Governance & Securities
Alert

Weil

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Heads Up for the 2024 Proxy Season: Key Corporate Governance, Disclosure and Engagement Topics

In this Alert we provide an overview of key corporate governance, disclosure and engagement issues that public companies should prepare to undertake as the 2024 proxy season approaches. The persistently challenging risk environment, whiplash of ESG and anti-ESG sentiments, numerous new disclosure requirements and global geopolitical instability have created significant burdens on public company boards of directors and management to oversee and implement effective enterprise risk management systems, internal controls over financial reporting and disclosure controls and procedures. At the same time, public companies are looking towards the future to implement technological advancements and address the demands of myriad constituencies. For a discussion of disclosure developments for annual reports see our *Disclosure Developments and 2023 Form 10-K Disclosure Locator* here and our recent alert specific to foreign private issuers *Foreign Private Issuers in the Spotlight: SEC and Other Recent and Proposed Rulemakings* here.

Key Topics for Consideration for the 2024 Proxy Season and Beyond

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- Cybersecurity
- ESG Disclosure and Greenwashing
- Climate Developments, Energy Transition and Climate-Related Disclosures
- Officer Exculpation

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1. HOT TOPICS IN BOARD RISK OVERSIGHT

Stakeholders expect companies to better anticipate, manage and communicate risks in today's highly complex, unpredictable and interconnected risk environment. As risk oversight expands for boards, it is increasingly important for boards to evaluate the risk oversight structure, including delegation of specific responsibilities to committees and risk monitoring mechanisms with briefings from management and experts at an appropriate frequency. Recent Delaware cases and SEC enforcement actions also underscore the board's mandate to exercise oversight over mission critical risks, including the implementation of a reasonable board-level system of monitoring such risks.

Artificial Intelligence (AI). The meteoric rise in generative artificial intelligence has dramatically altered the corporate landscape as companies increasingly invest in or incorporate artificial intelligence, including machine-learning technologies (together, referred to as "AI") into their businesses. These developments have led to greater scrutiny on disclosure relating to both the use of AI and the related operational, regulatory compliance, privacy, ethics, competition and safety risks, among others. As a result, boards of directors are evaluating how to best oversee the integration of AI into the risk management framework and find ways to engage more deeply on this quickly evolving topic. We expect to see more disclosure regarding AI and its related risks and oversight in the discussion of board risk oversight in companies' 2024 proxy statements. In our prior Alert here, we reviewed developments regarding AI disclosure in Forms 10-K and 10-Q and proxy statements.

Cybersecurity. Companies continue to grapple with the ubiquitous risks relating to cybersecurity breaches. In July 2023, the SEC adopted rules requiring disclosure of material cyber breaches under Item 1.05 of Form 8-K and specific disclosures about cyber risk management and governance in new Item 1C of Part I of Form 10-K, discussed in our prior Alerts available here and here. These new rules cast a spotlight on board oversight and process, especially for the disclosure required in Form 10-K (see *Disclosure Locator* here). In addition to these newly requires disclosures, we expect that companies will maintain their detailed proxy statement disclosures relating to board oversight of cybersecurity risk management. Also, while the SEC declined to require disclosure of director cyber expertise, we expect that companies will continue to highlight such experience in director bios and skills matrices in the proxy statement.

ESG and Greenwashing. Litigation and regulatory enforcement actions based on claims of misleading ESG disclosures ("greenwashing") continue to proliferate. Examples of recent greenwashing actions include allegations that statements such as "carbon neutral," "net zero," "recycled", "recyclable", "biodegradable", "ethical", "sustainable", "clean" or "organic" are misleading and deceptive, false advertising and fraudulent, constitute a nuisance and/or violate securities laws. Litigation includes actions by individuals, class actions and derivative suits, and may also include failure of oversight claims (e.g., at companies with widespread problems such as product safety failures or sexual harassment). Enforcement actions targeting "greenwashing" by companies and funds have been brought by the Department of Justice, state Attorneys General, the SEC's Division of Enforcement and the Federal Trade Commission and other regulators across the U.S. and internationally (see our prior Alert here and our most recent *Sustainability & ESG Quarterly Roundup* available here). Some companies have sought "safety in numbers" via alliances with other companies with similar goals (see article here). In establishing and overseeing an effective enterprise risk management framework over these topics, companies are forced to balance the demands of shareholders, newly required ESG-related disclosures and voluntary company disclosures of ESG initiatives and commitments with increased scrutiny from regulators and anti-ESG proponents. In response, some companies have engaged in "greenhushing" by deliberately under reporting or hiding their green or ESG credentials to attempt to evade such negative attention.

