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SHAREHOLDER ACTIVISM

Anticipating Activist Attacks

By David A. Katz, Sabastian V. Niles, and Carmen X. W. Lu

The surge in campaigns by activist hedge funds against companies of varying market caps, industry sectors, and governance/structural profiles is not abating. It is unlikely that today's elevated level of activism will be curbed by legislation, regulation, or market forces in the near term.[1] While some of these campaigns have been public, there are a number of private campaigns putting pressure on public companies, with more expected heading into 2024. Both well-established and newer so-called junior varsity activist funds are setting their sights on old and new targets and sectors.

Activist advisors are also seeking to bring non-traditional players and 14a-8 proposal proponents into the fold, training them on proxy contest techniques and proclaiming that "non-traditional activists and even non-profits are exploring the possibility of using the universal proxy card" to run director candidates next year, foreshadowing the possibility that single interest proponents may attempt to use the universal proxy card framework to support their causes.

In an increasingly crowded landscape, the risk of being "swarmed" by multiple activists amid new breeds of "activist wolfpacks" piling on has increased, with companies having to navigate funds with varying time horizons, distinct personalities, and sometimes competing priorities (some of which may be at odds with the interests of long-term investors and the company's preferred strategies). Companies are also striking back, playing offense and reaching favorable outcomes aligned with the views of their long-term investors and minimizing disruptive impact while benefiting from constructive input.

Well-advised public companies can integrate activism preparedness into strategic planning, risk oversight, and governance and sustainability hygiene practices by:

1. Preparing the CEO and other directors to deal with direct takeover and activist approaches and handling requests by institutional investors and activists to meet directly with senior management and independent directors by speaking with a single, consistent voice and preventing the activist from driving a wedge between the board and the CEO/senior management;
2. Ensuring that the company's board and management receive regular updates on the activist, takeover, and governance environment within the industry, understand their fiduciary duties and responsibilities, implement true "best practices" and are well-positioned to respond and handle an activist situation without missteps;
3. In connection with regular updates to the board, management should review the company's investor relations outreach and understand the feedback that management is receiving from the company's investors as well as other market participants;
4. Executing a measured, year-round program of focused shareholder engagement that reaches portfolio managers, governance/stewardship teams, and proxy voting professionals, with the goal of achieving a strong sense of investor priorities and assessing how the company is perceived and whether investors would be inclined to support an activist challenge;
5. Conducting a regular, objective self-assessment of the company and its major operations

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to identify opportunities for strengthening the company, sustaining value for investors and other stakeholders, mitigating potential vulnerabilities and responding to investor concerns—that is, being your *own*, long-run-focused "activist" in the best sense of the term;

6. Ensuring that the company's strategy is refreshed, well-articulated and understood, providing compelling evidence of the company's progress and performance, rebutting misleading or incomplete analyses or criticism and credibly presenting board and CEO performance in the strongest possible light;
7. Paying close attention to execution, management of organizational change, and success in business transformation efforts, especially as activist demands continue to turn towards operations, portfolio, and margins in this new era, taking into account the world's need for faster innovation and bold strategic vision, and the impact of social media and increased political polarization on business generally;
8. Anticipating activist tactics and approaches, knowing how to delineate among different activist funds and putting effective "early warning" systems in place;
9. Reviewing the company's governance and structural profile, including the shareholder base, relevant charter and bylaw provisions, board policies and technology that might be kept "on the shelf" (such as a rights plan) and legal developments;
10. Annually considering board composition, experience, expertise and tenure together with the company's strategy to make sure that the board reflects the company's needs while avoiding genuine governance vulnerabilities;
11. As part of the regular corporate governance review, developing and keeping current board and executive officer development and succession plans that take into account the objectives and challenges that the company faces while best positioning the company to act in times of crisis;
12. Attracting investors who will support the company's strategies and have investment criteria that line up with the board and management's strategic vision and time horizon;
13. Engaging constructively, prudently and proactively with activists where possible without outsourcing decisionmaking to the activist;
14. Having a plan for engaging with proxy advisory firms, responding to their recommendations and best positioning the company to convince investors to override adverse ISS and/or Glass Lewis recommendations;
15. Getting ahead of unfavorable activist-friendly press and media dynamics by refreshing media relationships, preparing statements for potential contingencies and cultivating respected third-party voices who can knowledgeably speak on the company's behalf; and
16. Preparing for potential litigation and attempts by an activist to obtain non-public books and records of the company, including board minutes and sensitive analyses, by ensuring good corporate hygiene and prudent email, text, and note-taking policies.

Complacency presents opportunities for activists and often provides them with first-mover advantages. In light of the current environment, companies are well-advised to follow closely activist developments in their industries and more broadly, carefully consider the opinions of their major investors, perfect and maintain their engagement activities, regularly review and adjust their plans designed to avoid an activist attack, and refresh their readiness to successfully deal with an activist attack if and when one should occur.

Note

1. *https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.28168.22.pdf.*

The Rise of the "Occasional Activist"

By Spencer D. Klein and Tyler Miller

The number of shareholder proposals put forward in 2022 increased by roughly 9 percent over 2021.[1] At the same time, however, the number of shareholder proposals put forward by hedge funds and dedicated activists went up by only 1 percent.[2] It appears that the rise in total proposals is due in part to "occasional activists" such as institutional investors and individuals, including company insiders.

In the first half of 2022, first-time activists accounted for approximately 37 percent of all campaigns initiated in that time period, while some of the most familiar activist names such as Elliott Management, Icahn Associates, Pershing Square Capital Management, Starboard Value, and Third Point accounted for only 23 percent, representing levels of dedicated activist participation below those observed over the past five years.[3]

The Changing Face of Dedicated Activism

Returns for activist funds as a group were down significantly in 2022. The sector lost 17 percent in 2022, compared with positive returns of 16 percent in 2021 and 10.3 percent in 2020, according to HFR Inc.[4] Moreover, dedicated activists continue to struggle to consistently win board representation when proxy contests have gone all the way to a shareholder vote; of the 70 proxy contests that went to a shareholder vote in 2022, only 34 saw the activist shareholder win board representation.[5] Indeed, several large and prominent activists lost shareholder votes in 2022. For example, Starboard Value's campaigns for board representation at both Box, Inc. and Huntsman Corporation, and Ancora Advisors' campaign for board representation at Blucora, Inc., all failed, with the management slates being elected in full.[6]

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In addition, the ability of activists to use environmental, social, and governance (ESG) concerns as a wedge issue in their campaigns—for several years an important tool for activists—may be diminishing. There is recent pushback against ESG, with some arguing that it places too much emphasis on non-financial factors and can be harmful to shareholder value. This is primarily because ESG is extremely broad and can cover factors that are material to operations and risk as well as those that may not be tied directly to financial performance.

Therefore, critics argue that this can result in lower returns for investors and may even harm the long-term sustainability of the company.[7] Another concern is that ESG ratings and criteria often are subjective and can vary widely depending on who is doing the rating. This can lead to confusion among investors and may make it difficult for companies to know how to best align with ESG expectations. Finally, some argue that ESG is a form of "greenwashing" that allows companies to appear socially responsible without actually making substantive changes to their practices.

