Governance & Securities
Alert

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Heads Up for the 2023 Proxy Season: Key Disclosure and Engagement Topics

In today's stakeholder-centric landscape marked by global economic and political uncertainty, the pressures on public company boards and management to address the demands of a myriad of constituencies and the ever-evolving regulatory landscape are greater than ever. In this Alert, we highlight some of the key disclosure and engagement topics for the 2023 proxy season.

Key Topics for Consideration for 2023 Proxy Season and Beyond

Executive Compensation and Human Capital Disclosure

- Pay Versus Performance
- Clawbacks
- Human Capital Management and Diversity, Equity and Inclusion

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- Continued Focus on ESG "Story" and Board Oversight
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Executive Compensation And Human Capital Disclosure

Pay Versus Performance. The most challenging new SEC requirement affecting companies for this proxy season likely is the new pay-versus-performance (PvP) disclosure. The PvP disclosure must be included in proxy and information statements in which executive compensation disclosure is required for companies with a fiscal year ended on or after December 16, 2022. Emerging growth companies, foreign private issuers, and registered investment companies are not subject to this new requirement. PvP disclosure will add several additional pages to the proxy statement, involve considerable additional time and analysis to prepare, and require input from the company's compensation committee and likely from a third party valuation consultant, as well as advice from a compensation consultant and legal counsel.

The new rule (Item 402(v) of Regulation S-K) mandates a new table that will disclose the following:

- For the principal executive officer (PEO) and for the other named executive officers (NEOs), as an average, the existing total compensation measure reflected in the Summary Compensation Table.
- For the PEO and for the other NEOs, as an average, a new measure – compensation actually paid (CAP) – which is to be calculated in accordance with the rule.
- The cumulative total shareholder return (TSR) of the company based on the value of a fixed investment of $100 and calculated in the same manner as in the stock performance graph required under Item 201(e) of Regulation S-K.
- The cumulative TSR of the company's peer group using either (i) the same peer group used for the stock performance graph required under Item 201(e) of Regulation S-K or (ii) the peer group used in the Compensation Discussion & Analysis (CD&A) for the purposes of disclosing the company's compensation benchmarking practices. If the peer group is not a published industry or line-of-business index, the identity of the companies included in the group must be disclosed in a footnote. If a company changes the peer group from the one used in the previous fiscal year, it will only be required to include in the PvP table the peer group TSR for that new peer group (for all years in the table), but must explain, in a footnote, the reason for the change, and compare the company's TSR to that of both the old and the new group.
- The company's net income.
- A self-selected financial performance measure that is the "most important" measure the company uses to link the CAP for the most recently completed fiscal year to company performance.

Accompanying the table will be a significant number of footnotes with additional required disclosures. Companies are finding that one of the most complex and arduous aspects of the new rule is the calculation of the CAP, which, among other things, requires many different valuations of equity-based compensation previously awarded to the NEOs.

Calculating the CAP requires taking the total compensation as reported in the Summary Compensation Table and adjusting the amounts used for equity awards and pension values. The PvP table requires companies to calculate the value of equity awards by calculating the end-of-year value of awards granted in the covered fiscal year plus, among other things, the change in the fair value of unvested awards granted in prior years, regardless of if, when or at which intrinsic value they will actually vest (not the grant date fair value or the dollar value realized upon vesting).

PvP disclosure also requires a clear narrative description of the relationships between each of the financial performance measures included in the table and the CAP to its PEO and, on average, to its other NEOs and a description of the relationship between the company's TSR and the TSR of the company's self-selected peer group. Companies likely will satisfy these "relationship" disclosures through a combination of graphs, tables, and narrative.

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For all companies subject to the rule (other than smaller reporting companies (SRC)), the rule requires a tabular list of between three and seven of the company's "most important" financial performance measures used in the most recently completed fiscal year to link the CAP with company performance. The list may include non-financial measures so long as at least three measures included are financial measures, and the list must include the company-selected financial performance measure included in the pay-versus-performance table.

There is a two-year phase-in period allowing most companies to begin with three years of PvP disclosure in the first year of the rule, increasing each year to include data for five years (except that SRCs may begin with two years of data and then phase-in to three years of data so long as they meet the SRC requirements). Newly reporting companies do not need to include PvP information for fiscal years prior to their first completed fiscal year as a reporting company.

