

Corporate Governance Hot Topics

September 21, 2023

Today's Panelists



Steve Patterson
Partner
Hunton Andrews Kurth LLP



Anna Lueje
Associate General Counsel
Raytheon Company

Corporate Governance Hot Topics for Today

- Corporate Governance Refresher
- Corporate DEI programs in light of U.S. Supreme Court's affirmative action ruling
- Climate disclosure rules
- State-level ESG vs. anti-ESG battle
- International ESG developments
- Greenwashing
- Consumer backlash events
- Board representation
- Other recent developments



Corporate Governance Refresher: Roles of Board and Other Players

Board of Directors

- Sets strategic direction of the company
- Oversees management team—ensures the right people are responsible for the right things
- Fiduciary duties
 - Duty of care
 - Duty of loyalty
 - Protected by the business judgment rule

Management – day-to-day operations of the company

Shareholders – owners of company; limited but expanding role

Corporate Governance Refresher: Stakeholders Board Should Consider

- Must consider maximizing profits in the interest of the company's shareholders
 - Core of the board's fiduciary duties
 - Traditionally considered the only stakeholder the board should consider
- Continued movement toward considering other stakeholders
 - Society generally, the environment, affected communities
 - Delaware: Board may consider other stakeholders to the extent they bear on the interests of the company and its shareholders—open debate as to where this line is drawn
 - Some states have codified the permissibility of the board to consider external stakeholders under the duty of care, see *e.g.*, Pennsylvania Business Corporation Law §515(a) and Ohio General Corporation Law §1729.23(D)

Refresher cont'd: Nonprofit Board Considerations



- Nonprofit boards share many of the same governance issues as for-profit boards
- Stakeholders:
 - Beneficiaries
 - Donors
 - Sponsors
 - Members
 - Staff
 - Community

Corporate Governance: Corporate DEI Programs

Students for Fair Admissions v. Harvard

On June 29, 2023, U.S. Supreme Court ruled it was unconstitutional to consider race in university admissions. In concurrence, Justice Gorsuch noted there is “materially identical language” to higher education discrimination laws in employment discrimination laws.



Challenges to Corporate DEI Programs

- Comcast “RISE” program offering grants exclusively to minority-owned businesses
- Amazon program awarding startup costs exclusively to Black, Latino, and Native American delivery-service contractors
- Starbucks company policies aimed at increasing the number of women and racial minorities in workforce
- Law firms Perkins Coie and Morrison Foerster diversity fellowships

Corporate Governance: Corporate DEI Programs

- Board preparedness for challenges to company DEI programs
 - No need to panic. Supreme Court's ruling does not directly address corporate DEI and does not change employment discrimination law. There are strong legal arguments to be made that corporate DEI programs are legal even after *Students for Fair Admissions v. Harvard*. That said, any DEI program that considers protected characteristics in employment decisions (hiring, promotion, pay, etc.) should be carefully reviewed given the attention this case has brought to DEI programming.
 - Strategic direction: Board's responsibility to make decisions about aggressiveness of its DEI programs in light of recent events.
 - Duty of care: Now is the time for the board to prepare for challenges to its company's DEI programs and ensure management understands its responsibilities.

Corporate Governance: U.S. Climate Disclosure Rules

- On March 21, 2022, the SEC proposed rules that would require public companies to make robust climate-related disclosures, including:
 - Climate-related risks and impacts on the company
 - Internal climate-related governance and management processes
 - Scope 1, 2 and 3 emissions
 - Climate-related notes to the financial statements
- Over the past year, the SEC has received pushback to and comments on its proposed rules. It is not certain how similar the final rules will be to the initial proposal or when the rules will be effective, although most experts expect final rules to be published by the end of 2023.

Corporate Governance: U.S. Climate Disclosure Rules

Public Companies

- Will be directly subject to the new rules
- Now is the time to exercise the board's core oversight function of deciding who is responsible for what—a robust internal governance framework is the key to climate disclosure reporting and controls



Private Companies

- In most cases, private companies will be substantially indirectly affected by the federal climate reporting developments
 - Private companies in supply streams with public companies will lose business if they cannot report climate disclosures to the public companies
 - Private equity owners of private companies are under climate disclosure pressures
 - Bank credit may be increasingly tied to climate disclosures

Corporate Governance: ESG / Anti-ESG Activity at State Level

There is competing ESG and anti-ESG legislation being introduced and enacted in various states.

