Vinson&Elkins

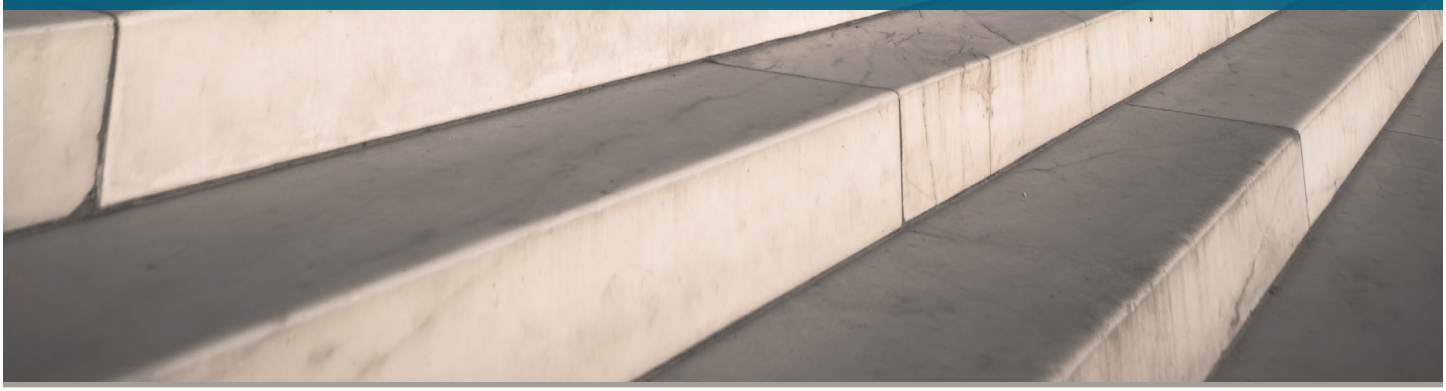
TEN HOT TOPICS & A NEW V&E TASKFORCE:

DEVELOPMENTS IN GOVERNANCE AND DISCLOSURE

SPRING 2019

GOVERNANCE UPDATE

Introducing the V&E ESG Taskforce



1 EARLY RESULTS FROM PROXY SEASON 2019

The number of reported shareholder proposals for 2019 meetings trended down again, with approximately 728 shareholder proposals reported for 2019 meetings, compared to approximately 797 shareholder proposals reported for 2018 meetings and approximately 858 shareholder proposals reported for 2017 meetings. Early takeaways for the top types of proposals being submitted this year include:

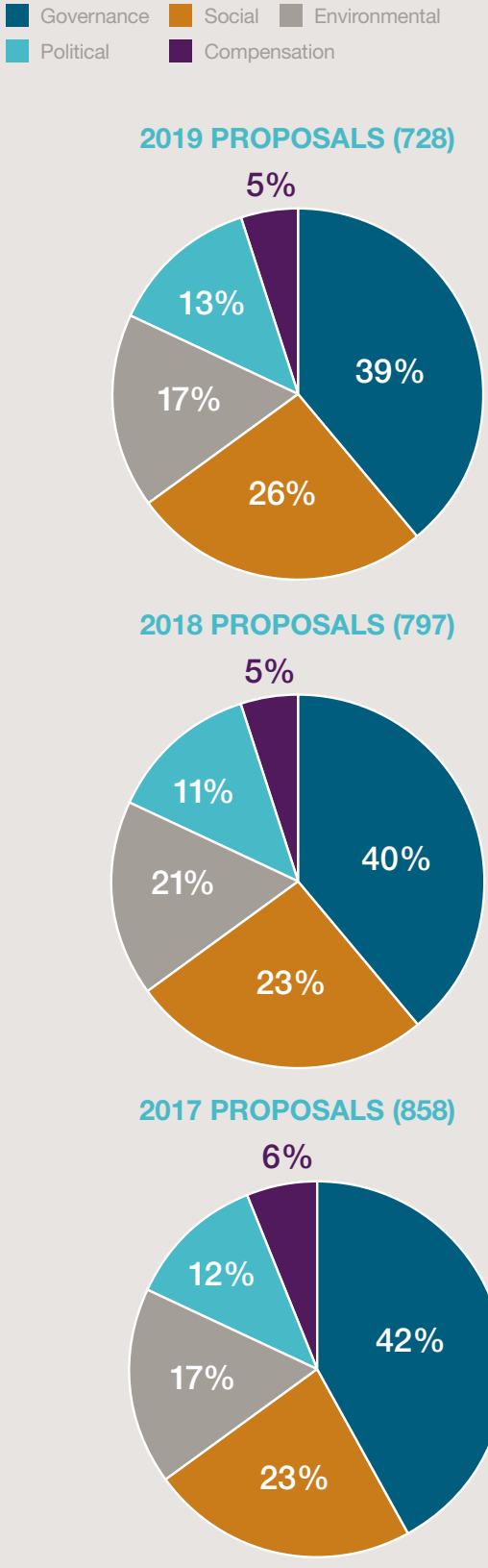
- The number of board diversity proposals jumped significantly, despite the decrease in the aggregate number of proposals submitted overall;
- Certain traditional governance proposals remained well represented, including proposals requesting that companies appoint an independent chair, provide investors with the right to act by written consent, or reduce supermajority vote requirements;
- Proposals requesting reports on climate change, GHG emissions and sustainability continued to gain traction, despite an overall decline in the total number of these proposals submitted; and
- The number of proposals regarding political contributions and lobbying payments and policies increased slightly, despite the decrease in the aggregate number of proposals submitted overall.

TOP 2019 SHAREHOLDER PROPOSALS

V&E internal compilation based on ISS data.

Proposals	Increased/Decreased	2019	2018
Independent chair	Increased	60	53
Board diversity	Increased	45	29
Provide right to call special meeting/reduce special meeting threshold	Decreased	32	74
Provide right to act by written consent	Same	42	42
Reduce supermajority vote/adopt simple majority vote	Increased	41	24
Adopt human rights policy/report on human rights issues in the supply chain	Increased	39	20
Report on climate change/GHG emissions	Decreased	51	75
Report on sustainability/energy goals	Decreased	42	61
Report on political contributions	Increased	59	37
Report on lobbying payments and policy	Decreased	38	47

2017–2019 SHAREHOLDER PROPOSALS



V&E internal compilation based on ISS data.

It is early days for annual meeting voting results as many companies have yet to hold their meetings, but a few early meeting results are worth mentioning:

- A proposal requesting a report on the company's governance measures implemented to "more effectively monitor and manage financial and reputational risks related to the opioid crisis" passed with 59.1% support at Walgreens. While the board opposed the proposal, the proponent filed a **proxy memorandum** arguing for the proposal following the company's filing of the proxy statement.
- A proposal requesting a report on reducing the company's environmental impact by increasing sustainable packaging initiatives received significant support (44.5%) at Starbucks. The proponent filed a **proxy memorandum** arguing for the proposal following the company's filing of the proxy statement, which included the board's opposition to the proposal.
- A proposal requesting the preparation of a report regarding employment diversity and diversity policies and programs received significant support (48.0%) at Analog Devices, despite the board's opposition of the proposal.

