2021 Governance Outlook

PROJECTIONS ON EMERGING BOARD MATTERS

A publication of the National Association of Corporate Directors and Partners
Baker Tilly
Broadridge Financial Solutions
Deloitte
Weil, Gotshal & Manges

BROUGHT TO YOU BY

Weil

Support for the *2021 Governance Outlook: Projections on Emerging Board Matters* was provided by the following partners, who were instrumental in the formulation of this publication:
Baker Tilly
Broadridge Financial Solutions
Deloitte
Weil, Gotshal & Manges

ABOUT THIS REPORT

The *2021 Governance Outlook: Projections on Emerging Board Matters* is designed to give corporate directors and senior executives a comprehensive overview of major business and governance issues that are likely to demand board focus over the coming year. The report begins with an introduction from NACD that highlights survey findings about leading board priorities for 2021 and follows with five partner contributions that provide distinct insights and projections on the following themes: strategic business risks, legal risks, data privacy, M&A oversight, and virtual shareholder engagement.

Each partner contribution provides (1) an overview of key trends in a particular area of governance, (2) an outlook for how those trends will play out in 2021, and (3) relevant implications and questions for boards to consider. The *2021 Governance Outlook: Projections on Emerging Board Matters* is designed as a collection of observations to help corporate boards to prioritize their focus in 2021 and increase their awareness of emerging issues through both detailed topical analysis and coverage of broader governance implications.

National Association of Corporate Directors

© Copyright 2020, National Association of Corporate Directors. All rights reserved.

Except as permitted under the US Copyright Act of 1976, no part of this publication may be reproduced, modified, or distributed in any form or by any means, including, but not limited to, scanning and digitization, without prior written permission from NACD.

This publication is designed to provide authoritative commentary in regard to the subject matter covered. It is provided with the understanding that neither the authors nor the publisher, the National Association of Corporate Directors, is engaged in rendering legal, accounting, or other professional services through this publication. If legal advice or expert assistance is required, the services of a qualified and competent professional should be sought.

Contents

The Future of the Virtual Board Room 2

By Andrew Lepczyk, NACD

2021 Strategic Risks for Boards 8

By Erich Bergen, Ann E. Blakely, Jeff Jorge, Mark Ross, Raina Rose Tagle, Frank Walker, and Kim Wylam, Baker Tilly

Shareholder Engagement in a Virtual World 16

By Dorothy Flynn, Broadridge Financial Solutions

Rethinking the Future of Privacy 25

By Daniel P. Frank, Deloitte & Touche LLP

Strengthening Board M&A Oversight in an Uncertain Time ... 34

By Trevear Thomas, Joel Schlachtenhaufen, Andrew Wilson, Annie Adams, Deloitte LLP

Board Oversight 2021: “Mission Critical” Risks and the Corporate "Mission" Converge 40

By Adé Heyliger, Lyuba Goltser, and Ellen Odoner, Weil, Gotshal & Manges

Contributing Partners 48

Board Oversight 2021: "Mission Critical" Risks and the Corporate "Mission" Converge

By Adé Heyliger, Lyuba Goltser, and Ellen Odoner, Weil, Gotshal & Manges[1]

Last year, without lowering the high bar that *Caremark* set for director liability, the Delaware courts signaled their expectations about effective board oversight over "mission critical" risks by taking the unusual step of allowing two *Caremark* cases to proceed beyond the motion to dismiss stage. In 2020, the Delaware courts reinforced this message by denying motions to dismiss *Caremark* claims relating not only to board oversight of a key regulatory risk, consistent with the earlier cases, but also (in the context of egregious alleged facts) to board oversight of effective financial reporting, a risk all public companies face.

The continued emphasis on "mission critical" risks by the courts has coincided with the extraordinary and tragic events of the past year, which revealed fissures in our society and heightened calls for boards to reconsider their company's corporate "mission" and its impact on a broader range of stakeholders. There is now an even stronger impetus for directors to use a wide lens in considering what risks should be deemed "mission critical" for their company. For most, if not all, companies, that means risks relating to employees, including racial and gender equity and overall safety and well-being, deserve a prominent place on the board's oversight agenda for 2021 and beyond.

---

[1] The authors express their appreciation to their Weil colleagues, Kaitlin Descovich and Andrew Holt.

The Delaware Supreme Court's spotlight on "mission critical" risks in its 2019 decision in *Marchand v. Barnhill* still burns bright.