What to Do Now:

- **Coordinate Key Function Areas.** The PvP rule is a significant and highly technical new disclosure obligation for public companies, and as such will require input and coordination across various areas of the company that could include finance, human resources, legal and investor relations, as well as outside advisors, such as compensation consultants, equity valuation experts and legal counsel. The disclosure and related calculations can be very time-intensive, especially with respect to valuation of stock options and performance-based equity awards.
- **Determine PvP Peer Group.** Companies should seek the input of the compensation committee's independent compensation consultant when selecting the PvP peer group. Any changes to the peer group could impact TSR disclosure. Companies should consider preparing a pro forma TSR calculation reflecting both the performance graph index peer group and the CD&A benchmarking peer group to help in the selection decision with their compensation committees, and also reconsidering critically the previously selected peer groups. Our expectation is that many companies likely will use their performance graph peer group since the peer group disclosed in the CD&A can only be used for the PvP disclosure if that peer group was used for "benchmarking" purposes.
- **Identify "Company-Selected Measure" and Tabular List Measures.** Companies should be focusing on identifying the "most important" performance measures, including the company-selected measure. Given that companies already discuss pay for performance in CD&A, they should take care to ensure that the measures identified align with that discussion and the compensation committee's views. The compensation committee and independent compensation consultant should be involved in determining and approving the appropriate performance measures for the Company-Selected Measure and the Tabular List.
- **Analyze Requirements for Calculating "Compensation Actually Paid."** The devil is in the details, and there are many to consider in this rule. Among these include how to derive CAP from the compensation amounts included in the summary compensation table, especially when it comes to valuing stock-based awards and pension values. Compensation teams should review these new rules and engage with internal and external accounting, compensation and valuation experts.
- **Consider Internal Controls.** Companies must also consider what, if any, additional internal controls and processes they may need to put in place regarding valuations needed for the PvP table, including the assumptions used in determining fair value of existing equity awards.
- **Impact on Say-on-Pay.** Although Item 402(v) disclosure will be treated as "filed" for the purposes of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and will be subject to the say-on-pay advisory vote under Exchange Act Rule 14a-21(a), the effect the new PvP disclosures may have on investor voting remains to be seen and will likely develop over time. Thus far, neither ISS nor Glass Lewis have adopted voting policies for 2023 relating to PvP.

- **XBRL.** Note that inline XBRL tagging is required for PvP disclosure, which can add additional time for design and formatting. Companies should ensure sufficient time, especially if using notice and access or if a preliminary proxy statement filing is required.

Clawbacks. As we discussed in our prior Alert, the SEC has adopted rules directing the stock exchanges to adopt requirements for listed companies to develop, implement and comply with written recoupment or "clawback" policies, or be subject to delisting. Companies listed on NYSE and Nasdaq will be required to adopt and comply with written "clawback" policies requiring the recovery of erroneously awarded incentive compensation from current or former executive officers who received such compensation during the three fiscal years preceding the date on which the listed company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement. In stark contrast to clawback policies that most companies currently have, the new rule requires that listed companies must adopt a clawback policy for executives that will leave little discretion to the board of directors, apply irrespective of misconduct, and be triggered by both "Big R" and "little r" restatements. The requirements will apply to all listed companies, including foreign private issuers, controlled companies, and debt-only issuers. The rules also require listed companies to provide disclosure about such policies and how they are being implemented. Listed companies also will have to file their policy as an exhibit to their annual report and disclose how they have applied the policy as well as use Inline XBRL to tag their compensation recovery disclosure.

What to Do Now:

- **Monitor Compliance Dates and Develop a Compliant Policy.** The SEC's rules were published in the Federal Register on November 28, 2022, which means that the stock exchanges must propose their listing standards by February 27, 2023, and the final listing rules must become effective no later than November 28, 2023. A listed company will be required to adopt a compliant clawback policy no later than 60 days following the date on which the applicable listing standard becomes effective. The stock exchanges will have very limited ability to vary from the prescriptive SEC rule, and accordingly, companies need not wait until the exchanges' listing rules are proposed and approved prior to developing policies.
- **Consider Clawback Program Holistically; Review Existing Clawback Arrangements.** Companies should consider these new requirements holistically, as part of their compensation program and risk assessment in order to evaluate the risk profile of the executive compensation program. Companies that have already adopted clawback or recovery policies should begin to review such policies to determine whether changes will be necessary to existing polices or forms of employment or award agreements.
- **Consider More Expansive Policy.** New Rule 10D-1 sets out the minimum requirements that a clawback policy must meet. Companies may wish to adopt clawback polices that are more expansive and cover matters beyond restatements, including situations involving employee misconduct leading to reputational damages to the company or breaches of company codes of conduct and policies.

