THE M&A JOURNAL

THE INDEPENDENT REPORT ON DEALS AND DEALMAKERS

VOLUME 21 NUMBER 4

JULY/AUGUST 2021

The Season of ESG

The Season of ESG 1

The proxy season, if any further evidence were needed, reveals the growing prominence of ESG in 2021. Lawyers at Freshfields analyze the results of the votes.

- **The Freshfields Proxy Survey 2021** 4
  A detailed report by Freshfields partner Pamela Marcogliese and counsel Elizabeth Bieber.

Chief Justice Strine on EESG 17

The former chancellor and former chief justice of Delaware Leo Strine, Jr. and a 2020 Tulane Corporate Law Institute panel of experts examine how far the phenomenon has spread from the relentless emphasis on shareholders alone.

*The M&A Journal is published approximately every six weeks, with ten issues per volume. The sequence of issues is therefore tracked by volume and issue number, rather than by month.

PROXY VOTING IN 2021 will be remembered as the season of ESG, according to the authors of a detailed 76-page report by Freshfields partner Pamela Marcogliese and counsel and head of shareholder engagement and activism defense Elizabeth ("Leza") Bieber. "Almost every development this year really hits on some aspect of ESG," says Ms. Bieber.

It was not long ago that corporate governance advisers found it difficult to get their clients to focus attention on ESG. "Do we really have to worry about that?" was one of the typical reactions, Ms. Bieber recalls. "We don't get that question anymore."

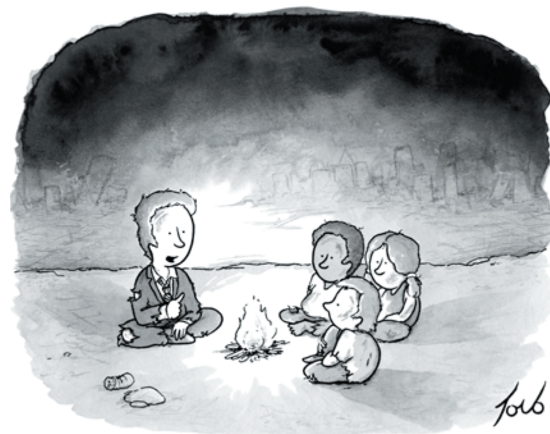
Entitled *An Overview of the Trends from the 2021 Proxy Season*, the report shows that institutional investors are on the march. "One of the biggest takeaways from this proxy season is that investors have been much more active in the ESG space. The large institutional investors are not necessarily submitting their own shareholder proposals, but they are much more willing to support shareholder proposals and to vote against management recommendations when they think that their company has not specifically addressed the ESG issues that these investors would like to see them take on."

This year, for example, Blackrock supported over one-third of shareholder proposals compared to under 20 percent in 2020. Of that 20 percent, 65 percent focused on the environment and 35 percent were social proposals. "That is a very significant change at Blackrock," says Ms. Bieber, "and among other investors as well. Large institutional investors are also voting against specific directors, holding them accountable for what the investors see as issues ignored by the companies in question."

One of the votes that came up this year was the so-called say-on-climate shareholder proposal, which has a similar structure to the more familiar say-on-pay item on corporate ballots. It was widely thought as the season began that this proposal would garner high levels of support. "It felt like it would be one of those times where institutional investors fall in line behind one another in support of an issue like this," Ms. Bieber says. "For a number of years, it has seemed as if any kind of new ESG proposal would get some amount of momentum. And this one did not."

Ms. Bieber attributes this result not as any sort of indifference to the climate crisis. In fact, she sees the cause of the lack of support as quite the opposite. "I do not think this should be confused as a lack of focus on climate or climate issues. Instead, I think it's an acknowledgement that companies need to be doing more and that a generic advisory vote each year takes accountability off individuals. The result could

Continued →



"Yes, the planet got destroyed, but for a beautiful moment in time we created a lot of value for shareholders."

Continued

continued

Pamela Marcogliese
Freshfields

be the dilution of the power of shareholder votes in a way that does not incentivize companies to make changes that address critical climate-related issues. I think many folks are taking this as an encouraging sign."

Diversity, another facet of ESG, is also growing in both breadth and depth, says Ms. Bieber. "There continues to be the expectation that companies should have diverse boards. The momentum is reflected in California legislation, the new NASDAQ rules and support from the SEC. It has also become apparent from the expectations of investors in their voting patterns and their guidelines."

What's more, says Ms. Bieber, the questions have become more profound and detailed. "After companies put a diverse director on the board, what follows? Are there diverse directors that are lead independent directors or chairs of significant committees?," she notes. "These demands have trickled down to executive management teams, to the workforce and into some of the gender pay and racial pay equity proposals and engagements, which have increased significantly over a handful of proxy seasons. These are the questions that are coming from institutional investors. It is no longer sufficient for a company to say that they have three women directors."

"Long-term performance is tied to doing the right thing."

– Pamela Marcogliese
Freshfields

It was not that long ago that ESG was either unknown or of little interest in the C-Suite. " 'Oh, do I really have to worry about that?'—that was one of the typical reactions," Ms. Bieber recalls. "Now, the issues we face as a society are the same ones that shareholders are increasingly beginning to think about: shareholder proposals about health, COVID-19, the effects of sugar on children and on people who consume it from the fast-food industry, antibiotics in the meat supply, the impact of food waste, plastic packaging, water pollution, animal welfare, the environmental impacts of refrigerants, social proposals about prison labor, policing and racial justice. All these topics affect how a company engages with its shareholders."

Activists are ever more involved in matters of ESG as well. "We used to say that if ESG came up in the context of a shareholder activism campaign, it was largely to marshal the support of other investors who might be interested in the subject in question. However, shareholder activism and ESG are increasingly intertwined."

Activism has itself evolved rapidly. "You more rarely see the historical model of acquiring significant amounts of company stock and then turning extremely aggressive," Ms. Bieber says. "Activists are successful with much lower equity stakes. Sometimes owning only two to three percent of a company can achieve an activist's objective of getting board seats or convincing the company to work with them. The only way they are able to leverage the kind of influence that comes with a small equity stake is by cultivating the support of the other shareholders."

And who are often the other shareholders? "Ownership has been consolidating at such a pace that now you've got the largest institutional investors – Blackrock, Vanguard and the State Street – owning something like twenty-five to thirty percent of seemingly almost every large public company," Ms. Bieber says. "That means the support of those institutional investors is critical for an activist's success. Without their support, companies would be able to tell an activist, 'Thanks but no thanks. We are not interested. Our investors are aligned with us and we are happy with what we are doing.' But in a world where you have such a high level of concentration, you see activists aligning with those investors. As those investors have shown that they care about ESG—whether it is diversity on the board or environmental concerns—you see activists being more sensitive to those concerns."

The rise of ESG has led to the increasing popularity of public benefit corporations. Pamela Marcogliese is a partner at Freshfields who recently became the only U.S. lawyer to be inducted into the Legal 500 Hall of Fame for corporate governance. She is one of the country's preeminent experts on public benefit corporations and has authored a book on the subject focused on practical considerations for companies, management and the board of PBCs.

PBCs are rapidly becoming a fundamental factor in the world of ESG. "They are gaining traction," Ms. Marcogliese says. "There is not yet a huge number of companies that are PBCs, but the conversations we are having in our practice shows that they are garnering significant interest at the highest levels of corporations. Conversions will obviously lag behind these conversations at first, but I foresee a significant uptick over the next year."

PBCs are creatures of statute, she explains, with one significant difference. In a standard Delaware corporation, directors owe fiduciary duties to the stockholders. "Essentially," she

says, "they have to act at all times in ways that are in the best interests of the stockholders."

At a public benefit corporation, in contrast, directors need to engage in a balancing of three things. "One is the stockholders, so that piece is the same," Ms. Marcogliese says. "Another is the public mission that the company selects and puts in its charter. And the final piece is the stakeholders that are most impacted by the company's conduct. Rather than being forced to favor one or the other of these three components, all directors have to do is balance the interests of each. They have to consider all three and then make their decision. So, at any one point, they could be benefiting one over the other two. The statute does not require a weighting of the three or any predetermined outcome. It only requires that the needs and interests of each be considered. Therefore, directors have much broader latitude and can take into consideration not just the stockholders but other stakeholders as well."

On January 31, of this year, Veeva Systems, a Pleasanton, California cloud-computing business focused on pharmaceutical and life science applications, became the first publicly traded company and largest ever to convert to a PBC. And that was by the vote of 99 percent of the shareholders. In its press release, the company wrote: "As a PBC, Veeva will remain a for-profit corporation but will be legally responsible to balance the interests of multiple stakeholders, including customers, employees, partners, and shareholders. It will also broaden its certificate of incorporation to include a public benefit purpose, to help make the industries it serves more productive and create high-quality employment opportunities."

On September 30, United Therapeutics Corporation became "the first publicly traded biotech or pharmaceutical company to take the form of a public benefit corporation," according to the firm's announcement after a successful vote at a special shareholders meeting. The company could already claim to have set up the first PBC subsidiary of a publicly traded biopharmaceutical company. After the vote, United Therapeutics released a statement saying that the conversion "aligns its legal charter with its longstanding practices of improving patients' health, enhancing employee engagement, attracting top talent, promoting healthy communities, and addressing important sustainability priorities through its use of green-building techniques, while simultaneously delivering strong shareholder returns."

Elizabeth Bieber
Freshfields

As Ms. Marcogliese says, "When you read the statements that these companies make, you see that they recognize that the long-term interests of stockholders and the long-term interests of the company are absolutely tied to the wellbeing of other stakeholders that the company is focused on. You cannot disaggregate the two. We are currently working with companies that are converting to PBCs as they are going public. Putting their mission into their charter both crystallizes that mission and gives their directors the latitude to make decisions based on all the company's constituents. By enshrining this in their charter, they can say that not only is this their mission but absolutely the underpinning of their success. Long-term performance is tied to doing the right thing."

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"The issues we face as a society are the same ones that shareholders are increasingly beginning to think about."

– Elizabeth Bieber
Freshfields

Here is the first half of the Freshfields report on the proxy season. The second half will appear in our next issue.