The Securities and Exchange Commission ("SEC") has caught up in responding to Rule 14a-8 no-action request letters following the shutdown, and only a few submitted no-action request letters for 2019 meetings remain unanswered as of the date of this governance update. To date, a few no-action request letter responses are notable:

Concurrences:

- The SEC staff concurred with exclusion on the basis of Rule 14a-8(i)(7)[1] of a proposal that requests that the Exxon board, in annual reporting from 2020, include disclosure of greenhouse gas targets aligned

[1] There are two bases on which a company may argue a proposal is excludable under Rule 14a-8(i)(7). The first is that "[c]ertain tasks are so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight." The second consideration relates to "the degree to which the proposal seeks to 'micro-manage' the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment." Exchange Act Release No. 40018 (May 21, 1998).

with the Paris Climate Agreement because, in the SEC staff's view, the proposal "would require the Company to adopt targets aligned with the goals established by the Paris Climate Agreement. By imposing this requirement, the [p]roposal would micromanage the [c]ompany by seeking to impose specific methods for implementing complex policies in place of the ongoing judgments of management as overseen by its board of directors." The SEC staff took a similar position with proposals submitted to Devon Energy and Wells Fargo.

- The SEC staff concurred with the exclusion of a proposal that requests that J.B. Hunt Transport Services adopt company-wide, quantitative targets for reducing greenhouse gas emissions and issue a report discussing its plan and progress towards achieving these targets under Rule 14a-8(i)(7) because, in the SEC staff's view, the proposal seeks to micromanage the company.
- The SEC staff concurred with the exclusion of a proposal on the basis of Rule 14a-8(i)(7) that requests that JPMorgan Chase institute transparent procedures to avoid holding or recommending investments in companies that, in management's judgment, substantially contribute to genocide or crimes against humanity because, in the SEC staff's view, the proposal seeks to micromanage the company.

Rejections:

- In contrast to the climate change proposals for Exxon, Devon Energy and Wells Fargo described above, the SEC staff could not concur with a Rule 14a-8(i)(7) exclusion of the proposal requesting that Anadarko Petroleum issue a report describing if and "how it plans to reduce its total contribution to climate change and align its operations and investments with the Paris Agreement's goal of maintaining global temperatures well below 2 degrees Celsius." In the SEC staff's view, the proposal "transcends ordinary business matters and does not seek to micromanage the [c]ompany to such a degree that exclusion of the Proposal would be appropriate."
- Proposals requesting that the company report on the extent to which risks related to public concern over drug pricing strategies are integrated into the company's incentive compensation policies were submitted to AbbVie, Bristol-Myers Squibb, Johnson & Johnson, and Pfizer. The SEC was unable to concur with the companies' views that these proposals could be excludable under Rule 14a-8(i)(7) because, in the SEC staff's view, these proposals "seek disclosure on the extent to which certain risks are integrated into senior executive compensation decisions."
- The SEC staff would not concur that a proposal requesting that Apple disclose a description of the specific minimum qualifications that the nominating committee believes must be met by a nominee to be on the board of directors and each nominee's skills, ideological perspectives and experience presented in a chart or matrix form was excludable under Rule 14a-8(i)(3) (false and misleading), (i)(7) (pertaining to the company's ordinary business matters) or (i)(10) (substantially implemented through company policy).
- The SEC staff would not concur that a proposal requesting that Amazon prohibit sales of facial recognition technology to government agencies (with limited exceptions) was excludable under Rule 14a-8(i)(5) (insignificant to the company's business), (i)(7) (pertaining to the company's ordinary business matters) or (i)(11) (duplicative of another shareholder proposal).
- The SEC staff would not concur that a proposal requesting that CBS strengthen the company's prevention of workplace sexual harassment in several enumerated ways was excludable under Rule 14a-8(i)(7) (pertaining to the company's ordinary business matters).

- The SEC staff would not concur that a proposal requesting that Coca-Cola publish a report on sugar and public health, with support from a group of independent and nationally recognized scientists and scholars providing critical feedback on the company's sugar products marketed to consumers, especially those Coke products targeted to children and young consumers, was excludable under Rule 14a-8(i)(3) (false and misleading), (i)(7) (seeking to micromanage the company) or (i)(10) (substantially implemented through company policy).
- The SEC staff would not concur that a proposal requesting that Verizon publish a report assessing the feasibility of integrating cyber security and data privacy performance measures into the company's executive compensation program was excludable under Rule 14a-8(i)(7) (pertaining to the company's ordinary business matters).

SNAPSHOT: EMERGING AREAS OF INVESTOR INTEREST

While shareholder proponents have submitted proposals pertaining to environmental and social matters for decades, only in the last few years have we begun to see highly specialized proposals pertaining to environmental and social policies.

- ***Cyber and data security:*** The number of proposals requesting reports on cyber/data risk/security or cyber expertise on the board is slowly increasing. While currently these proposals are aimed at companies in technology and related spaces or companies that have experienced a breach, we expect investor interest in this area to expand and the number of proposals to increase.
- ***Drug prices/availability:*** Increasingly, shareholder proponents are targeting specific industries, and this is an example. Similar to the concentration of climate change proposals in the energy space, we expect these types of proposals to grow in popularity and relevancy across companies in the pharmaceutical industry and related spaces.
- ***Public health:*** Public health proposals have quietly emerged over the past decade, but are coming into their own. From proposals regarding obesity and pesticides in food, to proposals regarding safe water sources and the impact of added sugar, these proposals contain elements of both environmental and social proposals and are highly specific to the company, and for that reason, can go untracked. We expect the number of these proposals to increase.
- ***Sexual harassment:*** Consistent with areas of social change, we are beginning to see proposals that specifically ask for information on companies' sexual harassment policies — there were five for 2019 annual meetings, but none for 2018, 2017 or 2016 meetings.
- ***Climate change:*** While climate change seems to make every list on emerging areas of investor interest, this year, the nuances were important. The SEC staff's approach to climate change proposals is become more subtle, and at the same time, climate change proposals generally are gaining legitimacy with investors. It appears that the SEC staff will treat proposals requesting targets aligned with the Paris Agreement as proposals that seek to micromanage the company by imposing "specific methods for implementing complex policies" under Rule 14a-8(i)(7), but will not take the same approach when a proposal only asks whether a company plans to adopt targets aligned with the Paris Agreement's goal of maintaining average global temperature increases below 2 degrees Celsius.

2 RECENT SEC REGULATORY DEVELOPMENTS

On February 19, 2019, the SEC **voted to propose** an expansion of the "test-the-waters" accommodation, which exempts from the gun-jumping provisions of Section 5 of the Securities Act certain written or oral offers prior to the filing of a registration statement. Under **the proposed rule**, all prospective issuers (in addition to the currently permitted emerging growth companies) would be allowed to gauge market interest in a possible initial public offering or other proposed registered security offering by engaging in discussions with certain investors prior to filing a registration statement. Specifically, authorized persons acting on behalf of the issuer, including underwriters, would be allowed to have oral or written communications with potential investors that are, or that the issuer reasonably believes are, "qualified institutional buyers" or "institutional accredited investors," to determine whether such investors might have an interest in the contemplated offering. Comments on the proposed rule are due by April 29, 2019.