Human Capital Management. Amendments to Item 101(c) of Regulation S-K that became effective November 9, 2020, require companies to disclose in the Form 10-K information about material human capital resources, measures or objectives that management focuses on in managing its business. Because the SEC has not defined the term "human capital management," companies take a variety of approaches to comply with the disclosure rule. Generally, companies have included disclosure relating to workforce composition and demographics, talent and succession planning, employee compensation, COVID-19 pandemic response, diversity, equity and inclusion in the workplace, and employee training and retention. A greater number of companies have begun to disclose future goals and measures. We can expect further rulemaking from the SEC in 2023 mandating additional human capital management disclosures, including relating to workforce diversity and corporate board diversity. Moreover, human capital management remains a strategic priority for management and the board, as well as a key engagement priority for investors. In addition to critical health and safety concerns relating to the pandemic, the range of human-capital issues for management to tackle includes employee retention, compensation, training and development, diversity and inclusion, and adapting the workforce to remote environments.

What to Do Now:

- **Continue to Evaluate Human Capital Issues and Disclosure.** Companies should continue to evaluate the human capital and diversity issues that are material to their businesses and stakeholders, including employees, shareholders, communities, and regulatory constituencies. Companies should review disclosure regarding their commitment to human capital issues and ensure that their underlying policies align with their public commitments and disclosure.
- **Consider Board and Committee Oversight.** Ensure that the board of directors, or a committee of the board, is expressly responsible for oversight of human capital issues, such as pay equity, culture, health and safety, and diversity, equity and inclusion. Many companies have been adding these oversight responsibilities to the responsibilities of the compensation committee. If the role of the compensation committee expands, consider updating the committee name to reflect this expanded scope of responsibility.

Board Governance: Leadership, Composition, Diversity

Board Leadership and Risk Oversight. In 2022, the SEC Staff issued a series of comments to a number of companies requesting specific and targeted information focused on enhancing disclosure of board leadership structure and the board's risk oversight function as required by Item 407(h) of Regulation S-K. See the box below with examples of these SEC Staff comments. In these comments, the Staff requested disclosure that extends far beyond the specific mandate of Item 407(h), and some companies are finding the questions posed divorced from the reality of the boardroom. In advance of the 2023 proxy season, companies should take a critical review of proxy statement disclosure on the board's leadership structure and risk oversight functions and evaluate whether such disclosure is meaningful and specific to the company's facts and circumstances, rather than boilerplate. We anticipate that even companies that have not received this comment will be enhancing disclosure around these items.

SEC Staff Comments on Board Leadership and Risk Oversight

Board Leadership

- Expand discussion of the reasons the company believes that its leadership structure is appropriate as opposed to an alternative structure
- Address circumstances under which the company would consider having the chair and CEO roles filled by a single individual (if currently held by two) or vice versa, and if the change were to occur, would shareholders be notified or given a chance to provide input into this decision
- Explain the role of the lead independent director or the independent chair in the leadership of the board, and why this structure is utilized
- State who may represent the board in communications with shareholders and stakeholders
- Explain if the board's vote is required to override the CEO or if the chair may do so on any risk matters
- Address whether the chair may provide input on the design of the board itself
- Elaborate on the extent of the board's role in risk oversight and the effect that this role has on the board's leadership structure

Risk Oversight

- Consider the role of the board in providing oversight of risk
- Disclose the timeframe over which the company evaluates risks (i.e. short, intermediate or long term)
- Discuss the different standards used to evaluate risks based on the immediacy of the risk assessed
- Avoid boilerplate disclosure of risk and uncertainties your company is facing
- Update potential future risk disclosure frequently
- Include whether the company consults with outside advisors and experts to anticipate future threats and trends
- Provide insight into how frequently the company re-assesses its risk environment
- Discuss how the board interacts with management to address existing risks and emerging risks
- Identify the company's chief compliance officer, if any, and to whom this person reports
- Ensure that the risk oversight disclosure adequately reflects the material risks disclosed in your financial report filings

What to Do Now:

- **Enhance Disclosure of Board Leadership and Risk Oversight.** These SEC Staff comments make abundantly clear that board leadership and risk oversight disclosures are priority areas for scrutiny. Companies that have received a comment letter have generally responded that they will address the comments in their future SEC filings. Moreover, it would also be prudent for all companies to review existing proxy statement disclosures and evaluate whether such disclosure could be enhanced to address some of the comments, as applicable.
- **Consider Board Self-Assessment Process.** A robust board and committee self-evaluation process can contribute to the discussion around the leadership roles of the board chair, CEO, and/or lead director, as appropriate, as well as the effectiveness of the board's risk oversight function. Companies should consider addressing these topics in their next board self-evaluation process.