July 2021

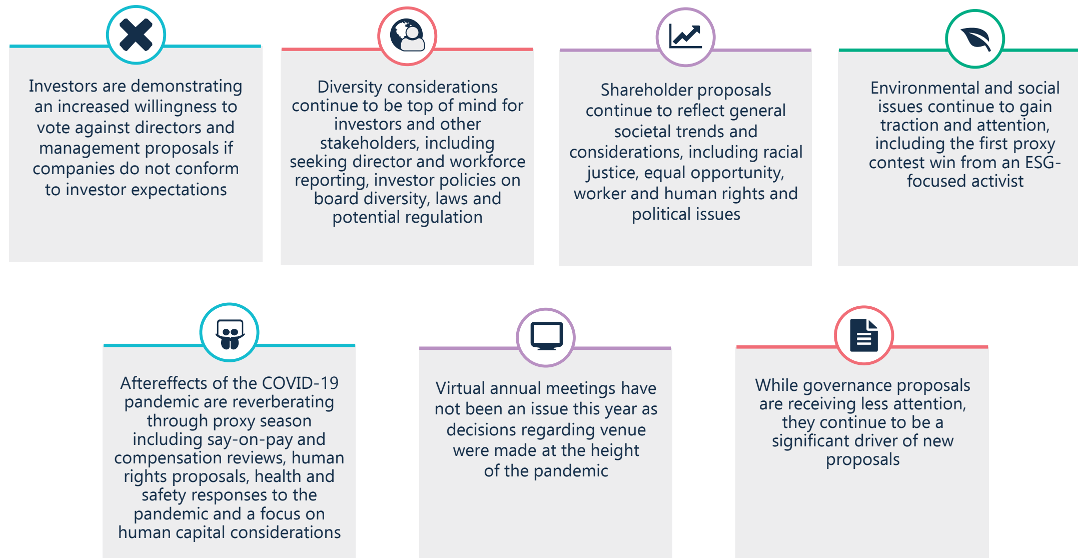
An Overview of the Trends from the 2021 Proxy Season

Freshfields

July 15, 2021

freshfields.us

2021 Proxy Season Highlights



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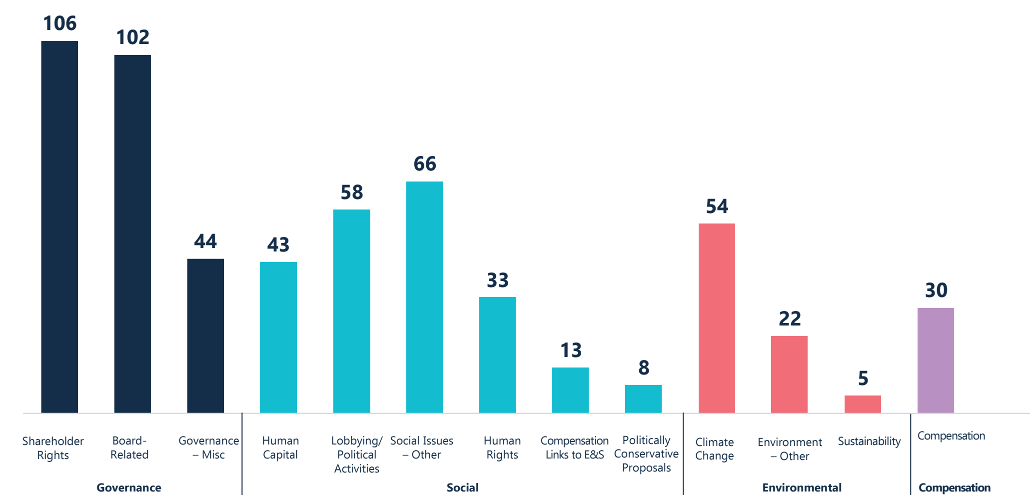
ESG Shareholder Proposals

Shareholder Proposal Filings by Category and Subcategory
January 1, 2021 – June 1, 2021



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Source: ISS

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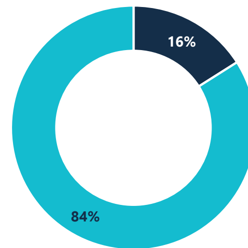
Support for E&S Proposals Continues to Grow

As of June 1, 2021, ISS found that, compared to the same time in 2020, of Russell 3,000 companies with disclosed voting results: there were fewer resolutions voted; a larger share of resolutions received majority support; and more resolutions were focused on E&S issues

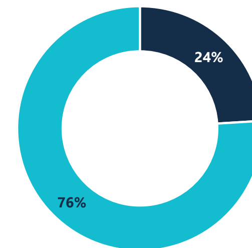
2020, Based on 140 Shareholder Proposals



>50% Support

<50% Support

2021, Based on 135 Shareholder Proposals



The top 250 companies have seen increased shareholder support for shareholder proposals as the proxy season advances

- Prior to and including April 15th, only one shareholder proposal received majority support
- Between April 16 and April 26, only one shareholder proposal received majority support
- Between April 27 and April 30, 17% of shareholder proposals received majority support
- Between May 1 and May 30, 16% of shareholders proposals received majority support

Average support for E&S proposals was **approximately 40%** through the end of May 2021, compared with 33% for the same period in 2020
Median support was **32% for social proposals** and **37% for environmental proposals**

Source: ISS and Semler Brossy

Proposals Reflect Societal Trends

Increasingly, companies are receiving tailored proposals that address societal trends

While these proposals may be submitted to only a handful of companies, they represent a trend of proponents attempting to create social movement through shareholder engagement

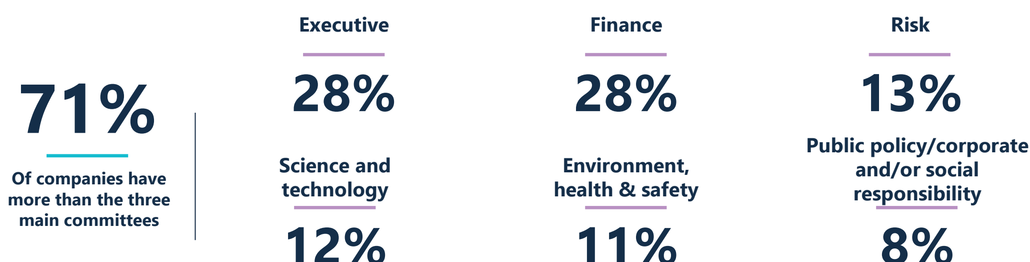
Example topics from the 2021 proxy season include:

Health	Ideological	Social	Environmental	Workers Rights
• Covid-19 • Effects of sugar • Public health-related issues for food and beverage business • Antibiotics in the meat supply • Opioid considerations	• Advertising policies contributing to hate speech • Politically conservative proposals • Lobbying • Surveillance and the cloud	• Indigenous relationships • Prison labor • Prohibition of partnerships with local police • Racial impact of overdraft policies • Reproductive rights • Child labor in supply chain	• Climate • Food waste impacts/metrics • Plastic packaging • Refrigerant impacts • Water pollution • Animal welfare	• Workforce pandemic council • Workplace sexual harassment

Source: ISS

Board Committee Trends

S&P 500 companies average four standing committees, or one additional committee in addition to audit, compensation, and nominating and governance



Executive and finance committees are frequent additional committees, but risk committees are more common than they were a decade ago

- The increase in the number of risk committees (from 4% to 13% in the last 10 years) is likely due to financial institutions, whose regulators may require a risk committee in the aftermath of the financial crisis
- Public policy and corporate and/or social responsibility committees have decreased in popularity (8% in 2021, compared with 14% in 2010), likely due to the view that the corporate governance committee or the full board has oversight of social responsibility issues
- Other committees include legal/compliance, strategy & planning, investment/pension and acquisitions/corporate development

Source: 2020 Spencer Stuart Board Index

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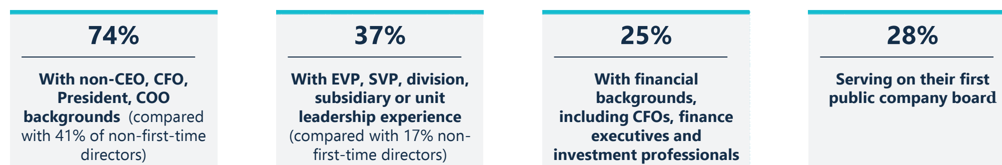
Board Refreshment Trends

Stakeholder attention to board refreshment and the pressure on companies to conduct thoughtful refreshment that reflects changing needs of companies, diversity and broad experience is evident in the continued refreshment of new independent directors elected to over half of S&P 500 companies

413

new independent directors in 2020

The new 2020 directors have a more varied set of backgrounds than non-first-time directors:



Only 9% of first-time directors are or were CEOs, compared with 37% of non-first-time directors, and more of the first-time directors with CEO experience are retired, which is unsurprising given the focus on overboarding for active executives in the last few years

The new directors represent only 8% of all S&P 500 directors and over half of S&P 500 boards added one (or more) new directors

Source: 2020 Spencer Stuart Board Index

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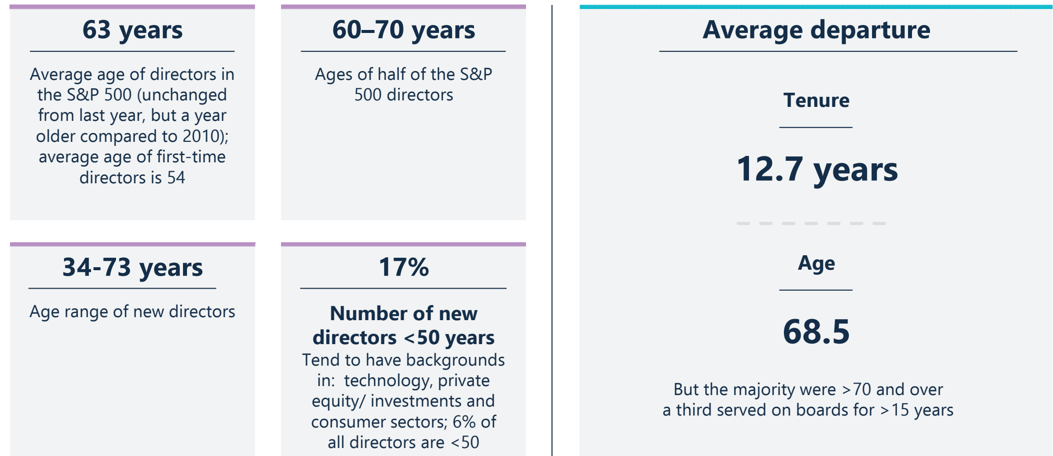
Age and Term Trends



Source: 2020 Spencer Stuart Board Index

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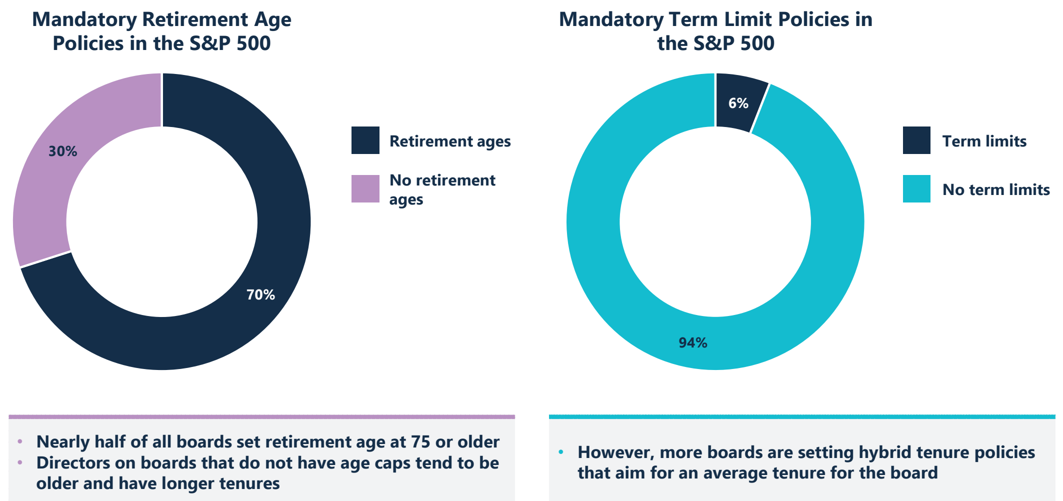
Departure Policies by the Numbers



