing boardroom diversity. Under the new policy, Vanguard “expects boards to publish their perspectives on board diversity, disclose their diversity measures, interview diverse pools of director candidates, and reflect a range of diversity.” Vanguard also “expects boards to identify diverse director candidates now” and develop relationships with executives who lead finance, technology, human resources, marketing, accounting, audit, or investment functions. Vanguard also emphasized the importance of clear disclosures to help a company’s shareholders understand its board diversity strategy and progress. The full text of the policy can be found [here](#).

2. Litigation Developments

- **Delaware Supreme Court Affirms Order to Produce Documents and Submit to Deposition in Section 220 Litigation:** On December 10, 2020, in *Amerisourcebergen Corp. v. Lebanon County Employees' Retirement Fund*, the Delaware Supreme Court unanimously affirmed a Court of Chancery decision ordering AmerisourceBergen Corporation to produce documents in response to a Section 220 books and records demand regarding AmerisourceBergen's alleged involvement in the opioid crisis. The Supreme Court held that because the AmerisourceBergen stockholders sufficiently alleged a credible basis of corporate wrongdoing, they were not required to specify the ends to which they intended to use the books and records. Further, the Supreme Court held that where the stockholders sought the books and records for purposes not limited to litigation, they did not have to establish that the potential wrongdoing would be actionable. The Supreme Court concluded that the Court of Chancery was within its discretion to grant the stockholders leave to depose a corporate representative to determine what books and records existed and who had them. Similarly, on November 24, 2020, in *Pettry v. Gilead Sciences, Inc.*, the Delaware Court of Chancery criticized the defendant for an "overly aggressive defensive strategy" in a Section 220 action, which the court found "epitomizes a trend" to "obstruct [demanding stockholders] from employing [Section 220] as a quick and easy pre-filing discovery tool." *AmerisourceBergen* and *Gilead Sciences* are rare decisions from the Delaware courts regarding the scope and application of stockholder books and records inspection rights. Both decisions may validate the existing acceleration of stockholders using DGCL 220 demands in anticipation of litigation involving Delaware corporations over the past two years. The full text of the opinion is available [here](#). A Sullivan & Cromwell memorandum on the decision is available [here](#).
- **Delaware Reaffirms Director Independence Principle in Founder-Led Company:** On October 26, 2020, in *United Food & Commercial Workers Union v. Zuckerberg*, the Delaware Court of Chancery declined to credit the plaintiffs' allegation that some Facebook directors lacked independence from Facebook's founder because they had themselves founded companies or supported founder control. This decision is a notable application of Delaware's presumption of director independence to founder-led companies. The full text of the Chancery Court's opinion is available [here](#).

3. Surveys, Policies and Reports

- **Increased Stakeholder Scrutiny of Corporate Political Giving:** Recent events in Washington D.C. have increased scrutiny on corporate political spending. Various media outlets have been tracking updates to companies' political contribution policies following the January 6, 2020 U.S. Capitol riot. Shareholder proposals seeking reports on corporate political contributions and lobbying payments have become more frequent and the average support for these proposals grew from 25 percent in 2018 to over 40 percent in 2020. As issuers move into the 2021 proxy season, they should be aware of the increased focus on this issue. A Sullivan & Cromwell memorandum on the topic is available [here](#).
- **Report on Practices for Virtual Shareholder Meetings (VSMs):** On December 10, 2020, the Rutgers Center for Corporate Law and Governance, the Council of Institutional Investors, and the Society for Corporate Governance released a report on "Practices for Virtual Shareholder Meetings." Notable findings in the report include: (i) 33 states permit virtual-only shareholder meetings, 45 states and the District of Columbia permit hybrid meetings, and only five states

require in-person meetings, (ii) a large group of institutional shareholders voiced that “a VSM is a wholly inadequate replacement for an in-person meeting, with few opportunities for the interactivity and discussion they expect,” (iii) generally, companies using VSM platforms for the first time in 2020 reported a positive experience, along with lower costs, increased shareholder attendance, and “higher-quality” questions submitted by shareholders, and (iv) the 2020 Working Group outlined “emerging practices” for VSMs, including posting a transcript of the full meeting (including the Q&A session) on the company’s website within a reasonable period of time after the VSM. The full text of the report is available [here](#).