A recent example of pushback by investors against an activist touting alleged ESG concerns was seen in Carl Icahn's 2022 proxy fight with McDonald's in which Icahn publicly criticized McDonald's for its suppliers' use of particular crates for pregnant pigs. McDonald's shareholders resoundingly rejected his director nominees and signaled that they were not at all convinced by his purported animal-welfare concerns.[8]

Several US states are also lining up to diminish the impact of ESG. In 2021, Texas passed a law banning government agencies from doing business with

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firms that the state's comptroller claims are essentially boycotting fossil fuels such as BlackRock, the world's largest investment firm, and Florida also started pulling $2 billion of its money from BlackRock because of its positions in relation to certain of the firm's climate and social initiatives.[9]

As of February 2023, Florida governor Ron DeSantis is proposing legislation to prohibit state and local governments from including any ESG considerations in investment decisions.[10] We note that the majority of the state level anti-ESG legislation is focused on climate change and of the 130 pieces of legislation introduced in the past two years, about 22 have failed. Although many of the bills are pending, more of the legislation have failed than enacted.[11]

While we don't expect dedicated activists to disappear from the corporate landscape, Bill Ackman's 2020 announcement that he was abandoning his traditional activist investing strategy in favor of a more passive approach was particularly noteworthy. Ackman's Pershing Square Capital Management has been known for its aggressive campaigns to push for change. In a letter to investors, Ackman explained that he had come to the realization that his previous approach, which involved taking large stakes in companies and using his influence to effect change, was not always the best way to create long-term value for his investors. Instead, he said he planned to focus on investing in high-quality companies with strong long-term growth prospects and holding those investments for extended periods.

The Rise of the Occasional Activist

Taking the place of these dedicated activists are "occasional activists" such as institutional investors and individuals, including company insiders. As institutional investors have grown in size, they have become major shareholders in many companies, giving them a significant voice in corporate decisionmaking and greater leverage to push for changes they believe will benefit both the company and its shareholders.

At the same time, the rise of online trading platforms and social media has made it easier for individuals to organize and advocate for changes in the companies they invest in. Directors and officers of publicly traded companies who typically are seen as being aligned with the interests of the company's management, also have become more vocal in their efforts to push for changes that they believe will benefit the company and its shareholders.

Occasional activism has taken many forms, including shareholder proposals, proxy contests, engaging with company management and board members, and publicly voicing concerns and recommendations. For example:

Neuberger Berman and NB Votes: In 2020, Neuberger Berman, a large, diversified asset manager, established its NB Votes initiative in which it preannounces its proxy-voting intentions on an array of voting topics that it believes will have material economic consequences for its clients. By telegraphing its voting intentions, NB Votes aims to promote better shareholder engagement and send a strong signal about the actions it would like certain companies to take.

David Hall and Velodyne Lidar: In 2021, the founder of Velodyne Lidar, who had been ousted as chairman of the board earlier in the year, prevailed in a proxy contest and won a board seat. The heated proxy contest involved allegations of false statements and misconduct on both sides. Increased activism by insiders adds another dimension—these individuals are likely to have deep knowledge of the company and its operations, employees, risks, etc. These kinds of contests may also become more emotional and/or involve more personal attacks than others.

Engine No. 1 and ExxonMobil: In 2021, hedge fund Engine No. 1 launched a campaign for changes in the strategy and leadership of ExxonMobil. Engine No. 1 sought to add four directors with experience in renewable energy and sustainability to the board, and to push the company to transition away from fossil fuels. The campaign was notable for the support it received from other institutional investors, including BlackRock and Vanguard, which signaled

a growing willingness among institutional investors to engage in shareholder activism on environmental and social issues. Engine No. 1 was successful in its bid to elect two of its nominees, while the other two were narrowly defeated.

Aerojet Rocketdyne: In 2022, the chief executive officer of defense supplier Aerojet Rocketdyne prevailed in a proxy contest against its executive chairman after the two had become embroiled in a bitter internal battle. The CEO's director slate received about 75 percent of the votes cast.

Neuberger Berman and Boeing: In 2022, after engaging for several years with Boeing's senior management, board of directors, and sustainability team, Neuberger Berman successfully pushed the company to update and expand its Governance & Public Policy Committee's responsibilities to include formal oversight of environmental sustainability and climate change.

AIM Immunotech: In 2022, AIM Immunotech successfully rejected the director nominees of Jonathan Jorgl and other members of an activist group that sought to take control of AIM's board of directors because their notice failed to disclose certain details as required by AIM's bylaws. This may indicate that, while occasional activism is increasing, some of these new activists' inexperience could pose difficulties for the success of their campaigns.

While these campaigns have not always been successful, it is clear that shareholder activism is increasingly being conducted by institutional investors and individuals who are not in the full-time business of activism. This trend is also likely to accelerate further now that the amendments to the proxy rules adopted by the US Securities and Exchange Commission requiring the use of a "universal proxy card" have become effective.[12] With shareholders able to cherry-pick nominees from competing slates, it seems more likely that dissidents will win minority representation. Shareholders who were previously reticent to use all of their votes on a short slate of director nominees can now make use of all of their votes by using some for the dissident's short slate and some for company nominees.

It is also possible that dissidents will be more likely to nominate short slates rather than full slates and continue the trend of nominating industry experts with extensive qualifications instead of the activist's employees or affiliates. On the other hand, the shareholders' ability to pick and choose from both proxy cards may make it less likely for dissidents to succeed in electing a majority of the board unless shareholders perceive the need for radical change or the dissident is proposing an acquisition favored by the shareholders.

Although the universal proxy card may not materially affect an established activist investor's willingness to commence a proxy contest, the enhanced ability to elect a minority slate might be attractive to smaller, newer, or occasional activists who might have otherwise shied away from the expense and resource requirements of a proxy contest, given the uncertain outcome.

Notes

1. Deal Point Data.
2. *Id.*
3. The Activism Vulnerability Report | Q2 2022, available at *https://corpgov.law.harvard.edu/2022/10/06/the-activism-vulnerability-report-q2-2022/*.
4. Ronald D. Orol, "Ranking the Insurgents," 40 *Corporate Control Alert* 11–12 (2023).
5. FactSet.
6. *Id.*
7. Some ESG factors, for example, anti-bribery, cyber and privacy, are directly tied to risk management and must be included within a company's compliance program.
8. Carl Icahn loses proxy fight with McDonald's over animal welfare, available at *https://www.cnbc.com/2022/05/26/carl-icahn-loses-proxy-fight-with-mcdonalds-over-animal-welfare.html*.
9. The secret money fueling the conservative anti-ESG push, available at *https://www.fastcompany.com/90824901/secret-money-fueling-conservative-anti-esg-push*.
10. DeSantis expands anti-ESG push in crusade against 'woke' investing, available at *https://www.washingtonexaminer.com/restoring-america/faith-freedom-self-reliance/desantis-anti-esg-crusade-woke-investing*.

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11. This information is current as of March 30, 2023.
12. Preparing for the Mandatory Universal Proxy Card and Its Potential Impacts on Shareholder Activism and Proxy Contests, available at *https://www.mofo.com/resources/insights/230131-preparing-for-the-mandatory-universal-proxy-card*.

CLIMATE DISCLOSURE

ISSB Provides Transitional Relief, Prioritizing Climate-Related Disclosures

By Mark S. Bergman

In April, the International Sustainability Standards Board (ISSB) announced that it had formally decided to prioritize climate-related disclosures (as opposed to the broader universe of sustainability-related metrics) to enable companies to focus their initial efforts on meeting strong investor demand for comprehensive, consistent and comparable decision-useful information on climate-related risks and opportunities.[1] This means that, in the initial year of reporting under ISSB standards, reporting companies will not be required to provide full reporting on sustainability-related risks and opportunities beyond climate. That full reporting will only be required in the second year.

The ISSB disclosure regime will be effective beginning in 2024, although initial application and reporting dates could vary as ISSB standards will need to be adopted on a jurisdiction-by-jurisdiction basis.