In a **March 15, 2019 speech**, William Hinman, Director of the SEC's Division of Corporation Finance, discussed the application of the SEC's principles-based disclosure requirements to topics involving complex, uncertain and evolving risks, including Brexit and sustainability. Here are our three key takeaways from Director Hinman's comments:

1. ***Remember to make your risk disclosure meaningful by considering your company's specific risk assessment process.*** Whether you are discussing Brexit, sustainability, or other emerging areas of risk, risk disclosure should explain to investors the specific impact of potential events, and should not be limited to boilerplate language (i.e., "cyber risks could have a material impact on our financial performance."). How your company's management assesses and analyzes risks and the potential impacts on the company's operations, what the company is doing to manage and/or mitigate those risks, and how the board exercises oversight of these processes are all relevant when drafting your risk-related disclosures.

2. ***The SEC staff likely sees the plethora of ESG frameworks, guidelines and ratings as a good thing, so ongoing ESG education is important.*** In his speech, Director Hinman indicated that, in his view, had the SEC "leapt into action and issued prescriptive sustainability disclosure requirements when people first began calling for them, I believe we would have stymied that evolution and stifled efforts to develop useful disclosure frameworks." Therefore, it is possible the SEC will continue to wait on developing additional guidance on disclosures regarding environmental and social matters, making a firm understanding of the existing third-party frameworks, guidelines and ratings more important.

3. ***Climate change may be the new cyber when it comes to board oversight.*** The SEC recently provided **additional guidance** on how companies should discuss their boards' role with respect to oversight of cyber matters, but the SEC has yet to provide the same level of detailed guidance with respect to climate change. The SEC's **2010 guidance on climate change** focused on how existing disclosure requirements under Items 101 (description of business), 103 (legal proceedings), 303 (management's discussion and analysis), and 503(c) (risk factors) of Regulation S-K may

apply, without mentioning board oversight. However, Director Hinman's speech draws a parallel between board oversight of cyber-related matters and board oversight of climate change-related matters, stating "[t]o the extent a matter presents a material risk to a company's business, the company's disclosure should discuss the nature of the board's role in overseeing the management of that risk. The Commission last noted this in the context of cybersecurity… [but p]arallels may be drawn to other areas where companies face emerging or uncertain risks… such as those related to sustainability or other matters."

3 SEC RULES TO MODERNIZE AND SIMPLIFY DISCLOSURE (FAST Act)

On March 20, 2019, the SEC **adopted amendments** to modernize and simplify disclosure requirements in Regulation S-K and related rules and forms. As discussed in our **Winter 2017 Governance Update**, the rules were originally proposed in October 2017 in connection with the SEC staff's recommendations in the **Report to Congress on Modernization and Simplification of Regulation S-K** as part of the SEC's **Disclosure Effectiveness Initiative** and related **Concept Release**. The majority of the final amendments become effective on May 2, 2019, with a few exceptions discussed below.

Noteworthy improvements in the new rules include:

- ***Providing companies with flexibility with respect to historical reporting periods for Management's Discussion and Analysis*** (Item 303). Specifically, when the financial statements included in a filing cover three years, the new rules allow companies to eliminate MD&A disclosure about the earliest year if that disclosure has already been included in any other prior EDGAR filing. The new rules also give companies the discretion to use an MD&A presentation format other than year-to-year comparisons if the format will enhance readers' understanding of the company's financial condition, and eliminate the reference to five-year selected financial data for discussing trends.
- ***Providing companies with greater flexibility with respect to exhibits, including*** (Item 601):
  - Allowing companies to omit schedules and similar attachments from exhibits unless they contain material information that is not otherwise disclosed in the exhibit or document. Instead, companies would provide a brief list identifying the contents of the omitted schedule or attachment, unless that information is already included within the exhibit in a manner that conveys the subject matter of the omitted schedules and attachments.
  - Limiting the two-year lookback for filing material contracts to newly reporting companies.
  - Expressly permitting companies to omit personally identifiable information from exhibits without submitting a formal confidential treatment request.

  - Permitting companies to omit confidential information from exhibits without submitting a formal confidential treatment request, if the information is not material and would likely cause competitive harm to the company if publicly disclosed. On April 1, 2019, the SEC provided **additional guidance** on this amendment, and on April 2, 2019, the amendment became effective. On April 16, 2019, the SEC released a **streamlined procedure** for addressing confidential treatment extensions, to which the new rules do not apply.

- ***Limiting the requirement to provide a description of property*** (Item 102). The new rules clarify that, for companies other than those in the mining, real estate and oil and gas industries, a description of physical properties is only required to the extent those properties are material to the company, and may be provided on a collective basis.

- ***Updating the incorporation by reference rules*** (Item 10(d), Rule 411, Rule 12b-23, Rule 0-4). The new rules remove the five-year limit for incorporating by reference documents on file with the SEC, require hyperlinks to information that is incorporated by reference if available on EDGAR, and prohibit cross-references and incorporation by reference in the financial statement of information outside the financial statements unless otherwise specifically permitted or required by SEC rules, U.S. GAAP or IASB reporting standards.

Other updates in the new rules include:

- Making formatting changes to the requirement to provide risk factor disclosure in registration statements and periodic reports, and eliminating the enumerated list of specific types of risk factors (Item 503(c) and new Item 105). The new rules encourage companies to provide risk disclosure that is "more precisely calibrated to their particular circumstances and therefore more meaningful to investors."

- Clarifying that disclosure about executive officers need not be repeated in a proxy statement if it is already included in Form 10-K (Item 401).

- Clarifying that companies may rely only on Section 16 reports filed on EDGAR in determining the compliance of reporting persons with Section 16(a) of the Exchange Act, and eliminating the requirement for reporting persons to furnish their Section 16 reports to the company (Item 405 and Rule 16a-3(e)).

- Standardizing the reference to the applicable requirements of the Public Company Accounting Oversight Board ("PCAOB") in the requirement that the audit committee discuss compliance with the PCAOB's standard regarding auditor communications with audit committees (Item 407).

- Clarifying that emerging growth companies are not required to provide a compensation committee report (Item 407).

- Making a number of technical changes with respect to registration statement and prospectus provisions, including (1) eliminating the instruction that a company may need to change its name if it could cause confusion or is too similar to another well known company; (2) permitting companies to move the details of an offering price method or formula to the body of the prospectus, and include a cross-reference on the cover page; (3) requiring on the prospectus cover page disclosure of the U.S. market(s) other than national securities exchanges in which securities are being offered; (4) streamlining the prospectus legend requirements; (5) providing a definition of "sub-underwriter"; and (6) deleting certain redundant or obsolete references (Items 501(b), 508 and 512).

