
CRAVATH, SWAINE & MOORE LLP

“Early Filer” COVID-19, ESG and HCM Disclosure Trends in Proxy Statements and 10-Ks

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Overview

- In 2020, the COVID-19 pandemic and social justice protests have put a spotlight on public companies' management of environmental, social and governance (“ESG”) issues and human capital management (“HCM”) issues like never before
- Recent proxy statements / 10-K filings by companies with non-calendar-year fiscal-year ends (“early filers”) provide useful guidance as to how public companies will address these issues in their upcoming SEC filings

Company	FYE	Proxy Date	10-K Date	Company	FYE	Proxy Date	10-K Date
AutoZone, Inc.	Aug 29	Oct 26	Oct 26	Automatic Data Processing, Inc.	Jun 30	Sep 24	Aug 5
Campbell Soup Company	Aug 2	Oct 2	Sep 24	Cardinal Health, Inc.	Jun 30	Sep 23	Aug 13
Copart, Inc.	Jul 31	Nov 2	Sep 28	Fox Corporation	Jun 30	Sep 24	Aug 10
Donaldson Company, Inc.	Jul 31	Oct 6	Sep 25	Parker-Hannifin Corporation	Jun 30	Sep 28	Aug 26
Palo Alto Networks, Inc.	Jul 31	Oct 20	Sep 4	The Estée Lauder Companies Inc.	Jun 30	Sep 24	Aug 28
Thor Industries, Inc.	Jul 31	Nov 5	Sep 28	The Procter & Gamble Company	Jun 30	Aug 28	Aug 6
Vail Resorts, Inc.	Jul 31	Oct 21	Sep 24	Avnet, Inc.	Jun 27	Oct 2	Aug 14
Seagate Technology plc	Jul 3	Aug 31	Aug 7	Maxim Integrated Products, Inc.	Jun 27	Sep 28	Aug 19
Western Digital Corporation	Jul 3	Oct 5	Aug 28	Performance Food Group Company	Jun 27	Oct 9	Aug 18
CACI International Inc	Jun 30	Oct 1	Aug 14	Sysco Corporation	Jun 27	Oct 7	Aug 26
Lancaster Colony Corporation	Jun 30	Oct 13	Aug 27	Tapestry, Inc.	Jun 27	Sep 25	Aug 13
Madison Square Garden Entertainment Corp.	Jun 30	Oct 27	Aug 31	Cintas Corporation	May 31	Sep 15	Jul 29
Madison Square Garden Sports Corp.	Jun 30	Oct 27	Aug 31	Conagra Brands, Inc.	May 31	Aug 13	Jul 24
Microsoft Corporation	Jun 30	Oct 19	Jul 30	FedEx Corporation	May 31	Aug 10	Jul 20
News Corporation	Jun 30	Oct 5	Aug 11	General Mills, Inc.	May 31	Aug 10	Jul 2
Paylocity Holding Corporation	Jun 30	Oct 22	Aug 7	NIKE, Inc.	May 31	Jul 24	Jul 24
Peloton Interactive, Inc.	Jun 30	Oct 22	Sep 11	Oracle Corporation	May 31	Sep 18	Jun 22
ResMed Inc.	Jun 30	Oct 6	Aug 13	Paychex, Inc.	May 31	Sep 4	Jul 17
The Clorox Company	Jun 30	Oct 6	Aug 13	Darden Restaurants, Inc.	May 30	Aug 10	Jul 24
The Hain Celestial Group, Inc.	Jun 30	Oct 13	Aug 25	H&R Block, Inc.	Apr 30	Jul 31	Jun 17
				Medtronic plc	Apr 30	Aug 14	Jun 19

Source: List of early filers provided by Broadridge.