Background

In February, the ISSB took final decisions on the technical content of its initial disclosure standards. IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures) are expected to be issued at the end of the second quarter of this year).[2]

The ISSB is part of the International Financial Reporting Standards (IFRS) Foundation. IFRS accounting rules are followed in more than 160 countries, although not in the United States.[3] These countries will have the option to use/not use the ISSB standards as part of their IFRS accounting frameworks.[4]

The ISSB standards are drawn in part from the existing materiality-focused standards of the Sustainability Accounting Standards Board (SASB), which now forms part of the ISSB ecosystem. The ISSB has stated that, where there are no clear ISSB guidelines, reporting companies, subject to certain conditions, may consider guidance from the Global Reporting Initiative (GRI) and the European Sustainability Reporting Standards (ESRSs) to be applicable in the European Union. This guidance will be set out in appendices to IFRS S1.

Transitional Relief

The relief provided this past week, together with prior decisions on relief, means that reporting companies *need not* for the first year they report in compliance with ISSB standards:

- Provide disclosures about sustainability-related risks and opportunities beyond climate-related information (in the first year of reporting);
- Provide annual sustainability-related disclosures at the same time as the related financial statements;
- Provide comparative information;
- Disclose Scope 3 GHG emissions (which already had a one-year grace period, decided last December)[5]; and
- Use the GHG Protocol to measure emissions, if they are currently using a different approach.

Furthermore, companies that only report on climate-related risks and opportunities in the first year

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will be able to avail themselves of additional relief in providing comparative information, such that they will not need to provide comparative information about sustainability-related risks and opportunities beyond climate in their second year of reporting.

The ISSB April 2023 Supplementary Update notes that the one-year transition relief would not change the effective date of IFRS S1.[6] The ISSB had tentatively decided in February to require that IFRS S1 be effective for annual reporting periods beginning on or after January 1, 2024 (with reports due the following year). However, for a company applying the transition relief in the first year it applies IFRS S1, the requirements in IFRS S1 would apply only insofar as they relate to the disclosure of climate-related financial information. The transition relief would have no effect on the application of, or requirements set out in, IFRS S2.

Other transitional relief, including as to timing of climate-related disclosure relative to release of financial statements, was agreed in February.[7]

Concluding Thoughts

The ISSB standards are separate from the EU sustainability-related disclosure requirements and the proposed SEC climate-related disclosure requirements. Some companies will be facing the prospect of complying with multiple climate-related, and potentially broader sustainability-related, disclosure regimes. According to data prepared by Refinitiv provided to the *Wall Street Journal*, at least 10,000 non-EU companies are likely to be subject to the EU Corporate Sustainability Reporting Directive (CSRD), including 31 percent that are US companies.[8]

The focus on disclosure is taking place against a backdrop of undeniable C-suite focus on climate change that underlies the urgency of the ISSB efforts. According to the Deloitte 2023 CxO Sustainability Report, business leaders generally ranked the threats posed by climate change as a top issue second only to the economy; 61 percent said climate change will have a high/very high impact on strategy and operations over the next three years and almost all respondents indicated their companies were negatively impacted by climate change in some way during 2022.[9]

The finding prompted Deloitte Global CEO, Joe Ucuzoglu, to conclude that, "If there was any doubt that climate change is an enduring part of the business agenda, the increased focus on sustainability by leaders over the past year should put it to rest." Pressure to act on climate change comes from multiple touchpoints: boards and management (68 percent), clients and consumers (68 percent) and regulators and governments (68 percent), as well as investors (66 percent), employees (64 percent) and civil society (64 percent). Competitors and peers (59 percent) and banks/lenders (50 percent) also are sources of pressure to act.

Interestingly, while the ISSB delay on the full sustainability framework gives companies an additional year for that more fulsome disclosure, there already are over 2,600 companies that use SASB standards in their public company communications.

All to say that the direction of travel remains clear, and companies should be well on their way to having the systems, processes and mindsets in place to manage their climate-related, and broader sustainability-related, disclosures. And, as I have noted in prior briefing notes, while the timing and scope of Securities and Exchange Commision climate-related rulemaking (not to mention the intensity of the political pushback) remains uncertain, and in terms of coverage, the contentious Scope 3 disclosure requirements in particular may well fall short of the emerging global standard, US companies may find that the bar is higher.

Notes

1. *https://www.ifrs.org/news-and-events/news/2023/04/issb-decides-to-prioritise-climate-related-disclosures-to-support-initial-application/*.

2. Last March 2022, the ISSB published an Exposure Draft Snapshot of IFRS S1 and S2 that provides a useful overview of the two standards, available at *https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/snapshot-exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information-and-exposure-draft-s2-general-sustainability-related-disclosures.pdf*.
3. *https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/*.
4. According to the IFRS Foundation, "the ISSB standards are intended to provide a comprehensive global baseline of sustainability disclosure standards that can be mandated and combined with jurisdiction-specific requirements or requirements aimed at meeting the information needs of broader stakeholder groups beyond investors." As with the approach generally taken for IFRS accounting standards issued by the International Accounting Standards Board, jurisdictional authorities are free to decide whether to mandate use of ISSB standards. The backing of the G7, the G20, IOSCO, the Financial Stability Board, the African Finance Ministers and finance ministers/central bank governors from over 40 jurisdictions underscores the global nature of the baseline. Some countries are creating their own sustainability standards boards as an interface with the ISSB. *See* ISSB FAQ at *https://www.ifrs.org/groups/international-sustainability-standards-board/issb-frequently-asked-questions/*.
5. In October, the ISSB confirmed the inclusion of Scope 3 disclosure, when material, as set out in its draft IFRS, S2 given feedback from investors that they cannot fully understand transition risk without information about absolute gross Scope 1, 2, and 3 emissions. However, the ISSB agreed it would provide support for companies in the provision of these disclosures through guidance and relief to help them implement processes to measure Scope 3 emissions.

   In December, the ISSB agreed to set out a framework in IFRS S2 for the measurement of Scope 3 GHG emissions that would require the use of reasonable and supportable information that is available without undue cost or effort and incorporates the use of estimation. Use of this framework would be accompanied by disclosures to enable investors to understand the basis for measurement of Scope 3 GHG emissions.

   The ISSB also agreed in December to the one-year Scope 3 grace period following the effective date of IFRS S2, to give time for companies to implement their processes. A company will also be able to include information that is not aligned with its reporting period, when that information is obtained from companies in its value chain with a different reporting cycle.
6. *https://www.ifrs.org/news-and-events/updates/issb/2023/supplementary-issb-update-april-2023/?utm_medium=email&utm_source=website-follows-alert&utm_campaign=immediate*.
7. *https://www.ifrs.org/news-and-events/updates/issb/2023/issb-update-february-2023/*.
8. According to Refinitiv data, close to 10,400 non-EU companies have EU listings and more than 100 non-EU companies that are not listed in the European Union exceed the €150 million EU revenue threshold. *See https://www.wsj.com/articles/at-least-10-000-foreign-companies-to-be-hit-by-eu-sustainability-rules-307a1406?mod=trending_now_news_1*.
9. *https://www.deloitte.com/content/dam/assets-shared/legacy/docs/2023-deloitte-cxo-sustainability-report.pdf*.