Source: 2020 Spencer Stuart Board Index

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Individual Director Accountability

There have been a few instances where organizations or groups have developed lists of individual directors that take or fail to take certain actions

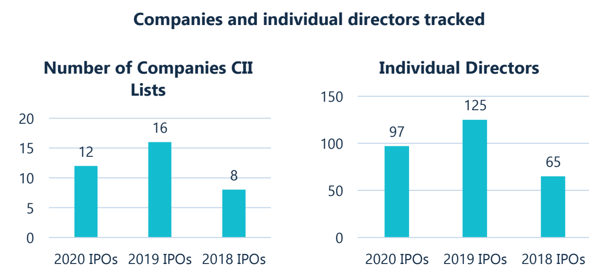
- Lists have been a common tool to promote change at companies, but historically the lists contained company names and not individual directors

Dual class directors

CII created a list of "dual-class enablers" that tracks directors of U.S. boards involved in decisions to go public with a dual class structure since 2018

- The list excludes directors to the extent they have included a time-based sunset of seven years or fewer into the structure, and directors at SPACs, FPIs, REITs and IPOs valued at less than $200m

Companies and individual directors tracked



Political transparency

The Center for Political Accountability conducted a corporate political transparency study that revealed which directors hold seats at two or more companies with ideological or political policies and/or make donations on opposite ends of the spectrum

- The study ranked companies in five tiers, with scores evenly divided among the tiers and studied and produced a list of directors at the top-tier companies that also sit on boards of bottom-tier companies

Individual votes

- 44 directors failed to receive at least 50% support for their election or re-election, an increase of almost 29% from 2020
- The percentage of directors that received between 70-90% support also increased

Source: CII, CPA and Georgeson: An Early Look at the 2021 Proxy Season

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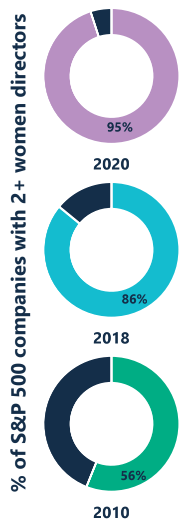
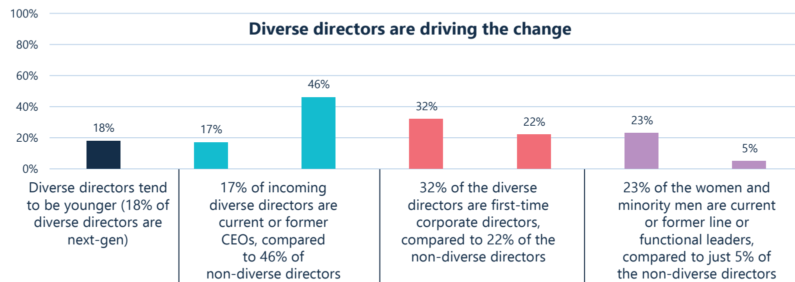
Boardroom Diversity





59%	New directors in the S&P 500 with gender, racial or ethnic diversity
47%	New female directors in the S&P 500 in 2020
21%	Overall female directors in the Russell 3000 in 2020 (compared with 10.8% in 2010)
28%	Overall female directors in S&P 500 (compared with 16% in 2010)
67%	S&P 500 boards with 3+ female directors (compared with 18% in 2010)
28%	Of S&P 500 boards that added independent directors in 2020 that expanded size of the board to add a female director
22%	New racially/ethnically diverse directors in the S&P 500 in 2020
20%	Racially/ethnically diverse directors in the top 200 S&P 500 (compared with 15% in 2010)

Methods used by boards to increase diversity: executive search firm (76%) | prioritize diversity as a criterion (71%) | skills/gap assessment (66%)

Source: 2020 Spencer Stuart Board Index and ISS

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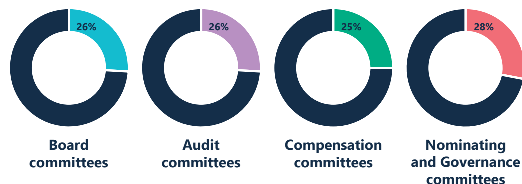
Diversity in Leadership

Board and Committee Leadership

- There is increasing scrutiny on how board and committee chairs and lead independent directors are allocated
  - Generally, less credit for leadership on committees outside of audit, compensation and nominating and governance
- Percentage of S&P 500 companies with women chairs in the following positions:



  - The biggest strides were made with audit committee and compensation committee leadership, up from 20% and 19%, respectively, in 2018
  - But, only seven women, representing 4%, serve as independent board chairs, and 11% are lead directors

A new program with a goal of increasing the ratio of Black executives on S&P 500 boards, the Black Boardroom Initiative, aims to raise the visibility of Black director candidates and is sponsored by a number of S&P 500 companies, including Amazon, Microsoft, Starbucks and Zillow

Management Diversity

- There is increased attention on management diversity and an increase in proposals that focus on senior management diversity
  - Women hold 30 CEO positions, 6% of the S&P 500, as of April 2021, and 11% of the top earners
  - There are four Black CEOs in the Fortune 500
- Stakeholders are also reviewing diversity and gender pay gaps across organizations, and a number of shareholder proposals request companies release EEO-1 data, release reports, or apply the Rooney Rule either to executives or all positions
- There is also increased scrutiny on diversity in leadership roles and racial equity audits, particularly when companies note significantly lower overall diversity
- Some companies have responded with publicly disclosed goals:
  - Proctor & Gamble wants to raise its level of African American employees from 10% to 13%
  - Facebook set a 5-year goal to have 30% more Black leaders
  - General Motors created an inclusion advisory board that meets quarterly
  - Starbucks conducts yearly civil rights assessments of the Company's policies

Source: 2020 Spencer Stuart Board Index, Catalyst, Women CEOs of the S&P 500 (April 1, 2021), NPR You Can Still Count The Number Of Black CEOs On One Hand (May 27, 2021)

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Investor Director Diversity Policies

	2020 (or earlier)	2021 and Looking Forward
BlackRock	Encouraged boards to disclose the racial and gender makeup of board members and the process by which board members are identified and selected	Stated proxy voting guidelines that boards should be comprised of a diverse selection of individuals; more voting action against boards not exhibiting diversity in 2022
State Street	Votes against all members of the nominating committee if there were no women on the board	Began voting against the Nom/Gov Chair at S&P 500 companies that do not disclose the board's gender, racial and ethnic composition; in 2022 will vote against S&P 500 Comp Comm Chair for companies that do not disclose their EEO-1 surveys and against the Nom/Gov Chair if there are no directors from underrepresented communities
Vanguard	Publicly requested companies to disclose their efforts to increase board diversity; notably opposed to quotas	May vote against the chair of the nominating committee at companies where progress on board diversity falls behind market norms and expectations
Legal & General Investment Management	Began voting against directors at largest 100 companies in S&P 500 where there were <25% women on the board	Extending its board gender diversity policy to all companies in S&P 500; expects all companies to have minimum of 30% women on the board and in senior management level by 2023
Goldman Sachs	Began voting against all members of the Nom/Gov committee at any company globally that has no female directors; in July 2020 companies needed to have at least one diverse board member for Goldman Sachs to participate in IPO	Will vote against all members of the nominating committee at US companies that do not have at least one female and one additional diverse director; will expand requirement to two diverse members in 2021
NYC Comptroller	Votes against Nom/Gov committee members where the board lacks meaningful diversity (including 80%+ directors of the same gender); submitted proposals to 53 companies, negotiated agreements with 20 companies to adopt the Rooney Rule for new CEO and director candidates and five companies to conduct gender pay gap analysis	Will vote against: incumbent directors at companies with no underrepresented minority directors; incumbent Nom/Gov committee members with one underrepresented minority director; board chairs and incumbent audit committee members at S&P 500 companies that do not disclose the individual director racial/ethnic diversity; incumbent Nom/Gov committee members that have not made both gender and racial/ethnic diversity an explicit consideration in director searches; incumbent directors at companies that failed to adequately respond to the Comptroller's August 2020 letter

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Other Diversity Policies

Proxy Advisory Firms		
	2020	**2021 and Looking Forward**
Glass Lewis	Began recommending against chair of nominating committee at S&P 500 and Russell 3000 firms if there were no women on the board	Will note as a concern boards with fewer than two female directors but will make voting recommendations based on the current requirement of at least one female board member; starting in 2022, will generally recommend against the nominating chair if the board has fewer than two female directors
ISS		Will flag in its reports boards that have no apparent racial/ethnic diversity; will recommend against the chair of the nominating committee at firms that have no racially/ethnically diverse directors (exception if the board temporarily decreased its gender diversity and makes a firm commitment to return to a gender-diverse status within a year)

Workforce Diversity: A number of financial institutions have adopted or expanded Rooney Rule policies, largely as a result of shareholder engagement

- **Citi** will expand its policy from requiring one diverse candidate to requiring at least two diverse candidates on interview slates at the assistant VP level and above
- **U.S. Bancorp** will expand its policy from requiring at least one woman or person of color on slates for managers and above to all positions in the company
- **Bank of America** will expand its policy of considering at least one woman and one person of color to include all executive and senior-level roles, as well as a large share of midlevel employees and others
- **JPMorgan** will disclose an assertedly long-held policy of considering at least one woman and one person of color for all new hires in the U.S.

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California Board Diversity Requirements

California-headquartered companies are in phase-in periods now and will need to prepare for increased gender and underrepresented board diversity requirements

As of January 1, 2021, California Assembly Bill 979 mandates that California-headquartered public companies listed on NYSE or NASDAQ have at least one director that is an underrepresented minority serve on the board

Starting December 31, 2022, additional requirements for corporations will go into effect:

No. of directors	Minimum underrepresented minority directors
≥9	3
5-8	2
≤4	1

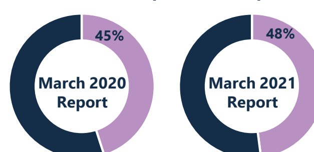
A member of an underrepresented community is defined as "an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender"

On Dec. 31, 2019, California Senate Bill 826 went into effect mandating California-headquartered public companies listed on NYSE or NASDAQ have at least one woman serve on the board

Starting December 31, 2021, additional requirements for corporations will go into effect:

No. of directors	Minimum female directors
≥6	3
5	2
≤4	1

Women serving on the boards of California-incorporated companies



Percentage of public companies with CA listed as a principal executive office or otherwise provided in annual filings that self-reported compliance with Women on Board requirements*

*Note: These figures include corporations that did not file a Corporate Disclosure Statement.