- **FW Cook’s 2020 Director Compensation Report:** On December 9, 2020, FW Cook released its 2020 Director Compensation Report, which studies non-employee director compensation at 300 companies of various sizes and industries. The report observed year-over-year increases to total compensation: the large-cap companies’ median increased 1.6 percent to \$290,000, the mid-cap companies’ median increased 1.7 percent to \$216,950, and the small-cap companies’ median increased 5.1 percent to \$163,500. The report also found that an average director’s compensation structure remained consistent with prior years, with an average mix of 57 percent equity and 43 percent cash across the entire sample. The report also observed an increasing number of women on boards: 94 percent of companies in the study have at least one female director (compared to 90 percent in 2019), 59 percent of large-cap companies have three or more female directors (compared to 50 percent in 2019) and 25 percent of both mid-cap and small-cap companies have three or more female directors (22 percent and 13 percent in 2019, respectively). Due to the COVID-19 pandemic, 15 percent of S&P 500 companies and 13 percent of Russell 3000 companies reported reductions in director compensation through the third quarter of 2020, which generally consisted of cash retainer reductions. The full text of the report is available [here](#).
- **COVID-19: Analyzing Approaches to Workplace Wellness and Employee Mental Health:** The COVID-19 pandemic has heightened attention to workplace wellness, as pandemic-related illness and loss of life, economic and job insecurity, and social isolation have negatively impacted employee mental health. In the U.K., an investor-led mental health engagement program created by CCLA Investment Management has been seeking to build a coalition of investors to “drive workplace mental health to the top of the corporate agenda” and “boost the mental resilience and wellbeing of workers across all sectors and industries.” Other activities on employee mental health include: (i) CCLA and Chronos Sustainability announced a formal “Mental Health Benchmark” assessing FTSE-listed issuers to be launched in 2021, (ii) on October 19, 2020, Janus Henderson Investors concluded that businesses with effective well-being and mental health policies achieve better employee retention, work cultures and a more resilient workforce, and (iii) on December 14, 2020, the Diligent Institute released a report on “What Lessons Have Boards Learned from COVID-19?” highlighting that corporate directors “have focused on the human aspect of the crisis, and of doing business, like never before.” Additional information on CCLA’s “Mental Health Benchmark” is available [here](#). The full text of the Janus Henderson Investors’ statement is available [here](#). The full text of the Diligent Institute’s report is available [here](#).
- **PricewaterhouseCoopers 2020 Annual Corporate Director Survey:** On November 1, 2020, PricewaterhouseCoopers LLP released its 2020 Annual Corporate Directors Survey. Key findings from the report include: (i) only 37 percent of directors say that their board fully understands the company’s crisis-management plan, (ii) 67 percent of directors (up from 54 percent in 2019) see a role for climate change when forming company strategy, (iii) 84 percent of directors say companies should do more to promote racial and gender diversity in the workplace,

but only 39 percent of directors support diversity and inclusion goals in pay plans, and (iv) 49 percent of directors say that at least one fellow board member should be replaced. The full text of the report can be found [here](#).

- **2020 Spencer Stuart Board Index:** On January 26, 2021, Spencer Stuart released its 2020 Board Index. Key takeaways from the index include: (i) in recent years, boards have prioritized gender diversity, with female representation among new S&P 500 directors more than doubling over the past decade, increasing from 21 percent in 2010 to 47 percent in 2020; (ii) the number of new minority directors in the S&P 500 almost doubled over the past decade to 22 percent; and (iii) nearly all (97 percent) of the top 200 S&P 500 companies have at least one minority director, and 71 percent have two or more minority directors. The full text of the 2020 U.S. Spencer Stuart Board Index is available [here](#).
- **CII Research and Education Fund Releases Board-Employee Interaction Report:** On January 26, 2021, the CII Research and Education Fund released a report examining the thematic differences in how S&P 100 companies disclose the policies and practices surrounding board access to employees, both at the management level and below. Overall, the report found that 97 percent of companies in the S&P 100 had policies stating that board members have access to either employees generally or management. About half had policies specifically granting board members access to all employees. More than one third, or 36 percent, of the companies detailed some kind of formal or informal process by which boards can interact with employees. The full text of the report is available [here](#).