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Silicon Valley's Largest Companies: Stepped Up ESG Reporting Last Year

By David A. Bell and Ron C. Llewellyn

Environmental, social and governance (ESG) concerns and how companies respond to them continue to generate scrutiny from a large number of stakeholders. Last year, in our "ESG in Silicon Valley: A Look at the ESG Disclosure Practices of the SV 150" we examined how technology and life sciences companies were responding to the growing interest in ESG and related disclosure by looking at the voluntary ESG reporting practices of the companies included in the 2022 Fenwick-Bloomberg Law SV 150 List (SV 150)—based on their disclosures in the 2021 proxy season.[1] This report builds on that analysis by looking at the ESG reporting for SV 150 companies based on proxy statements filed during the 2022 proxy season, which generally covers the period between July 1, 2021 and June 30, 2022, and other publicly available information.

Key Takeaways

- The number of SV 150 companies disclosing ESG information and the comprehensiveness of such disclosures increased in 2022.
- Although ESG reporting has not been mandated, most companies have opted to provide some level of disclosure in response to stakeholder demands and in anticipation of likely mandated disclosures by the Securities and Exchange Commission (SEC).
- Areas most frequently disclosed include: environmental issues, human capital resources, diversity, supply chains, customers and products, community impact, and governance.

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- The quality of ESG disclosure varied by size of company, with the larger SV 150 companies generally providing more comprehensive disclosure, including quantitative metrics.
- Technology and life sciences companies contemplating whether to voluntarily disclose ESG information or expand their disclosure should consider these trends and the types of information disclosed, to better assess their preparedness for ESG disclosure and meeting the demands of investors and other stakeholders.

By the Numbers: A Look at the Trends

Generally, the number of companies providing voluntary ESG disclosures increased slightly in 2022 compared to the data we gathered from 2021. In particular, our analysis of the public disclosures of the SV 150 companies shows the following trends during 2022:

- Overall, approximately 92 percent of SV 150 companies provided ESG information, up slightly from 90 percent in 2021, though the most comprehensive disclosure was often on company websites or in standalone corporate social responsibility, sustainability or ESG reports or their equivalent (referred to as CSRs), rather than in proxy statements.
- Approximately 85 percent of SV 150 companies provided some level of ESG disclosure in their proxy statements compared to 80 percent in 2021.
- Approximately 62 percent of SV 150 companies provided some level of ESG disclosure in CSRs compared to 58 percent in 2021.
- Approximately half of the SV 150 companies reported using a third-party standard or framework to guide their disclosure.

- Almost half of SV 150 companies (49 percent) disclosed Scopes 1 and 2 GHG emissions, with a slightly lower percentage (42 percent) disclosing Scope 3 GHG emissions.
- A majority of SV 150 companies disclosed gender and racial/ethnic demographic information for their US employees.

92 Percent of SV 150 Companies Provided ESG Information

Compared to 2021, there was a slight increase in the number of SV 150 companies providing ESG information, with 92 percent of companies providing such data in 2022, versus 90 percent in 2021. The number of companies disclosing ESG information in their proxy statements increased to 85 percent from 80 percent in the prior year. Similarly, the number of companies disclosing ESG information in CSRs increased to 62 percent, compared to 58 percent in 2021. Only 12 of the 146 SV 150 companies provided no ESG disclosure, while two companies only provided website disclosure and two only provided brief disclosure in Form 10-K.

Robust ESG disclosure skewed towards the larger companies in the SV 150 that tended to disclose information in both proxy statements and CSRs, but with more comprehensive disclosures on the latter platform. For example, although overall only 58 percent of SV 150 companies disclosed in both CSRs and proxy statements, approximately 90 percent of the top 50 companies disclosed in both, compared to just 51 percent and 32 percent of the middle and bottom 50 companies, respectively.

Where Companies Disclosed ESG Information

Exhibit 1 shows the percentage breakdown of where various sized companies disclosed their ESG information.

ESG Disclosure Quality

The larger companies in the SV 150 tended to provide the most detailed and extensive ESG disclosure, typically in CSRs that covered a broad range of environmental, social, and governance topics and included both qualitative and quantitative data. While many companies disclosed on multiple platforms, they used CSRs to provide more granular details regarding their ESG programs and initiatives and to discuss goals and performance against stated objectives. Third-party disclosure standards and frameworks often guided these disclosures, with many CSRs containing indices indicating how the information in the CSR satisfied one or more standards.

Below are some of the most common topics on which SV 150 companies reported.

Environmental

Disclosures of environmental matters included both qualitative and quantitative discussions on a wide variety of issues. Approximately 79 percent of SV 150 companies provided environmental disclosures. Qualitative disclosures often included descriptions of sustainability initiatives such as recycling programs, LEED building certifications, hybrid/remote work policies and other greenhouse gas (GHG) emission reduction programs. Companies also discussed how their products contributed to their customers' environmental sustainability efforts.

On the quantitative side, almost half of the SV 150 companies (49 percent) provided Scopes 1 and 2 GHG emissions data, and approximately 42 percent provided Scope 3 emissions. Companies also discussed energy consumption (electricity and gas), water usage and waste management, and disclosed specific goals and commitments to reduce their carbon footprint and/or increase their usage of renewable energy.

Social

Social disclosure comprised the broadest range of topics from human capital resources (HCR) to supply chain management to community impact.

Human Capital Resources. Companies provided information most often on HCR, with approximately 84 percent of SV 150 companies providing some form of HCR disclosure. This disclosure often

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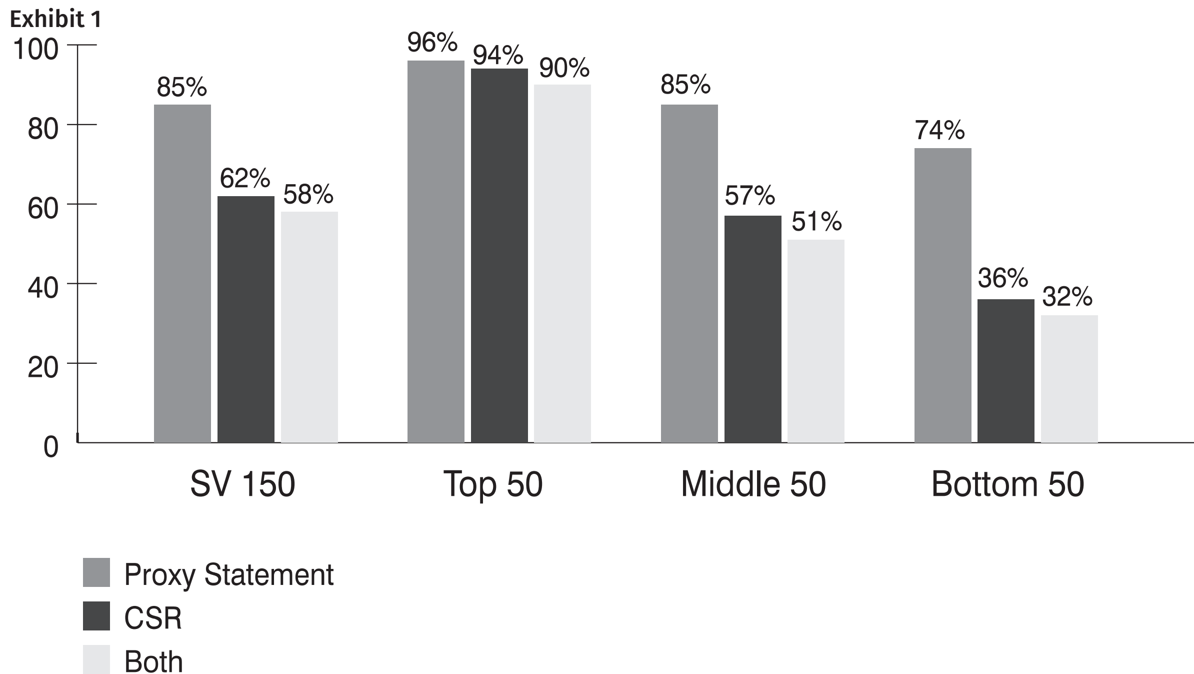


consisted of discussions regarding employee training and engagement, employee resource groups, workplace safety issues, and employee turnover. Although much of this information was qualitative, in some instances companies provided quantitative metrics.