Source: CA Secretary of State

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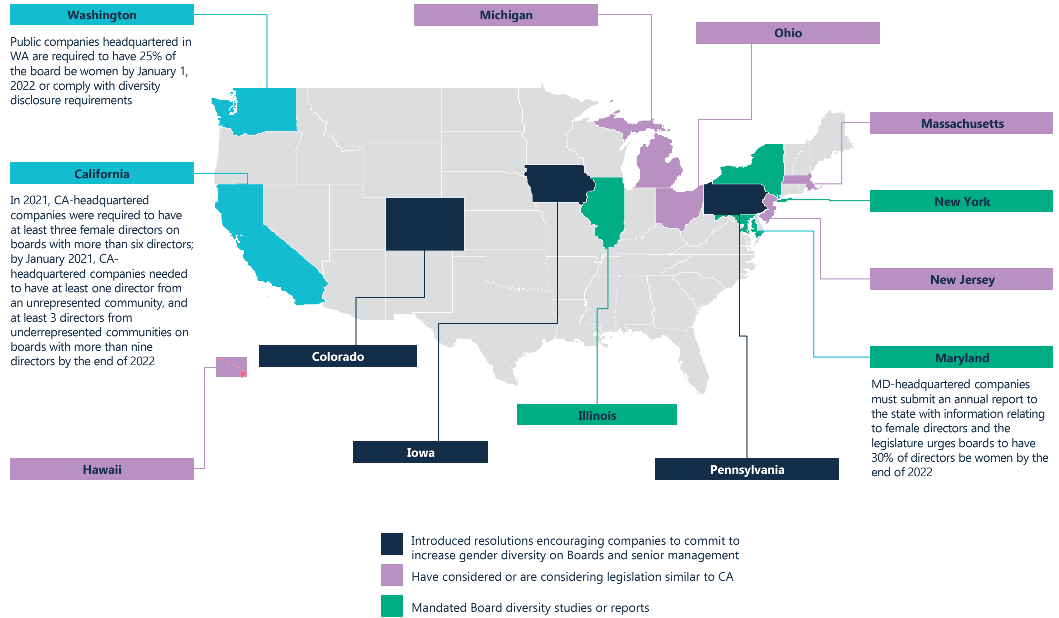
State Laws on Board Diversity



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Nasdaq Pushes for Board Diversity

Nasdaq noted that more than 75% of its currently listed companies would not be in compliance with its proposed board diversity requirements and has partnered with Equilar to assist listed companies in addressing board composition issues

DECEMBER 2020

- **Nasdaq asks the SEC for permission to adopt its amended rule** requiring each of the companies listed on its main US stock exchange to:
  - Publicly disclose (in either the proxy statement, on its website or in its 10-K or 20-F) diversity statistics regarding directors using **a standardized matrix template** provided by Nasdaq
  - Meet, or explain why they do not meet, an **objective of at least two diverse directors**, including one female director and one director who self-identifies as either an underrepresented minority or LGBTQ+ (later revised)

FEBURARY 2021

- Nasdaq revises proposal to **provide more time and flexibility to companies** listed on its exchange to comply with its proposal
- Nasdaq tells SEC that it will allow companies with five or fewer board members to have only one diverse member. All companies also will have two years to meet diversity obligations if the proposal is adopted
- Nasdaq will provide a one-year grace period for a company that no longer meets the diversity requirements as a result of a vacancy on the board

MARCH 2021

- On March 10, the **SEC announced that it would defer its decision** on whether to approve the Nasdaq diversity proposal and urged additional comments from the public on this matter

AUGUST 2021 (Expected)

- The SEC will **decide by August** whether to approve Nasdaq's proposal

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Nasdaq Pushes for Board Diversity (cont'd)

Flexibility for Certain Companies

- Smaller Reporting Companies and Foreign Issuers could satisfy the diverse director requirements with two female directors or explain their reasoning for not doing so. Smaller Reporting Companies and Foreign Issuers could meet the objective with one female director plus one director who is female and either an underrepresented minority or LGBTQ+; revisions to proposal would permit one diverse director at boards of five or fewer directors
- SPACs would be exempt from the rules; post-business combination entities would have two years to comply
- A two-year phase-in period will be applied to newly listed companies from the date of listing or the date the company files its proxy statement for the second annual meeting

Potential Timing

- The proposed rules will be published in the Federal Register and have a 21-day public comment period and 30-240 calendar days in which they may approve the proposal after publication
- If approved, listed companies will be required to be in compliance:
  - Within one year of SEC approval or the date the proxy statement is filed for an annual meeting during the calendar year of SEC approval: provide the board diversity disclosure information
  - Within two years: companies would be subject to comply-or-explain requirements with respect to one director
  - Within four (Nasdaq Global Select/Global Markets) or five (Nasdaq Capital Market) years: companies would be subject to comply-or-explain requirements with respect to two directors

NYSE Position

- NYSE president Stacey Cunningham has publicly opposed quotas, indicating that NYSE is unlikely to follow suit, stating:
  - "When we use exchange listing standards to require things like diversity profiles or others, we're defining the investable universe"

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Recent SEC Updates Concerning Climate and ESG

Appointment of Senior Policy Advisor on Climate and ESG

- On February 1, the SEC named Satayam Khanna to a new role as Senior Policy Advisor for Climate and ESG, which will advise on environmental, social and governance matters and advance new initiatives across its offices and divisions

SEC Review of Climate Related Disclosures

- On February 24, acting chair of the SEC, Allison Herren Lee, directed the Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings
- Increased focus in this area will include staff review of the extent that public companies have addressed topics identified in the SEC's 2010 Guidance Regarding Disclosure Related to Climate Change

SEC Division of Examinations Announces 2021 Examination Priorities

- On March 3, the SEC Division of Examination announced in its 2021 Examination Priorities that it will increase its focus on climate-related risks by "examining proxy voting policies and practices to ensure voting aligns with investors' best interests and expectations, as well as firms' business continuity plans in light of intensifying physical risk associated with climate change"

SEC Climate and ESG Task Force

- On March 4, the SEC announced the creation of a 22-member Climate and ESG Task Force within the Enforcement Division
- The Task Force will initially focus on identifying material gaps or misstatements in issuers' climate disclosures and is charged with proactively identifying ESG-related misconduct, which would be considered a violation of existing anti-fraud provisions
- SEC Commissioners note the impact of the task force remains "programmatically unclear" and a clear strategy for identifying misconduct has not yet emerged

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Recent SEC Updates Concerning Climate and ESG (cont'd)

SEC Seeks Climate Disclosure Input

- On March 15, acting chair of the SEC, Allison Herren Lee, delivered a speech about "meeting investor demand for climate and ESG information at the SEC"
- The statement provides a list of 15 questions that the SEC is seeking public input regarding
- The questions focus on topics such as:
  - SEC regulation of climate disclosure
  - What information can be quantified and measured
  - What are the advantages of drawing from existing frameworks (i.e., TCFD and SASB/VRF)
  - Should climate requirements be part of broader ESG disclosure framework
  - How should the SEC address climate change disclosure by private companies

Response to SEC's Request for Public Comment

- Companies like Uber, Apple, and Salesforce support a principles-based disclosure regime that a company can personalize to suit their business and adapt for changing circumstances
- Uber also supports making use of existing disclosure frameworks (e.g., TCFD, SASB/VRF)

Political Spending Should be Part of ESG Regime

- Allison Herren Lee announced on March 15 that corporate political spending is "inextricably linked" to ESG issues and deserves more attention from lawmakers and regulators given that investors are calling for companies to make political spending disclosure

"[C]limate and ESG are front and center for the SEC. We understand these issues are key to investors – and therefore key to our core mission"

Acting Chair of SEC Allison Herren Lee

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Recent SEC Updates Concerning Climate and ESG (cont'd)

SEC Identifies Climate as a "Top Priority"; New Rules Expected in Fall 2021

- The SEC intends to propose new disclosure rules regarding climate change risks (as well as board diversity and workforces) by October
- It is anticipated that formal plans on environmental, social and governance reporting will be released, with final rules that may take effect as early as 2022
- SEC Chair Gary Gensler noted that climate change and human capital disclosures are top priorities
- The SEC continues to gather feedback from its request for public comment

States Respond

- Attorney General of West Virginia: new disclosure requirements introduce First Amendment concerns
- A coalition of 12 state attorneys general, led by CA, are urging the SEC to require detailed and accurate information about financial risks of climate change; other states involved include CT, DE, IL, MD, MA, MI, MN, NY, OR, VT and WI
- 16 state attorneys general sent a letter to the SEC questioning the SEC's authority to impose mandatory non-material climate change disclosures and put the SEC on notice that it may challenge any rulemaking; states involved include AK, AZ, AR, KS, KY, LA, MS, MO, MT, NE, OH, OK, SC, UT, WV, WY

Exchange Response

- NYSE is surveying its listed companies on their views about climate disclosure to help inform its advocacy efforts related to potential climate disclosure requirements

Unlikely Support

- The Business Roundtable supports the SEC's efforts to adopt climate change disclosure rules, but urges the SEC to rely on a principles-based approach tied to traditional materiality concepts

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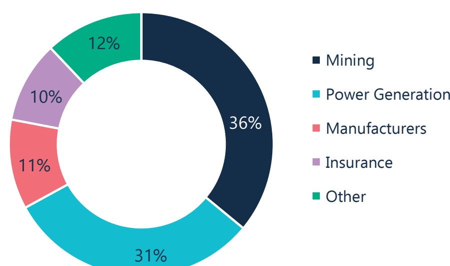
SEC Comment Letters to 2010 Guidance on Climate-Related Disclosures

- The SEC's 2010 interpretive guidance on climate-related disclosures focused a company's disclosures in the following areas:
  - Risk factors;
  - Business description;
  - Legal proceedings; and
  - MD&A
- In 2010, after the SEC's Division on Corporation Finance began to focus on climate-related disclosures, over 30 comment letters to annual reports, proxy statements or prospectuses referenced "climate change." Since 2016, only two comment letters, one of which was in 2021, have referenced "climate change"

SEC "Climate Change" Comment Letter Topics (2010 – 2016)	Number of Letters
Risk Factor Disclosure	39
Business Overview Disclosure	26
Oil, Gas and Mining Reserve Disclosure	26
Liquidity Issues	25
Contingency Accounting Issues	23

Climate Change Comment Letters by Industry (2010-2016)



Source: Intelligize

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Global ESG Reporting Rules to Focus on Climate Change

On March 8, the Trustees of the International Financial Reporting Standards (IFRS) Foundation announced that, based on feedback received, IFRS would be establishing an international sustainability reporting standard within its existing governance structure for global sustainability reporting standards. The strategy of the new board will include the following:

1 Investor focus on enterprise value	The new board will focus on information that is material to decisions of investors, leaders and other creditors
2 Sustainability scope, prioritizing climate	Initial efforts of the board will focus on climate-related reporting and also focus on meeting information needs of investors on other ESG topics
3 Build on existing frameworks	The new board will build on the work of the Financial Stability Board's Task Force on Climate-related Financial Disclosures and the alliance of leading standard-setters in sustainability reporting that is focused on enterprise value. IFRS will continue to seek feedback from relevant organizations through structured engagement process
4 Building blocks approach	The goal of the new board is to issue standards that will provide a globally consistent and comparable sustainability reporting baseline and provide flexibility for coordinating on reporting requirements that capture wider sustainability impacts

The International Organization of Securities Commission (IOSCO) is establishing a technical expert group, jointly led by the SEC and the Monetary Authority of Singapore, that will monitor IFRS's progress on developing a prototype reporting framework, which is expected to be completed for the UN Climate Change Conference in November

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Investment Firms Escalate Pressure on Portfolio Companies to Embrace Sustainability

BlackRock Commits to Creation of Sustainable Portfolios

- In 2020, BlackRock voted against directors at 69 companies on a list of 440 companies it classified as carbon intensive. In 2021, the list will expand to 1,000 companies
- In April, BlackRock created its first two ETFs aligned with the Paris Agreement
- In May, BlackRock publicized its rationale for supporting a shareholder proposal calling for faster climate action, but against a shareholder proposal calling for a report of climate lobbying activities
  - Stated a preference for the annual Say-on-Climate advisory vote as the best mechanism for receiving feedback from shareholders

"We believe that sustainability should be our new standard for investing."