KEY PROJECTIONS

1. Boards will face heightened expectations to apply a "mission critical" risk framework in oversight.

Directors are expected to establish and then monitor reporting systems reasonably designed to provide timely, accurate information sufficient to enable the board to make informed judgments about key risks to legal compliance and business performance. In order to prevail on a *Caremark* claim, however, a plaintiff needs to meet the difficult burden of showing that the board acted in bad faith—either by having "utterly failed" to implement a board-level reporting system or, having implemented one, by having "consciously failed" to monitor the system it implemented. On the infrequent occasions when this high bar has been met, the *Caremark* breach is considered a breach of the duty of loyalty, carrying potentially significant reputational and liability concerns for the board.

The Delaware Supreme Court's spotlight on "mission critical" risks in its 2019 decision in *Marchand v. Barnhill.* still burns bright.[2] There the court found that plaintiffs had met their burden to show the board had failed to institute a board-level reporting system targeting the "mission critical" risk of the company's business (food safety for an ice cream company). While many *Caremark* cases continue to be dismissed, two courts this year looked to *Marchand* in denying motions to dismiss. This underscores the importance of targeting key areas for board oversight, establishing a regular oversight cadence, and keeping a careful, written record of the oversight processes and activities—including how the work of board committees measures up to their charters.

In *Inter-Marketing Group USA, Inc. v. Armstrong*,[3] plaintiff brought a *Caremark* case against the directors of the general partner of a pipeline company following a devastating oil spill. Plaintiff alleged that, as in *Marchand*, the directors "utterly failed" to ensure that a reasonable reporting system existed with respect to a compliance issue "intrinsically critical" to the company's business operations—pipeline integrity. Defendants argued that the existence of its audit committee was evidence that a monitoring system was in place because review of legal and regulatory compliance was part of its charter. However, at a trial related to the spill, the CEO and board chair testified that decisions to review problematic pipelines were made at lower managerial levels, and that neither the board nor any board committee ever discussed pipeline integrity policies or management. The Delaware Court of Chancery denied the motion to dismiss on the ground that pipeline integrity was a "mission critical" risk for a pipeline company and that plaintiff had drawn a reasonable infer-

[2] See Marchand v. Barnhill, 212 A.3d 805 (Del. 2019).

[3] Inter-Marketing Group USA, Inc on Behalf of Plains All American Pipeline, L.P. v. Armstrong, 2020 WL 756965, *11+, Del.Ch., (NO. *CV* 2017-0030-TMR) (January 31, 2020).

Boards should expect workforce diversity disclosure to proliferate, and for disclosure of pay-equity data to gain traction.

ence from the trial testimony that the audit committee had not lived up to the oversight responsibilities in its charter.

In *Hughes vs. Hu*,[4] plaintiff brought a *Caremark* case against the audit committee of a company that restated three years of financial statements and failed to remediate material weaknesses in internal control over financial reporting disclosed three years earlier. Informed by a Section 220 books and records investigation that preceded the case, plaintiff alleged what the Delaware Court of Chancery characterized as "chronic deficiencies": the audit committee met sporadically and briefly, the outside auditor (later sanctioned by the PCAOB) missed key issues, and the audit committee relied blindly on management despite its demonstrated inability to report accurately about related-party transactions. The court noted that the defendants did not produce any documents in the Section 220 investigation that would have rebutted this inference, and, while not explicitly describing the effectiveness of financial reporting controls as a "mission critical" risk, the court denied the motion to dismiss.

2. Boards will face growing demands for transparency and accountability on racial, ethnic, and gender equity within the workforce.

Boards should expect workforce diversity disclosure to proliferate, and for disclosure of pay-equity data to gain traction, in 2021. In the wake of racial and social protests earlier this year, many companies have publicly affirmed their commitments to racial equality and diversity. Institutional investors are now seeking commitments from companies to make public the "hard data" that will enable investors to evaluate and compare companies' performance on diversity and track their progress.

Disclosure of Consolidated EEO-1 Reports is becoming the "gold standard" for investors. These annual reports sent to the US Equal Employment Opportunity Commission reveal the race, gender, and ethnicity of the employees filling various job categories, including senior management. The comptroller of New York City has announced commitments from 34 of the 67 S&P 100 companies it contacted this summer to adopt a policy to publicly disclose their Consolidated EEO-1 Reports.[5] The comptroller has also encouraged disclosure of broken-out data on pay. Simi-

[4] Hughes v. Hu, C.A. No. 2019-0112-JTL, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).
[5] See press release, "Comptroller Stringer and NYC Retirement Systems Announce 34 S&P 100 Companies Will Publicly Disclose Workforce Demographics," September 28, 2020. See also press release, "Comptroller Stringer and Three New York City Retirement Systems Call on 67 S&P 100 Companies Who Issued Supportive Statements on Racial Equality to Publicly Disclose the Composition of their Workforce by Race, Ethnicity and Gender," July 1, 2020; and Letter of Office of the Comptroller Scott M. Stringer to Chief Executive Officer of Amazon.com, Inc., July 1, 2020.

