

# DLA Piper

Agile Mindset. Global Vision. Valued Partner.

## On Your Board's Service: The Latest in Corporate Governance

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# Protecting the Company from Dr. No – Institutional Investors, Activists and Proxy Advisors



# 2022 Proxy Season Review

- Largest number of shareholder proposals for Russell 3000 companies, mostly related to ESG.
- Support was more modest compared to prior years, although some newer social proposals saw significant support.
  - An ESG counterpoint has emerged, demonstrated by an increase in more conservative proponents advocating an anti-ESG focus.
  - Climate-related proposals that receive majority support are generally narrowly tailored and core to a company's business.
- Diversity continues to be a focus, even as California courts invalidated board diversity requirements for California headquartered companies.
- New shareholder proposal topics continue to follow societal issues and trends.
- Trend towards investors de-levering voting authority.
  - BlackRock, Vanguard, and T. Rowe Price are permitting some clients the ability to direct voting of their own shares.

# Shareholder Activism

- Investors are increasingly willing to vote against directors and management proposals if companies do not conform to investor expectations.
- Activists and companies continue to favor settlements over drawn-out proxy fights.
- Activists are making fewer operational demands, such as cost-cutting and efficiency drives, than in previous years, as companies grapple with share price declines and rising energy prices.
- Technology was the most popular sector for new activist investment in Q1 2022, even amid share price declines and volatility in this sector.
- Shareholder support for environmental proposals has been mixed and down compared to last year (perhaps in part due to the Russia/Ukraine war and rising gas prices).
  - Glass Lewis has recommended against more proposals than in previous years, while ISS has recommended in favor of more proposals.

# Key Takeaways – Protecting Against Shareholder Activism

## 1. Communicate with shareholders

- Effective and formal communication channels can help a company identify “red flags” early and proactively address shareholder concerns in a timely manner.

## 2. Follow best practices in corporate governance

- ISS, Glass Lewis and large institutional investors produce voting guidelines. Companies should seek to follow such guidelines and best practices whenever possible as these organizations have significant influence on proxy contests.

## 3. Be alert to accumulations of ownership positions

- Be aware of increasingly large ownership positions or acquisitions by potential “joint actors.” Could be an indication of an impending take-over bid or proxy fight. Routinely pull record holder lists and beneficial ownership report filings. Watch for increases in objecting beneficial owners.

## 4. Board succession and renewal plan

- The board should ensure that the directors have the knowledge and skills necessary to enhance the long-term performance of the organization. The board should establish a board selection profile outlining general qualifications and core competencies.

## 5. Watch for requests from shareholders

- Activist shareholders may make requests of the company that tip their hand, including transferring share ownership from beneficial to registered and requesting meetings with management or directors.

## 6. Monitor voting activity

- Monitor the number of proxies returned to the transfer agent and any changes in patterns from prior years, including from street name holders.

## 7. Implement - or be prepared to implement - available legal protections

- Certain structural defenses are likely to help, including adopting advance notice corporate by-laws that require timely notice to propose nominees for directors and having a shareholders’ rights plan on the shelf.

## 8. Establish a proxy defense team

- Have relationships with counsel, proxy advisor and investor relations teams that will be able to assist if and when the time comes, as things will move very fast.

# Key Takeaways – Proposed Amendments to Rule 14a-8

**Referred to as “the shareholder proposal rule,” Rule 14a-8 requires companies subject to the federal proxy rules to include shareholder proposals in their proxy statements, subject to certain procedural and substantive requirements.**

- The SEC has been narrowing the bases for excluding shareholder proposals, resulting in greater access to proxy statements for shareholders to force a vote on a wide array of topics, including executive compensation, governance and other matters.
  - On July 13, 2022, the SEC proposed amendments to the substantial implementation exclusion; the duplication exclusion; and the resubmission exclusion contained within Rule 14a-8.
  - These three bases for exclusion represented roughly 45% of no-action relief requests received by the SEC under Rule 14a-8 during the 2018 through 2021 proxy seasons.
- If adopted as proposed, companies should expect a restricted ability to rely on these bases for exclusion.
- The proposed rules were subject to a comment period through September 12, 2022. After this period, the proposed amendments may be revised.

# Overview – Proposed Amendments to Rule 14a-8

- **Rule 14a-8(i)(10) – Substantial Implementation Rule**

- Permits exclusion of proposals that have already been substantially implemented in order to avoid shareholders having to consider proposals for matters that have already been favorably acted upon by a company.
- Under the current rules, a proposal may be viewed as substantially implemented even if all of the proposal's elements have not been implemented.
- The SEC has proposed a new “essential elements” standard for assessing substantial implementation, to permit exclusion only if all “essential elements” of a proposal have been implemented.