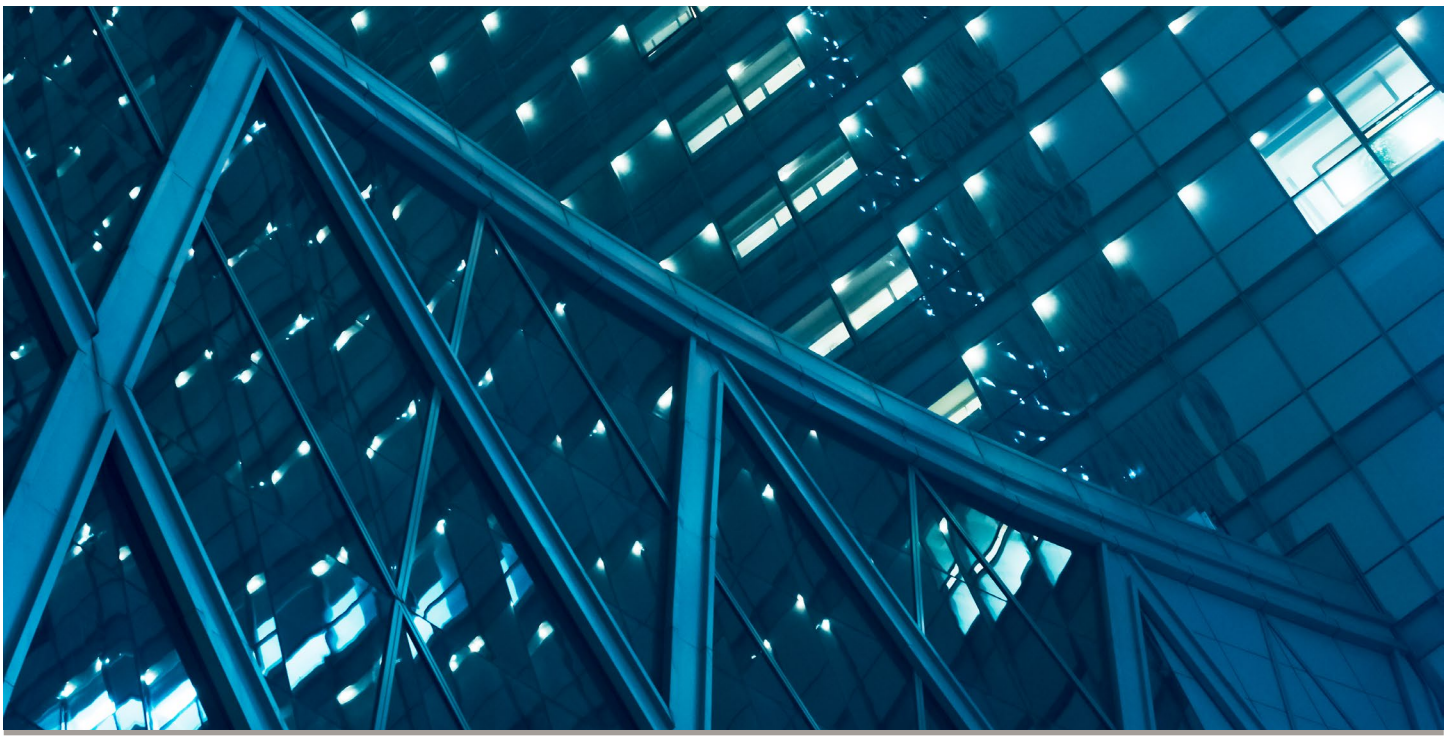
The new rules do include a few new requirements, which include:

- Requiring companies to provide a description of their securities as an exhibit to Form 10-K in addition to as an exhibit to their registration statements, which can be provided by hyperlinking to a previously filed exhibit if the information remains unchanged.
- Revising the heading for Item 405 disclosure from “Section 16(a) Beneficial Ownership Reporting Compliance” to “Delinquent Section 16(a) Reports” and encouraging companies to exclude the heading entirely if they have no delinquencies to report (Item 405).
- Revising the cover pages of Form 10-K, Form 10-Q and Form 8-K to require the trading symbol for each class of registered securities (similar changes are also made for Form 20-F and Form 40-F), and revising the cover pages of Form 10-Q and Form 8-K to require the title of each class of registered securities and each exchange on which the securities are registered.
- As discussed above, requiring that prospectus cover pages include U.S. market(s) other than national securities exchanges in which securities are being offered (Item 501(b)).
- Requiring companies to tag all the information on the cover pages of Form 10-K, Form 10-Q and Form 8-K using Inline XBRL. This requirement is phased in over three years beginning June 15, 2019.
- As mentioned above, requiring hyperlinks to information that is incorporated by reference if available on EDGAR. The new rules also expand certain existing hyperlink requirements to investment companies.

4 SEC DIVERSITY GUIDANCE

On February 6, 2019, the SEC issued two new identical compliance and disclosure interpretations ("C&DIs") addressing the disclosure of self-identified director diversity characteristics under Items 401 and 407 of Regulation S-K. In summary, the C&DIs remind companies that Item 401(e) of Regulation S-K requires "a brief discussion of the specific experience, qualifications, attributes, or skills that led to the conclusion that a person should serve as a director," and Item 407(c)(2)(vi) of Regulation S-K requires "a description of how a board implements any policies it follows with regard to the consideration of diversity in identifying director nominees."

However, the C&DIs also provide clarity regarding when the SEC would expect to see a discussion of the board's or board committee's consideration of "self-identified diversity characteristics," such as race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background. Specifically, the C&DIs provide that if, in assessing an individual for board membership, the board or nominating committee has considered self-identified diversity characteristics, and that individual has consented to the company's disclosure of those characteristics, the SEC would expect the company to identify such characteristics and how they were considered, together with any diversity policies followed. While the SEC's C&DIs are interesting and helpful in that they provide additional clarity on Item 401 disclosure and the degree to which the SEC is considering how existing disclosure requirements speak to board diversity, we do not expect the SEC's new guidance to significantly alter the disclosures that companies are providing overall.



5 THE SEC ON HUMAN CAPITAL MANAGEMENT

On March 28, 2019, the SEC's **Investor Advisory Committee recommended** that the SEC recognize the significance of human capital management ("HCM") and incorporate it in the SEC's Disclosure Effectiveness Review and approach to modernizing corporate reporting and disclosure. In their recommendation, the Committee references the **petition** submitted to the SEC in 2017 by the Human Capital Management Coalition, and states that "[a]s the U.S. transitions from being an economy based almost entirely on industrial production to one that is becoming increasingly based on technology and services, it becomes more and more relevant for our corporate disclosure system to evolve to include disclosure regarding intangible assets, such as intellectual property and human capital." The recommendation identifies the following as potential disclosure improvements:

- Item 101 of Regulation S-K could be revised to require disclosure of the numbers of full-time, part-time, and contingent workers, and discuss key performance indicators such as workforce stability, safety, training, diversity and satisfaction. This disclosure could also be augmented with a summary of material elements of material company policies and goals regarding career development, safety and health compliance, subcontracting and outsourcing, and data on the productivity, education, experience, and training of the workforce.
- Existing executive compensation disclosure could be augmented to include, for example, useful summaries of material information about broader workforce compensation and incentive structures, such as how performance, risk, compliance, and long-term sustainability are considered in setting pay and making promotion decisions more generally and through what organizational structures.

The recommendations also highlight the benefit of tabular or otherwise structured disclosure, and encourage the SEC to work with the Financial Accounting Standards Board to consider how HCM disclosures may interact with the accounting principles.