Board Composition, Diversity and Skills. Board composition remains a focal point for investors and regulators alike. Although legislation seeking to mandate board diversity has seen setbacks in states like California, market forces continue to demand and influence greater board diversity, including through the voting policies of ISS and Glass Lewis, as well as institutional investor engagement priorities, and the Nasdaq diversity rules. See below for these diversity policies at-a-glance. The SEC's regulatory agenda for 2023 also includes proposed rule amendments to enhance disclosure around board diversity. As a result, companies are continuing to focus on enhancing board diversity. For the 2023 proxy season, we expect an increase in the use of skills and diversity matrixes and other methods of enhanced disclosure of board composition and diversity. This trend is to be expected, in part, as a result of Nasdaq's disclosure requirement, as well as shareholder proposals and letter writing campaigns requesting that companies provide a tabular disclosure of the board's skills and diversity characteristics. The SEC's proposed cybersecurity and climate change disclosure rules, when finalized, will likely impose additional requirements on disclosure relating to board composition, which companies should begin to consider in evaluating board skills, composition and future recruiting efforts.

Diversity Policies At-A-Glance

ISS

ISS will generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) where a board does not have:

- At least one gender diverse director at Russell 3000 or S&P 1500 companies for annual meetings held on or after February 1, 2022
- At least one racially/ethnically diverse director at Russell 3000 or S&P 1500 companies for annual meetings held on or after February 1, 2022
- At least one gender diverse director at all companies for annual meetings held on or after February 1, 2023

Glass Lewis

Glass Lewis will generally recommend against the chair of the nominating committee where a board does not have:

- At least two gender diverse directors at all Russell 3000 companies for annual meetings held on or after January 1, 2022
- At least one gender diverse director at all companies with six or fewer directors for annual meetings held on or after January 1, 2022
- At least 30% gender diverse directors at all Russell 3000 companies for annual meetings held on or after January 1, 2023
- Following state law mandates on board diversity for annual meetings held on or after January 1, 2022

For Nasdaq-Listed Companies (updated as of December 14, 2022)

Nasdaq-listed companies are required to do the following, subject to a one-year phase-in for newly public companies and a grace period for vacancies:

- Disclose in proxy statement or on website the Nasdaq-required board matrix
- Have one diverse director or explain why none (including boards with five or fewer directors) by December 31, 2023
- For boards with six or more directors, have two diverse directors or explain why not by December 31, 2025, for companies listed on the Nasdaq Global Select Market or Nasdaq Global Market, and by December 31, 2026, for companies listed on the Nasdaq Capital Market

What to Do Now:

- **Continuously Refresh Skills and Composition "Gap" Analysis.** The board should continue to evaluate its composition, including its leadership, competencies, independence, diversity, tenure and effectiveness, to determine whether it aligns with the company's strategic objectives. Further, boards should continuously and carefully reassess the skills and qualifications of directors to ensure that they have the right directors to meet the evolving needs and strategic direction of the company. Assess the board through the eyes of an activist investor to determine vulnerabilities and skills gaps on the board. Ensure that the skills highlighted in the company's skills matrix or other forms of skills disclosure are aligned with the company's disclosure around its strategy.

- **Review Diversity Disclosure.** Ensure that proxy statement disclosure is clear about the company's policies around board diversity and the existing composition of the board. Although many companies still prefer to aggregate diversity disclosure as a total number or percentage of the board, we expect to see more companies disclosing diversity characteristics of individual directors in light of recent shareholder proposals and letter-writing campaigns seeking such disclosure.
- **Update D&O Questionnaires.** Consider how to best obtain information from directors regarding their diversity and backgrounds, including by making updates to D&O questionnaires. In advance of the SEC's proposed climate change and cybersecurity disclosure rules, companies are starting to add questions regarding background, qualification and expertise in climate and cyber to their questionnaires in order to gauge existing expertise.
- **Monitor Legal Requirements and Consider Director Recruitment.** In light of SEC's proposed climate and cybersecurity rules, which would require companies to disclose to what extent board members possess cybersecurity expertise and whether any board member has expertise in climate-related risk, companies should begin to assess whether any director currently possess such skills, or whether such skills are necessary for near term recruitment. Companies may wish to consider asking directors to provide information about specific courses or certifications or other experience that they have that would support their expertise in areas such as ESG, climate or cybersecurity.
- **Understand ISS and Glass Lewis in Director Elections.** As discussed in our prior Alert, ISS and Glass Lewis policy updates for the 2023 proxy season focused on the accountability of the board of directors and its committees for climate, diversity and ESG oversight. Companies should familiarize themselves and their boards with the new and updated policies, which will influence the results of director elections and support for shareholder proposals in the 2023 proxy season.