Subject Matter	ESG Legislation	Anti-ESG Legislation
<u>State Investments – Fossil Fuels</u> Legislation regarding which types of companies the state's treasury can invest in. ESG bills typically prohibit or cut back investment in fossil fuel companies; anti-ESG bills typically prohibit investment in companies that discriminate against the fossil fuel industry.	<ul style="list-style-type: none"> • Connecticut (C.G.S.A. § 3-13d) • Maine (Maine P.L. 2021, c. 231, § 3) • Maryland (Senate Bill 566) • Massachusetts (Bill H.4170) • New Jersey (Bill S416) • Vermont (Bill S.251) 	<ul style="list-style-type: none"> • Kentucky (Ky. St. §§ 41.470-480) • South Carolina (House Bill 4996) • Tennessee (Tenn. Pub. Ch. 1039) • West Virginia (W. Va. Code §§ 12-1C)
<u>Firearms</u> ESG legislation typically punishes firearms manufacturers and suppliers in some way, primarily through divestment. Anti-ESG legislation punishes entities that discriminate against firearms manufacturers and suppliers.	<ul style="list-style-type: none"> • Massachusetts (Bill H.43) • New Jersey (Bill A1752) 	<ul style="list-style-type: none"> • Kentucky (House Bill 123)
<u>Broad ESG Implementation/Prohibition</u> Certain legislation has been introduced that very broadly either requires substantial ESG disclosures from companies that contract with the state or prohibits ESG considerations altogether.	<ul style="list-style-type: none"> • Maryland (House Bill 1200) • New York (Assembly Bill A8352) 	<ul style="list-style-type: none"> • Kentucky (House Bill 779) • New Hampshire (House Bill 1469) • Pennsylvania (House Bill 2799)

Corporate Governance: International ESG Developments

On January 5, 2023, the EU adopted the Corporate Sustainability Reporting Directive (“**CSRD**”), which subjects companies doing business in Europe to certain mandatory ESG reporting, beginning in 2025. There is a spectrum of how connected a company is to the EU, and the extent of the reporting obligations varies along that spectrum.

Minimal Contacts

The CSRD’s reach is expansive, potentially reaching companies unexpectedly. For example, a company that had a debt instrument listed on an EU exchange decades ago may have to comply with certain CSRD reporting obligations.

EU Operations

Companies with EU operations will have certain CSRD reporting obligations, although there is some relief as a foreign company

EU Parent Company

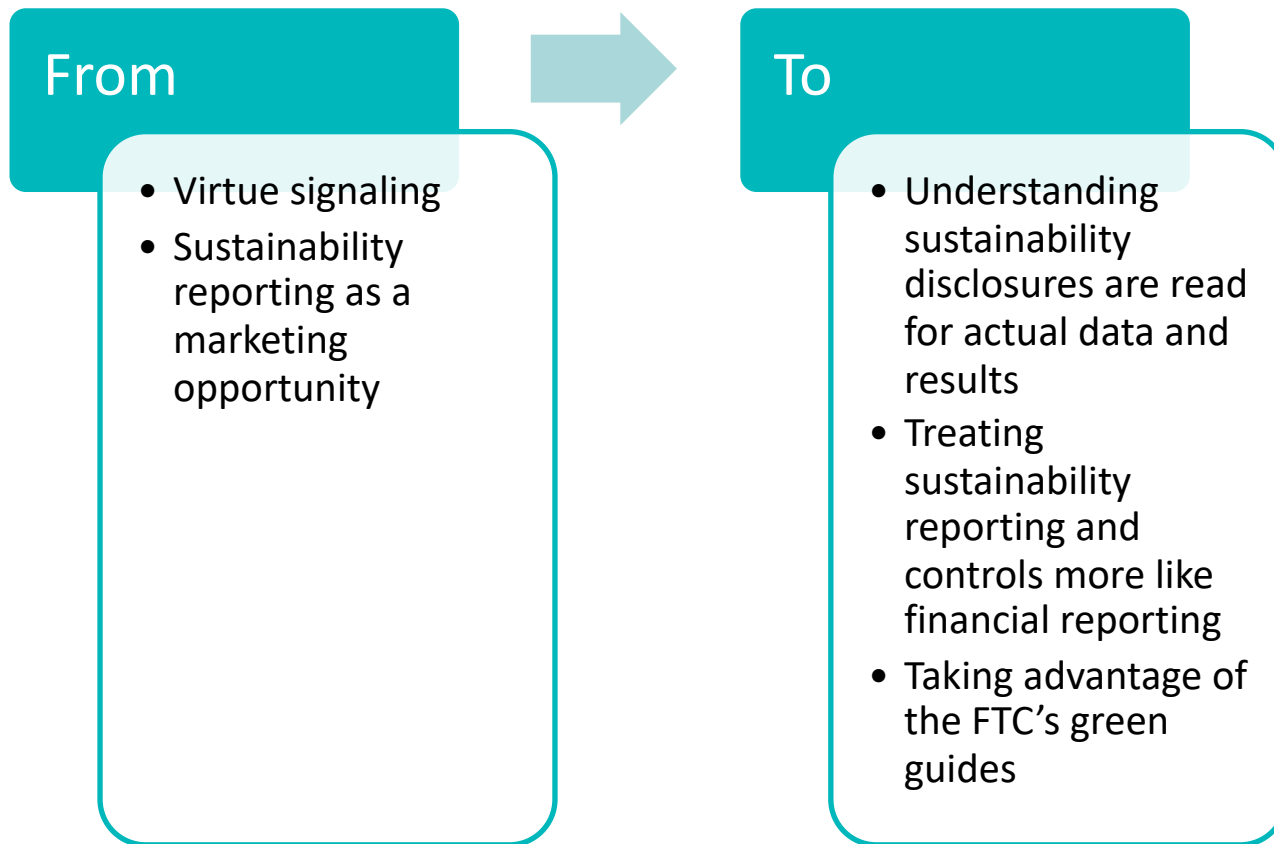
Full CSRD compliance will be mandatory for subsidiaries with an EU parent