Nasdaq proposed a new rule requiring most listed companies to have, or explain why they do not have, two "diverse" directors.

larly, among other institutional investors, State Street Global Advisors has called on the board chairs of public companies in its investment portfolio to disclose measures of workforce diversity using the EEO-1 Report framework.[6] Both the NYC comptroller and State Street have cautioned they are prepared to use their proxy voting authority to hold the boards accountable should they fail to meet these expectations.

3. Boards will expand their oversight mechanisms to give a more central place to human capital.

The COVID-19 pandemic and recent protests combined to underscore the need for heightened focus on what many companies refer to as their "greatest asset": their employees. In addition to critical health and safety concerns, the range of human-capital issues for management to tackle includes employee retention, compensation, training and development, diversity and inclusion, and adapting the workforce to remote environments—along with ensuring that internal controls are recalibrated for proper oversight of these matters.

Boards should expect these issues to receive more sunlight with new SEC disclosure requirements mandating that companies provide a description of their human-capital resources and any human-capital measures or objectives the company focuses on in managing its business, to the extent such disclosure would be material to an understanding of the company's business in their Form 10-K.[7] SEC chair Jay Clayton emphasized the SEC's expectation "to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs."[8]

4. Companies will face intensified pressures on board diversity.

In December, in a major development, Nasdaq proposed a new rule requiring most listed companies to have, or explain why they do not have, two "diverse" directors (one self-identified as female and one self-identified as being from an underrepresented racial OR ethnic group or as LGBTQ+). The proposal intensifies the pressure from institutional investors for change at both the board and CEO levels.[9] The NYC comptroller's 2019 "Rooney Rule" campaign resulted in 14 companies adopting policies

[6] See form letter from State Street Global Advisors, Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies, August 27, 2020.

[7] See SEC press release, "SEC Adopts Rule Amendments to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K," August 26, 2020.

[8] See Chair Clayton's public statement, "Modernizing the Framework for Business, Legal Proceedings and Risk Factor Disclosures," posted on sec.gov, August 26, 2020.

[9] Proposal File No. SR-2020-081, "[a] proposal to advance board diversity and enhance transparency of diversity statistics through new proposed listing requirements."

A number of states have either enacted or are currently considering mandatory board-diversity legislation.

requiring that the initial list of board or external CEO candidates include qualified female and racially/ethnically diverse candidates.[10] Similarly, in its August 2020 letter to board chairs, State Street requested companies to provide "diversity characteristics, including racial and ethnic makeup, of the board of directors," and "[a]rticulate goals and strategy related to racial and ethnic representation at the board level."[11]

Currently, Institutional Shareholder Services (ISS) will generally recommend against the chair of the nominating committee if the company's board does not include at least one woman (subject to limited mitigating factors). Starting in 2022, ISS will extend this voting policy to any Russell 3000 or S&P 1500 company that has no apparent racial and/or ethnic board diversity—and will cite the lack in 2021.[12]

At the state level, California has led the way with laws requiring public companies with principal executive offices located in the state to have at least two or three women directors, depending on board size, by the end of 2021, at least one director who self identifies as being from an "underrepresented community" (defined in terms of race, ethnicity, or sexual orientation) by the end of 2021 and either two or three such directors, depending upon board size, by the end of 2022.[13] Washington recently required companies incorporated in that state to meet certain gender diversity targets by January 1, 2022, or provide new diversity disclosure,[14] and a number of other states have either enacted or are currently considering mandatory board-diversity legislation.[15]

Shareholders seeking to advance diversity have turned to litigation, alleging that directors violated their fiduciary duties by failure to have racial diversity on their boards, inaction on diversity and inclusion issues and tolerance of racially discriminatory practices at their companies, and that commitments to diversity appearing in proxy statements and other

[10] See press release, "Comptroller Stringer Launches Boardroom Accountability Project 3.0, a First-in-the-Nation Initiative to Bring Diversity to Board and CEO Recruitment," October 11, 2019. The "Rooney Rule" was originally instituted by the National Football League and requires league teams to interview ethnic-minority candidates for head coaching and senior football operation jobs.

[11] See State Street Global Advisors' August 27, 2020, letter to board chairs.

[12] See ISS, *Proxy Voting Guidelines Benchmark Policy for 2021 Recommendations*, p. 2. Proxy Voting Guidelines (effective for meetings on or after February 1, 2021)

[13] See California Senate Bill 826 and Assembly Bill 979.