DOJ Enforcement Sweep: Interlocking Directorates. The Department of Justice has recently emphasized its enforcement of Section 8 of the Clayton Act, which prohibits an individual from simultaneously serving as an officer and/or director at competing companies if the companies satisfy certain economic thresholds established by the Clayton Act. In April 2022, DOJ Assistant Attorney General Jonathan Kanter put companies on alert that the DOJ is "ramping up efforts to identify violations . . . , and [we] will not hesitate to bring Section 8 cases to break up interlocking directorates." The DOJ announced in October 2022 that seven directors at five companies resigned following DOJ inquiries.

What to Do Now:

- **Establish Controls and Enforce Notification Policies for Service on Other Boards.** Companies should establish appropriate controls around the notification and evaluation of new directorship for its officers and directors, or the change of primary employment of directors. For example, often company policies require employees to request permission to join a board, and directors to notify the board chair or nominating committee chair in advance of joining a new board or upon a change in primary employment, each of which can serve as an alert to potential conflicts of interests and interlocks issues.
- **Review and Update D&O Questionnaires.** In addition to establishing and enforcing companies' policies, D&O questionnaires can also serve as an important tool for identifying potential interlocks. A question requesting a list of all public, private and not-for-profit boards where directors and officers serve can assist the company in ensuring that it has all of the information to evaluate potential interlocks, related party transactions and any other actual or potential conflicts.

DGCL Amendments Permitting Officer Exculpation. Effective August 1, 2022, Section 102(b)(7) of the Delaware General Corporation Law (the "DGCL") was amended to authorize the exculpation of certain senior officers from personal liability for monetary damages for breaches of the fiduciary duty of care for direct claims only (not derivative claims). Historically, officers have been the target of stockholder litigation where exculpation has not been available. The amendments provide officers with similar protections as previously available only to directors,

except directors may also be exculpated for derivative claims. If a Delaware corporation wishes to implement officer exculpation as now permitted by the DGCL, the board will need to approve and recommend to stockholders for approval an amendment to the certificate of incorporation and receive the requisite stockholder support. Although we expect to see a number of companies seek stockholder approval of an amendment to provide for officer exculpation during the 2023 proxy season, many companies are adopting a "wait and see" approach this year. No doubt that one reason for this approach might be that a "preliminary" proxy statement filing with the SEC would be required for this proposal, likely accelerating the timetable for the preparation of the proxy statement in a year that companies already may be very busy with the new PvP disclosure requirement.

What to Do Now:

- **Analyze Potential for Support of Amendment Proposal.** Companies should consider engaging a proxy solicitor to assist in evaluating the potential support for this proposal, especially given that the required vote threshold is at least a majority of the outstanding shares under Delaware law and brokers cannot vote uninstructed shares. Proxy solicitors can also assist with understanding the voting behaviors of the stockholder base and soliciting "retail" stockholders.
- **Provide Clear Disclosure and Engage with Investors.** Companies seeking to implement officer exculpation as a result of the DGCL amendments should provide clear and reasoned disclosure of why they are doing so. ISS's policy provides that it will recommend case-by-case on proposals on director and officer indemnification, liability protection, and exculpation in consideration of the stated rationale for the proposed change and other factors, including the extent to which the provision will eliminate liability for monetary damages for violations of the duty of care or duty of loyalty. Glass Lewis's policy provides that it will closely evaluate proposals to adopt officer exculpation provisions on a case-by-case basis and will generally recommend voting against eliminating monetary liability for breaches of the duty of care for officers, unless a compelling rationale for the adoption is provided by the board. To date, ISS has generally recommended in favor of these proposals, while Glass Lewis has recommended against at least one proposal since its policy became effective for meetings held after January 1, 2023.

Environmental, Social And Governance (ESG) Oversight And Disclosure

Continued Focus on ESG "Story" and Board Oversight. ESG continues to dominate the engagement priorities of institutional investors. Investors and the SEC are reviewing company disclosures to understand their commitment and approach to overseeing risks relating to climate change, sustainability and social responsibility matters. In particular, they are looking for measurable results that demonstrate commitments and related oversight. Accordingly, many companies have enhanced disclosure in their proxy statements by highlighting board oversight of ESG, including specific allocations across committees, disclosure in alignment with the Task Force on Climate-related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB) frameworks, identifying priorities and measurable goals and highlighting progress toward such goals and how the company has been recognized by third parties.

Board oversight of ESG matters continues to be an increasingly complex and scrutinized topic for investors and regulators. An increasing number of companies continue to review and refresh their board guidelines and committee charters to clarify the board's oversight of ESG-related matters and enhance disclosure in their proxy statements by highlighting board and committee oversight responsibilities on these matters.

What to Do Now:

- **Enhance disclosure around board and committee accountability and oversight of ESG.** Companies should review and update disclosure relating to oversight of ESG initiatives and how ESG is linked to company-wide strategic planning decisions wherever relevant.