- **Rule 14a-8(i)(11) – Duplication Exclusion**

- Permits exclusion of proposals that are substantial duplicates of those received for the same meeting (favoring the earliest submitted proposal).
- The proposed new framework to assess duplication would analyze if a proposal “addresses the same subject matter and seeks the same objective by the same means,” instead of the existing “principal thrust” or “principal focus” framework.
- The new rule would likely encourage consideration at the same meeting of multiple proposals that present different means to address a particular issue.

- **Rule 14a-8(i)(12) - Resubmission Exclusion**

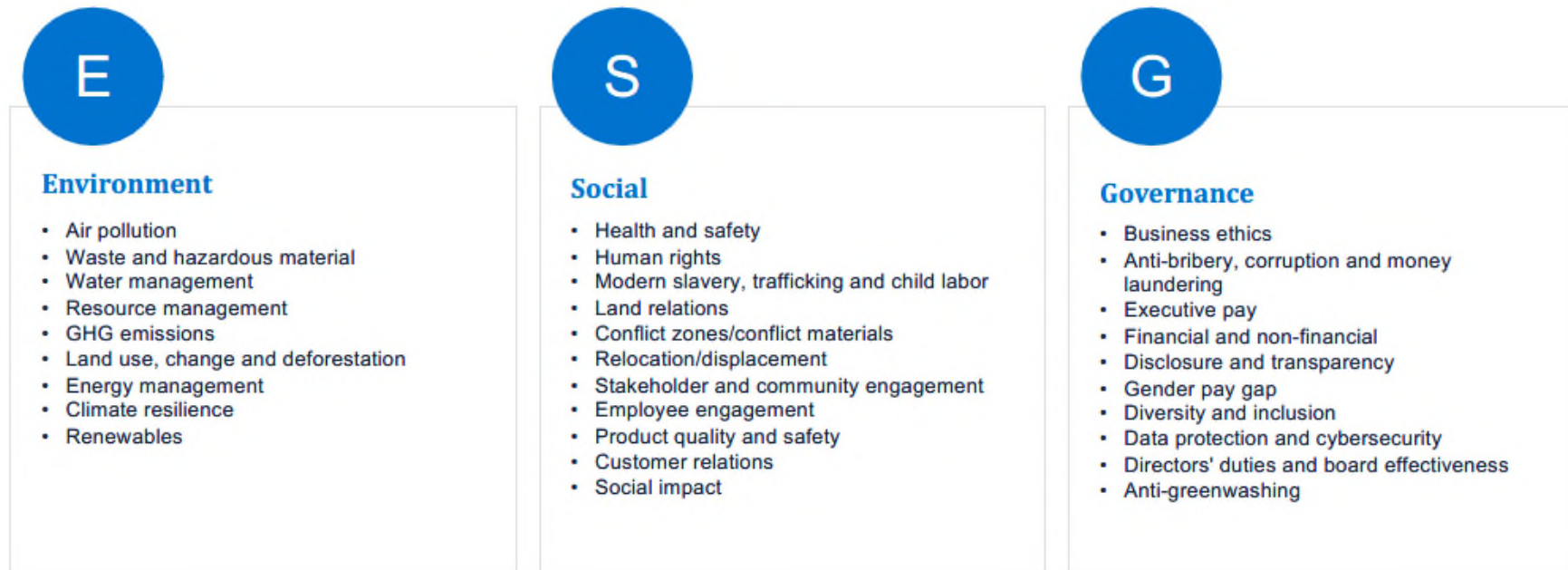
- Permits exclusion of proposals if the same subject matter was substantially addressed in a company's proxy materials within the preceding five calendar years and voted on at least once in the preceding three years without receiving sufficient support.
- Currently, the SEC believes that the resubmission proposal likely discourages shareholders from presenting different or newer approaches to addressing the same issue.
- The amendments would adopt the same subject matter seeking same objective by the same means framework proposed for the duplication exclusion described above.
- If adopted, companies should expect a restricted ability to avoid revisiting defeated shareholder proposals, so long as the resubmissions are tailored to seek different objectives or offer different means of addressing the same matter.



# You Only Live Once – Sustainability and Environmental, Social and Governance

# Environmental, Social and Governance (ESG)

- What do we mean by ESG?