While it is unlikely the SEC will adopt rules on HCM soon, private investors are increasingly stating that HCM is a priority. In January the International Organization for Standardization ("ISO") published a standard that establishes guidelines on human capital, measurement, analysis and reporting. With the trend going toward HCM, companies should consider whether there are benefits to using such guidelines to measure recruitment success, turnover, productivity and even effectiveness of leadership. Working to find the benefits of such processes before they become mandatory reporting requirements in the future may greatly benefit multinationals and other organizations.

6 DIGITAL ASSETS GROW UP: THE SEC ISSUES A FRAMEWORK FOR BLOCKCHAIN

On April 3, 2019, the SEC's Strategic Hub for Innovation and Financial Technology ("FinHub") published **a framework** for analyzing whether a digital asset is in fact a security. At the same time, the Division of Corporation Finance issued **a response to a TurnKey Jet, Inc. no-action request letter** indicating that the Division will not recommend enforcement action to the Commission if the company offers and sells the digital asset described in that request without registering it. The framework is consistent with prior positions taken by the SEC in dealing with digital assets and initial coin offerings, but it provides detailed guidance on how each element of the *Howey* test is applied under the facts and circumstances of digital asset transactions.

SNAPSHOT: UNDERSTANDING BLOCKCHAIN

Blockchain technology, at its core, is a relatively simple idea, although the technological aspects are often complex. A blockchain is a system of shared digital information, usually taking the form of a ledger, where each participant in the system can access and update the ledger, and no single party controls the entire ledger. This model allows the accuracy of the ledger to be governed by consensus, instead of by a single copy of the ledger or a single user.

In this model, for a user to add a "block" to the "chain", he or she must be able to solve a puzzle, usually a computationally hard mathematical and cryptographic puzzle which takes, on average, over 590 quintillion attempts to solve.[2] This "mining" is designed to prevent forgery and to make the blockchain an immutable record. Current users are also required to check the work of prior users, which makes group-consensus required for each "block" stored in the blockchain.

Perhaps the most well-known example of a blockchain system is Bitcoin, created by Satoshi Nakamoto in 2008. Bitcoin implements all of the blockchain aspects described above in the context of logging financial transactions. Bitcoin is both a currency (or cryptocurrency) and a blockchain ledger of Bitcoin transactions. Every Bitcoin user has a copy of the Bitcoin ledger, which updates after the new block is generated, and every Bitcoin user effectively "checks the work" of the prior user.

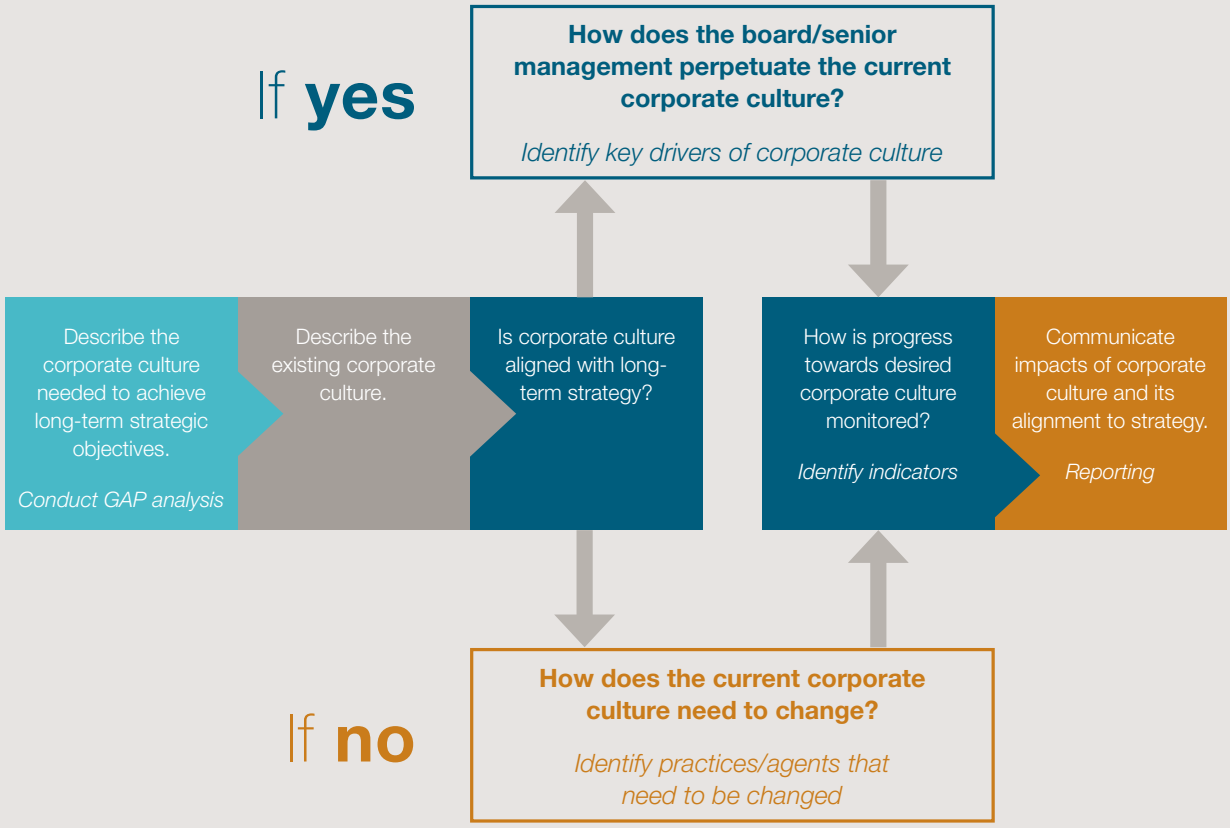
These puzzle and group-consensus aspects purportedly make blockchain systems highly secure, however, blockchain systems are not foolproof to all types of malicious attacks. In a business environment where integrity of information and security are highly-valued, it is no surprise that transactions are increasingly using blockchain-based authentication and record-keeping protocols.

[2] Nick Szabo, The Dawn of Trustworthy Computing, Unenumerated.com (Dec. 11, 2014), **http://unenumerated.blogspot.com/2014/12/the-dawn-of-trustworthy-computing.html**.

7 STATE STREET GLOBAL ADVISORS UPDATES VOTING GUIDELINES

Following its January 15, 2019 release of its **annual proxy letter**, on March 18, 2019, State Street Global Advisors ("SSGA") released its **2019 Proxy Voting and Engagement Guidelines** and new **Global Proxy Voting and Engagement Guidelines for Environmental Issues** ("ES Guidelines"). In its annual proxy letter to board members, SSGA emphasized that it is the "focus on long-term value" that drives its engagement with respect to environmental and social matters, such as diversity and sustainability, and not "a political or social agenda," and stated that this year, SSGA's focus will be corporate culture as "one of the many, growing intangible value drivers that affect a company's ability to execute its long-term strategy." The proxy letter outlines SSGA's framework for companies to address the importance and difficulty of aligning culture and strategy as replicated below.

FRAMEWORK FOR ALIGNING CULTURE AND STRATEGY



Source: State Street Global Advisors.

For 2019, SSGA has updated its Proxy Voting and Engagement Guidelines in two significant ways: (1) beginning in 2020, SSGA will vote against the entire nominating committee "if a company does not have at least one woman on its board and has not engaged in successful dialogue on SSGA Global Advisors' board gender diversity program for three consecutive years"; and (2) SSGA provides more detail on its approach to engaging companies on environmental and social issues. SSGA also directs companies to their new ES Guidelines.