[14] See Washington Business Corporation Act and Substitute Senate Bill 6037.

[15] New York, Maryland, and Illinois have enacted board diversity disclosure requirements; Hawaii, Massachusetts, Michigan, and New Jersey are currently considering mandatory board diversity legislation; Colorado has adopted a nonbinding resolution, and Pennsylvania is considering nonbinding legislation, to encourage companies to improve gender diversity on their boards. See *Washington State's New Gender Quota for Boards Reflects Broader Trends*, (Arlington, VA: NACD, 2020).

The impact of the pandemic has strengthened the call upon boards to review their corporation's mission with a stakeholder-centric critical eye.

disclosures were materially false and misleading.[16] While it remains to be seen how these lawsuits will fare, shareholders are likely to continue to use litigation as another means to press for greater board and workforce diversity.

BOARD IMPLICATIONS

1. Evaluate corporate purpose with a stakeholder-centric eye. The decades-long, widely held view that a corporation's purpose is solely to enhance shareholder value is under challenge—a challenge bolstered by the severe impacts of the COVID-19 pandemic on the economy and its disproportionate impact on low- to mid-income workers. Companies are confronting a panoply of employee and human-capital management issues that are critical to long-term value creation at a time when investors and others are seeking commitments from corporations to align their governance principles with stakeholder capitalism. Many corporations have endorsed the Business Roundtable's 2019 "Statement on the Purpose of a Corporation" and the related shift away from the primacy of shareholders toward a broader view of responsibility to the corporation's wider stakeholders. This "modern standard for corporate responsibility" has seen additional support from Business Roundtable CEOs who, in October 2020, committed to a range of corporate actions and public policy initiatives in order to advance racial equity and justice within their businesses and in the broader community.[17]

The impact of the pandemic has strengthened the call upon boards to review their corporation's mission with a stakeholder-centric critical eye. As part of their strategic reviews, boards can engage in an active dialogue with management to understand how key company stakeholders are identified, the impact of the company on these stakeholders and related risks—all of which may evolve or change at any given time—and the processes by which these determinations are made before they are elevated to the board. Understanding these processes will enable the board to better assess whether the corporate mission is adequately addressing the needs of its stakeholders, central among whom should be the company's employees.

---

[16] See complaint, Klein v. Ellison, Case No. 20-cv-4439 (N.D. Cal. July 2, 2020); Complaint, Ocegueda v. Zuckerberg, Case No. 20-cv-04444 (N.D. Cal. July 2, 2020); and Complaint, Kiger v. Mollenkopf, Case No. 20-cv-01355-LAB-MDD (S.D. Cal. July 17, 2020).

[17] See Business Roundtable, "Advancing Racial Equity and Justice." The CEO recommendations address six systems: employment, finance, education, health, housing, and criminal justice aimed principally at reducing the economic opportunity gap in communities of color, including disparities in access to financial tools and high-quality jobs, education, and health care.

Boards must allocate appropriate agenda time to probe management regarding "mission critical" risks.

2. Address diversity and inclusion at both the board level and organization-wide.
Institutional investors and other stakeholders have made clear that they view diversity and inclusion as a significant means of mitigating risks and achieving long-term growth and stability. Boards should ensure that robust employee-diversity initiatives are central to the organization's overall human-capital-management strategy, and they should make oversight of these initiatives and their effectiveness a regular part of the board's agenda. In particular, the board should understand and receive regular reports on the human-capital metrics tracked by management, as investors and the SEC are looking for meaningful disclosure of these metrics. Boards should use the current climate as an opportunity to review and, if necessary, refresh its own board composition to address gender, racial, and other diversity, the absence of which will attract increasingly unforgiving scrutiny, internally and externally.

3. Ensure that evolving "mission critical" risks are receiving proper attention from the full board and committees.
Boards must allocate appropriate agenda time to probe management regarding "mission critical" risks. It can be helpful for the board leader and the corporate secretary to review the board schedule to ensure that meetings are designed to encourage dialogue on these topics, and that an appropriate record is maintained. These records should reflect the data received and considered, follow-up steps, responses to prior follow-up steps, and reports on relevant regulatory and other developments.

Board committees can help the board fulfill its risk oversight responsibilities by shouldering and reporting on particular "mission critical" risks. For example, the work of the compensation committee could be expanded to encompass the panoply of risks relating to human capital. The nominating/corporate governance committee could address steps to achieve greater diversity in the nomination process as well as take on holistic oversight of the impact of ESG issues on the company. Alternatively, given their importance to a company, some risks may merit their own stand-alone committee (e.g., environmental or technological risk). Committee charters should be updated annually to reflect the key areas of risk for which the committees are responsible, and committees should conduct a robust, annual self-evaluation to ensure that they have fulfilled the commitments in their charters and documented their activities.