While much of this information was contained in CSRs, the SEC has indicated that it intends to propose new rules in 2023 that would likely require companies to disclose more HCR/human capital management information, including quantitative data, in their SEC filings. Accordingly, it is likely that the amount of HCR disclosure in proxy statements and/or other SEC filings will increase in the near future.

Diversity. Most companies provided quantitative information regarding diversity, including the demographic breakdown of their workforce by gender, race/ethnicity, and role. Notably, 63 percent of companies provided employee gender demographic information and 59 percent provided US employee race/ethnicity information on an aggregated basis (49 percent of companies provided such information with specific racial/ethnic categories based on or similar to EEO-1 reporting).

In addition to these metrics, companies also provided information regarding efforts to increase diversity within their ranks and programs to support underrepresented communities. Disclosure of employee demographic information is likely to increase as a number of shareholders and other stakeholders have called on companies to disclose information consistent with EEO-1 reports filed by many companies with the Department of Labor.

Supply Chain. Approximately half of the SV 150 companies (51 percent) disclosed issues related to their supply chains. Such disclosure included information regarding supplier codes of conduct and supplier diversity and audits. Companies also discussed supply chain integrity and related initiatives, including participation in third-party organizations such as the Responsible Business Alliance. When a company's business involved the sourcing of raw materials and minerals, it often noted adherence to responsible sourcing policies and compliance with regulations such as the SEC's Conflict Minerals Rules.

Customers and Products. A majority of companies (64 percent) disclosed information related

to customers and products. In particular, many companies addressed their policies and practices regarding data security and privacy. Such disclosures noted, where applicable, how their products promoted or enhanced data security. In the case of life sciences companies, the disclosure focused on issues such as product safety, access to care and ethical marketing.

Communities. A majority of companies (66 percent) discussed philanthropic activities such as corporate donations, employee donation corporate match programs, community-based programs, and employee volunteer activities. To the extent that a company's product or service had a broader social impact, it emphasized the tie between the product and/or service and the societal or community benefit.

Governance

Approximately 83 percent of companies included governance disclosure separate from the disclosure required under applicable SEC proxy rules. In addition to required proxy statement disclosures such as board structure, oversight, and composition, companies discussed board diversity, compliance programs, management oversight, stakeholder engagement, anti-bribery and anti-corruption programs, and business ethics. Descriptions of and/or links to relevant policies, such as codes of conduct and corporate governance guidelines, were also provided in CSRs to demonstrate board or management oversight in these areas.

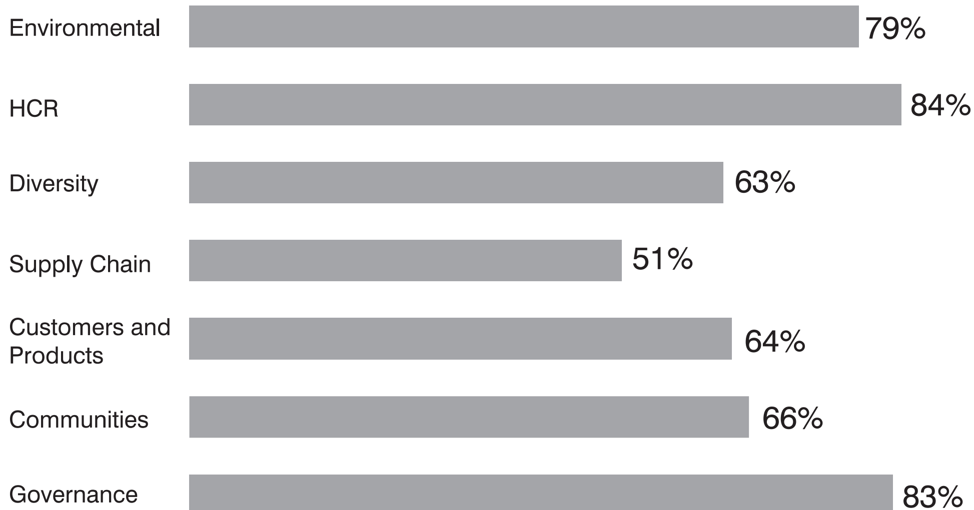
What Companies Disclosed About ESG

Exhibit 2 shows what type of information about ESG was disclosed by companies. It also indicates what percent of total disclosure each type of ESG represented.

Third-Party Frameworks and Standards

Third-party frameworks and standards can be valuable in guiding companies on what information to disclose based on industry and stakeholder interest. Just over half of the companies in the SV 150 (51 percent) followed or were influenced by a third-party standard-setter in determining what information to disclose. The most prominent frameworks and standards included Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Task Force on Climate-related Financial Disclosure (TCFD) and the United Nations Sustainable Development Goals (UNSDG).

Exhibit 2



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SV 150 companies cited SASB most often as the standard to which they adhered, with 91 percent of the companies disclosing standards citing SASB compared to 87 percent in 2021. GRI was the second-most popular standard, with 63 percent of reporting companies favoring it. Finally, approximately 43 percent of companies that reported to a standard or framework (22 percent of all SV 150 companies) indicated that they used the TCFD framework.

The most prominent frameworks and standards include:

- Global Reporting Initiative (GRI)
- Sustainability Accounting Standards Board (SASB)
- Task Force on Climate-related Financial Disclosure (TCFD)
- United Nations Sustainable Development Goals (UNSDG)

Disclosure Trends: Top 50 Companies

Overall, the top 50 companies exhibited the most widespread and robust ESG disclosure practices, with approximately 96 percent and 94 percent of such companies reporting ESG information in their proxy statements and CSRs, respectively. Compared to the other companies in the SV 150, the top 50 companies generally have greater resources that can be devoted to developing the necessary controls and infrastructure to provide more comprehensive reporting.

The top 50 companies also were more likely to align their disclosure with third-party standards or frameworks such as GRI or SASB. Eighty-eight percent of the top 50 reported to such standards or frameworks, compared to 84 percent in 2021. All top 50 companies provided ESG disclosure in their proxy statement, CSR or both. The top 50 companies include companies with revenue of approximately $2.9 billion or more and market capitalizations averaging $211.2 billion (based on values at the time of announcement of the most recent SV 150 index list).

Disclosure Trends: Middle 50 Companies

Only 57 percent of middle 50 companies provided disclosure in CSRs, representing a slight increase from the 55 percent of middle 50 companies using CSRs in 2021. However, approximately 85 percent of middle 50 companies disclosed their ESG information in their proxy statements, compared to 82 percent in 2021. Five companies provided no ESG disclosure.

Just over a third (36 percent) of middle 50 companies reported to one or more third-party standards or frameworks, with SASB cited most often (15 companies) followed by GRI (12 companies). Middle 50 companies include those with revenue of at least approximately $776 million but less than approximately $2.9 billion, and market capitalizations averaging $15.8 billion (based on values at the time of announcement of the most recent SV 150 index list).

Disclosure Trends: Bottom 50 Companies

Only 36 percent of the bottom 50 companies provided disclosure in CSRs, representing an increase from the 28 percent of companies using CSRs in 2021. Approximately 74 percent of the bottom 50 companies disclosed ESG information in their proxy statements, increasing from 70 percent in 2021. Seven companies provided no ESG disclosure.