Climate Developments, Energy Transition and Climate-Related Disclosures. Boards are focused on adapting companies' long-term corporate strategy and related risk management to climate-related developments and energy transition, which is increasingly the focus of regulation in the U.S. and internationally. At the same time, companies face pressure from investors, suppliers, employees and communities to disclose information about the company's environmental impact, including greenhouse gas emissions, energy usage, recycling, waste and use of natural resources, and a path towards minimizing (or neutralizing) such impact. As companies await the adoption of the SEC's climate disclosure rules as discussed in our prior Alert here, some state legislatures and other regulators are implementing their own disclosure requirements regarding climate-related matters. As summarized in our most recent *Sustainability & ESG Quarterly Roundup* (available here), significant regulatory developments include the new Climate Corporate Data Accountability Act applicable to public and private companies with over $1 billion in revenue doing business in California (discussed in our Alert here), as well as the Corporate Sustainability Reporting Directive (CSRD) applicable to companies doing significant business in the European Union. Moreover, BlackRock, State Street, Vanguard and other institutional investors continue to advocate for climate-related disclosures that demonstrate that the board has policies for risk oversight and mitigation. See our Alert here for more information on the proxy voting policies of the Big 3 relating to climate (among other ESG topics), that were in effect for the 2023 proxy season.

Selected SEC Enforcement Actions: Compliance in the Spotlight

There have been several recent enforcement actions and legal proceedings relating to oversight and implementation of key compliance and disclosure policies, with the following key reminders:

- **Perquisites.** The SEC continues to focus on compensation perquisite disclosure. In addition to liability for companies who do not comply with SEC disclosure rules, officers and directors who do not carefully review and disclose information to the company about perquisites, including through D&O questionnaires, risk liability liability under federal proxy rules and books and records provisions. See *In the Matter Jeffery D. Ansell* (Stanley Black & Decker) (June 20, 2023).
- **Whistleblowers.** Separation and other agreements with employees that permit participation in government whistleblower programs but require participants to forgo financial incentives may violate whistleblower protection laws. See *In the Matter of J.P. Morgan Securities LLC* (Jan. 16, 2024); *In the Matter of Monolith Resources, LLC* (Sept. 8, 2023) and *In the Matter of Gaia, Inc. and Paul C. Tarell, Jr., CPA* (May 23, 2023). For a more fulsome discussion of related matters see our most recent *Sustainability & ESG Quarterly Roundup* (available here).
- **Non-GAAP Measures.** Companies must appropriately evaluate and oversee the disclosure of non-GAAP measures, including by implementing non-GAAP policies or disclosure controls and procedures specific to the use of non-GAAP measures. As indicated by the ISS 2023 policy survey question discussed in our Alert here, investors are also focused on the use of non-GAAP measures, particularly in incentive compensation metrics. See *In the Matter of DXC Technology Company* (March 14, 2023).
- **Related Party Transactions.** Companies must appropriately track transactions involving family members of directors and officers, including by establishing appropriate controls and processes for obtaining information through D&O questionnaires. See *SEC v. Guosheng Qi and Gridsum Holding, Inc. and Relief Defendant Huijie He* (S.D.N.Y. filed Sept. 7, 2023).

Officer Exculpation. Pursuant to the amendments to §102(b)(7) of the Delaware General Corporation Law (DGCL), since August 2022, Delaware corporations have been permitted to adopt charter provisions that allow officer exculpation, providing corporate officers with certain protections that had previously been available only to directors. In light of recent trends in stockholder litigation against officers, particularly the rise of claims that officers breached their duties of care by negligently preparing corporate disclosures, Delaware now permits this important but tailored shield for officers against direct claims brought by stockholders. Notably, unlike the protections available to directors, officer exculpation will only shield officers against direct claims brought by stockholders, but not against derivative claims brought by the board of directors. As discussed in our prior Alert here, hundreds of publicly traded Delaware corporations have asked shareholders to approve an amendment to their certificates of incorporation to adopt officer exculpation in 2023, and we expect many more to do so in 2024. Additionally, on January 17, 2024, the Delaware Supreme Court upheld the Chancery Court's decision in *In re Fox Corp./Snap Inc. Section 242 Litigation,* holding that a separate class vote is not required to adopt officer exculpation provisions at dual class companies. As a result, we expect that companies with Up-C or other dual class structures that had put adoption of officer exculpation on hold pending the outcome of the litigation, will also move forward with adoption of such provision.

What to Do Now:

- **Evaluate board risk oversight structure, including committee charters and company policies.** Consider from time-to-time whether the full board, a committee or subcommittee should be charged with oversight of a particular area of risk for the company. For example, full board oversight of AI may be appropriate at some companies, while others may give the responsibility to a separate technology committee or form a subcommittee of one of its key committees. Once determined, confirm that board guidelines and committee charters clearly define risk oversight responsibilities, roles and management structure. Consider committee composition and skills, and whether one committee, often the audit committee, is overburdened.
- **Evaluate the adequacy of internal controls and procedures and related disclosure controls.** Review and consider company processes for assessing, identifying and managing material risks, including from cybersecurity threats, development and use of AI and threats associated with third-party service providers. Confirm that the company has effective management-level reporting structures to facilitate effective board oversight. For AI, such structures could include the periodic reporting AI risk assessments, establishment of procedures to respond to material AI-related incidents, and regular briefings of key AI incidents to the board. Review company compliance policies to confirm that they are consistent with applicable law in light of recent SEC enforcement actions and other legal and regulatory developments.
- **Consider disclosure controls.** Establish a process to support the new disclosure requirements. Specifically, in light of the new disclosure rules, establish controls to evaluate whether cyber events, including as a result of any previous cybersecurity incidents, have materially affected or are reasonably likely to materially affect the company, including its business strategy, results of operations, or financial condition, and if so, how.
- **Consider new and enhanced disclosure.** We expect to see more disclosure regarding AI and its related risks and oversight in the discussion of board risk oversight in the annual proxy statement. We also expect enhanced proxy statement disclosure of board oversight of cyber risk as well as oversight of AI and other ESG risks such as safety.
- **Execute on the company's ESG strategy and review commitments to ensure they are still accurate and not misleading.** Despite the controversy around the politicized umbrella term "ESG," companies must continue to focus on E, S and G topics that can contribute to sustainable corporate performance over the long-term when setting corporate strategy, providing risk oversight and communicating publicly with investors and regulators. Companies should ensure that they provide accurate representations and appropriate context and detail for company sustainability efforts rather than making free-standing or unadorned claims. Where appropriate, include disclaimers noting that initiatives and standards are not guarantees that all goals will be met and all policies followed. On an ongoing basis, review achievability of forward-looking commitments in light of company performance and changes to assumptions and measurement techniques.