4. Disclosure Developments

- **Nasdaq Proposes Board Diversity Requirements:** On December 1, 2020, Nasdaq submitted new proposed listing rules to the SEC regarding board diversity. The first proposed rule would require listed companies to (i) have at least one director who self-identifies as female and at least one director who self-identifies as an underrepresented minority (based on EEO-1 reporting categories, including Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities) or as LGBTQ+, or (ii) explain why the company does not satisfy that requirement. The second proposed rule would require public disclosure of the number of directors who voluntarily self-identify as male, female or non-binary and who voluntarily self-identify as an underrepresented minority or LGBTQ+. If the proposed rules are approved by the SEC, Nasdaq-listed companies would have (i) two years to have (or explain why they do not have) at least one diverse director, (ii) four or five years (depending on their Nasdaq listing tier) to have (or explain why they do not have) at least two diverse directors, and (iii) one year to meet the public disclosure requirement, in each case, from the date of SEC approval. There are limited exceptions for foreign issuers, smaller reporting companies, and certain exempt companies (most notably special purpose acquisition companies). The full text of the proposal is available [here](#). A Sullivan & Cromwell memorandum on the topic is available [here](#).
- **NYSE Proposes to Permanently Amend Stockholder Approval Rules:** On December 28, 2020, the NYSE proposed to officially amend Sections 312.03, 312.04, and 314.00 of the NYSE Listed Company Manual. The proposal includes modifications that are identical to the temporary waiver in effect during the COVID-19 crisis, which the NYSE has extended through March 31, 2021. The proposed rule change is intended to reduce the obstacles that companies face when seeking to raise capital and generally is intended to relax the requirements for shareholder approval of related-party equity issuances. These proposed changes would bring the NYSE

stockholder approval rules into closer alignment to the comparable Nasdaq rules. In observing the impact of the temporary waiver, the NYSE has seen “that a significant number of companies have benefited from the flexibility provided by the waiver and has not observed any significant problems associated with companies’ completion of transactions permitted by the waiver.” The full text of the SEC filing and proposed rule change is available [here](#).

- **The Department of Labor’s Final ESG Rule:** On October 30, 2020, the U.S. Department of Labor (“DOL”) released its final rule on “Financial Factors in Selecting Plan Investments” relating to a fiduciary’s consideration of ESG factors when making investment decisions for plans subject to the Employee Retirement Income Security Act of 1974. This final regulation comes after the DOL’s proposed rule received several thousand comments, the vast majority of which opposed the new rule. However, the DOL has finalized the rule substantially in the same form as it was proposed. The largest change from the proposal is that the final rule removes all explicit references to ESG. Instead, the final rule requires a fiduciary to base its investment decisions solely on pecuniary factors and not subordinate the interests of participants and their beneficiaries to any non-pecuniary objectives. The final rule took effect on January 12, 2020. The compliance deadline for retirement plans related to the selection of a qualified default investment alternative is April 30, 2022. However, in an executive order titled “Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis,” the Biden administration announced that it will review the final rule. The full text of the final rule is available [here](#). The full text of the Biden Administration’s executive order is available [here](#).
- **2020 U.S. Shareholder Activism:** On December 2, 2020, Sullivan & Cromwell LLP released a report on the “Review and Analysis of 2020 U.S. Shareholder Activism and Activist Settlement Agreements.” Key findings in the report include: (i) public activism levels were down during the 2020 proxy season in response to the COVID-19 pandemic, with the number of U.S. activism campaigns down approximately 30 percent through August 2020, (ii) there were still a number of high-profile activism campaigns in 2020, with Starboard, Hindenburg, and Elliott leading the way with the most publicly announced campaigns against U.S. issuers, (iii) activists and private equity funds are increasingly borrowing from each other’s playbooks, further blurring the lines between activists and other investors, (iv) activists are increasingly mentioning environmental, social, and political (ESP) themes in their campaigns, although ESP themes have yet to take hold as primary campaign objectives among traditional activists, and (v) activism campaigns during the 2020 proxy season concluded in settlement agreements more frequently and more promptly compared to years prior, with one in three settlement agreements through August 2020 being reached within one month of the activist publicly initiating its campaign. Activism activity is expected to pick up throughout the 2021 proxy season as the economy stabilizes. The full text of the Sullivan and Cromwell report is available [here](#).

The entire collection of Sullivan & Cromwell memoranda on corporate governance topics and issues, including the report outlined above, is available [here](#).