Larry Fink, CEO of BlackRock

Vanguard clarifies expectations for say-on-climate proposals

- Vanguard expects management to disclose relevant climate risks and preventative actions
- It may support management Say-on-Climate proposals that identify a climate risk and seek shareholder input, as well as shareholder proposals on climate-related disclosures

LGIM will make climate ratings for over 1,000 companies publicly available

- Companies that fail to meet LGIM's minimum standards (incomplete disclosures, lacking certifications) will be subject to a vote against and potential divestment from select funds
- LGIM is willing to reinvest when companies demonstrate improvement
  - Seven of the ten companies with the largest improvements since 2019 were previously considered "laggards" by LGIM
    - Reinvestment occurred in some instances

NYS Common Retirement Fund divests from coal and oil sands companies

- In December, the fund adopted a goal of net zero greenhouse gas emissions by 2040 for its portfolio
- The fund has divested from seven oil sands companies and 22 coal companies, as well as set standards for the thermal coal mining industry
- Companies in other oil and gas sectors are still being evaluated by the fund

Climate Action 100+ Net-Zero Benchmark

- CA100+ is a coalition of more than 570 investors with over $54 trillion in assets
- In 2020, launched the Net-Zero Company Benchmark to aid investors in assessing progress on climate matters
- Aligns with the Paris Agreement

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Sustainability Reporting Standards Consolidation

Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC) merged this June to form the Value Reporting Foundation (VRF).

- VRF intends to maintain the Integrated Reporting Framework and will use the SASB standards to add comparability across companies within industries
  - Through the end of October 2020, 454 global companies have provided sustainability reporting using SASB-compliant metrics
- Stakeholders have been calling for simplification of the corporate reporting landscape
  - In September 2020, SASB, IIRC, CDP Global, the Climate Disclosure Standards Board (CDSB) and the Global Reporting Initiative (GRI) released a statement of intent to work together towards complementary sustainability reporting frameworks
  - In October 2020, SASB and IIRC announced they would work closely with the International Organization of Securities Commission and the International Financial Reporting Standards Foundation on a unified global sustainability reporting standard
  - The objective is to create a better pathway for companies to articulate a long-term climate action plan

SASB produced preliminary findings from Human Capital Management Research Project

- The report identifies the following four core themes for consideration:
  - Workforce culture: The values, processes and outcomes of an organization can drive a company's ability to produce a more productive, fair and respectful work environment, thereby making it easier for the company to acquire, develop and retain talent
  - Workforce investment: Providing employees with career- and wealth-building opportunities is becoming increasingly critical for worker engagement and retention
  - Mental Health & Health Related Benefits: Employee mental health affects business productivity. Issues that are particularly impacting businesses are employee stress prevalence, depression and anxiety. Related benefits such as paid sick leave may be associated with factors like job turnover, recruitment and retention
  - Alternative Workforce: Contingent and contract labor are increasing in prevalence, highlighting the potential to more effectively account for issues associated with this alternative workforce

"The Value Reporting Foundation will merge the SASB and IIRC into a credible, international organization that maintains the Integrated Reporting Framework, advocates integrated thinking, and sets sustainability disclosure standards for enterprise value creation."

Value Reporting Foundation Press Release

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The EESG Panel

Justice Strine champions employees as the second "E"

The co-moderators at the Tulane Corporate Law Institute in 2020: David Katz, a corporate partner at Wachtell and Leo Strine, Jr., Of Counsel at Wachtell and the former chancellor of the Delaware Court of Chancery and the former chief justice of the Delaware Supreme Court.

The panelists: Donna Anderson, vice president and head of Corporate Finance at T. Rowe Price; Brandy Bergman, founding partner and chief executive officer at Reevemark; Milissa Sawyer, a partner at Sullivan & Cromwell; and Patricia Vella, a partner at Morris, Nichols in the Corporate Counseling practice.

(This transcript has been lightly edited for clarity.)

Mr. David Katz: Our panel is going to talk about ESG issues. I'm very pleased to introduce my co-moderator Leo Strine, who is Of Counsel at Wachtell, but is better known as the former Chief Justice of the Delaware Supreme Court. And then we've got a wonderful set of panelists with us today to really discuss a variety of important issues on ESG. Donna Anderson from T. Rowe Price; Patricia Vella from Morris, Nichols; Melissa Sawyer from Sullivan & Cromwell, and Brandy Bergman from Reevemark.

Leo, why don't you give your perspective on where ESG is today and where you think it's going. We tend to use EESG with an extra "E" to stand for employees because otherwise employees will be subsumed under the "S" and we think it's much more important than just being part of the "S." It really is a separate issue as Justice Strine will discuss.

Justice Leo Strine: Thank you, David. It's great to be with you all. It's a pleasure to not be interrupting folks from Bourbon Street. I have some gumbo file powder and some Creole seasoning with me and hopefully we'll all be together next year in the place that we love. And it's so good, though, that we can continue this tradition David, and to be with such a great panel.

I think our panel couldn't be more relevant, I think David, in terms of where things are and how corporate practitioners and their clients are being buffeted. And I'm just going to set the stage a little bit about where we are and what we mean by EESG. And as David said, I do add an "E" and we can discuss why, but the reality is that the year 2020 and the BRT's statement [the Business Roundtable] on revising corporate governance is a reflection of concern in our society about growing inequality in terms of how the many who are responsible for capitalist success and the top executives and stockholders get treated.

There's been a huge decline in the share of profits that go to worker pay in the last 40 years in the United States. It's not a case that the pie has not grown. The pie has grown considerably, but the share of the pie that's gone to middle management and line employees has gone way down. That is part of what generated the BRTs admirable response. But 2020, as you know, David really underscored this because we had that tragic violence against Black people, exemplified by what happened to Mr. Floyd and Ahmaud Arbery. But then when the pandemic hit, it turned out that the essential worker class, the people who kept our society knitted together, who had to go to work in grocery stores, gas stations, other things that we needed, and who were at the most risk during the pandemic, they made far less than average and were the lower paid folks in society And it turned out that Black Americans in particular were much more likely to be essential workers and to face those risks while tending to be lower paid. And also, if they kept a job, it was more likely to be as essential

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workers, and they were also more likely to be unemployed.

So we had the growing concern about overall inequality heightened, David, as you know, by a concern about racial inequality, which has only put more focus on this reality, which is that it is difficult for companies to be good corporate citizens to society if they're not good to the people who work for them. And because so many people spend most of their time under the domain of their employer, how they get treated, how they get paid, how they treat each other, things like #MeToo are important.

Diversity, equity and inclusion is coming to the forefront. You and I have thought for many years that there should be a focus on the workforce and that's surfacing. This has not in any way diminished the demand for companies to be more environmentally responsible and to address, in particular, the existential threat to our way of life that is climate change.

And so companies are facing pressures from a variety of sources. One is just society itself and the things like Brexit, the election in 2016, exemplify the fractiousness that can come when economic insecurity is not addressed in a positive way, and you get appeals to divisiveness. And so there is a concern to have the corporate sector address that and try to bring society together.

We have a new administration in Washington that is very interested in making the economy work better for everybody and that very much embraces the ideals of the New Deal and the Great Society and the idea that our economy works best when it works for everyone. The administration has expressed an interest in stakeholder governance.

We know that the Department of Labor has already loosened up and is authorizing institutional investors to take into account EESG. I expect the administration in general is going to promote inclusiveness, and the institutional investor community, as we know, has reacted to this for their own reasons. And they're catching up. They focused initially on climate and on some gender equality at the board level for women. They're much more focused now on racial equality, and workforce issues are coming to the fore.

And then as you know, David, there's international pressures because throughout the OECD, regulators are concerned about this. There are pressures for this and where we're at is a really interesting time because there's all these pressures, but it's a cacophony. We have competing standards with all sorts of acronyms. As I always understood it, acronyms are pronounceable things like snafu, words you can say, they're not just strings of initials, but we have the strings of initials all over the place. And this G-R-I-E-L-T-C-F-T-F-C-D. I can't ever get the ordering straight. And when you're at a company now, and you know this,, audience, you get 300 questionnaires, but maybe not that much, but it's a lot. It's confusing. It's confusing for boards about where to situate the response to this. Some boards are reflexively, just creating a sustainability committee.

Folks don't know what to do. Some people are advising companies to play this like the old corporate governance rating scheme. Some are thinking that they can wait it out. And some are just confused. And I think what we're going to try to do today, David, and I'll stop talking is to be practical about this and to see whether we can address some of the challenges that companies face in disclosures. Talk about how perhaps you can integrate, if you think about the connection between EESG and your already obligations to engage in good risk management, Caremark, and law compliance practices. If you integrate those and think about it in a deep way, you can probably come up with some effective and efficient solutions.

And we've got some really great panelists to talk practically about that. And also about some techniques that are emerging in the market, like the B Corp, which allow your clients. If they're interested to embrace a model of stakeholder governance that might fit more with these demands and give them a little bit of insulation from stock market pressures. So thanks, David, for letting me kind of set the stage a little bit and I'll turn it back to you to moderate.

Mr. Katz: Thanks Leo. That's very helpful. Donna you work for one of the leading institutional investors. Institutional investors, from my perspective, are playing an essential role in engaging with companies to be responsive to EESG concerns. What's your perspective and how do you approach EESG matters with the companies that you invest in and what advice would you give companies about engaging with their investors on EESG issues?