SSGA's first ES Guidelines provide clarity on SSGA's approaches to (1) assessing the materiality and relevance of sustainability issues; (2) engaging companies on sustainability issues; and (3) voting on sustainability proposals. With respect to materiality and relevance, SSGA identifies the following as frameworks and resources it uses to inform its views:

- The Sustainability Accounting Standards Board ("SASB") Materiality Map
- The Task Force on Climate-related Financial Disclosures ("TCFD") Framework
- Disclosure expectations in a company's given regulatory environment
- Market expectations for the sector and industry
- Other existing third-party frameworks, such as the CDP (formally the Carbon Disclosure Project)
- R-Factor score (a proprietary SSGA metric that aligns with the SASB materiality map)

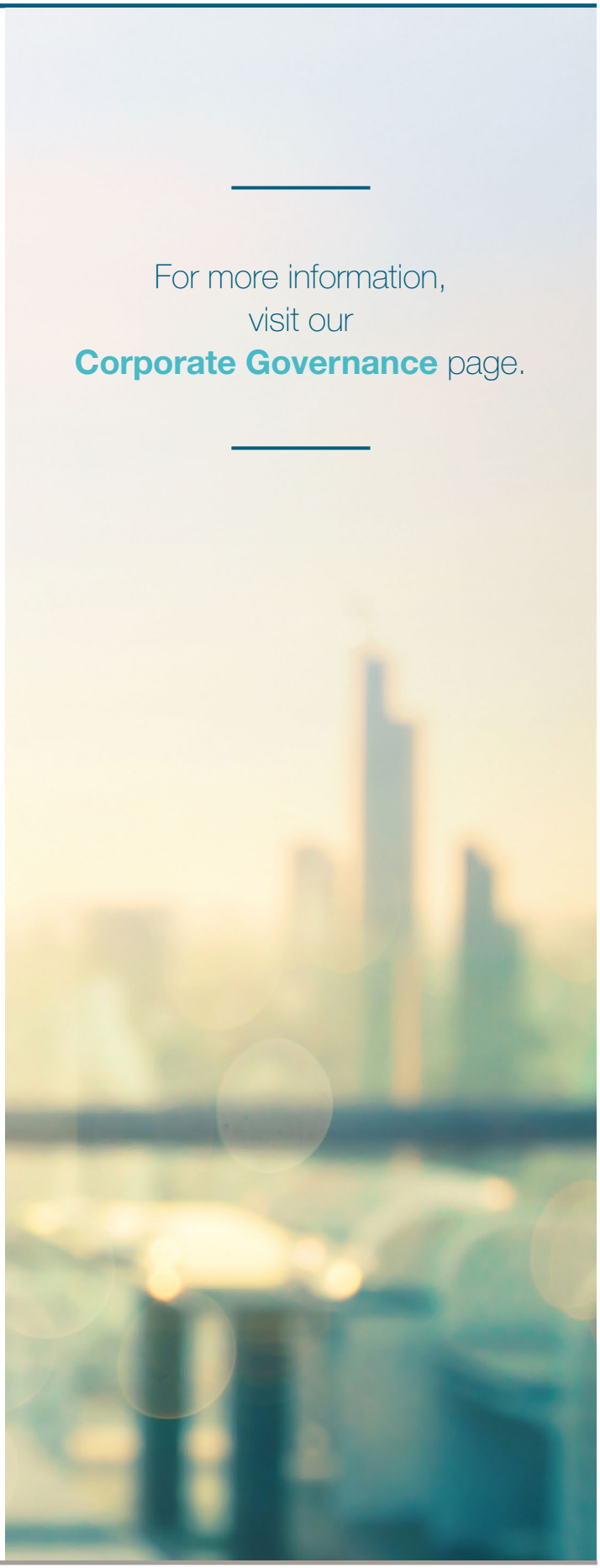
The ES Guidelines indicate that SSGA uses its proprietary R-Factor score to identify sector and industry outliers for engagement, and also identifies thematic sustainability priorities to address at most engagement meetings. SSGA affirms its case-by-case approach to voting on environmental and social proposals, and indicates that it will support environmental and social proposals if they address a material issue and the company has poor disclosure and/or practices relative to SSGA's expectations.

8 OTHER FEDERAL AND INTERNATIONAL E&S DEVELOPMENTS

- In January 2019, the CII Research Education Fund published **a white paper on board evaluation disclosure**, which includes examples of disclosures on board evaluations that CII considers effective and useful.
- On February 20, 2019, the UN Principles for Responsible Investment ("PRI") announced that for 2020 it will require its entire book of signatories — all 2,250 of them — to report on how they consider climate change risks in their portfolios. PRI is the largest international investor network focused on sustainability investing.
- On February 25, 2019, the **European Commission announced** that the European Parliament and EU member states had reached an agreement on two new categories of low-carbon benchmarks — a climate-transition benchmark and a specialized benchmark to bring investment portfolios in line with the Paris Agreement goal to limit the global temperature increase to 1.5° above pre-industrial levels. The rules were first proposed by the Commission in May 2018.
- The European Commission is proposing updates to its **nonbinding guidelines on non-financial disclosure obligations** seeking to integrate the concepts contained in the Non-Financial Disclosure Directive 2014/95 and the TCFD **recommendations**. The updated Guidelines reflect the recommendations in **the report** published by the European Commission's Technical Expert Group in January 2019. The comment period on the proposed updated Guidelines is open through March 20, 2019.
- On March 14, 2019, **Climate Action 100+** announced that **Shell had set out initial steps** for delivering commitments on climate change made jointly with Climate Action 100+. This follows BP's **announcement** on February 1, 2019 that it would support a shareholder resolution from Climate Action 100+, seeking disclosure of BP's strategy to align its business with the goals of the 2015 Paris Agreement as well as a similar **announcement** on February 19, 2019 by Glencore PLC, the British–Swiss multinational trading and mining company.
- In April 2019, the Bank of England Prudential Regulation Authority published a **policy statement** on enhancing banks' and insurers' approaches to managing the financial risks from climate change. Among other suggestions, the policy statement proposes that entities "fully embed the consideration of financial risks from climate change into their governance framework," stating that in particular, "the board and its… committees should have clear responsibilities for managing the financial risks from climate change, including individual responsibility(ies) for the relevant existing [senior management function] holder(s)."