Corporate Governance: Greenwashing

- Broadly, greenwashing is when a company exaggerates its sustainability goals or achievements. There has been an increase in greenwashing actions against companies. In the last year, some notable examples included:
 - Coca-Cola's being sued for false advertising for claiming its bottles are "100% recyclable"
 - Shell's being sued for misrepresenting its renewable energy investment claims in SEC filings
 - FIFA's being sued for branding the 2022 World Cup as "carbon neutral"
- In some cases, it does not necessarily require a misstatement to be sued, at least in Europe—in a Dutch case, Shell was sued simply for setting a 2030 sustainability goal that climate activists did not deem ambitious enough
 - *Milieudefensie v. Royal Dutch Shell*

Corporate Governance: Greenwashing

- What can a board of directors do to mitigate greenwashing risks? It begins with a mindset shift.



Corporate Governance: Consumer Backlash Events

- Several recent high-profile examples that resulted in substantial reputational fallout:
 - Bud Lite transgender promotional campaign
 - Target Pride Month clothing collection
- What can a board of directors do to mitigate consumer backlash risks?
 - Often, these events are caused by statements or decisions made by middle management. However, taking a political position, even in company advertising, is a *strategic* decision. Understand when your board should be informed of a matter and when it should be presented as a matter for decision.
 - There should be a unified external communications approach. Management and the board should both understand what types of matters for external communication should be brought before the board before issuance.

Corporate Governance: Board Representation

- Stakeholders continue to emphasize the importance of a diverse board
 - Shareholder activism has increased year over year.
 - Popular shareholder proposals in recent years include those related to gender diversity and racial diversity on the board.
 - Institutional investors have published board diversity goals.
 - ❖ BlackRock says companies should aspire to have at least two female directors and one who identifies as a member of an underrepresented group
 - ❖ State Street says companies must have at least one female director
 - The European Commission has proposed legislation that would require public companies to have at least 40% female directors.
- Board representation is on the SEC's radar as well. The cybersecurity rules recently finalized by the SEC initially contained a requirement to have a cybersecurity expert on an issuer's board, although that requirement did not make the final rules.

Corporate Governance: Other Recent Developments

- Artificial intelligence implementation
 - Ethical and reputational impact
 - Disclosure issues
- Third-party risks
 - Supply chain and customer monitoring
 - ❖ Compliance program developments
 - ❖ Environmental and human rights risks
 - ❖ EU developments: Germany's Supply Chain Act effective January 1, 2023
 - ❖ E-commerce issues
- Subsidiary governance
 - Ultimate beneficial owner requirements
 - Know your customer requirements



Contact Information



Steve Patterson
(202) 419-2101
spatterson@HuntonAK.com



Anna Lueje
(321) 451-5017
anna.lueje@rtx.com