COVID-19

- **Early filers specifically discussed their responses to the coronavirus pandemic, in addition to addressing the financial implications of COVID-19 for their businesses**
 - Responses to COVID-19 were typically addressed in the proxy statement, while the 10-K primarily focused on the financial impact of COVID-19, both on a current and going-forward basis
- **The three main responses to COVID-19 discussed in proxy statements included:**
 - ① **How companies have supported their employees**
 - Protecting the health, safety and well-being of employees
 - “Working from home” policies
 - Greater flexibility around sick pay
 - Extension of parental leave and increasing childcare benefits
 - Salary increases / bonuses for front-line workers
 - Assistance for additional transportation expenses
 - Adjusting performance plans
 - Cleaning protocols / securing personal protective equipment
 - Communications with employees / improving “virtual” connectivity among employees while working remotely
 - ② **How companies have supported their communities**
 - Helping the fight against COVID-19
 - Public donations / donations to employee matching funds
 - Spearheading / participating in fund-raising efforts to support organizations and causes
 - ③ **How companies have continued serving their customers**
- **Early filers also discussed, if relevant, measures to reduce expenses and conserve liquidity, including cost-cutting initiatives and temporary reductions in board and senior management compensation**
 - After many withdrew guidance in Q2 2020 on account of COVID-19, companies have also generally resumed providing earnings guidance, but often with more caveats, larger ranges or multiple forecasts for different recovery scenarios

COVID-19

- **SEC guidance on COVID-19 disclosure has focused primarily on the pandemic’s impact on a company’s operations, liquidity and capital resources (including whether and to what extent the company received federal assistance)**
- **However, investors increasingly seek to understand the broader ways in which companies have been affected by the pandemic, and we expect upcoming SEC filings will include a more comprehensive discussion of the impact of COVID-19**
- **For example, Americans for Financial Reform (“AFR”), a nonprofit coalition founded in the wake of the 2008 financial crisis, called on the SEC to require public companies to provide “consistent, reliable data to investors about the economic impact of the pandemic on their business, human capital management practices, and supply chain risks”**
 - The AFR organized its recommended disclosures into the following 11 categories, which are broadly in line with what we have observed among early filers and expect to see in 2021
 - Workplace COVID-19 Prevention and Control Plan: Company’s practices regarding hazard identification and assessment, employee training, provision of personal protective equipment, etc.
 - Identification, Contact Tracing, and Isolation: Policies for identifying employees who are infected, contact tracing and notification for potentially exposed employees and customers, and leave policies for infected employees
 - Compliance with Quarantine Orders and Phased Reopening Orders
 - Financial Implications: Impact on the company’s cash flows and balance sheet and steps to preserve liquidity
 - Executive Compensation: Rationale for any material modifications of senior executive compensation due to COVID-19, including changes to performance targets or issuance of new equity compensation awards
 - Employee Leave: Policy on paid sick leave, paid leave for quarantine workers, paid leave at any temporarily closed facility, family leave options
 - Health Insurance: Coverage ratio, policy for any employees who are laid off during COVID-19
 - Contingent Workers: Whether they receive all the protections and benefits provided to full-time company employees
 - Supply Chains: Status of payments to suppliers
 - Workers’ Rights: Policies for protecting employees who raise concerns about workplace health and safety from retaliation
 - Political Activity: Election spending and lobbying activity

Diversity, Inclusion and Racial Justice

- **Over the past several years, there has been a major shift in consensus regarding companies' responsibilities to non-stockholder constituencies and to society in general, with an increased focus on ESG issues**
 - ESG issues are top-of-the-mind for investors, driven by prominent institutional investors who now link a company's ESG profile with its long-term financial performance, and other shareholders who desire to align investments with social values and goals

- **Among ESG issues, diversity, inclusion and racial justice are a key focus, and public disclosures by early filers highlight their importance**
 - Clorox: ***"Standing up for racial justice: In fiscal year 2020, we pledged financial donations of \$3.1 million to support Black businesses in our communities, engage Black youth who represent our future and accelerate Black community access to justice and criminal justice reform. It is important to us that when Clorox and our brands choose to take a public stance on a social issue, it demonstrates our core value, Do the Right Thing, is undertaken with our strategic goals in mind and is impactful to our business interests."***
 - Microsoft: ***"The Call for Racial Justice As the U.S. and much of the world faced a wave of protests calling for racial justice, we worked to build on our past commitments and help push for greater impact by supporting inclusive economic opportunity. First, we committed to increasing our representation and culture of inclusion. We will build on our diversity and inclusion ("D&I") momentum from the past five years by adding an additional \$150 million of D&I investment, and will double the number of Black and African American people managers, senior individual contributors, and senior leaders in the U.S. by 2025."***
 - Western Digital: ***"Our commitment to fairness and equality is reflected in our promotion of racial understanding amidst the social injustices seen across the U.S. during the second half of fiscal 2020. [We have] engaged in open and honest dialogue with employees across our company on the importance of embracing diversity, practicing inclusion and eliminating racism."***