- On April 10, 2019, the U.S. administration issued an **Executive Order on Promoting Energy Infrastructure and Economic Growth**, which included a section on ESG issues and proxy advisory firms. The section reiterates the definition of "material" as defined in the Supreme Court case *TSC Industries, Inc. v. Northway, Inc.*, and the principle that companies "owe a fiduciary duty to their shareholders to strive to maximize shareholder return, consistent with the long-term growth of a company." The Executive Order indicates that the Secretary of Labor will be reviewing data filed with the Department of Labor by retirement plans in order to identify whether there are any "discernable trends with respect to such plans' investments in the energy sector." This review could be used to enforce the **Department of Labor's April 23, 2018 Interpretive Bulletin**, which emphasized that "ERISA fiduciaries may not sacrifice investment returns or assume greater investment risks as a means of promoting collateral social policy goals." The Executive Order's comments about proxy advisory firms was limited to a statement that the Secretary of Labor will also conduct a review of "existing Department of Labor guidance on the fiduciary responsibilities for proxy voting to determine whether any such guidance should be rescinded, replaced, or modified to ensure consistency with current law and policies."
- On April 12, 2019, S&P Global Ratings ("S&P") announced the launch of "ESG Evaluation," a new benchmark designed to evaluate environmental, social and governance (ESG) factors. The new benchmark is separate from S&P's credit ratings and is an aggregate of two components: a quantitative data-driven assessment of a company's current ESG performance and a qualitative review of how a company is prepared to mitigate future ESG risks and take advantage of opportunities following discussions with the company's senior management and board of directors. S&P's launch of ESG Evaluation highlights the increased focus on incorporating ESG-related factors into the overall assessment of companies. In January of this year, Moody's released and updated its methodology to assess and incorporate ESG risks, and Fitch Ratings also launched a scoring system to show how ESG factors affect the agency's rating decisions.

For more information,
visit our
Corporate Governance page.



9 EXECUTIVES BEHAVING BADLY: APPLYING THE "MUSK PRINCIPLES"

On February 25, 2019, the **SEC filed a motion** for an order to show cause why Elon Musk, CEO of Tesla, Inc., should not be held in contempt for violating the October 2018 Final Judgment, which, among other things, required that Musk obtain pre-approval of any written communications that contain, or reasonably could contain, information material to Tesla or its shareholders. **The motion** related to two February 19 tweets by Musk stating that "Tesla made 0 cars in 2011, but will make around 500k in 2019," and "Meant to say annualized production rate at end of 2019 probably around 500k, i.e. 10k cars/week. Deliveries for year still estimated to be about 400k."

On February 13, 2019, the **SEC filed insider trading charges** against a former senior attorney at Apple whose duties included executing the company's insider trading compliance efforts. The SEC's complaint alleges that the attorney, who previously served as Apple's global head of corporate law and corporate secretary, received confidential information about Apple's quarterly earnings announcements and used this confidential information to trade in Apple securities ahead of three quarterly earnings announcements in 2015 and 2016 and made approximately $382,000 in combined profits and losses avoided.

The "Musk Principles": Our recommendations for dealing with executive-related risks:

1. ***Include public company compliance knowledge and demonstrated past compliance in criteria for new executives.*** Not all brilliant and creative entrepreneurs are equipped to be executives in public companies. In both the IPO scenario and in new executive recruitment, the level of understanding a candidate has of the compliance requirements for public company executives and a history of demonstrated compliance should be considered.

2. ***Conduct governance and compliance trainings for top executives.*** Companies frequently assume that executives who have served at public companies previously and are business savvy do not need training around basic governance and compliance matters. Making this assumption can be risky. An annual training on governance and compliance essentials, including social media considerations, is recommended.

3. ***Know your executives.*** As we mentioned in our **September 2018 NACD article "When CEOs Go Rogue**," understanding the degree to which key executives are prone to impulsive or unpredictable behavior, and the degree to which the company's reputation is particularly tied to the personalities of those executives, is imperative. Boards should be made aware if an executive has exhibited warning signs of unpredictable or noncompliant behavior in the past, and this knowledge should factor into their succession planning and crisis preparation.

4 ***Create thoughtful risk disclosure for key executives.*** As reflected in Tesla's risk disclosure regarding Musk, drafting risk factors around key personalities can be a sensitive business. Sophisticated governance counsel can help a company craft appropriate and thoughtful disclosure in this area. Below is Tesla's risk disclosure regarding Musk as contained in the company's most recently filed Form 10-K:

> ***We could be subject to liability, penalties and other restrictive sanctions and adverse consequences arising out of certain governmental investigations and proceedings.***[3]
>
> …Aside from the settlement with the SEC discussed below relating to Elon Musk's statement that he was considering taking Tesla private, to our knowledge no government agency in any ongoing investigation has concluded that any wrongdoing occurred… [O]n October 16, 2018, the U.S. District Court for the Southern District of New York entered a final judgment approving the terms of a settlement filed with the Court on September 29, 2018, in connection with the actions taken by the SEC relating to Mr. Musk's statement on August 7, 2018 that he was considering taking Tesla private. Pursuant to the settlement, we, among other things, paid a civil penalty of $20 million, appointed an independent director as the Chair of the Board, appointed two additional independent directors to the Board, and made further enhancements to our disclosure controls and other corporate governance-related matters. ***Although we intend to continue to comply with the terms and requirements of the settlement, if there is a lack of compliance, additional enforcement actions or other legal proceedings may be instituted against us.***

Note that this disclosure was included in Tesla's Form 10-K filed with the SEC early on February 19, 2019, just a matter of hours before Musk tweeted the first tweet mentioned above that resulted in the SEC's motion for an order to show cause. Talk about timely risk disclosure.

5 ***Check your checks and balances.*** Ultimately, it is the job of in-house counsel to first protect the company, and to a lesser extent the executives, which as interests diverge can be a difficult balance to strike. Establishing the procedures and policies for key personnel to have access to the independent directors of the board can be critical for companies with key executives who may be prone to impulsive or unpredictable behavior. A truly independent board-level review of these executives' performance and value to the corporation also is imperative.

[3] Tesla, Inc. Form 10-K for year ended December 31, 2018, available here.