- **Avoid Silos.** Given the range of E, S and G topics, most companies take a multidisciplinary approach to ESG. Many boards have reviewed and clarified the oversight of ESG risk at the board level in corporate governance guidelines and committee charters. Companies and their boards should establish appropriate controls to support the implementation of a comprehensive, cross-functional ESG strategy. Controls should include processes and procedures relating to ESG disclosures to confirm accuracy of commitments and their consistency with the company's strategy and help manage challenges that may arise.
- **Consider whether to amend certificate of incorporation to adopt officer exculpation; preliminary proxy required.** In light of the success of the proposals during 2023 and the Delaware Supreme Court's recent ruling, we expect more companies to propose an amendment to their certificate of incorporation to provide for officer exculpation at their upcoming 2024 annual meeting for shareholder approval. As part of this process, it is prudent to have a preliminary discussion of an amendment and the rationale for its adoption with the governance committee and, if appropriate, the board, before formally presenting it to the board. Also consider including initial feedback from stockholder engagements after previewing the proposal. If the charter requires a supermajority vote to amend, also consider engaging a proxy solicitor. Further, a charter amendment will require a preliminary proxy statement filing at least 10 days prior to filing the definitive proxy statement.
- **Consider fiduciary duties and protections "refresh" for directors and officers.** The current risk environment provides an appropriate opportunity to provide a refresher to the board of directors and officers relating to director and officer fiduciary duties and protections available to them under the law, including the availability and limits of exculpation.

2. BOARD COMPOSITION

Expectations for directors continue to expand and board accountability for company performance and risk oversight continues to challenge directors. As a result, board composition is under greater scrutiny than ever before as investors pressure test whether companies have the appropriate composition, skills, leadership and diversity to oversee the company's business and strategy while navigating the myriad issues facing the company.

Board Qualifications and Skills. Investors are clamoring for boards to be comprised of individuals who have the skills and experience to effectively navigate cyber security threats, natural disasters and other crises, growth of generative AI, regulatory instability, geopolitical uncertainty, energy transition and drive strategy. Investors are scrutinizing directors' background to confirm whether they have the right skills to effectively oversee these challenges. Over the last several years, the "Big 3" institutional investors, BlackRock, State Street and Vanguard have adopted board diversity policies, in some cases holding directors accountable with negative recommendations in director elections for failing to adhere to their policies, as discussed in our prior Alert here.

Director Interlocks. The Federal Trade Commission ("FTC") and Department of Justice ("DOJ") have heightened their focus on impermissible director interlocks resulting from simultaneous service as an officer or director of competing companies, leading to the first enforcement action under Section 8 of the Clayton Act in nearly 40 years. As discussed in a Weil Alert here, on August 16, 2023, the FTC announced an agreement with EQT and Quantum, requiring Quantum to surrender any rights to an EQT board seat and prohibiting Quantum representatives from serving on the board of seven other natural gas producers without the FTC's approval. As of September 2023, the DOJ's interlocks initiative led to 15 interlocking director resignations from 11 boards. The heightened enforcement of the Clayton Act demonstrates a growing antitrust scrutiny for the years to come.

Director Commitments. Given the enormous responsibility of public company directors today, "overboarded" or overcommitted directors should expect criticism. To address director overboarding, the vast majority of S&P 500 boards have policies limiting public company directorships guided by institutional investor and proxy advisory firm policies. Beginning in 2024, State Street will vote against the chair of the nominating/governance committee of S&P 500 companies that fail to disclose an internal policy on director time commitments replacing the strict quotas that State Street previously favored. Vanguard is maintaining its own limits and also calling on companies to adopt a formal overboarding policy and to disclose the board's oversight of the implementation of that policy.