Ms. Donna Anderson: Sure David. T. Rowe Price is still a traditional all active asset manager. And so I point that out because you don't often see us kind of up on the mountain, mak-

ing pronouncements on ESG issues from 50,000 feet. We are very company focused. So where we spend really all of our time is company by company coaching. And when you think about the range of investment strategies we have, where a developing market big cap company is versus an emerging market company that only issues public debt, versus a US small cap, versus a Japanese corporation—they all are on totally different places on the EESG map. One thing they have in common is most people feel pretty overwhelmed and pretty confused and kind of pulled in a lot of directions because of the intensity right now, the focus on these issues. I would agree it's intense to the point of maybe a little bit out of hand right now. So we try to really cut through that noise and be very practical.

What we're telling these companies, generally, I would say, if we can generalize on these engagements, we're kind of nudging companies along a continuum of starting with a narrative, right? That's most companies' first instinct when it comes to their first sustainability-type disclosures—let's talk about our programs, our philanthropy, let's highlight our people. And then you kind of nudge them along from that, which is a great useful start, but you want move on into data. What institutional investors need is data and where we all need to nudge the industry and companies and ourselves along is the standardizing of that data. I think we'll get into some of that later.

That's kind of the journey we see companies on. The other just kind of common theme that comes out of it goes back to Leo Strine's comments—what it means to be competitive. The definition of that? We can see that changing in real time. A lot of commentators have observed the differences in corporate engagement in their employees and their workforces in the great financial crisis versus now, just the prioritization of employee needs now versus then. And partly because it's a pandemic, but partly I think the times have really changed and what it means to be a competitive brand to attract talent and public goodwill and all of that stuff, has really changed. And it's tied up in these issues.

Mr. Katz: Thanks, Donna. Do you see companies making the same mistakes time and time again?

Ms. Anderson: Well, when it comes to disclosure, I don't know if "mistake" is the way we think about it. It's more sort of like generally the direction is more is better. And it's about fine tuning what's relevant to disclose. If you mean incidents, yes, things do happen in companies. And we do like to see some evidence that boards or management or whatever responsible entity has learned from those and how they have moved on.

Mr. Katz: Thanks Donna. Brandy, from an IR/PR perspective, what should companies be doing with their best work for an ESG concerns? And are there any big landmines that they should try to avoid?

Ms. Brandy Bergman: Of course there are. I think from an ESG perspective though, you can't just treat it like you're ticking a box, right? You put out your sustainability report and you're done for the year. You really have to integrate it with your communications, to all your stakeholders, whether it's earnings or town halls with employees, it should be done on a regular basis. And talking about employees, I would venture to say, if your employees don't believe in or understand what your commitment to EESG is, you should not be publicly patting yourself on the back about it. I really think that companies also need to make sure that when they think of the metrics that they want to define themselves by it's relevant to their company and their industry, it's meaningful for their stakeholders, and it's realistically achievable.

I keep going back to what Leo was saying about employees. When you think about it, not all companies can have a measurable impact on the environment per se, but everyone can treat their employees fairly, right? Everybody. Fair wages and benefits to employees are low hanging fruit. It can't be, "Should we do do it?" It's got to become, "We have to do it." And I think especially now, when you see there are really no clear guidelines, companies really need to be careful not to make promises that they can't deliver on or, worse, appear to be hypocritical. Hypocrisy, that public "Gotcha!", that is the biggest landmine out there.

The SEC is out now with a new "Gotcha!", a new landmine that might take over. But I do think from an IR perspective, back to what Donna was saying, I think the biggest mistake companies make is that they don't understand that this EESG risk analysis, it's not a game. It's real. And it's how investors make their decisions and companies that don't take it into account, they're going to expose themselves to reputational risk and value destruction. And I would say this: activists in the past would kind of add the governance thing on as a sidebar. That's

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really changed. I think we all look at EESG now as potentially as big a vulnerability for companies as performance.

Mr. Katz: Thanks, Brandy, that's quite helpful as a look from a company perspective. Melissa, large companies have been looking at EESG issues for quite some time and they seem to have really started putting in significant resources into those efforts, both considering policies and also determining how to best disclose them. What should mid-caps and small-cap companies do since they lack those resources that are available to larger companies and how should they be approaching this issue?

Ms. Melissa Sawyer: Yeah, David, you're absolutely right to point out the disparity in resources that large companies allocate to EESG versus smaller companies because large companies are able to pay for frequent refreshment of their public disclosures to adapt them to new and emerging trends and issues. It's not uncommon for larger companies to hire a chief sustainability officer or to have a dedicated infrastructure for EESG related issues. When I work with smaller companies, I'm often working directly with a general counsel who may also be wearing the head of IR hat and drafting all the disclosures and also trying to manage compliance and HR issues at the same time. And so there is a real resource constraint there. And I think the temptation sometimes for smaller companies is to say, "Well, I'm just going to look at what my larger peer companies are doing. And maybe I'll just copy over their disclosures." Copying disclosures is okay as an end point, I think, if you've identified that you have the same risks and that you would address them in the same way, but I think you have to go through that analytical step first before you just copy disclosure. At the end of the day the real challenge for small companies, but something that I think they're actually quite good at, is figuring out what EESG-related issues are material to them.

And they already have the infrastructure to do that. They have a management team that goes through an annual budgeting process and a strategic planning process. And as part of that process, the management team should be asking themselves questions like, "Are our numbers baking in an assumption that we'll be retaining 80 percent of our employees? What happens if that number drops to 60? And what investments could we make to mitigate against that sort of erosion? What happens if climate change causes average temperatures in our region to rise by 20 degrees and what investments should we be making to mitigate against the risks that that sort of change creates for us?"

Small companies also have boards of directors and those boards in all likelihood do have strategic planning meetings where they could be discussing these types of risks and applying some checks and balances to the assumptions that management is making in its strategic planning exercise.

I think small companies also get input from their investors. They may not have the whole IR infrastructure to engage with investors in the off season on a regular basis the way large companies do. But they can certainly establish some protocols and habits of engaging with their key investors to solicit their input on what sorts of EESG issues those investors consider to be important. And certainly in this day and age with social media, employees and other stakeholders have also become an important source of inputs about what EESG types of issues are important to a company. You may wish sometimes you didn't read it on social media first, but it's a good backstop in case you're missing something.

So then once you've figured out what is material, then you can start thinking about disclosure. And if you're a smaller company, maybe you can't afford to prepare a stand-alone sustainability report, a glossy full-color presentation on your website or something of that nature, but maybe it's just a matter of refining your risk factors or enhancing some EESG related items in your MDNA. Maybe it's a letter from your independent directors that you put as a cover letter in your proxy statement, outlining the board's priorities when it comes to EESG-related matters.

I think what I would say though, for smaller companies especially, whatever you do on the disclosure front, you do have to be careful to subject it to the same kind of disclosure controls and procedures and rigor that you subject your other disclosures to. And that's a step in the process that sometimes gets missed. So people do need to pay attention to that.

The one other thing I'll say is once you figure it out, what your issue are and how you want to disclose them, I think the next step is to take it a step further and also think about how you want to address those issues. Do you want to allocate resources to mitigating these issues? Do you want to diversify your supply chain? Do you

want to diversify your C-suite or your board? These are sort of more proactive, next steps that even smaller companies can take. And as a matter of fact, small companies may have an advantage in this regard because they're less siloed. The person who is the decisionmaker on climate change is possibly also the CEO who is making other capital allocation decisions at a smaller company. And so you sort of eliminate a layer of bureaucracy and decision making at a smaller company that can actually weigh down progress on EESG issues at some larger companies.

Mr. Kataz: Thank you, Melissa. Donna—

Justice Strine: Hey, David, can I just echo that? I just want to say that I actually think there's tremendous incisiveness in what Melissa just said, not just for mid-cap and small-cap companies, but actually for large-cap companies, because I think everybody is struggling a bit now with whether this is an add on addition. And we've had a checklist approach to corporate governance as you know, David for a long time and we just keep things on. And I think if you think about the "E" inenvironment, do you want two separate sets of employees doing that for compliance, risk management, and Caremark purposes, and then have a group doing it for EESG purposes, the same thing for human resources issues, the "E" environment, the same thing for a consumer safety issues.

The reality is the law rubs up against your company when your company rubs up against the society or a stakeholder. If you keep your eye on the minimum bottom line, you're more likely to be a good citizen. And if you try to have higher objectives like EESG objectives, you're more likely to hit the legal bottom line. And there's a lot of evidence that compliance programs that are infused with the why, like why it's good to do are more effective. And so I think there's a lot of power in what Melissa is saying about thinking about these things, integrating them and not duplicating your efforts. And that's really essential as Melissa said about small- and mid-caps,bBut I would argue that the large-caps, because the expectations are so much that really looking across your committee structures, we'll talk about, but even at the officer level, of making sure that things are integrated and that you're not just doing things on top of each other.

And then also using your disclosure metrics as a decision-making tool and a way of evaluating. And I thought both Melissa and Brandy and Donna were also good about being measured, picking achievable goals, acknowledging what you're doing. So I just wanted to say, I just thought that, I frankly think that advice that Melissa just gave is so good that I think it actually applies across the board, but as she said with much more force, the more limited your resources are.

Mr. Katz: Donna, I know you look at a company-by-company basis. Do you treat small-cap companies and mid-cap companies differently than you would necessarily a large-cap company on these types of issues?

Ms. Anderson: Yeah, absolutely. I mean, where you are by industry and what your exposures are and where you are in the life cycle, those absolutely inform our expectations. I mean, one thing Melissa brought up, I thought it was a great point and I'm seeing evolution on this—the big sustainability phone book every year might not be the right objective. I mean, that is a huge heavy lift and it gets dated right away. And we're seeing some companies that are ready to disclose on EESG, but just don't have the resources to do that. Take a more portal approach. Just create a site on your IR page or wherever. And you have topics: e here's our DEI two-page PDF and here's our environmental footprint two page PDF, or whatever your own dashboard tells you are the relevant factors. Those can be updated more often, they're more data heavy than narrative, a lot less work,, and just a lot more timely. I think that's a great solution to the problem of resourcing when it comes to the reporting side.

Mr. Katz: Thanks Donna. Patricia, Delaware led the way on the public benefit corporations. Can you explain for our audience, really what is a public benefit corporation and how it differs from the regular corporation? I think Delaware's really played a leading role here and I think if you could talk about that and also if there are some new changes that we're going to see in the coming year from some recent statutory amendments, that would be helpful too.

Ms. Patricia Vella: Sure. Absolutely David. So the public benefit corporations were created by a statutory amendment in Delaware, actually dating back to 2013. We're starting to hear a lot more about them in recent years but the amendments do date back to 2013. A public benefit corporation is similar to a traditional for-profit corporation, except it has a couple of additional requirements, including the requirement to pursue a public benefit and to operate in a respon-

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sible and sustainable manner. Now the statute defines a public benefit to mean a positive effect or a reduction of a negative effect on one or more categories of persons, entities, or communities or interests other than stockholders in their capacity as stockholders. And it includes things like effects of an artistic, charitable, cultural, economic, medical, environmental sort of nature. So it's pretty expansive in the statute of what your public benefit can mean.