Diversity, Inclusion and Racial Justice

- **We expect that in the upcoming 2021 proxy season we will see greater disclosure by public companies regarding diversity as a business imperative, focusing on:**
 - The role that diversity plays at the management level and on the board of directors
 - Diversity efforts and progress made towards achieving diversity goals
 - Specific actions companies are taking to address racial issues
 - Specific actions companies are taking to achieve gender pay equity
 - How companies are addressing other categories of diversity, including LGBTQ+
 - How companies' products and services impact diversity, equity and inclusion

- **We also expect that there will be increasing disclosure of metrics about workforce diversity, including at the board and C-suite level, and greater engagement with stockholders about what type of information would be most appropriate to disclose**

Climate Change & Sustainability

- **Climate risk continues to be a top concern of stakeholders**

- There are increasing calls for more transparency, and companies are implementing environmentally-friendly initiatives, including reduction targets, following pressure from investors
- There also is increasing pressure relating to establishing long-term reduction targets following the EU's 2050 net zero carbon target consistent with the recent EU Green Deal and proposed European Climate Law

- **Institutional investors and proxy advisory firms are increasingly focused on climate change and sustainability**

- In March 2020, ISS published its Climate Voting Guidelines, which include a recommendation to vote against directors who fail to adequately address climate-related risks, realize climate-related opportunities and improve climate-related performance
- BlackRock, like many other large investors, has announced a number of initiatives aimed at putting sustainability at the center of its investment approach, which have been welcomed by climate groups
- Climate initiatives under the new Biden administration are likely to further increase investor expectations

“Climate change is almost invariably the top issue that clients around the world raise with BlackRock... [Clients] are seeking to understand both the physical risks associated with climate change as well as the ways that climate policy will impact prices, costs, and demand across the entire economy.”

Larry Fink, Annual Letter to Executives and Clients, January 2020

Human Capital Management

- **In August 2020, the SEC released Final Rules amending Regulation S-K, including Item 101 (Description of Business)**
 - Regulation S-K disclosures are mandated in both registration statements (e.g., Form S-1, S-3 and S-4) and periodic reports (Forms 10-K and 10-Q), although Item 101 disclosures with the description of the business are not required in quarterly reports on Form 10-Q
 - Item 101(c) deals with Human Capital Management

- **Prior to amendment, Item 101(c) only required disclosure of the number of employees**
 - Some companies included additional detail such as information on full-time vs. part-time employees and unionized vs. non-unionized employees

- **Amended Item 101(c) broadens the potential disclosures to include a description of the company's human capital resources, including relevant human capital measures or objectives that the company focuses on in managing its business, but solely to the extent they are material to an investor's understanding of the business (see Appendix)**
 - The SEC does not define the term "human capital", instead opting for wording whose meaning can evolve over time and may vary significantly based on industry

Human Capital Management

- **In 2020, one of the largest increases in ESG disclosures occurred in HCM**

- HCM disclosures have historically been located in proxy statements as opposed to in 10-Ks
 - We expect this balance to shift following the effectiveness of the amendments to Item 101(c) of Regulation S-K

- **HCM disclosures by early filers focused on:**

- ① **Articulating the board's / relevant board committee's role in HCM, including succession planning**

- *ADP: "As part of its focus on human capital management and tight integration with company strategy, a key responsibility of our board of directors is to ensure that ADP has a strong, performance-driven senior management team in place. In connection with this responsibility, our board of directors oversees the development and retention of senior talent to ensure that an appropriate succession plan is in place for our CEO as well as the members of the company's executive committee that directly support our CEO."*

- ② **Employee development**

- *Campbell: "A core pillar of Campbell's strategic plan is to build a winning team and culture. ... We launched three new training and development programs to support these efforts: perform to WIN, manage to WIN and include to WIN to equip current employees with the tools they need to thrive at Campbell. We are committed to fostering a more diverse and inclusive culture at Campbell. We have 10 employee resource groups to support employee engagement, connection and development ..."*