What to Do Now:

- **Evaluate board composition and assess vulnerabilities; consider refreshment.** Boards should continuously evaluate the leadership structure, competencies, independence, diversity, tenure and effectiveness of the board as a whole, and of committees and individual directors, to determine whether the board's composition aligns with the company's strategic objectives and important risks facing the company. As we discuss below, given the success of activists using universal proxy cards to obtain at least one seat, companies should work to enhance director profiles, where appropriate, through refreshment, training and improving the presentation of director background information to minimize vulnerabilities of individual directors.
- **Review and update director bios.** Companies should take the time to thoughtfully review director background information and how the information is presented in their proxy statements. Identify important skills that each director possesses and elaborate on how the director acquired each skill and why it is important for the company. Although the SEC declined to require disclosure of director cyber expertise, investors are expecting boards to have cyber expertise, and we expect companies to highlight such experience in director bios and skills matrices.
- **Differentiate skills and qualifications among directors.** While many public company directors possess the full range of qualifications and skills identified by companies, rather than demonstrating that all directors have all of the skills, consider prominently highlighting the most distinctive skills at which the director is most proficient.
- **Review director time commitment and overboarding policy; disclose reasons for overcommitted directors.** The board should assess whether directors that may be overcommitted have sufficient time and ability to take on the significant tasks relating to public company directorship. Companies should review their overboarding policies against key institutional investor policies and publicly disclose whether such policies exist. Board refreshment can include replacing retiring directors due to mandatory retirement or term limits, adding new skills to the board composition, and applying the results from board/director evaluations. For directors that may be overboarded or overcommitted, clear disclosure addressing the contributions of, and rationale for retaining, a particular director may serve to mitigate criticism and the potential impact on director elections.
- **Add interlocks to onboarding checklist and D&O questionnaire.** Amid FTC and DOJ enforcement scrutiny of interlocks, companies should carefully review the overlaps between directors and executive officers with potentially competing businesses, and add to their onboarding checklist a review of interlocks.

3. EXECUTIVE COMPENSATION AND HUMAN CAPITAL MATTERS

Clawbacks: Listing Rules and Beyond. As we discussed in our Alert here, as of December 1, 2023, all companies listed on the New York Stock Exchange (the "NYSE") or the Nasdaq Stock Market ("Nasdaq") must have adopted a policy providing for the recovery (or clawback) of incentive-based compensation received by current or former executive officers where such compensation is based on the erroneously reported financial information, in the event of a required accounting restatement. Investors and proxy advisory firms are also encouraging companies to adopt broader policies to address clawbacks of incentive compensation arising from misconduct, among other things. BlackRock's U.S. proxy voting guidelines favor clawback policies that allow a company to recover compensation from executives whose behavior caused material reputational risk or a criminal investigation, whether or not there was a restatement. Glass Lewis's newly adopted policy applicable to 2024 annual meetings provides that companies should also adopt discretionary policies permitting the clawback incentive payments (whether time-based or performance-based) when there is evidence of problematic decisions or actions, such as material misconduct or a material reputational, risk management or operational failure, the consequences of which have not already been reflected in incentive payments. Further, in the event that the company does not exercise discretion to recover compensation following relevant events, Glass Lewis expects the company to provide a thorough, detailed discussion of the its decision, how the company has otherwise rectified the disconnect between executive pay outcomes and negative impacts of executives' actions on the company. The absence of such enhanced disclosure may impact Glass Lewis' assessment of the company's disclosure and its say-on-pay vote recommendation.

What to Do Now:

- **Consider a supplemental, discretionary policy.** Consider shareholder feedback on whether to adopt a discretionary policy tying clawbacks to misconduct, violations of company policy and other material failures and events. Companies considering these broader discretionary policies should be sure to consult with their accountants to identify any possible issues.
- **Ensure coordination among board committees; assemble team to be ready to claw back.** In the event of a restatement, the coordination between the audit committee, which is likely charged with evaluating whether a restatement of financial statements is necessary, and the compensation committee, which likely oversees the clawback policy, will be imperative. Companies should review their committee charters to determine whether responsibilities with respect to their clawback policy should be addressed. Further, companies should consider the necessary process framework for the recovery of compensation, have a team ready to be assembled and apply the policy in the event it becomes necessary. In determining the appropriate framework, companies will need to consider the conflict-of-interest that may exist with management.
- **Consider variables for the application and enforcement of clawback policy.** There are still a number of variables under consideration as companies determine how to implement and enforce their clawback policy, such as whether to require signed consents or acknowledgments of the policy and how to ensure consistency among award agreements and employment agreements, among other things.

Year 2 of Pay versus Performance (PVP): CDIs, SEC Comment Letters. During the 2023 proxy season, new Item 402(v) of Regulation S-K required most public companies (other than EGCs, FPIs and registered investment companies) to disclose for the first time in proxy and information statements containing executive compensation disclosure, specified executive compensation and financial performance measures, illustrating the relationship between "compensation actually paid" (CAP) and the financial performance of the company. In light of a number of implementation issues, the SEC Staff has issued three sets of Compliance and Disclosure Interpretations (CDIs) – or 34 CDIs in total (including revisions to two prior CDIs), available here. Among other things, the CDIs include the following important clarifications:

- **Equity Award Retirement Features.** For equity awards that provide for accelerated vesting upon retirement: (i) where retirement eligibility is the sole vesting condition, the condition will be deemed to be satisfied for purposes of the CAP calculation in the year the holder becomes retirement eligible; (ii) if the vesting provision includes a "double trigger" (i.e., participant is retirement eligible and must actually retire or meet another condition (including market conditions related to share price) to receive or exercise the award) such award is not considered vested for purposes of PVP and calculation of CAP until the contractual vesting date or retirement if earlier.
- **Dividends.** Dividends and dividend equivalents paid that are not otherwise reflected in the fair value of equity awards or included in another component of Summary Compensation Table total compensation must be included in the calculation of CAP.
- **CAP Footnotes.** Starting with a company's second year of PVP, footnote disclosure of the amounts deducted and added to arrive at CAP is only required for the current year's PVP CAP calculations unless such footnote disclosure for previous years included in the PVP table would be material to an investor's understanding of the PVP table for the current year or relationship disclosure provided under Item 402(v)(5).
- **Peer Groups.** In a reversal of prior guidance, the SEC Staff advises that companies may use for PVP a peer group that is disclosed in their CD&A as being used to help determine executive pay, even if such peer group is not used for "benchmarking." In addition, for companies using a peer group other than a published industry or line-of-business index, if the peer group changed from the prior year solely due to (i) removal of a company because it is no longer in the line of business or industry or (ii) the application of pre-established objective criteria, there is no need to compare the company's TSR to the TSR of both the old and new groups (though a specific description of and the bases for the change must be disclosed, including any names of companies deleted).

- **Loss of EGC and SRC Status.** Companies are required to provide PVP disclosure in any proxy or information statement in which Item 402(v) disclosure is required that is filed after having lost EGC status. Companies that have lost Smaller Reporting Company (SRC) status as of January 1, 2024 that plan to incorporate executive compensation disclosure from the proxy or information statement into the 2023 fiscal year end Form 10-K pursuant to General Instruction G(3) may provide scaled PVP disclosure for an additional year (i.e., PVP must cover fiscal years 2021, 2022, and 2023).

The SEC Staff also provided a number of comments on company disclosures to help provide further guidance on PVP disclosure, which focused primarily on:

- **Missing requirements.** Such as the description of the relationships between CAP and the various financial performance metrics, or the list of 3-7 most important financial performance measures used to link CAP with company performance.
- **Rule interpretation errors.** Such as not identifying the NEOs included in the table for every year presented, only including partial compensation, and incorrect equity award valuation calculations.
- **Identifying multiple company-selected measures (CSM).** Additional measures may be provided, but they should not be designated as a CSM.
- **Reconciliations.** Reconciliation of adjustments to CAP totals are required to show each disaggregated numerical amount added and deducted to arrive at CAP.
- **Peer group.** The TSR peer group must be either the industry group used for the annual report performance graph pursuant to Regulation S-K Item 201 or a compensation peer group disclosed in the CD&A as a peer group actually used to help determine executive pay.
- **Non-GAAP.** Describe how a non-GAAP measure is calculated from the company's audited financial statements (though disclosure of non-GAAP measures in PVP is not subject to Regulation G and Item 10(e) of Regulation S-K).

What to Do Now:

- **Coordinate and draft early.** Though likely less onerous than last year, Year 2 PVP calculations will still require considerable time, effort and coordination across various internal departments, as well as the involvement of external advisors such as valuation experts and compensation consultants.
- **Year 2 requires an additional year of disclosure.** Pursuant to the two-year phase-in period, for companies that have already been required to provide PVP disclosure, Year 2 will require 4 years of PVP disclosure rather than the 3 years provided last year and the full 5 years will be required in Year 3.
- **Review SEC comment letters, CDIs and peer disclosure.** Companies should review SEC comment letters and the CDIs to assess whether their PVP disclosure could be adjusted to better meet SEC requirements. Companies should also compare their PVP disclosures and metrics with those of their peers to assess whether their disclosures are in-line with peers, which may also shape investor expectations for PVP among the peer group. Companies may also want to consider whether the peer group used for purposes for this disclosure should be updated.

Human Capital Management. Focus on oversight of human capital management (HCM) issues – such as health and safety, diversity/inclusion, labor, pay equity, recruitment, retention, sexual harassment, training, and engagement – continues to be critical as companies focus on the development of an effective future workforce. Although many companies disclose details with respect to human capital topics in the Form 10-K in response to Item 101(c) of Regulation S-K, given that investors view human capital management as an important engagement topic, many companies also highlight human capital priorities in the proxy statement. Additionally, rules expected to require more detailed HCM disclosures remain on the SEC's Rulemaking Agenda for 2024, as we discuss in our Alert here.

Against the backdrop of the Supreme Court's 2023 decision in *Students for Fair Admissions v. Harvard*, which held that race-based affirmative action programs in college admissions processes violate the Equal Protection Clause of the Fourteenth Amendment, company DEI programs are also facing increased scrutiny from advocacy groups, stockholders, employees and regulators. Companies are concerned that their DEI initiatives may face litigation. For example, on July 13, 2023, attorneys general from thirteen states sent a joint letter available here to the largest companies in the U.S. warning them that race-based preferences may violate federal and state discrimination laws and urging companies to "immediately cease any unlawful race-based quotes or preferences" (see our Sustainability and ESG Quarterly Round-up here). Plaintiffs have filed new discrimination lawsuits under Section 1981 and Title VII, challenging individual employment decisions and DEI initiatives with respect to suppliers and partners.