Now the public benefit does not have a priority over the interests of stockholders. Instead, the statute requires this balancing of interests and it mandates that the directors balance the pecuniary interest of the stockholders, the interests of those materially affected by the business of the corporation, and then the public benefit that is specified in the company's certificate of incorporation. Now this is an advantage for a company wishing to promote publicly beneficial objectives while remaining a for-profit entity. Now, before we enacted the public benefit corporation statute, and for companies who don't want to go that path today, I think directors are still provided leeway about making decisions on social responsibility. They're given that leeway under the business judgment rule, but they're ultimately required to act for the purpose of maximizing the value of the enterprise.

So, I don't think anybody's going to argue with the idea that treating your employees well and treating your suppliers and your customers well is good for maximizing the value of the enterprise. But in corporate sales situations, a non-PBC, a traditional for-profit Delaware corporation of course, has to act for the sole purpose of maximizing the return for stockholders. Under the PBC statutes, the directors are given more flexibility and they have to engage in this balancing of interests of the stockholders and the other stakeholders in their day-to-day operations as well as in a sales context. So they have that flexibility that the PBC statute gives them.

Now the PBC statute was crafted or drafted carefully to ensure that the obligation of balancing the interests doesn't create a new type of interest. For example, the statute provides that directors of a PBC do not owe a duty to any person because of that person's interest in the public benefit, but it does allow stockholders to bring claims that directors failed to balance the stockholders' interests and the benefit interests correctly.

The statute also statutorially hardwires the business judgment rule and specifies that a director will be deemed to have satisfied his or her duties to stockholders and the corporation if the director's decision is informed and disinterested and is not such that no person of ordinary sound judgment would have approved the particular decision. The statute was also amended in 2020 to provide that a director's ownership of stock in a PBC alone does not create a conflict of interest on the part of a director with respect to the director's decision implicating that balancing of interests, except to the extent that the ownership of the stock would have created a conflict if the corporation were not a PBC.

A couple of other highlights from the 2020 amendments: the statute was amended to reduce from a two-thirds vote of the outstanding shares to a majority of the outstanding shares, the vote required to convert a traditional corporation to a PBC. And that's why you need a charter amendment to merge with an entity where PBC shares are issued. And it also eliminated all appraisal rights for that same conversion. The other thing that differentiates a PBC from a traditional corporation is a PBC has reporting obligations. So they're obligated to report to their stockholders at least every other year, with respect to their view of their public benefit and how they are achieving the goals.

Mr. Katz: Okay. That's very helpful. And I do think we'll be learning a lot more about public benefit corporations as we go forward.

Justice Strine: David, can I just mention one thing that I think is topical? There are some stockholder proposals to convert to public companies, and some of the responses have been tendentious and there's an argument that they're misleading. And I'll just put a point on one thing. As Patricia said, there's the distinction between a typical Delaware for-profit corporation and a B corporation, quite narrow actually. The Revlon duty is tempered. So in a sale, you have to consider the interests of stakeholders, but that means you can run an auction where you put requirements on, you set a level playing field, but requirements to protect stakeholders. That's important. And that's something that people, and they already exist by the way, in many other states on a may basis because of the constituencies, but some disclosures David had been putting out that it's really uncertain what the legal framework is for a PBC.

And that's just kind of silly and stupid and overstated for this reason. If you get a 220

demand, 220 applies. If you have a self-dealing transaction, all the traditional protections against unfairness apply. And as Tricia said, actually I think Tricia, the corporate law committee and the general assembly and the governors who've worked on this have actually strengthened the business judgment rule protections. There's an argument, David, that you have a stronger safe harbor for good faith business judgements and insulation more from traditional stockholder suits, which is why some of the opponents of Delaware embracing this were actually in the plaintiffs' bar.

And then I just would underscore that the actions to enforce the benefit, you can have monetary damages, right Tricia? it's just a form of declaratory or injunctive relief. So you really have almost every aspect of traditional corporate law applies except with the tempering of the Revlon doctrine and the duty to stakeholders and these stronger business judgment rule protections. So most of what you would do in advising companies is pretty traditional David.

And I think with what Donna and Brandy and Melissa have said about reporting the reporting requirements of the act actually kind of anticipated what institutional investors are expecting and regulators are expecting anyway. And so there's a lot of alignment with this model. And for those of you who are international focused, the public benefit corporation model actually looks, as you know David, a lot like governance in most of the OECD nations in the European Union. And there are many successful companies that you all represent in the US and represent abroad that have essentially these things. And ultimately the only voting rights Tricia are the stockholders still. So it really does depend on the institutional investor community supporting the benefits and doing that. But it's just important for that clarity. And I would urge those of you facing proposals, it's one thing to oppose them but it's another thing to put out things that really are kind of silly. And this argument, David, that no one knows what the governance is, frankly, silly.

Mr. Katz: I realize the reality because there are companies out there that are making these decisions every single day, and they're not having difficulty in this area. Thanks, Tricia. Thanks Leon, on that. Switching gears a little bit, Donna, we actually had the first public company they converted to a public benefit corporation. It was a company named Veeva. Do you think Veeva's a harbinger of things to come or is it something that's just unique and different about Veeva? And then much more generally from an investor standpoint, what's your perspective on public benefit corporations and companies that are actually going public as public benefit corporations, as opposed to trying to convert?

Ms. Bergman: I'll lmake a prediction that Veeva is not a harbor of things to come. I could be wrong and we might see that when we gather in some future year here, but I think there were some unique characteristics to that. And the main one is that that was a decision really initiated and led by and approved by a single person. Veeva at the time of that vote was a controlled company by means of dual class stock and superior voting rights. And so at the moment that voting started, voting was over. Now it's true that institutional investors did support that. And we did too. But for that reason and others, their very uniquely long-term business cycle, for example, I think there were some unique things going on at Veeva that don't apply to most.

I would say our assessment of these when they come up—this this is a portfolio-manager-driven culture and shop and they're very involved in voting. There is a little bit of hesitation, a few questions raised when we see companies going public in that form, for instance, but we have gotten comfortable that as you said, that the direction of travel for public companies is heading this way anyway. And so the differences are not that profound.

Mr. Katz: That's helpful. Brandy, some commentators talk about EESG and things like public benefit corporations as simply marketing ploys for either an institutional investor who has a fund that uses EESG or other things that companies do to differentiate themselves without really making a significant change. How do you give advice to companies about avoiding this trap and put EESG front and center so that it's real and it's something that the company can measure and show, and that it's not just a marketing gimmick or something along those lines?

Ms. Bergman: Well, as we've said all along, you really have to integrate it with the entire culture, right. EESG has to be part of the culture, your operations, your mission, your values, all your stakeholder communications. Again, it's not a sustainability report, it's programmatic and it becomes second nature, which is really important. Clear goals. The company needs to set clear goals rather than talk in general terms. They need to articulate why they've chosen met-

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rics and topics to focus on and why management believes those are important for their company or for its stakeholders. You want to make sure the company has really set out measurement tools, right? How are you going to measure progress? How are you going to measure success? How are you holding yourself accountable? I mean, these are all the kinds of things you would apply to typical elements of an investor relations program or a communications program. They've got to apply more to EESG now, especially because of the risk that's inherent in seeming to not do that part of your company right.

It's more the exception than the norm, but I think that board oversight is going to become a critical part of this. And I think any company that doesn't have somebody on the board who's overseeing EESG, it's going to look like a laggard because I think it's actually critical. And it does show that you're putting your money where your mouth is, this is really important, and you're making sure that there the oversight needed to make sure there aren't mistakes.

Mr. Katz: I have seen with some companies either their IR or their PR function basically has ownership of EESG,and I think, to your point and to Melissa's point earlier, that's really a big mistake, because if you want to have change, you've got to have it integrated throughout the corporation. You have to be very careful about somebody taking ownership of it that really doesn't have the broad pathway to both talk to the board about it, talk to suppliers, other constituencies about it, and frankly, make it work from a real perspective. I think as human capital issues come up more and more, that's going to be a greater issue. Melissa, there are a number of human capital and an employee/employer issues that we're seeing public companies struggling to deal with today. Whether you call it part of EESG or not, these are really critical, important issues for companies. What should boards and management teams be worrying about on these types of topics and what pitfalls they need to try to avoid?

Ms. Sawyer: The biggest question I'm getting from companies right now is how to organize themselves and their governance processes to deal with human capital issues. And so I often get the question of, is it appropriate for the comp committee to exercise oversight over all labor, HR, human capital related issues. And that approach certainly makes sense for one of the hot topics that's coming up in this area, which is coming up in the form of shareholder proposals at annual meetings, seeking to link performance-based compensation to EESG metrics. That is clearly a comp related issue and I think having that reside at the comp committee makes a lot of sense. But there are a lot of other hot topics in this area. Just to tick through a few that I've been hearing about in the last few months, obviously diversity and inclusion is top of mind at many companies. Gender and racial pay equity is sort of under that umbrella as well. Talent development and succession planning, workforce retraining to adapt to new technology, labor unions, workforce conditions, including child labor and things like that. And worker health and safety, including importantly during the pandemic, employee mental health. Those have all been very hot topics in the last year. And I really don't think all of those belong in comp for a very, very practical reason, which is that the CEO's responsibility is in part to manage people. And the CEO is often not in comp committee meetings. And I think it's very strange to take away the one person who is actually involved in managing people from being at the table for decisions about human capital allocation. You would never take the CEO away from a decision about financial capital allocation. So where does that leave you? I think it depends. It varies from company to company. Some companies are thinking about creating standalone committees to consider these issues. Other companies will keep this at the full board level. I think the important thing, no matter how you do it, is to make sure you have the right flows of information and the right cadence for those discussions on your board agenda, whatever that may be.

Mr. Katz: Thanks, Melissa. Patricia, how do you see EESG issues impacting the corporate advice we give to the clients every day and especially how are boards handling these issues? Is there a potential for Caremark-type claims on EESG issues? How do you think the Delaware judiciary is starting to approach these issues?

Ms. Vella: Sure. So look, I think the first key is to identify legal compliance issues around mission-critical factors, and then consider what systems you will put in place to monitor or oversee those operations. So if you create a separate committee for oversight and the committee charter requires the committee to meet quarterly and have reports from management, then make sure

that you follow through and you meet quarterly and have reports from management. And so I think the key is identifying the mission-critical factors, to the extent there are any in this EESG bucket. And then really making sure that you set up a system and then you continue to monitor it.

I think second, with respect to factors that might not be mission-critical or might not raise legal compliance issues but nevertheless drive value for the enterprise, you want to consider where those should live and how you oversee them. I think Melissa just pointed out some of those types of issues and not all of them necessarily raise legal compliance issues or are mission-critical in the sense that some of our Caremark case law has described, including food safety and things like that. But just give some thought to where you want them to reside, what is the right body to consider them and then make sure that you follow through on the systems that you've put in place and monitoring them.