Only 30 percent of bottom 50 companies disclosed following a third-party standard or framework, with SASB being cited most often (14 companies) followed by GRI and the UNSDG (six companies each). It stands to reason that the bottom 50 companies, which are generally younger and have less revenue than the larger companies in the SV 150, have fewer resources to devote towards providing more substantial ESG disclosure. The bottom 50 companies include companies with revenue of at least approximately $327 million but less than $770 million, and market capitalizations averaging $6.3

billion (based on values at the time of announcement of the most recent SV 150 index list). Seventy-four percent of the bottom 50 companies disclosed ESG information.

ESG Board Oversight

Most SV 150 companies (76 percent) disclosed board or committee oversight of ESG, which surpassed the 73 percent of SV 150 companies disclosing this information in 2021. In particular, 85 percent of the companies providing such disclosure stated that the nominating and corporate governance committee (or its equivalent) had primary responsibility for ESG oversight. Just 9 percent of disclosing companies expressed that the full board provided oversight while the same percentage of companies reported the audit committee or the compensation committee (or their equivalent) oversaw ESG.

Approximately 10 percent of companies reported that multiple committees oversaw ESG. In some cases, even when a company indicated that the nominating and corporate governance committee had primary responsibility for ESG, it also noted that other board committees oversaw aspects of ESG that were in their purview (for example, the compensation committee overseeing the use of ESG metrics in executive compensation plans).

Conclusion

Although ESG reporting has not been mandated, most companies have opted to provide some level of disclosure in response to stakeholder demands and in anticipation of likely mandated disclosures by the SEC. The number of SV 150 companies disclosing ESG information and the comprehensiveness of such disclosures increased in 2022.

Technology and life sciences companies contemplating whether to voluntarily disclose ESG information or expand their disclosure should consider these trends and the types of information disclosed by SV 150 companies. Doing so may help such companies to better assess their preparedness for disclosing ESG information and meeting the demands of investors and other stakeholders.

Background and Methodology

For our research we looked at the public disclosures, primarily CSRs and the most recent proxy statements of 146 of the 2022 constituent companies of the SV 150. The SV 150 companies ranged from Apple, with $378 billion in revenue for 2021, to Poshmark, with $327 million in revenue for 2021. As we noted in our "2022 Corporate Governance Practices and Trends," SV 150 companies are generally smaller, younger, and have less revenue than the large public companies of the Standard & Poor's 100 Index (S&P 100), although some of the larger SV 150 companies are also represented in the S&P 100 and S&P 500.[2] Because of the wide range in sizes of companies in the SV 150 we have grouped them into subcategories of top 50, middle 50, and bottom 50 companies by revenue. A company was regarded to have ESG disclosure if it specifically referenced "ESG," "sustainability," "corporate social responsibility" or another similar term, and addressed ESG risks and opportunities as a unified concept.

Notes

1. *https://www.fenwick.com/insights/publications/esg-in-silicon-valley-a-look-at-the-esg-disclosure-practices-of-the-sv-150.*
2. *https://www.fenwick.com/insights/publications/2022-corporate-governance-practices-and-trends.*

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COSO Issues Guidance on Internal Control Over Sustainability Reporting

By Dan Goelzer

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) has published guidance on the application of its internal control framework to sustainability reporting. "Achieving Effective Internal Control Over Sustainability Reporting (ICSR): Building Trust and Confidence through the COSO Internal Control—Integrated Framework" states that "akin to internal control over financial reporting (ICFR), we are now seeing the emergence of what we call internal control over sustainability reporting (ICSR)." The article explains in detail how the 17 principles in COSO's Internal Control—Integrated Framework, as revised in 2013 (ICIF-2013), apply to sustainability reporting.[1]

Background

COSO, a group of five global accounting and auditing organizations, was founded in 1985 in response to concerns about the quality of financial reporting. In 1992, COSO published Internal Control—Integrated Framework to define internal control and provide a common framework for evaluating and improving internal control systems. In 2002, the Sarbanes-Oxley Act required public companies to report on the effectiveness of their ICFR and, for larger companies, required the auditor to attest to management's report.

This reporting must be based on a suitable internal control framework that meets certain criteria. The SEC has indicated that the COSO framework satisfies those criteria and, as a practical matter, virtually all ICFR reporting is based on COSO.

In 2013, COSO updated its framework to incorporate a risk-based approach to designing, assessing, and reporting on internal controls and to expand the objectives to include other important forms of reporting, such as nonfinancial and internal reporting. ICIF-2013 defines internal control as "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance." ICIF-2013 is comprised of five components:

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring Activities

Each of the five components contains three to five principles, for a total of 17 principles. Each principle is subdivided into "points of focus" that explain how the principle works in practice. An organization has an effective system of internal controls when all 17 principles are present and functioning.

Applying ICIF-2013 to Nonfinancial Information

The bulk of the COSO paper consists of explanation and interpretation of how the 17 ICIF-2013 principles apply to sustainability. The discussion of each principle includes the ICIF-2013 points of focus

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regarding that principle and provides "insights" on how the principle can be implemented with regard to sustainability information. These insights are based on proposed regulations, evolving professional standards, organizational practices, "authoritative and thought leadership materials" and the authors' interviews with professionals with a variety of relevant backgrounds. In addition, the principles discussion references publicly available corporate environmental, social, and governance (ESG) reports that illustrate the application of the various principles to sustainability.

To illustrate the paper's approach: The first of the five ICIF-2013 components is the control environment. The second control environment principle is "The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control." There are four ICIF-2013 points of focus for that principle. The COSO paper relates them to sustainability reporting as follows:

1. *Establishes oversight responsibilities*. A board of directors executes its responsibilities over sustainable business management through a system of oversight that facilitates the organization's satisfaction of mandates and expectations. Often, the organization's board of directors establishes structures, such as a designated committee or subcommittee, to oversee the organization's sustainable business activities and reporting. This may necessitate amending existing organizational documents such as the articles of incorporation, bylaws, or charters.
2. *Applies relevant expertise*. A board of directors identifies requisite skills and areas of expertise for its own membership. Therefore, it ensures that board members charged with oversight responsibilities regarding sustainable business have the knowledge base and skill set to be effective.
3. *Operates independently*. A board of directors operates independently from management with respect to oversight and responsibilities for decisionmaking on sustainable business issues. This point of focus operates in the same way with respect to sustainable business activities as it does for all other organizational activities.
4. *Provides oversight of the system of internal control.* The board oversees an organization's design, implementation, and performance of controls, systems, and processes related to sustainable business activities and reporting. Often, this is a check on management and an oversight of how the organization is utilizing its resources and processes to achieve sustainable business activities, such as programs around energy, waste, green house gas (GHG) emissions, supply chain, cybersecurity, and diversity, equity, and inclusion.

As an insight with respect to this principle, the COSO paper lists actions that an organization might take to enhance audit committee oversight of sustainability business information that is released to external stakeholders. Examples of these audit committee actions include:

- Revising charters to include oversight of external reporting of sustainability information and to include oversight of disclosures regarding the effectiveness of the organization's system of ICSR.
- Conducting educational sessions on recent developments regarding sustainable business.
- Overseeing the internal audit function and review of sustainable business information.
- Developing processes to operationalize oversight of external reporting, such as determining the frameworks, standards, and guidelines to follow for external ESG reporting.
- Reviewing external ESG reports before issuance.
- Determining the extent to which ESG information is subject to independent assurance or verification and determining the appropriate outside firm to perform independent assurance or verification.