What to Do Now:

- **Evaluate HCM disclosure.** Companies should consider taking an inventory of internally and externally disclosed human-capital metrics, statements and reports, while paying close attention to any general short, medium and long-term targets or goals they set for human capital-related efforts to ensure that they are on track. Companies should also make sure that any human-capital related disclosures are consistent and supportable with quantifiable data.
- **Review company DEI policies, commitments and disclosures.** Companies should review their DEI policies, commitments and public statements and consider how their policies advance the mission of the organization and whether the policies are closely tailored to the needs of the company and comply with the law.
- **Be mindful of upcoming rulemaking.** We expect further HCM disclosure rulemaking from the SEC in the spring, which will likely be more prescriptive as suggested by the Investor Advisory Committee here.

4. SHAREHOLDER ENGAGEMENT TOPICS

It remains essential for companies to engage with shareholders year-round to receive feedback on executive compensation, board composition and governance, shareholder proposals, as well as strategy and performance. In today's environment of active stakeholders that want to share their views, engagement programs give companies early-warning into emerging issues and provide opportunities to demonstrate responsiveness to shareholder concerns.

Universal proxy cards and advance notice bylaws. Company bylaws are fundamental to shareholder engagement and also dictate if and how shareholders can nominate directors to the board of directors. As discussed in our prior Alert here, 2023 was the first proxy season where, in a contested election of directors, the company and the shareholder activist could use a "universal" proxy card (i.e., a proxy card that includes the names of both parties' nominees), pursuant to SEC Rule 14a-19. Although the universal proxy card gives activists easier access to a company's proxy card, it did not appear to have opened the flood gates for proxy contests, although it seems to have helped activists' ability to win at least one board seat, based on proxy fight results during 2023.

As discussed in our prior Alert here, the Delaware Court of Chancery ruling in *Jorgl v. AIM ImmunoTech Inc.* that a company can reject a universal proxy notice under SEC Rule 14a-19 when it does not comply with the requirements and deadlines of the company's advance notice bylaws. The ruling was consistent with the view of the SEC Staff in three CDIs issued in December 2022. In December 2023, when faced with another activist campaign, in *Kellner v. AIM ImmunoTech Inc., et al.*, the Court of Chancery again upheld the company's rejection of the dissident's nomination notice for failing to comply with the company's advance notice bylaws. In applying the *enhanced scrutiny* standard of review to the particular advance notice bylaws at issue, the Court of Chancery evaluated whether the provisions were disproportionate to any threatened corporate objectives and, ultimately, upheld certain provisions while rejecting others as overly broad. More specifically, the Court upheld the requirement to disclose the dates of first contact among those individuals or entities involved in the nomination effort and for the dissident's director nominees to complete a D&O questionnaire and struck down several extensive disclosure requirements, including required disclosures about arrangements and understandings among, and ownership of company securities by, a broad group of "stockholder associated persons" and others "acting in concert" or previous nominations in the last 10 years.

What to Do Now

- **Consider updating bylaws to specifically address SEC universal proxy rules.** To the extent not yet updated, companies should review and consider making reasonable amendments to their bylaws in order to best position the company to respond to activists that seek to take advantage of the SEC universal proxy regime.
- **Review advance notice bylaw provisions.** In light of the Court of Chancery's opinion, companies should review their advance notice bylaws to ensure that the terms are unambiguous and narrowly tailored to avoid enhanced judicial scrutiny. A board's actions in rejecting a dissident's nominations – even when the dissident has failed to comply with an advance notice bylaw may be subjected to enhanced judicial scrutiny evaluating whether the bylaw requirements served a legitimate corporate purpose and whether the board's actions in rejecting the nominations were reasonable.

Shareholder Proposal Expectations for 2024. During the 2023 proxy season, the five most popular shareholder proposal topics related to ESG topics – namely (1) climate change, (2) independent chair, (3) nondiscrimination and diversity-related, (4) shareholder approval of certain severance agreements and (5) special meetings. There were also many proposals in 2023 relating to "anti-ESG" topics such as discriminatory DEI programs, corporate political involvement and fiduciary duty concerns relating to climate and ESG. Despite the increase in number of proposals submitted and voted on in 2023, overall support for proposals was meaningfully down due to the prescriptive character of most anti-ESG proposals. We expect the focus on these issues and the level of shareholder support to continue in the 2024 proxy season, with a renewed focus on DEI topics (specifically, proposals relating to racial equity and civil rights audits) from both ESG and anti-ESG proponents. Additionally, given the presidential election year, companies should be prepared for more politically motivated proposals on hot-button social and environmental topics.