- ESG includes the Environmental, Social and Governance dimensions of a company's operations and performance, which are used to measure the sustainability of investments.
- Sustainability refers to the ability of a company to create value over the long term.

# Environmental, Social and Governance (ESG)

- ESG is an important aspect of creating and maintaining long-term value by preparing a company to respond to systemic risks.

Businesses must integrate ESG –  
or face exposure to uncertainty  
and major risks:



Businesses that fail to  
address  
such risks stand to lose:



# Why is ESG such a hot topic?

## Legal/Regulatory Interest

- 2021/2022 saw a number of significant ESG focused government regulatory developments throughout the world.
- In June 2021, the House of Representatives passed a bill that would require public companies to annually disclose certain ESG metrics and their connection to the long-term business strategy of the issuer.
- The SEC formed a Climate and ESG Task Force leading to the March 2022 release of proposed rules that would require public companies to disclose extensive climate-related and cybersecurity information in their SEC filings.

## Investor Interest

- The ESG investing market continues to grow. More and more investors and funds are investing solely in companies that take ESG issues seriously.
- Credit rating agencies are increasingly evaluating ESG risks and opportunities as part of their credit analyses.

# Implementing an ESG Program

## Step 1: Formulate ESG Strategy and Story

- In order to formulate an ESG strategy and story, a company should take inventory of where they currently are in their ESG journey. This may involve gathering data from various sources throughout the company, reviewing ESG reports from various rating agencies, and conducting a materiality analysis.
- This will allow a company to determine what ESG topics may be material to its business and to form an “ESG Story” that considers where a company’s mission overlaps with its ESG strengths and the material ESG focus areas identified through its analysis.

## Step 2: Determine KPIs and Build Reporting Function

- Once a strategy is formulated, companies can determine certain KPIs to track and build out related internal processes. This will require collaboration with business units, finance/accounting and internal audit.
- Consider setting strategic goals related to the KPIs once established.
- Part of this analysis will require assessing various ESG reporting standards (SASB, Global Reporting Initiative (GRI), Task Force on Climate-related Financial Disclosures (TCFD)), due to the fact that there are currently multiple standards and no required SEC disclosure rules as of yet (outside of proposed climate and cybersecurity rules).

## Step 3: Create Communication Strategy

- Formulate a strategy to proactively tell your ESG story to investors and employees.
- This may involve a combination of required (or voluntary) disclosures in SEC filings, an ESG or sustainability report or website, including ESG related content in earnings calls and press releases and engaging investors in conversations surrounding ESG.



# ESG Disclosure Trends in SEC Filings

- Recent study of Fortune 100 companies' public filings
- Increased disclosure of:
  - Environmental matters
  - Human capital management (including DEI)
  - Environmental and sustainability goals and targets
- Every company surveyed included environmental disclosure in their 2022 filings.
- Almost every company included disclosure on diversity or related initiatives
- Increased disclosure of Board oversight of ESG matters
  - Over 60% of companies disclosed that they allocated ESG oversight to more than one committee (Nominating and Corporate Governance, Compensation Committee, Specialized Committees)
- Growing trend of including more ESG related disclosures in 10-Ks as opposed to just proxy statements.

# ESG – What Should the GC Know

- GCs are well positioned to drive their company's ESG program given their roles as trusted advisors and the cross-functional nature of their positions.
- Prepare for push back and the need to achieve management buy-in.
- Consider whether it is appropriate to use outside resources/consultants to assist in developing your ESG program
- Importance of building appropriate processes to ensure accuracy of reported data

# Minding M – SEC Rules and Enforcement Updates

# ESG at the SEC Today

***“This is one of my top priorities and will be an early focus during my tenure at the SEC” – Chair Gary Gensler (May 2021)***



Climate and  
ESG Task Force

Comment  
Letters

Investigations/  
Enforcement

Rulemaking/  
Guidance

## ESG at the SEC Today (cont'd)

Proposed rulemaking:  Comment periods have closed	Cybersecurity - Investment Advisers & Funds (2/9/22)	Risk management, incident reporting, investor disclosure and recordkeeping for investment advisers and funds
	<a href="#">Cybersecurity – Public Companies</a> (3/9/22)	Risk management, strategy, governance, and current disclosure, with periodic updates, of cyber incidents
	<a href="#">Climate Change</a> (3/21/22)	Prescriptive climate-change disclosures for public companies
	ESG Investing (5/25/22)	Disclosures and reporting of ESG practices and strategies for investment advisers and funds