Beginning in 2023, Glass Lewis will generally recommend voting against the chair of the governance committee of companies in the Russell 1000 index that fail to provide explicit disclosure concerning the board's role in overseeing environmental and/or social issues.

For companies in the Russell 3000 and instances where Glass Lewis identifies material oversight concerns, Glass Lewis will review a company's overall governance practices and will identify which directors or committees have been charged with oversight of environmental and/or social issues. When evaluating a board's role in overseeing ESG, Glass Lewis will examine a company's proxy statement and governing documents (such as committee charters) to determine if directors maintain a meaningful level of oversight of and accountability for a company's material environmental and social impacts.

As discussed in our prior Alert, ISS and Glass Lewis are holding boards accountable for risk oversight of climate change and related risks. Boards should educate themselves on the policies of key shareholders. In 2023, ISS will generally recommend voting against directors at companies in the Climate Action 100+ Focus Group list if the company does not have adequate climate risk disclosure, based on TCFD standards, and the company does not have either medium-term GHG emissions reduction targets or Net Zero-by-2050 GHG reduction targets for its operations (Scope 1) and electricity use (Scope 2). Similarly, starting in 2023, Glass Lewis will recommend against responsible directors in the absence of clear and comprehensive disclosure in line with TCFD standards regarding climate risk mitigation and oversight at companies where GHG emissions represent a financially material risk. ISS ESG, the responsible investment arm of ISS, recently added 23 new factors to its Governance QualityScore, building out its analysis in seven different areas, including information security, director skills, director and executive pledging, emerging risk oversight, DEI, and pay-for-performance.

- **Understand and Be Prepared to Engage with Major Investors; Consider ESG Skills and Experience.** Companies should expect and be prepared to continue to engage with stakeholders on various ESG matters. In their recently published proxy season voting and engagement guidelines, major institutional investors such as BlackRock, State Street, Vanguard and others have identified ESG issues as some of their most significant engagement priorities. Furthermore, companies should be prepared to discuss and highlight skills and expertise, if any, of board members that help illustrate their ability to oversee ESG risks facing the company and its industry.

ESG Enforcement & Greenwashing. The SEC's focus on ESG-related issues has implications for public companies that tout their ESG bona fides. The SEC has clearly signaled that "greenwashing" is a top priority for the agency's Division of Enforcement. Furthermore, if adopted, the SEC's March 2022 proposed climate change disclosure rules will require public companies to provide detailed information about potential financial risks related to climate change and greenhouse gas (GHG) emissions.

What to Do Now:

- **Be Mindful of ESG Commitments and Disclosures.** Companies should regularly review their ESG-related commitments and disclosures to support the accuracy and verifiability of statements made in SEC reports, on websites, in sustainability reports and representations regarding products in marketing materials, and to regulators. If any issues or inconsistencies are identified, consider the best approach for proactively getting out in front of such issues, which can cause reputational damage, as well as legal and regulatory challenges.
- **Ensure Disclosure is Consistent.** Companies preparing ESG or sustainability reports should ensure that disclosure in such reports is consistent with Form 10-K and proxy statement disclosure and across the company's communications platforms and SEC filings. Companies should also review the SEC Division of Corporation Finance's published Sample Comment Letter containing comments that the Staff intends to issue to companies regarding their climate change disclosure. For example, one comment requests an explanation of what consideration the company gave to providing the same type of climate-related disclosure in the company's SEC filings as the company included in its corporate social responsibility (CSR) report.

Annual Meetings

Universal Proxy. As discussed in our prior Alerts available here and here, this will be the first full proxy season where, in a contested election of directors, the company and the shareholder activist will use a "universal" proxy card (i.e., a proxy card that includes the names of both parties' nominees), as required by new SEC Rule 14a-19, which took effect for meetings after August 31, 2022. Subject to some minor procedural requirements, activists therefore now have easier access to a company's proxy card without the minimum ownership requirements or guardrails on the types of proposals that they can put forth required by other means of access – e.g., proxy access and the Rule 14a-8 shareholder proposal system, respectively.

The SEC also adopted other proxy disclosure requirements and updates at the same time as it adopted of the universal proxy rules. The SEC updated Rule 14a-4(b) to require proxy cards for all director elections to include an "against" option, rather than a "withhold authority" to vote option if the company's state law gives legal effect to votes cast against a nominee. In a majority voting situation, shareholders must be given the option to "abstain" when they do not support any nominee, rather than "withhold authority." Companies must also clearly identify in their proxy statements how votes will be counted and the treatment of all votes, including the "withhold" option, if provided. The SEC also updated Rule 14a-5(e) to require proxy statements to state the deadline for a potential insurgent's notice of a solicitation of proxies in support of its director nominees pursuant to Rule 14a-19.