Thus far in the 2024 proxy season, two unique proposals have been introduced. The first is a proposal requesting companies to adopt a bylaw that requires directors to submit in advance a springing resignation that would become effective if the director fails to receive the required majority shareholder support in an uncontested election and requires the board to accept the resignation unless there is a "compelling reason" not to do so. The proposal also provides that the bylaw will require the automatic resignation of any holdover director who remained on the board for a compelling reason after such director does not receive the required majority shareholder support at the subsequent annual meeting. We understand that this proposal was distributed broadly and that certain recipients have sought no-action relief to exclude the proposal on the grounds that it would require the company to violate Delaware law by limiting the decision-making authority of the company's board of directors in contravention of its fiduciary duties, effectively allowing shareholders to remove a director without the required vote. Such basis also requires the company to include as an exhibit an opinion of Delaware counsel to the letter. To date, the SEC has not yet published its views on any of these requests. The second is an AI proposal calling for the preparation of a transparency report explaining the company's use of AI in its business operations, the board's role in overseeing its usage, and any ethical guidelines the company adopted regarding its use of AI. To date, the SEC has declined no-action relief to exclude such proposals on "ordinary business" and "micromanagement" grounds. With these early successes, we should expect to see proponents ramping up efforts on this matter in 2024.

In a recent development, ExxonMobil decided to skip a no action letter and instead go right to court in response to a proposal from Arjuna Capital and Follow This requesting that the company accelerate the pace of greenhouse gas emissions reductions. Given that the SEC had previously declined to provide no action relief to other companies that received this proposal. ExxonMobil filed a complaint with the U.S. District Court for the Northern District of Texas seeking a declaratory judgment that it could exclude the proposal on the basis of Rule 14a-8(i)(7) as the matter relates to the company's ordinary business operations and Rule 14a-8(i)(12) because the proposal did not satisfy the resubmission threshold (similar proposals only received 27.1% support in 2022 and 10.5% support from ExxonMobil shareholders in 2023). ExxonMobil also requested an expedited review in light of the company's planned March 20, 2024 proxy statement filing date.

What to Do Now:

- **New SEC portal for submitting no-action requests.** In November 2023, the SEC launched a new online portal for submission of no action requests (available here). The portal includes a web form that requires a submitting party to provide the following information: (1) whether the request is an initial request or supplemental correspondence; (2) the identity of the submitting party (i.e. "company" or "proponent"); (3) the submitting party's contact information, and if submitted by a company, the option to provide the proponent's contact information; (4) the company's anticipated proxy print date; (5) the text of the proposal's "resolved clause"; and (6) the Rule 14a-8 bases for exclusion asserted, using a checkbox interface.
- **No action relief remains difficult.** The SEC Staff has made it progressively difficult to exclude shareholder proposals at a time when proponents have become increasingly agenda-driven, which has led to ExxonMobil seeking judicial intervention. We await what impact the ExxonMobil case has on SEC no action relief and whether it discourages proponents. Companies should also consider re-evaluating their approach to shareholder engagement to address shareholder proposals to avoid a protracted conflict with proponents or the SEC Staff.
- **Review investor policies.** Companies should be familiar with the relevant voting policies of their top investors and should advise the board of expected outcomes for shareholder proposals as well as any concerns, particularly as they pertain to governance and compensation matters and other areas of strategic or other importance to the company or directors. We expect that institutional investor voting policies for 2024 will place a heavy emphasis on strong climate-related disclosure for 2024 in light of new climate-related disclosure regulations from California and the European Union. These regulations will start to impose recordkeeping and disclosure-related obligations on certain companies beginning on January 1, 2024. We also expect weight to be given to director commitments, oversight of company DEI efforts and clawback policies (as discussed above).

Impact of Changing Voting Dynamics. In the 2023 proxy season, retail stockholders owned 31.5% of shares and institutional investors owned 68.5% of shares, yet retail stockholders voted only 29.6% of the shares they own, while institutional investors voted 82% of the shares they own. The lack of retail stockholder votes has been well noticed for years, and for at least a decade many have lamented their poor participation in the proxy voting process. Recently, Fintech startups have introduced services available to retail stockholders to make casting votes easier, such as the Iconik service, which allows a stockholder to create a custom voting profile based on their values and authorizes Iconik to vote automatically on behalf of them. Other institutional complexes such as Vanguard, BlackRock, and State Street have been rolling out forms of pass-through voting to their institutional and retail customers. These new developments do raise issues for companies when attempting to predict the outcome of proxy ballot items and complicates their engagement and solicitation efforts.

What to Do Now:

- **Regularly review shareholder base.** A regular review of the company's shareholder base with a proxy solicitor or other providers of "market intelligence" will help the company to understand and monitor shareholder sentiment and anticipate voting behaviors for the next annual meeting.
- **Encourage voting through investor communication strategies.** Companies should consider and evaluate communication strategies designed to target and influence potential voters and investors. In particular, companies may need to be focused on retail stockholders and on the new pass-through voting initiatives by certain asset managers.

Engagement through Proxy Statements. When preparing a proxy statement, companies must keep in mind the diverse audience of stockholders, proxy advisors, institutional investors, individual shareholders, board members, company executives, employees, labor unions, analysts, journalists, activists and many others. These groups utilize the disclosures in proxy statements in a variety of ways, including to help with voting decisions, to review for compliance, and to use as educational materials. While many actually read the statements, others are using AI tools, which can read the statement within seconds, rate it, recommend certain aspects, and even summarize the statement. AI can also prepare a "fight" letter or vote automatically.