## ESG at the SEC Today (cont'd)

### Enforcement actions:

Vale S.A. (4/28/22)

Alleged false statements in sustainability reports posted on a corporate website

BNY Mellon Investment Adviser, Inc. (5/23/22)

Alleged misstatements and omissions about ESG considerations in making investment decisions for managed funds

First American Financial Corp. (6/15/21)

Alleged failure to maintain disclosure controls and procedures concerning a cybersecurity vulnerability that exposed sensitive customer information

Pearson plc (8/16/21)

Alleged misleading statements regarding disclosure of a data breach and inadequate disclosure controls and procedures

# Cybersecurity Disclosure Rules

## Key Takeaways

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Intended to address cybersecurity risk management, strategy, governance and incident reporting, requiring prompt and ongoing materiality assessments

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Would create a new, mandatory incident disclosure regime, with an affirmative duty to update, that may conflict with other regulatory or law enforcement obligations

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Combines principles-based incident disclosure obligations with prescriptive process and governance disclosures

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Could prompt board and management changes and the implementation of new processes, procedures and controls

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Would apply to all US public companies and foreign private issuers without differentiation in applicability or transition timing

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Effectiveness timing not specified in rule proposal

# Cybersecurity Disclosure Rules (cont'd)

## Areas of Focus

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Current reporting of incidents within four business days after materiality determination, with assessment required as soon as reasonably practicable after discovery

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Affirmative duty to update, on a current basis, prior incident reporting that has become inaccurate or materially misleading

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Quarterly updates to prior cybersecurity incident disclosures and disclosure of immaterial incidents that in the aggregate are material

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Description of cybersecurity risk management, strategy and policies and procedures, as well as management's role and cybersecurity expertise

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Disclosure of board cybersecurity expertise and oversight, including frequency of board discussions and identification of director cybersecurity experts

# Climate Change Disclosure Rules

## Key Takeaways

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Intended to enhance and standardize climate-related disclosures and to “provide investors with consistent, comparable, and decision-useful information”

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Based, in part, on frameworks from Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol

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Transitions from a largely principles-based framework to prescriptive disclosures

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With limited exceptions, would apply to all US public companies and foreign private issuers without differentiation in applicability or transition timing

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If adopted, could be effective as soon as annual reports for fiscal 2023 (with certain phase-ins)

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SEC cost estimates for first 4 years range from \$1.75M to \$3.25M

# Climate Change Disclosure Rules (cont'd)

## Areas of Focus

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Description of climate-related risk management processes, including board oversight

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Enhanced disclosure of climate-related risks, including transition risks, and impacts over the short-, medium- and long-term

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Financial statement impact, on a line-item basis, of climate-related events and transition activities, as well as related estimates and assumptions, all subject to audit and ICFR

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Climate-related targets, transition plans or scenario analysis, including progress against publicly stated goals

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Greenhouse gas emissions data



# Climate Change Disclosure Rules (cont'd)

## Greenhouse Gas Emissions Data

### Scope 1 & Scope 2

Direct emissions (Scope 1) and indirect emissions from production of energy used in business (Scope 2)

Independent, third-party attestation required for all but the smallest or newly public companies

Initially limited (negative) assurance, phasing-in to reasonable assurance

### Scope 3

Indirect emissions from upstream and downstream activities in a company's value chain

If material or if a company has adopted targets that include Scope 3 emissions, with only the smallest public companies exempted

*47% of Fortune 100 companies already report Scope 3 emissions as of 6/21/22*

No attestation requirement and safe harbor from certain liability

## Next Steps



### Cybersecurity Rules

- March 9, 2022 - Proposed Rules Approved
- May 9, 2022 – Public Comment Period Ended

### Climate Change Rules

- March 21, 2022 - Proposed Rules Approved
- June 17, 2022 – Public Comment Period Ended

Potential Legal Challenges: West Virginia v. EPA may lead to more litigation and has the potential to impact the scope of the SEC's final rules

# Pay vs. Performance Disclosure Rules

## Applicability

- Apply to U.S. registrants that file proxy or information statements requiring executive compensation disclosure for fiscal years ending on or after December 16, 2022
  - Will be required in proxy statements filed in 2023 for calendar year companies
- Emerging growth companies (EGCs), foreign private issuers (FPIs) and registered investment advisers are exempt
- Smaller reporting companies are required to comply with the new rules (with some exceptions)
- There are phase-in periods that ramp up the number of years for which disclosure must be provided over time