- ③ **Employee well-being**

- *Fox: "We are proud to invest in our people through competitive pay and benefits, flexibility and support to balance work and personal demands, and extensive professional and personal learning and development programs. We also provide a generous benefits package that supports our employees' health and wellness, educational endeavors and financial stability."*

- ④ **Culture / work environment**

- *General Mills: "Beyond leadership development, our board is continuously focused on culture and human capital management priorities for promoting a safe, inclusive and respectful work environment, where employees across our entire workforce feel empowered to speak on issues important to them, inspired to act ethically and raise concerns and enabled to implement new and innovative ideas in the best interests of the business ..."*

- **Diversity and inclusion was a key theme that featured prominently in all HCM disclosures**

Note: The examples cited above are included for illustrative purposes only from proxy statements filed prior to the effectiveness of the amendments to Item 101(c), which will require additional HCM disclosure in annual reports on Form 10-K. In many instances, the identified company touched on several of the highlighted themes in its proxy disclosure.

Human Capital Management

- **We expect that HCM disclosures will keep gaining traction, especially in light of the Reg S-K amendments and increased institutional investor focus**

The “current crisis has brought human capital management strategies to the fore.”

Ray Cameron
Head of BlackRock’s investment stewardship team in the Americas

- **Companies need to be thoughtful about the disclosure they include regarding the respective roles and qualifications of the board, compensation committee or other committees in oversight of HCM (including considering what HCM metrics or objectives are actually being collected and reviewed)**

“We expect boards to oversee human capital management strategies. Absent disclosure about the board’s role in overseeing the company’s human capital practices, including an explanation of the type of information reviewed and how frequently, [BlackRock] will hold members of the relevant committee, or the most senior non-executive director, accountable.”

BlackRock’s Engagement Priorities for 2020

- **Having said that, companies should carefully evaluate the need for such HCM disclosures and they should be:**

- Fact-based;
- Included only to the extent they are material and the company actually focuses on them in managing its business; and
- Based on the unique circumstances of each particular company

- **HCM should not be viewed as an opportunity to disclose “aspirational” matters that may be attractive to ESG-focused investors due to potential for litigation and/or liability**

- For example, several issuers have been subject to shareholder litigation arising out of ESG-centered disclosures in their proxy statements
 - Securities fraud claims under federal law
 - Books and record demands under state law