- **Be Prepared for Activists.** The likelihood of activist campaigns may increase because the price of entry onto the company's proxy card under this rule is low.
- **Review the Qualifications of Each Board Nominee.** Companies should carefully review, through an activist's lens, the qualifications, attributes and potential vulnerabilities of each board nominee in the context of the overall composition of the board.
- **Review Advance Notice Bylaws.** Companies should review their advance notice bylaws and consider whether to include additional procedural safeguards for the use of Rule 14a-19. In December 2022 (Question 139.04), the SEC Staff confirmed that dissident stockholders must comply with both Rule 14a-19 and the company's advance notice bylaw requirements.
- **Review New Proxy Statement Disclosure and Proxy Card Format Requirements Application in All Elections.** The amended rules include requirements designed to help ensure that universal proxy cards clearly and fairly present information. As noted in our prior Alert, the adopted rules also included amendments to the form of proxy and proxy statement disclosure requirements relating to voting options and standards that would apply to all director elections, contested or not.
- **Review SEC Staff CD&Is.** In August 2022 and December 2022, the SEC issued additional guidance on Rule 14a-19 (available here) (Questions 139.01 to 139.06), including clarifications around (i) listing alternate nominees in Rule 14a-19 notices (Question 139.01), (ii) notice requirements related to multiple dissident stockholders (Question 139.02), (iii) the application of Rule 14a-19 vis-à-vis a company's advance notice by-laws (Questions 139.03 to 139.05), and (iv) solicitation obligations of dissident stockholders (Question 139.06).

Shareholder Engagement. In today's environment driven by stakeholder interest and scrutiny of corporate ESG programs and related disclosures, investor relations and, particularly, proactive engagement by companies with their various stakeholders on these and other topics of focus can serve to develop productive relationships with stakeholders and gain an understanding of areas where the company can make a meaningful impact.

What to Do Now:

- **Maintain Year-Round Engagement Program.** It remains essential for companies to engage with shareholders year-round to receive feedback on important matters such as executive compensation, board composition and governance, shareholder proposals, as well as strategy and performance more generally. Annually, the major institutional investors identify ESG issues as significant engagement priorities.
- **Brief Board on Investor Concerns and Priorities.** In connection with drafting the upcoming proxy statement, companies should consider investor feedback from the prior years' engagement efforts to improve and clarify

disclosure on key topics. Companies also should brief their boards of directors on investor concerns and engagement priorities.

- **Be Prepared for ESG Activism.** ESG activist campaigns did not see as much success in 2022 in comparison to Engine No. 1's successful proxy contest at ExxonMobil in 2021, among others. However, the 2022 campaigns did bring attention to the issues to which proxy contests were tied. For example, the use of gestation crates for pregnant pigs by pork suppliers that was at the center of Carl Icahn's campaigns did not gain him any board seats, but generated many headlines about the treatment of pigs. We expect ESG activism to continue as investors continue to focus on specific ESG issues that they believe are important to the growth of their investments and to promote operational and governance changes that they believe will advance these issues.
- **Consider Impact of "Pass Through" Voting on Engagement.** In late 2021, Blackrock unveiled a new pass-through voting program to give certain institutional investors the option to vote the shares that they hold through the Blackrock index funds. Blackrock has expanded the program to cover institutional investor clients representing 47% of its index equity assets, and eventually aims to expand the program to all investors, including individual investors. As the pass-through voting concept begins to gain steam, proxy advisors such as ISS and Glass Lewis may become even more influential, particularly because Blackrock's pass-through voting program allows investors to align its votes with an off-the-shelf policy from a proxy advisory firm. Solicitations could also become more challenging and costly, as companies may have to engage both with Blackrock directly and with Blackrock's individual investors. Finally, pass-through voting is likely to be piloted or adopted by other large institutional investors. In November 2022, Vanguard unveiled a pass-through voting trial program for the 2023 proxy season that will pilot a number of proxy voting policy options for individual investors to choose from in several Vanguard-managed equity index funds. Other institutional investors such as State Street are likely also to replicate this model in the near future.