# Pay vs. Performance Disclosure Rules

## Overview

### Three Main Requirements

- Pay for Performance Table
  - Specified executive compensation and performance measures for five most recently completed fiscal years (three for smaller reporting companies)
  - Includes disclosure of “actually paid” compensation to the CEO and other NEOs, and metrics such as Total Shareholder Return, net income and a “Company-Selected Measure” that the company considers most important in linking performance to actually paid compensation.
  - Note this is more than the three years required in the Summary Compensation Table
- Descriptive Disclosure
  - Description of the relationship between financial performance and executive compensation
  - Description of the relationship between the company’s total shareholder return and its peer group’s return
- Tabular List of Performance Measures
  - Disclose at least 3, and up to 7, financial performance measures that it determines are most important
  - Not required for smaller reporting companies

# Pay vs. Performance Disclosure Rules

## Key Takeaways

- Most fundamental change to the executive compensation rules since 2006
- Signifies a continuation of the SEC's recent approach towards prescriptive and expansive rulemaking
- Companies should begin planning for next year's disclosure
  - Assess how existing disclosure aligns with new rules
  - Consider which performance measure is most relevant to executive compensation for most recent year, and which additional measures to include in the tabular list
  - Create processes for collecting and validating data



# Avoiding Austin Powers – DE&I, Culture and Human Capital Management

# Board Diversity and Inclusion

- Factors Driving Director Diversity
  - Stockholder Pressure to Diversify Boards and Improve Disclosure
    - Goldman Sachs will not IPO companies with all-male boards.
    - New York Comptroller Boardroom Accountability Project 3.0 (Rooney Rule).
    - Derivative litigation arguing lack of diversity violates fiduciary duties and fraudulently contradicts statements that the board values diversity.
  - ISS/Glass Lewis recommend voting against NCG chair if all-male board.
    - In 2023, Glass Lewis will recommend voting against the NCG chair if (i) a board is less than 30% gender diverse or (ii) the company fails to provide diversity statistics in its proxy statement.

# Board Diversity and Inclusion

- Factors Driving Director Diversity (cont'd)
  - Social Movements
    - 2017: “Me Too” drove gender diversity.
    - 2020: Racial equity protests drive broader diversity.
  - Legislation and Rulemaking
    - California SB 826 and AB 979 required publicly held corporations headquartered in California to appoint directors that were female or from “underrepresented communities”
      - In April and May 2022, California courts struck down the laws on equal protection grounds.
    - Illinois HB 3394 passed in 2019 requires publicly listed corporations headquartered in Illinois to disclose information in Illinois state filings about diversity of their board, how demographic diversity is considered in identifying directors and officers, and policies and practices for promoting diversity, equity and inclusion.

# Board Diversity and Inclusion

- Nasdaq Diversity Standard – Approved by the SEC in August 2021, the rule requires Nasdaq-listed companies to:
  - Provide annual disclosure in proxy statement or on website of diversity statistics regarding their boards in a consistent and transparent manner.
    - Disclosure must include each director’s “voluntary self-identified gender and racial characteristics and LGBTQ+ status” presented in a Board Diversity Matrix.
  - Have, or explain why they do not have, at least two “Diverse” directors, including one female and one who self-identifies as either an Underrepresented Minority or LGBTQ+.
    - “Diverse” is defined as (i) Female; (ii) an Underrepresented Minority (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 (iii) LGBTQ+.
  - One Diverse director is required by August 2023 and two Diverse directors are required by August 2025.

# Board Diversity and Inclusion

- Diversity Disclosure Trends
  - Companies are improving disclosure related to diversity, the board nomination and qualification process and human capital.
  - Enhanced Proxy Disclosure
    - Director “skills matrix”
    - Photographs of board
    - Enhanced disclosure of director diversity self-reporting in D&O questionnaires
    - Enhanced disclosure of director nomination, qualification and evaluation process

# Management Diversity and Inclusion

- There is continued attention to management and workforce diversity.
- Stakeholders continue to press companies to disclose EEO-1 and DEI reports and employee demographic data.
- Some companies have publicly disclosed goals and progress reports in response to shareholder scrutiny and activism:
  - P&G wants to raise its level of African American employees from 10% to 13%; in 2021, 11% of its employees were African American.
  - Facebook set a 5-year goal to have 30% more Black leaders; as of July 15, 2021, it achieved a 38.2% increase.
  - Salesforce set a goal in 2019 to have 50% of its US employees from underrepresented groups by 2023; as of January 2022, 50.7% of its employees are from underrepresented groups.