What to Do Now:

- **Take notice of how AI will process proxy statements.** At an increasing pace, AI is expected to become more sophisticated and its use more prevalent by these constituencies. While AI may not be able to process SEC filings in their entirety as discussed here, aspects of the disclosures particularly in proxy statements will undoubtedly be subject to AI analysis. Companies should take notice of this development for the proxy statement and all other company disclosures.
- **ISS and Glass Lewis policy updates.** As discussed in our recent Alert here, ISS and Glass Lewis have each released the updates to their policies applicable for annual meetings in 2024, available here and here. ISS's policy changes are minimal for 2024 and are not expected to have an impact on director elections in 2024. Glass Lewis implemented some significant changes to policies relating to ESG, cybersecurity oversight, clawback policies (as more fully described above) and other corporate governance matters that could impact annual meeting voting.
- **Review director vulnerabilities to ISS and Glass Lewis policies.** Understand ISS and Glass Lewis views on the company's governance profile and the impact director elections. Review ISS and Glass Lewis policies affecting director elections, summarized here and here.

5. PROXY SEASON NUTS & BOLTS: DISCLOSURE REMINDERS

Housekeeping considerations in light of rule changes. During the last year, there have been a number of regulatory and legislative developments from the SEC, the NYSE and Nasdaq applicable to public companies that impact disclosure, corporate governance and the adoption of controls and procedures. Although these new rules primarily require disclosure in Forms 10-K and 10-Q (as summarized in our prior Alert here), the rules also impact elements of disclosure in the proxy statement and the annual meeting preparation process.

What to Do Now:

- **Update D&O questionnaires.** Consider updates to address skills, certifications, experience and diversity, particularly as it relates to hot-button topics such as AI, cyber, human capital and climate, as well as disclosures confirming adoption and termination of Rule 10b5-1 plans for purposes of required disclosures under Item 408(a) of Regulation S-K.
- **Confirm director consents.** Ensure that consents from directors for their re-election to the board and inclusion in the company's proxy materials, which are usually included in D&O questionnaires, are sufficiently broad to include universal proxy cards used in a shareholder's solicitation.
- **Reconsider executive officer / Section 16 officer list.** Given the application of the required clawback policies to directors and Section 16 officers, companies may want to take the opportunity confirm that the officers that are currently identified as Section 16 officers should continue to be subject to such requirements and, thus, potential incentive compensation recovery in the event of a restatement.

- **Be mindful of required disclosures for 2025.** Several of the new requirements will not apply until the Form 10-K and/or proxy statement filed in 2025, including the requirement to file insider trading policies and disclose stock option grants close in time to the release of material nonpublic information. Companies should use this delayed rule application to further review and refine their policies.

Changes to shareholder approval standards to facilitate certain transactions. Recent changes to §242 of the DGCL aimed to simplify the process by which Delaware corporations may take certain corporate actions and, at least in part, to make it easier for Delaware public companies to implement forward stock splits, reverse stock splits and other increases or decreases in the number of authorized shares, unless otherwise required by their certificate of incorporation. For example, public companies with one outstanding class of stock that is not divided into series do not need shareholder approval to amend their certificate of incorporation to implement a forward stock split. Additionally, public companies that will meet or maintain exchange listing requirements regarding the minimum number of shareholders need the approval of only a majority of votes cast – rather than the majority of the outstanding shares – to implement a reverse stock split or other increases or decreases in the number of authorized shares.

The NYSE also recently made changes to one of its shareholder approval rules. NYSE Rule 312.03(b) was amended to narrow the shareholder approval requirement for sales in excess of 1% of a listed company's outstanding common stock or voting power outstanding before issuance. Under the amended rule, shareholder approval is no longer required for substantial security holders (i.e., holders of 5% or more) to acquire stock in excess of 1%. Shareholder approval is still required if a control party (i.e., directors and officers and controlling shareholders or members of a control group or any other substantial security holder of the company that has an affiliated person who is an officer or director of the company) acquires more than 1% of the outstanding common stock or voting power before issuance. This change allows listed companies that routinely require additional capital in the ordinary course of business or for strategic investments to look more easily to their existing shareholders who may be more inclined to invest and are not otherwise affiliated with the company (i.e., do not have directors on the board).

What to Do Now:

- **Review voting standards in organizational documents.** The new DGCL amendments provide that statutory shareholder approval thresholds govern unless otherwise required under a company's certificate of incorporation. Companies should review the voting standards in their organizational documents and expressly opt out of the new DGCL §242 requirements, if desired.
- **Review disclosures of voting standards; shareholder approval requirements.** Always review and confirm accuracy of voting standards included in proxy materials to ensure consistency with the company's organizational documents and applicable state law and stock exchange requirements. A close review could avoid disclosure claims from shareholder plaintiffs, SEC comments or potential SEC enforcement. Similarly, be mindful of compliance with applicable NYSE and Nasdaq shareholder approval rules to ensure that shareholders appropriately approve company actions.

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