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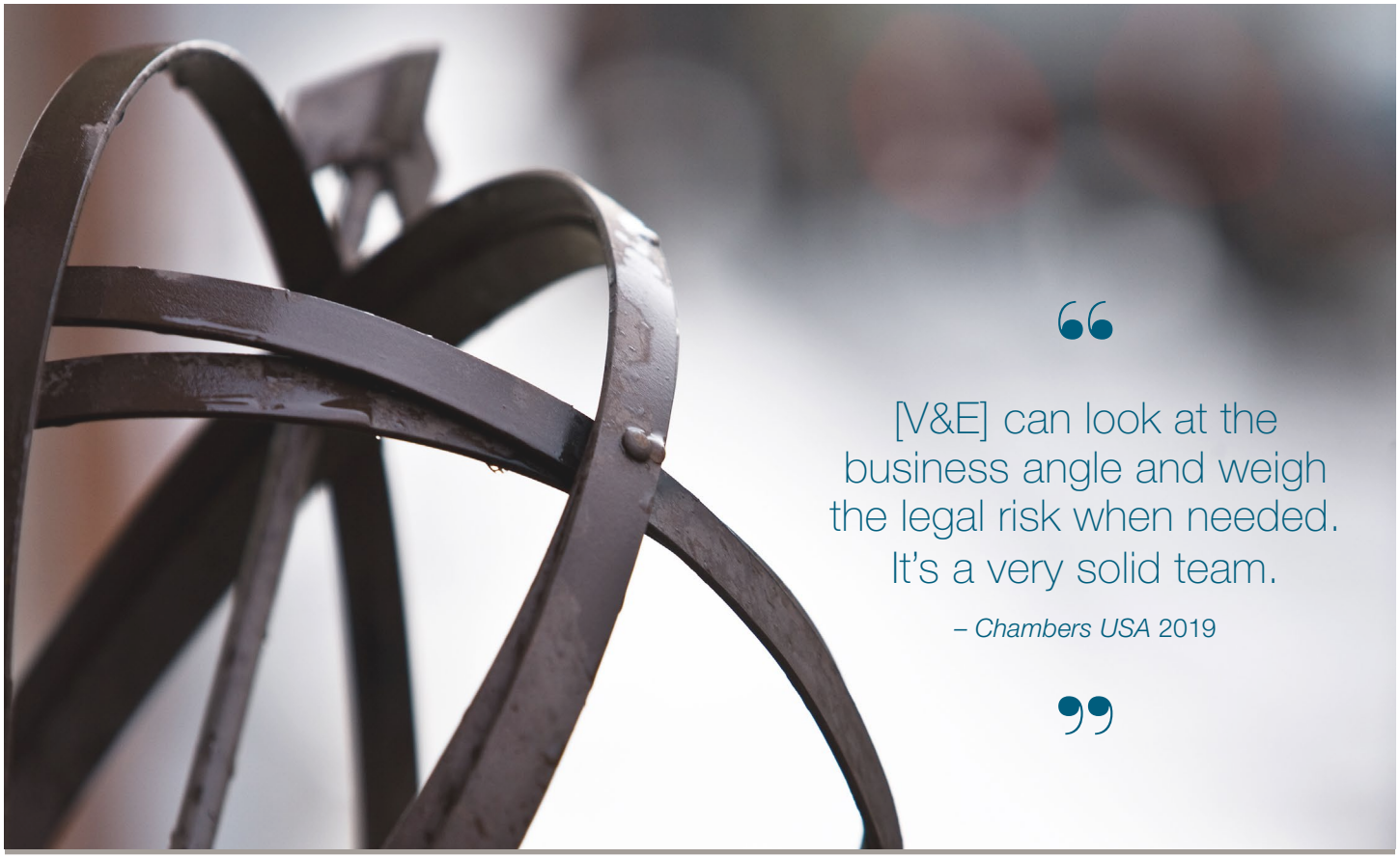
CRITICAL AUDIT MATTERS UPDATE

On March 18, 2019, the PCAOB issued staff guidance on **Implementation of Critical Audit Matters: A Deeper Dive on the Determination of CAMs**. As a reminder, the purpose of CAMs, or critical audit matters, is to provide audit-specific information that is meaningful to investors and other financial statement users about matters that require especially challenging, subjective, or complex auditor judgment. The guidance provides several staff FAQs on, among other things, how auditors should apply the "challenging, subjective, or complex" standard and the relationship between CAMs and critical accounting estimates, whether CAM determinations should be consistent across auditors and should be expected to vary from year to year, how risks, significant corporate events or matters or material weaknesses or significant deficiencies in internal controls should be considered when determining CAMs, and how decisions about audit strategy and disclosures outside the financial statements should be considered in determining CAMs. Currently, there still appears to be only one CAM in an SEC filing — it appears in the Form N-CSR filed by Church Capital Fund on December 10, 2018. Deloitte recently issued a white paper entitled **"What to expect from auditor reporting of critical audit matters"** which outlines the board's role with respect to CAMs and provides insight on the auditor process for identifying and reporting on CAMs."



INTRODUCING THE V&E ESG TASKFORCE

V&E's Environmental, Social, Governance ("ESG") team is dedicated to helping companies proactively understand and manage ESG risk factors within their supply chains. By equipping our clients with the right resources, we believe we can help organizations build long-term ESG strategies and an empowered message to investors and stakeholders. Covering a range of topics from sustainability, climate change, corporate social responsibility, human rights, cybersecurity, investor relations, and more, our ESG practitioners are committed to narrowing the scope of this area into practical, legal guidance for companies working to better understand ESG.

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> The firm has a strong, young team on environmental, social and governance (ESG) matters. They understand our business objectives and ESG challenges while also seeing where the investor community is headed on these issues.
>
> – *Chambers USA* 2019

TOM WILSON

Human Rights and Supply Chain Proficiency

- Tom is an accomplished labor and employment lawyer with over 30 years of experience counseling clients on the management of their employees, work places, supply chains and projects around the world.
- Tom is sought after by clients outside the United States for advice on their U.S. operations, and by U.S. clients for his direction on matters related to managing a global workforce. His representative reach spans Europe, Africa, South America, and Asia, including China.
- Tom advises employers regarding transfers and relocation of employees internationally, has worked on numerous transactions that involve complex, international workforces, and is a frequent speaker and author on related subjects, including ESG and international human rights.

DEVIKA KORNBACHER

Cybersecurity and Data Privacy Proficiency

- Devika leverages her background and extensive experience in engineering, information technology and intellectual property rights to provide comprehensive strategic advice to clients regarding domestic and international cybersecurity and data privacy matters.
- Devika's advises clients on obtaining, protecting, licensing, and enforcing intellectual property rights in the context of mergers, acquisitions, investments, joint ventures, project development and day-to-day business transactions. She counsels clients in a broad array of industries.
- Devika has spoken and published articles on topics such as Navigating and Negotiating Information Technology Agreements, Effective Incident Response Teams, Protecting Data in Unlikely Places, the California Consumer Privacy Act, Big Data Governance, and revising privacy policies in view of FTC actions regarding geolocation data.

MAGGIE PELOSO

Environmental and Climate Change Proficiency

- Margaret's areas of practice are environmental law and climate change. With respect to climate change, she handles a variety of matters, including advising on climate change risk management and climate change adaptation issues. Margaret also regularly advises clients with respect to the renewable fuels obligations and standards, climate-related disclosures and regulatory policy, and environmental litigation and transactions, and is well-versed in the nuances of the various climate change-related frameworks, standards and rankings.
- Prior to joining V&E, Margaret completed her Ph.D. in environment at Duke University, where she wrote her doctoral dissertation on legal and policy issues associated with sea-level rise adaptation. Margaret frequently authors articles on climate change, environmental law and environmental shareholder activism, including a published book titled *"Adapting to Rising Sea Levels: Legal Challenges and Opportunities,"* and presents papers on a variety of climate change topics at academic and industry conferences.

SARAH FORTT

Corporate Governance and Disclosure Proficiency

- Sarah's principal areas of practice are corporate governance, board representation and securities law, and she advises clients on Securities and Exchange Commission reporting requirements, board and committee procedures and governance documents, board and senior management succession planning, shareholder engagement and corporate governance activism, proxy and periodic disclosures, director independence and qualification matters, proxy advisory firm voting policies, and internal and disclosure controls and procedures.
- Sarah's areas of experience also include board-level crisis preparedness, cybersecurity and cyber-risk considerations, and environmental and social governance matters and disclosures, including climate change-related disclosures, and investor outreach and relations.

Feeling overwhelmed or exhausted by ESG? Our ESG team can help make ESG concrete and approachable. Contact us for our ESG strategy menu.

CORPORATE GOVERNANCE, COMPLIANCE & ESG AT V&E

Vinson & Elkins lawyers are available to assist in addressing any questions you have regarding the matters included in this Governance Update. To learn more about these matters, please contact any of the following lawyers:

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