# Human Capital Management Disclosure Review

- Key Themes in 2022 10-K disclosures
  - Hiring and Retaining Talent
    - Talent Development (training and mentorship programs, participation rates)
    - Compensation and Benefits (including shifts in benefits offered resulting from COVID)
    - Hiring and Recruitment (statistics related to new-hires and turnover)
  - Diversity, Equity and Inclusion
    - Discussion on specific DEI initiatives, such as employee resource groups, trainings and recruiting efforts.
    - Increase in quantitative DEI disclosures compared to previous year, including gender and race/ethnic breakdowns of workforce.
  - Employee Engagement
    - Typically qualitative disclosure surrounding engagement surveys, employee resource groups and turnover.
    - About 1/3 provide quantitative data such as participation rates in surveys and quantitative turnover statistics
  - COVID, Health and Safety
    - Many companies discuss health and safety of workforce, including discussions surrounding mental health and safety programs and training

# Don't Bet the House – The Board's Role in Risk Management



# Risk Oversight – Not Risk Management

- Major institutional shareholders and proxy advisory firms routinely engage companies on risk-related topics and increasingly focus on risk oversight matters when evaluating corporate performance, including in proxy contests and when considering to withhold votes in uncontested director elections
- Both the law and practicality continue to support the proposition that the board cannot and should not be involved in day-to-day risk management
- Board's role in risk oversight includes steps taken at the board level, rather than solely at the management level:
  - Active engagement in monitoring key corporate risk factors;
  - Appropriate use of board committees; and
  - Appropriate documentation of board level monitoring efforts through minutes and other corporate records
- Directors should:
  - Require that the CEO and senior executives prioritize risk management
  - Satisfy themselves that the risk management policies and procedures designed and implemented by senior executives and risk managers are consistent with the company's strategy and risk appetite and that such policies and procedures are functioning as directed
  - Ensure that necessary steps are taken to foster an enterprise-wide culture that supports appropriate risk awareness
  - Keep aware of the type and magnitude of the company's principal risks

# Risk Oversight Obligations

- **Fiduciary Duties**

- Delaware courts take the lead in formulating the national legal standard for directors' duties for risk management
  - Generally, directors can be liable for a failure of board oversight only where there is a "sustained or systemic failure of the board to exercise oversight such as an utter failure to attempt to assure a reasonable information and reporting system exists"
  - It is a demanding test and courts will look at the totality of the circumstances surrounding the risk management and oversight function

- **SEC Risk Disclosure and Stock Exchange Rules**

- SEC requires companies to disclose the board's role in risk oversight, the relevance of the board's leadership structure to such matters and the extent to which risks arising from a company's compensation policies are reasonably likely to have a material adverse effect on the company
- NYSE and Nasdaq corporate governance standards impose certain risk oversight obligations on the audit committee of a listed company
  - The audit committee should discuss guidelines and policies to govern the process by which risk assessment and management is undertaken, including:
    - Major financial risk exposure
    - Steps management has taken to monitor and control risk exposure

- **Third-Party Guidance and Best Practices**

- Committee of Sponsoring Organizations of the Treadway Commission (COSO)
  - In 2017, COSO released the final version of its updated enterprise risk management framework
  - The COSO approach presents five interrelated components of risk management: risk governance and culture (the tone of the organization); setting objectives; execution risk (the assessment of risks that may impact achievement of strategy and business objectives); risk information, communication and reporting; and monitoring enterprise risk management performance

# Recommendations for Improving Risk Oversight

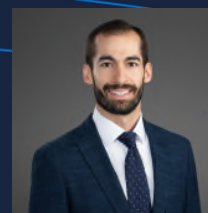
- Effective, ongoing risk dialogue with management
  - Design the right relationships between the board and its committees
  - Ensure appropriate and adequate resources to support the risk management functions
- Tailored to specific company needs and goals and relevant risks
- Appropriate risk disclosure in public filings, including the role of the board in risk management
- Highlights of a successful risk management system:
  1. Adequately identify material risks in a timely manner
  2. Effective and efficient information flow between senior executives, the board and board committees
  3. Implement appropriate risk management strategies that are responsive to the company's risk profile, risk exposure and risk tolerance, and business strategies
  4. Integrate consideration of risk and risk management into strategy and business development and decision-making throughout the organization
  5. Feature regular reviews (quarterly or semi-annual) of the effectiveness of the company's risk management framework
  6. Document the existence of risk management protocols and board-level engagement on risk matters



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Thank you