4. Most important, take a proactive approach to risk.
Boards should regularly review the effectiveness of management's enterprise risk management systems to ensure that they provide sufficient information on existing risks and raise new or evolving risks to the relevant board committee or full board, all on a timely basis. However, in addition to relying on management, boards should step back and think about risk in a common sense way—returning to *Marchand*, what could

be a more important risk for a food company than ensuring food safety? Boards should be proactive in periodically challenging their company's traditional approach to risk by capitalizing on the relevant expertise of board members and reaching out to outside advisors and other experts for a fresh look. ■

QUESTIONS FOR DIRECTORS TO ASK THEMSELVES

- When did the board last identify the company's "mission critical" risks?
- Has the board established a regular cadence for reevaluating these risks?
- Are written records of the board's risk oversight efforts—specifically with respect to "mission critical" risks—maintained in sufficient detail?
- Has the board considered whether to disclose EEO-1 or other employee data publicly and how to approach the SEC's new principles-based disclosure requirements relating to human capital?
- Has the board recently reviewed management's risk management and mitigation policies and programs? Are "reporting up" systems adequate to ensure that the board is properly informed?
- Are committees being used effectively to enhance board oversight? In particular, how is human-capital risk allocated among the board and its committees?
- Does the board take a critical look each year at how the work of the committees has measured up to their charters?

Adé Heyliger

Lyuba Goltser

Ellen Odoner

Adé Heyliger, a partner in Weil's Public Company Advisory Group in Washington, DC, regularly advises public companies, corporate boards, and foreign private issuers on a broad range of SEC disclosure and regulatory matters, securities regulation, corporate governance, and compliance issues. Lyuba Goltser, a partner in Weil's Public Company Advisory Group counsels public and private companies and board of directors in complex governance and disclosure matters, including internal investigations, shareholder activism, CEO transitions and related party transactions, and corporate governance best practices. Ellen Odoner is cohead of the firm's Public Company Advisory Group, which advises US and foreign public companies on corporate governance, SEC disclosure, financial restatements, and internal control matters.

Contributing Partners

BAKER TILLY VIRCHOW KRAUSE LLP (BAKER TILLY) is a leading advisory, tax, and assurance firm whose specialized professionals guide clients through an ever-changing business world, helping them win now and anticipate tomorrow. Headquartered in Chicago, Baker Tilly, and its affiliated entities, have operations in North America, South America, Europe, Asia, and Australia. Baker Tilly is an independent member of Baker Tilly International, a worldwide network of independent accounting and business advisory firms in 145 territories, with 34,700 professionals. The combined worldwide revenue of independent member firms is $3.6 billion. Visit bakertilly.com or join the conversation on LinkedIn, Facebook, and Twitter.

BROADRIDGE, a global fintech leader and S&P 500® company with $4 billion in revenues, provides communications, technology, data, and analytics to drive business transformation. Our solutions help our clients, including corporations, enrich engagement, navigate compliance, and optimize efficiency to get ahead of today's challenges and capitalize on what's next.

DELOITTE provides industry-leading advisory, consulting, audit, and tax services to many of the world's most admired brands, including nearly 90% of the Fortune 500® and more than 7,000 private companies. Our people come together for the greater good and work across the industry sectors that drive and shape today's marketplace — delivering measurable and lasting results that help reinforce public trust in our capital markets, inspire clients to see challenges as opportunities to transform and thrive, and help lead the way toward a stronger economy and a healthier society. Deloitte is proud to be part of the largest global professional services network serving our clients in the markets that are most important to them. Now celebrating 175 years of service, our network of member firms spans more than 150 countries and territories. Learn how Deloitte's more than 330,000 people worldwide connect for impact at www.deloitte.com.

WEIL, GOTSHAL & MANGES LLP, Founded in 1931, has been a preeminent provider of legal services for more than 80 years. With approximately 1,100 lawyers in offices on three continents, Weil has been a pioneer in establishing a geographic footprint that has allowed the firm to partner with clients wherever they do business. The firm's four departments, Corporate, Litigation, Business Finance & Restructuring, and Tax, Executive Compensation & Benefits, and more than two dozen practice groups are consistently recognized as leaders in their respective fields. Weil has become a highly visible leader among major law firms for its innovative diversity and pro bono initiatives, the product of a comprehensive and long-term commitment which has ingrained these values into our culture. Our proven, demonstrated experience allows the firm to provide clients with unmatched legal services. Please see www.weil.com for more information, including awards and rankings.

NACD