As an example of the application of this principle to sustainability reporting, the COSO paper quotes from Travelers description of the roles of its various board committees.

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COSO's Top 10 Takeaways

The COSO paper concludes with a list of ten takeaways. Those that appear most relevant to audit committees are:

- "Be committed to ensuring your organization has effective internal control over sustainability-related matters, including operations, compliance, and various types of reporting (external, internal, nonfinancial, and compliance)."
- "Work with others to determine the best organizational structures, roles, and responsibilities to create the desired results, achieve appropriate internal and external efficiencies, and achieve effective internal control. This includes the board and board committees, management, operations, compliance, and internal audit."
- "Educating yourself on new topics like sustainability is critical. Take advantage of seminars, new publications, and certificate programs."
- "Internal assurance and confidence in sustainability reporting need to exist before external assurance. Take advantage of your internal audit function in this regard to provide objective assurance and other advice."
- "This is a fast-moving area, and there is bound to be lots of change over the next several years. So, monitoring activities are key in terms of evaluating progress and knowing when to make corrections and enhancements."

Comment: In many cases public company sustainability reporting has developed without the kinds of controls over accuracy and completeness that are routine with respect to traditional financial disclosures. As investors rely more heavily on sustainability information in their decision-making and as regulators become more focused on these disclosures, it is imperative that companies create appropriate controls.

COSO's ICIF-2013 is the gold standard for controls over financial reporting and, as such, is familiar to public company reporting personnel, internal audit, auditors, and audit committees. Audit committees may want to consider how COSO's framework can be extended to their company's sustainability reporting.

Note

1. *https://www.coso.org/SharedDocuments/COSO-ICSR-Report.pdf*.

DISCLOSURE CONTROLS

SEC's Continued Focus on Cybersecurity Incident Disclosures

By David Engvall, Mellissa Duru, Ian MacDonald, Ashden Fein, Caleb Skeath, and Micaela McMurrough

On March 9, 2023, the Securities and Exchange Commission (SEC) Enforcement Division's Crypto Assets and Cyber Unit announced a settlement with Blackbaud, Inc. involving allegations of inadequate disclosure controls and procedures and material misstatements and omissions concerning a 2020 cybersecurity incident.[1] Blackbaud, a South Carolina-based public company that provides donor data management software to non-profit organizations, agreed to pay a $3 million civil penalty to settle charges that it failed to maintain disclosure controls and procedures and misled investors in its quarterly report on Form 10-Q about the 2020 ransomware incident that affected information from over 13,000 of its customers.

The SEC's Order in the Blackbaud matter highlights the SEC Staff's continuing scrutiny of public companies' disclosures, and disclosure controls and procedures, regarding material cybersecurity incidents.[2] This focus also is reflected in the SEC's March 2022 rule proposal that would require public companies to provide real-time disclosures on Form 8-K about material cybersecurity incidents and increased information about their cybersecurity risk management and strategy, among other items. The SEC's rulemaking agenda indicates that the SEC could consider adopting a final rule as early as April 2023.[3]

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The Blackbaud Order serves as a reminder of the risks of making an inaccurate disclosure, or failing to update a prior disclosure, as an investigation into a cyber incident progresses. Public companies should carefully review their disclosure policies and procedures to ensure that cybersecurity incidents are accurately and quickly reported to management, with appropriate updates as an investigation into an incident unfolds, so that disclosure obligations can be properly considered.

Background

According to the Blackbaud Order, on May 14, 2020, Blackbaud's technology personnel detected unauthorized access to the company's systems, as well as a message from an attacker demanding payment in exchange for deleting exfiltrated customer data. The Order alleges that by mid-July 2020, Blackbaud understood that the attacker had exfiltrated at least one million files, and the company had reviewed the file names to determine which products and customers were affected. However, the Order states that the company did not analyze the content of any of the files, which would have revealed the extent of the customer information that had been affected.

On July 16, 2020, Blackbaud publicly announced the incident and contacted affected customers, stating that the attacker did not access bank account information or Social Security numbers. By the end of July 2020, the Order alleges that company personnel learned that the attacker had, in fact, accessed unencrypted bank account information and Social Security numbers. However, the personnel with this information did not communicate it to Blackbaud's senior management responsible for disclosures.

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As a result, on August 4, 2020, Blackbaud filed its Form 10-Q for the second fiscal quarter of 2020, which omitted the fact that a number of customers had unencrypted bank account and Social Security numbers exfiltrated in the attack. Additionally, the Form 10-Q risk factors described as "hypothetical" a risk that customer data could be accessed in a cybersecurity incident. At the end of September 2020, the company publicly disclosed for the first time that the attacker had accessed unencrypted donor bank account information and Social Security numbers for certain impacted customers.

Disclosure Controls and Procedures

Rule 13a-15(a) of the Securities Exchange Act of 1934 (Exchange Act) requires every issuer to maintain disclosure controls and procedures designed to ensure that information required to be disclosed by an issuer in reports it files or furnishes pursuant to the Exchange Act is recorded, processed, summarized, and reported, within the time period specified in the SEC's rules and forms.

The Order emphasized that while Blackbaud is in the business of providing software that allows its customers to manage sensitive data, the company "did not have disclosure controls and procedures related to the disclosure of cybersecurity risks or incidents, including incidents involving the exposure of sensitive donor information." Due to the failure to escalate relevant information about the incident, the Order noted that information related to the incident was not assessed from a disclosure perspective and was not timely communicated to the company's senior management and other disclosure personnel. This lapse in communication was a key component of the finding that the company had inadequate disclosure controls and procedures.

Material Misstatements and Omissions

The SEC also found that Blackbaud's August 4, 2020 Form 10-Q omitted the material fact that the cyber attacker had exfiltrated customers' unencrypted bank account and Social Security numbers, in contrast to the company's unequivocal, and ultimately erroneous, claims in its July 16, 2020, announcement and subsequent customer notices. The Order concluded that this omission rendered the statements about the incident in the Form 10-Q materially misleading because they perpetuated the false impression that the incident did not result in the attacker accessing "highly sensitive donor data"—data which, the Order notes, is at the core of the company's business—when in fact the company's personnel learned before August 4, 2020, that such data had been accessed and exfiltrated by the attacker.

The Order also focused on the company's cybersecurity risk factor, which spoke of the "hypothetical" risk of a cybersecurity incident affecting sensitive customer data, which the Order characterized as "misleading." The Order noted that the risk factor omitted the material fact that such data had actually been exfiltrated by the attacker, which meant that the risks of such an attack on the company's business were no longer hypothetical.

Notably, at the time of these misstatements, Blackbaud offered and sold stock to its employees through an equity and incentive compensation plan. As a result of this ongoing offering of securities, the SEC also determined that Blackbaud's material misstatements and omissions violated the antifraud provisions of Section 17(a) of the Securities Act of 1933, which makes it unlawful to offer or sell securities by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

Takeaways

In light of the SEC's ongoing focus on the adequacy of cybersecurity incident disclosures, public companies should consider:

- Assessing cybersecurity incident response planning and preparedness, including whether they

contain clearly defined escalation procedures to senior management and disclosure personnel;

- The adequacy of disclosure controls and procedures with respect to cybersecurity incidents, including procedures for assessing the need to update prior disclosures;
- The need to ensure that public statements about cybersecurity incidents, both in periodic reports and in connection with pending and ongoing securities offerings, are accurate, complete, and timely; and
- Developing and executing cross-functional tabletop simulations that include testing escalations, disclosure controls and procedures, and communications.