Rule 14a-8 Shareholder Proposals. The number of Rule 14a-8 shareholder proposals submitted for inclusion in company proxy statements has been increasing year over year. The largest category of submissions in 2022 (and we expect for 2023) are social/political proposals on topics such as political contributions, civil rights/racial equity audits, pay equity, DEI (diversity, equity and inclusion), reproductive rights, and other human capital proposals such as mandatory arbitration of employee claims, harassment issues, paid sick leave, employee safety, food supply chain and animal rights. Governance proposals, while declining in number overall, reflect the greatest levels of support. Over the last two years, the most prevalent governance proposals have been to adopt or lower the threshold for a shareholder special meeting right, to adopt shareholder action by written consent, and to adopt an independent board chair. Environmental proposals, such as those relating to climate targets, transitions plans, packaging and plastics, and general reporting, are growing in number but are also becoming so granular and prescriptive that some institutional investors, such as BlackRock, have stated that they expect to support proportionately few climate-related proposals.

Additionally, as we discuss in our prior Alert, in July 2022, the SEC proposed amendments to Rule 14a-8, which would revise three of the potential bases for a company's exclusion of a Rule 14a-8 shareholder proposal – "substantial implementation," "duplication" and "resubmissions." The proposal is intended to "improve the shareholder proposal process and promote consistency." However, without additional clarifications, the proposed amendments could create confusion and pose a greater challenge for companies seeking to exclude shareholder proposals under these rule exclusions. Since these rule changes have not yet been adopted, they will not impact the no-action process for 2023 for calendar-year end companies.

What to Do Now:

- **Strategically Evaluate Alternatives; Consider SEC Staff Guidance.** As companies consider shareholder proposals for their upcoming 2023 annual meetings, companies should evaluate available alternatives, taking into consideration their stockholder profile, support for prior proposals, as well as optics and investor relations issues. In evaluating whether to include a proposal in the proxy statement or seek to exclude it either through the SEC no-action letter process or negotiation with the proponent, companies should consider that it has become

more difficult to obtain favorable no-action letter relief under certain circumstances. The SEC staff's recent position enumerated in Staff Legal Bulletin 14L significantly narrowed its interpretation of the scope and applicability of two exceptions frequently relied upon by companies to exclude proposals – Rule 14a-8(i)(5) (the "economic relevance" exception) and Rule 14a-8(i)(7) (the "ordinary business" exception).

- **Consider Disclosing the Proponent.** While not required by the SEC rules, Glass Lewis' new voting policy for 2023 will recommend against the governance committee chair when a company does not clearly disclose the identity of a shareholder proponent (or lead proponent when there are multiple filers) in their proxy statement.

Other Annual Meeting Considerations

It is important to consider the agenda and expectations for the annual meeting concurrently with the preparation of the proxy statement. In addition to director elections, say-on-pay, auditor ratification and shareholder proposals, this year many companies will need to include an advisory vote on say-on-pay frequency.

What to Do Now:

- **Say-on-Pay Frequency.** SEC Rule 14a-21(b) first required public companies to conduct an advisory vote on the frequency of the say-on-pay vote at the first annual or other meeting of shareholders on or after January 21, 2011, with subsequent frequency votes to take place no more than every six years thereafter. Companies that held their last frequency vote in 2017 will need to include such vote on the agenda for the upcoming 2023 annual meeting, requesting that shareholders vote on whether the say-on-pay vote should take place every one, two or three years. Following the meeting, companies also must disclose in an Item 5.07 Form 8-K (or in an amendment within 150 calendar days after the meeting) the frequency with which the company determined to hold the say-on-pay vote (a decision that most likely should be made by the board of directors). Failure to timely disclose the frequency decision can result in the loss of Form S-3 eligibility.
- **Determine Annual Meeting Format and Year-Over-Year Improvements.** According to Broadridge, during the 2021 season, it hosted over 2,300 virtual shareholder meetings, with 98% of those being virtual-only. During the 2022 season, Broadridge data continued to show most companies conducting virtual-only meetings, suggesting that virtual-only meetings are here to stay given the conveniences and efficiencies they offer for companies and shareholders alike. Consider feedback on the prior years' annual meetings, including with respect to the format, the interface with the company for virtual formats and investors' ability to engage with the company. Consider prior years' experience and ways to improve the experience for the company and shareholders and improve on any technical difficulties experienced.
- **Review Prior Year's Say-on-Pay Results; Consider Plan Proposals.** According to Semler Brossy, say-on-pay approval in 2022 was the lowest in ten years at an average of 89.2% for the Russell 3000. Companies should review the prior year's say-on-pay result and feedback from investor engagement efforts to support this year's say-on-pay disclosure and executive compensation decision making. In addition, the CD&A requires companies to disclose whether and, if so, how the company has considered the results of the most recent say-on-pay vote and, if so, how that consideration has affected the company's executive compensation decisions and policies. ISS released updated FAQs on Compensation Policies in December 2022 covering updates and clarifications to compensation policies, equity compensation plans, and peer group methodology, which provide general guidance on how ISS will analyze those and other compensation issues.

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