Appendix

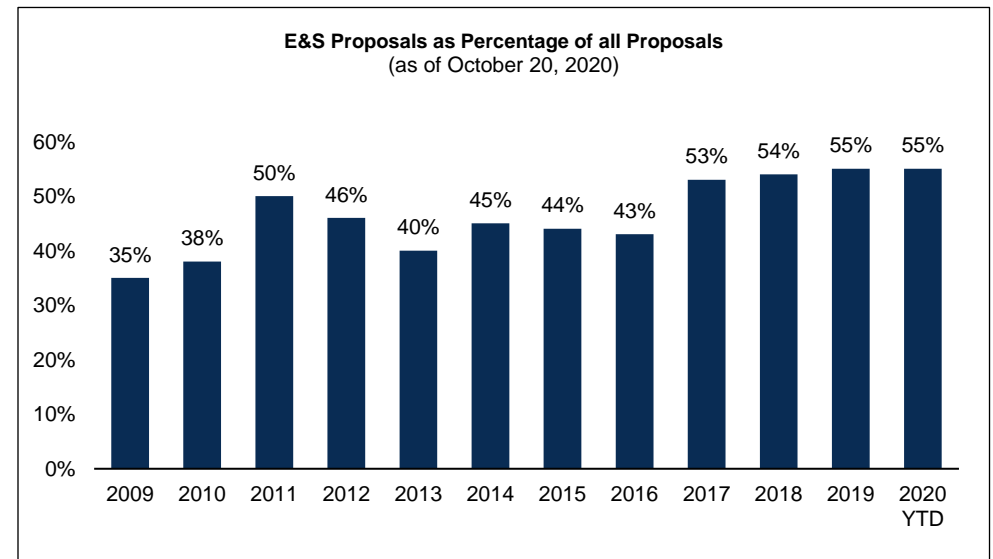
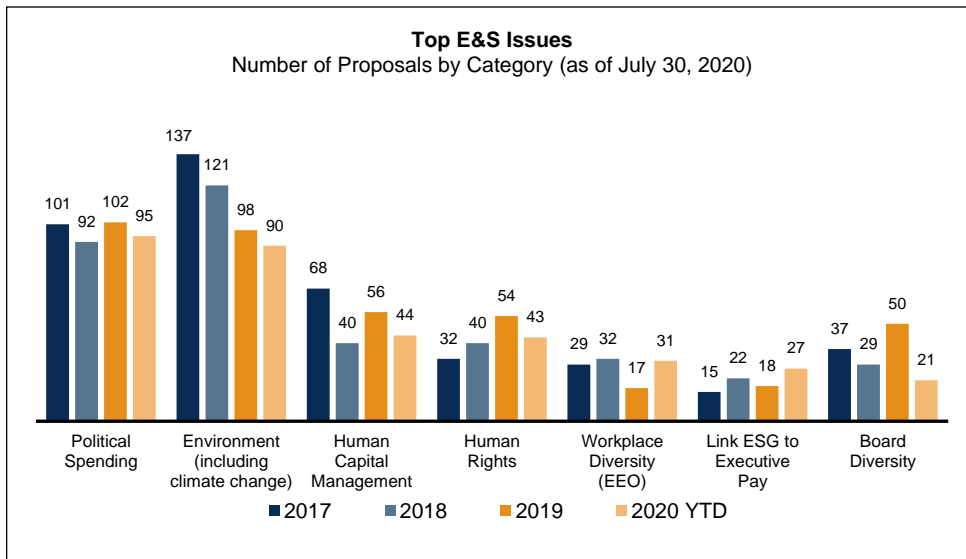
Disclosure of ESG Topics in Previous Proxy Seasons

- Companies are increasingly disclosing ESG information in their proxy statements

	2017	2020
Percent of Fortune 100 Companies Highlighting Human Capital Matters in Proxy Statements	32%	77%
Percent of Fortune 100 Companies Highlighting Environmental Sustainability Matters in Proxy Statements	37%	77%
Percent of Fortune 100 Companies Disclosing Boards' Racial/Ethnic Diversity in Proxy Statements	24%	50%

- ESG shareholder proposals exploded in 2017 and remained popular in the 2018, 2019 and 2020 proxy seasons

- ESG proposals represented a record 55% of filed proposals in 2019 and 2020. This trend is unlikely to significantly diminish in the near term



Source: Ernst & Young, "EY Center for Board Matters: Four ESG highlights from the 2020 proxy season" (July 2020); ISS, "U.S. Environmental & Social Shareholder Proposals: 2020 Proxy Season Review" (Oct. 2020)

Item 101(c) – Text of New Rule

Item 101(c) Description of business.

(1) Describe the business done and intended to be done by the registrant and its subsidiaries, focusing upon the registrant's dominant segment or each reportable segment about which financial information is presented in the financial statements. When describing each segment, only information material to an understanding of the business taken as a whole is required. Disclosure may include, but should not be limited to, the information specified in paragraphs (c)(1)(i) through (v) of this section.

(i) Revenue-generating activities, products and/or services, and any dependence on revenue-generating activities, key products, services, product families or customers, including governmental customers;

(ii) Status of development efforts for new or enhanced products, trends in market demand and competitive conditions;

(iii) Resources material to a registrant's business, such as: (A) Sources and availability of raw materials; and (B) The duration and effect of all patents, trademarks, licenses, franchises, and concessions held;

(iv) A description of any material portion of the business that may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the Government; and

(v) The extent to which the business is or may be seasonal.

(2) Discuss the information specified in paragraphs (c)(2)(i) and (ii) of this section with respect to, and to the extent material to an understanding of, the registrant's business taken as a whole, except that, if the information is material to a particular segment, you should additionally identify that segment.

(i) The material effects that compliance with government regulations, including environmental regulations, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries, including the estimated capital expenditures for environmental control facilities for the current fiscal year and any other material subsequent period; and

(ii) A description of the registrant's human capital resources, including the number of persons employed by the registrant, and any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel).

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