As to what the Delaware courts might be looking at and might be doing, I don't know that I'm the right person to answer that question when we have our former chief justice on the panel. Candidly, I'm not sure that the courts would expand the potential for director liability beyond legal compliance, mission-critical factors. But I'm curious as to what Leo has to say on that.

Justice Strine: Well, I think Patricia, I agree with you. I just think that you already see around the country, a wave of Caremark decisions around diversity, equity, inclusion and-

Ms. Vella: Leo, did you go on mute?

Mr. Katz: Leo, we can't hear you.

Ms. Vella: He can't hear us.

Mr. Katz: Leo, we can't hear you.

Justice Strine: . . . the compliance and the audit committee. They have accountants dealing with pharma compliance. And this is where I disagree a little bit with Melissa. I think you can certainly have the comp committee become a workforce committee and there'll be meetings in which the CEO is not included. That doesn't mean, frankly, I think comp committees would do a better job if they covered all HR issues and they situated executive com[in the context of a pay plan they know about. And what we're talking about right now, I think it’s true is that many of these functions don’t have a board level or committee level home and that, frankly, there hasn't been a place for the key HR officers or other people to report to. I would agree with Melissa, for example, I wouldn't put worker safety issues in a workforce committee, but they have to be attended to. There probably ought to be an industry specific committee for each company.

And when we talk about board diversity, and for example, what institutional investors should be looking for, you can diversify the talent in the boardroom, which you need to do, if you appropriately align your committee structure. Because if you're trying to have everybody, Patricia, do compliance beyond audit, and it has to be a financial expert, the cost of that is that you have nobody who's a worker safety issue expert, nobody who's a regulatory expert, nobody who's an HR expert. And if you look at government and the military in particular, if you look at the academic community and the nonprofit sector, there are many areas of our nation where organizations have done better in diversity in terms of racial and gender diversity, where you have talented people who could really help you cover these regulatory risks. And by structuring the board in a better way, you can not only get their talents in the board room, but also can meet in an efficient way, the racial and gender demand.

And the bottom line on the courts is yeah, high salience things, #MeToo disputes, Title Seven issues. There's our grist for the Caremark mill. And as they become more salient, some of the worker safety issues are. And I guess what I'm saying is for years, I've observed us keeping more and more on audit, not spreading the work of the board. And I think if you think about it functionally, you'll have more time for the board with key officers in areas, you'll actually be aligning what the board's approach to it is with management's approach. And yet we haven't done that. And I think you're going to these cases you get out of Chancery, Patricia, I think are lessons in how bad governance can actually lead to things. And by the time you've got a Caremark case, you've usually lost. What I mean by that is it's not the case itself that's the issue. It's usually the embarrassing factors, the turnover, the regulatory fines, the harm to a stakeholder and the sort of things that Brandy will have to manage, help you manage talking about. And so I think there's already a focus on these human issues around the country. And I think if you get ahead of it with a good organizational structure and think about some of the things Melissa said in terms of avoiding duplication and trying to kind of be efficient, you're probably going to address

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your legal liability at the same time as you're addressing the rising expectations.

Mr. Katz: Leo, that's helpful from a judiciary stand. We lost a little bit what you said at the beginning with an audio problem. So I apologize for that folks, but Brandy I think good EESG issues and practices actually have to change in the corporate culture. Are you seeing people tie it to exec comp and are they publicizing how they're related or is this just something that is not seen very much and is not used very much?

Ms. Bergman: I think we're seeing companies are certainly exploring it in a way that they never did before. I think they're looking at it more of like a long-term thing, like over the next few years, can we tie executive comp to annual incentive plans or long-term incentive plans? I think a big obstacle for some of these companies is really that there are no clear guidelines. I think once it's commonplace and everyone knows exactly what the guidelines are and there are metrics that factor in industry size geography so that the companies don't make these missteps in disclosures and defining their topics and their metrics. I think you'll see it become more common. I mean, obviously investors want it. And I think that obviously it's shareholder value and a successful EESG program are now inextricably linked, right? EESG mistakes can impact valuation as much as a performance issue. So it has to be treated in the same way.

And it's interesting because I do think from a diversity perspective and I think about what makes my job easier here, a diverse leadership team, a diverse board is value enhancing because it mitigates risk. It's simple. I mean, especially on these social issues, they're so value destructive or potentially value destructive that a strong and diverse board can really give you amazing insights and credibility to help you navigate those kinds of issues that frankly, an all-white, 60-year-ol male board is not going to do for you. So it actually, it provides a lot of insights and a lot of value and a really great buffer for some of those issues.

Mr. Katz: Donna, we at the beginning started talking a little bit about EESG disclosure and I think one of the competing things out there on this is there are so many disclosure frameworks. There's no commonality right now. As Leo talked about at the beginning, they each have their own acronyms and they are far too many for me to try to repeat them. But I mean, do you think investors are going to drive this because they want to see comparable reporting for sustainability, much as they do for counting and other issues, or do you think that they're working to just continue to have this morass of each company picking whatever makes it look best?

Ms. Anderson: It is a mess right now let's acknowledge, you're right. And one thing that I think is not helpful, and I think companies are very aware of this, is you're being rated by outside third parties I would call it a checklist kind of approach. Do you have a policy on this kind of sourcing? Do you have a policy on this HR issue? It's like the presence of policies. Well, the presence of policies on issues like that, that are quite narrow is correlated with size and are you European or not? It's not correlated, it turns out, with performance. So I think that the scoring systems that rely on just how many pieces of paper you've got out there are going to prove themselves to be useless and we'll migrate more toward a substance oriented approach.

But yeah, what we advise companies is look at the peers, look at the industry, but also what's on your own dashboard. It doesn't necessarily in our view have to be in the compensation plan, but what does the board talk about when they are measuring progress against some of these issues. Start there. That's the stuff we're going to be interested in. And then if you're looking to expand that, we do think SASB is likely to have a good voice in the long-term and is a very sensible approach in that it's very industry specific and it's been informed over years by feedback from buy-side and sell-side investors saying, "Well, this is what we think is relevant in your industry." So it's not an all-or-nothing switch. You don't have to comply with SASB or not. You can take SASB items for your industry or industries, if you're across multiple, and choose what you think is relevant. We think that's a more substantive exercise than just putting out a bunch of pieces of paper.

Mr. Katz: I think that's very helpful advice because I think people have to really start looking at how investors are going to compare them across companies with these types of issues. Melissa, I know something that you and I have talked about in the past that Brandy introduced and the chief justice also mentioned, which is diversity and inclusion on the board level and how that affects the way companies operate lon-

ger term. I think that it's important to have these issues really, so that there's good tone at the top to lead the way, but how do you see companies dealing with these issues? And what mistakes are companies making or what are they not taking advantage of that they could be taking advantage of here?

Ms. Sawyer: Well, I totally agree with you that tone at the top is key here. And a lot of companies have taken that first step in establishing a better tone through trying to diversify their boards, trying to diversify their C-suite, doing more training on implicit bias, putting together better data on equity and inclusion within their organization. I think the next level, which some companies are already starting to tackle, is how do they set a tone beyond the governance angle? And this can cover a wide range of issues, but the things that I think about, and I'm starting to see some companies do, are things like making sure that their advertising shows their product being used by a good cross section of the population in all its diversity, whether they're making capital investments, building facilities in communities of color, for example, considering diversity, when they establish supply chain relationships or vendor relationships. And also, holding their advisors, even their lawyers and their investment bankers, God forbid, to the same sort of standards and requiring them to focus on diversity and inclusion issues as well. So I think setting that tone, it's almost like a wheel-and-spoke sort of model where the wheel, the center is their own practices, their own board of directors, their own governance, their own C-suite, but then sending those spokes out into the world with what they view as the tone that they want to set, I think is really the next level.

Mr. Katz: Do you think companies are actually making real gains in this area or do you think we still have a long way to go?

Ms. Sawyer: I think we have a really long way to go. I think there are a few companies that have been incredibly successful and it's through a lot of hard work and effort on their part. They've been highly focused on this issue and they've made a lot of gains, but I think they're few and far between at this point, that's my personal view.

Mr. Katz: Yeah. And we do have the California statute that's now first started with gender diversity on boards and now it's expanding beyond that. To me, that's not really the right approach to be taking, but you can't argue with the success that California has had on that basis because companies are worried about not complying. And Brandy, how do you see these changes in the boardroom being broadened to key issues that the company faces in the way the company is forward-facing into its social issues, it's media presence, et cetera?

Ms. Bergman: It's an interesting dynamic because you really having the younger generations informing a lot of the strategies and that means that some of the more seasoned executives and board members have to take a step back and listen to things that aren't as familiar to them. And I'm actually seeing companies listening more to their employees. I mean to your point, Melissa, the vendors, it's even a matter of having a good checklist. I mean, there are a lot of different diverse hires, but I mean, it really can have a long laundry list. And some of these companies are actually starting to form these laundry lists. I mean, they're still optional. And if a vendor prints everything out and has two people and there's no diversity they're going to still use them. But I think the fact that it's starting to filter through from the younger generation up to the boardroom is something that I think is remarkable.

Mr. Katz: And we are actually starting to see a trend, especially at small and mid-sized companies that are having younger members on their board. And I think that that will help accelerate some of those changes. Right now, it looks like there's about 3,320 public benefit corporations out there. And there's about 165 public benefit LLCs. So it's not a small number. Although the number for public companies is obviously much smaller than that. Donna, we started with you, I'm going to let you get the last word in here. Are you seeing diversity and inclusion have real impacts on the companies, those things that you really push them on when you're talking to them about what changes they need to make?

Ms. Anderson: Yeah. There was really enormous interest in we'll call it engagements with companies over the past year on our side, of course, and on theirs, on getting a handle on what do investors need in terms of disclosure? What are the proper kind of guard rails around objectives and things like that. And I guess I would just say that, yeah, as compared to the last big market crisis that we faced, the intensity of the focus on not only providing benefits to

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employees and by this, I mean extra paid time off to take care of yourself and mental health benefits and tele-health, and I mean, they just raced to make sure that they had those basic needs covered. And then things like spot bonuses, pretty significant bonuses, for those in hardship.

And if they had to do furloughs, they really kept in touch with them in some way. They had an organized way to keep in touch with them and get them back as soon as we could, like all of that, not only did they race to put that in place, they raced to tell us about it and all the other unique ways that they've really incorporated employee protections, diversity and inclusion, really increasing the robustness of their approach, not just "Oh, we added a couple of schools that we recruit at." So yeah, the fact that it's been such an important topic for virtually all the companies we speak to, that tells me this is a very different ball game.

Mr. Katz: We'll let that be the last word. I think that's really good guidance to companies that are starting to focus on this issue. Let me thank Brandy, Tricia, Donna, Melissa, and my co-moderator Leo Strine for what I hope was a very interesting panel. We covered a lot of area in a relatively short period of time. Thank you guys.

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The M&A Journal, 1008 Spruce Street, Suite 2R, Philadelphia, PA 19107