Notes

1. *https://www.sec.gov/news/press-release/2023-48*.
2. *https://www.sec.gov/litigation/complaints/2023/comp-pr2023-48.pdf*.
3. For a discussion of the proposal, *see https://www.cov.com/en/news-and-insights/insights/2022/03/cyber-risk-management-response-and-transparency-sec-proposes-public-company-cybersecurity-disclosure-rules*.

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FOREIGN PRIVATE ISSUERS

Factors for London-Listed Companies to Consider Before Dual Listing or Relisting in the United States

By Danny Tricot, Simon Toms, Denis Klimentchenko, Adam M. Howard, Maria Protopapa, Justin Lau, and Georgian C. Dimopoulos

There has been increased focus recently among London-listed companies in exploring US listings, whether as a further listing or migrating from London altogether. This is primarily being driven by companies seeking to close the valuation and trading liquidity gaps that they face compared to their US-listed peers, as well as to expand their US investor base and gain greater access to the US capital markets.

For most FTSE 350 companies, the London Stock Exchange (LSE) will likely remain the most logical primary trading venue given the sector, geographical scope, investor base, and market capitalization of these companies. Nonetheless, there may be a select group of UK companies for which a dual listing or even migration to the United States makes sense.

Before London-listed companies explore a US listing, they should carefully consider the rationale and suitability of such a move. Below are some of the key issues.

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1. Key Steps, Documentation, Eligibility, and Timing

Registration

- A UK-listed company undertaking a listing on the New York Stock Exchange (NYSE) or Nasdaq which is not raising new capital must register its securities by preparing and filing with the US Securities and Exchange Commission (SEC) for its review a registration statement on Form 20-F if it qualifies as a "foreign private issuer" (FPI) (*see* below) or a Form 10 if it is deemed or elects to be a US domestic issuer.
  The company must address and satisfy all of the SEC's comments before the registration statement can be declared effective and the listing can take place. Other than financials prepared to the standards of the Public Company Accounting Oversight Board (PCAOB) (*see* below), most of the disclosure required in such a registration statement should be readily available from the company's existing annual reports.
- The SEC review process can be confidential initially, but a public filing will be required during the later stages of the process. The SEC generally provides its first round of comments within 30 calendar days of the first filing and there are typically two to three subsequent rounds of comments. The SEC's

comments and the company's responses will become publicly available on the SEC's online filing system.

Listing

- The NYSE and Nasdaq rules require that the company meets certain eligibility criteria that an LSE-listed company should be able to satisfy, including a minimum number of public shareholders, a minimum number of publicly held shares or a minimum market value of publicly held shares.

2. FPI or US Domestic Issuer?

- UK-listed companies should consider whether they would qualify as an FPI or a US domestic issuer. Given the reduced disclosure requirements for FPIs under US securities laws, many companies opt for FPI status. However, a company can elect to be a US domestic issuer by redomiciling in the United States, especially those with larger market capitalizations that are eligible for inclusion in S&P indexes (*see* below).
- If a company qualifies as an FPI, it will be subject to a lighter continuing disclosure and reporting regime under the SEC rules than if it were a domestic issuer. For example, US proxy rules, including a mandatory advisory vote on executive compensation, do not apply to FPIs, and FPIs are not required to file quarterly financial statements with the SEC, with limited exceptions. FPIs also are generally permitted to rely on home country practice and are exempt from stock exchange governance rules, particularly the requirements to have a majority of independent directors and the requirement to seek shareholder approval for equity incentive plans and share issuances of more than 20 percent of the outstanding voting power.FPIs are required to file annual reports on Form 20-F and disclose material events on Form 6-K. An FPI must prepare its financial statements according to US generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS), pursuant to PCAOB standards.

3. Obtaining US Indexation, FTSE Indexation, and Effects on Share Trading

- In order to be included in S&P indexes, a company must be a US domestic issuer, have a plurality of its fixed assets in the United States, generate a plurality of its revenue from the United States and have its primary listing on a US exchange (for example, NYSE or Nasdaq). The company would also need to have a minimum market capitalization ($12.7 billion for the S&P 500) and certain trading liquidity thresholds calculated according to a US consolidated volume.
- UK-listed companies should consider their continuing eligibility for FTSE indexation. A UK-incorporated company with a dual listing will no longer be eligible automatically for FTSE indexation unless trading of its shares in the United Kingdom continues to meet certain liquidity thresholds, in addition to other factors that FTSE may consider. If a US holding company structure is adopted when a company lists in the United States, it may no longer be eligible for FTSE indexation.
- Companies, with their financial advisors, should also consider the short-term effect on their share price of (i) selling by institutional investors due to exclusion from a FTSE index and (ii) mandatory buying of their shares following indexation with S&P.

4. US Holding Company Structure?

- Cancellation of a premium listing in London, including moving to a standard listing, requires (i) the preparation of a shareholder circular approved by the UK Financial Conduct

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Authority (FCA) and (ii) convening an extraordinary general meeting and obtaining the approval of 75 percent of shareholders voting (including a majority of independent shareholders in the case of a company with a controlling shareholder).

- If a US holding company structure is to be used:
  - The required corporate reorganization would normally be implemented by way of a UK scheme of arrangement that requires, among other things, the approval of 75 percent of shareholders voting at a court-convened meeting.
  - The US holding company would need to list its shares (via depositary interests) in London and prepare an FCA-approved prospectus.
  - If a company is in a regulated sector, it should consider whether any regulatory approvals are required for inserting a new US holding company above the existing company.
- If the UK Takeover Code ceases to apply, then a listed company could consider adopting appropriate takeover defenses.

5. US Securities Law Liability Regime

- The liability regime for false or misleading disclosure under the US Securities Act of 1933 and the US Securities Exchange Act of 1934 is comparable to the UK regime and is enforced by the SEC.
- Although the plaintiff's bar is more active in the United States, it has not proved a significant deterrent for companies choosing to list in the United States.

6. Listing Ordinary Shares versus US Depositary Shares

- A UK-listed company may opt to list its ordinary shares on a US exchange, which must be cleared through the Depository Trust Company (DTC) and transferred into DTC. Also, see the tax considerations below.
- A UK-listed company could also opt to have American depositary shares (ADS) traded, in which case it would need to deposit shares with a depositary bank, which would issue American depositary receipts (ADRs) to shareholders. In this scenario, shareholders would hold ADRs representing shares in the company rather than the shares themselves.

7. Tax Considerations

- For shares of a UK-incorporated company to be transferred or issued into DTC, clearance from HM Revenue and Customs (HMRC), the UK tax authority, is typically sought to confirm there is no stamp duty or stamp duty reserve tax on the transfer or issuance, which typically takes three to six months. An HMRC clearance would usually be sought for depositing shares of a UK-incorporated company with a depositary bank if ADSs are issued.
- If a new US holding company structure is used, relief must be claimed from HMRC to obtain exemption from UK stamp duty on the transfer of the shares of the UK company to the US holding company.
- Careful consideration must be given to any impact of the listing arrangements—especially in the context of the introduction of a new holding company—both on the shareholder base (for example, to ensure that there is no taxable transaction and to mitigate future withholding obligations) and on the new structure of the group (for example, cash repatriation planning, any necessary internal reorganizations, and modeling of incremental costs from various regulatory requirements that may become applicable).

All the factors above should be considered by a UK-listed company evaluating whether a dual listing in the United Kingdom and United States or a full migration to the United States would benefit the company and its shareholders and achieve the company's strategic aims.

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