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ESG Proposals Make Early Waves in the 2022 Proxy Season

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Environmental, social, and governance (ESG) issues received unprecedented attention from investors during the 2021 proxy season, and early indications show that the momentum will continue to build this year.

On March 4, two ESG shareholder proposals were approved at the Apple Inc. (Apple) annual meeting.

Civil Rights Audits

The first proposal, which was approved by approximately 53.6% of shareholders, asks the board of directors to conduct a third-party civil rights audit for public disclosure on Apple's website. Specifically, the proposal requests that the third-party audit analyze "the adverse impact of Apple's policies and practices on the civil rights of company stakeholders … and provide recommendations for improving the company's civil rights impact."[1]

Proposals for third-party civil rights or racial equity audits first appeared in 2021, arising from the ongoing political and social movements, including the Black Lives Matter movement. Some companies, including Airbnb, Inc. (Airbnb) and Meta Platforms, Inc. (Facebook), voluntarily conducted racial equity audits prior to these proposals in response to outside pressure arising from scrutiny of their business practices.

A civil rights audit evaluates the interplay between a company's policies, procedures, and business, and civil rights and racial equity issues. Laura Murphy, who conducted civil rights audits for Airbnb and Facebook, notes that, in a civil rights audit, "auditors with civil rights expertise will assess a company's business policies practices, products, and services to determine whether and how those components have a discriminatory effect and/or disparate impact on people historically subject to discrimination."[2] Based on the results, the auditors then form a plan with the company to improve its performance in these areas.

During the 2021 proxy season, shareholder proposals calling for civil rights audits largely focused on financial institutions, with these proposals being filed at eight large financial institutions. Ultimately, all of these proposals failed or were withdrawn. However, where the proposals went to a vote, they garnered sizable minority support. In fact, six months after a racial equity audit proposal received support from approximately 38.6% of shareholders during its annual meeting, Citigroup Inc. announced that a third-party would conduct a racial equity audit.

Shareholder proposals for civil rights audits have shown no signs of slowing down for the 2022 proxy season, with such proposals being submitted to companies including Amazon.com, Inc. (Amazon), Chipotle Mexican Grill, Inc.,

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and Dollar Tree, Inc., in addition to Apple.

ISS also released new guidelines for the 2022 proxy season regarding shareholder proposals on racial equity and civil rights audits. ISS will vote on a case-by-case basis for these proposals, taking into account a number of factors, including: (i) the company's established process or framework for addressing racial inequity and discrimination internally; (ii) whether the company has issued a public statement related to its racial justice efforts in recent years, or has committed to internal policy review; (iii) the company's track record in recent years of racial justice measures and outreach externally; and (iv) whether the company has been the subject to recent controversy, litigation, or regulatory actions related to racial inequity or discrimination.[3] Notably, during the 2021 proxy season, ISS recommended "against" all of the shareholder proposals on racial equity audits, except for the proposal filed with Amazon, while Glass, Lewis & Co. largely recommended "for" these proposals. However, ISS backed the shareholder proposal regarding the civil rights audit for Apple, which may indicate a change in its analysis of these proposals.

Further, the U.S. Securities and Exchange Commission (the SEC) has signaled that it does not intend to allow companies to exclude proposals related to civil rights or racial equity audits from their proxy statements. Companies have attempted to exclude these proposals under the substantially implemented and ordinary business exceptions of SEC Rule 14a-8. In arguing substantial implementation, companies pointed to, among other things, public pledges and commitments to racial justice initiatives, internal programs implemented to address racial inequities, and ESG publications. Companies further argued that these proposals relate to ordinary business operations by impacting day-to-day aspects of the business, including customer and supplier relations, choices about public relations and messaging to stakeholders, and workforce management. However, in each instance, the SEC denied the exclusion requests, noting that the staff was unable to concur with the exclusion on either of these bases.

Concealment Clauses in Agreements with Employees

The second proposal, which was approved by approximately 50.04%, requests that the board of directors prepare a public report "assessing the potential risks to the company associated with the use of concealment clauses [in employment agreements] in the context of harassment, discrimination, and other unlawful acts."[4]

Concealment clauses can be used in agreements with employees for legitimate purposes, such as protecting intellectual property and trade secrets. However, stakeholders are increasingly concerned with broad concealment clauses that may also prevent employees from publicly disclosing harassment, discrimination, and other illegal acts.

While such concerns are relatively new, stakeholders are forging ahead with these demands at a rapid pace. Shareholder proposals have been filed, similarly asking for a public assessment of the risks of concealment clauses at some of the biggest technology companies across the U.S., including Facebook, Alphabet Inc., Amazon, Twitter, Inc., IBM, Etsy, Inc., and Salesforce.com, Inc. These demands come on the heels of the passage of California's Silenced No More Act (the Act), which became effective on January 1. The Act prevents a company from entering into settlement agreements that prohibit or restrict an employee from disclosing information related to harassment or discrimination. It further restricts a company's ability to enter into non-disparagement or severance agreements that prevent an employee from disclosing information about the

employer's unlawful acts.[5] The proliferation of shareholder proposals is, at least in part, motivated by an attempt to urge companies that operate in many states to extend the protections of the Act to all of their employees, not just those located in California.

As with shareholder proposals related to civil rights audits, companies have also attempted to exclude shareholder proposals regarding concealment clauses to no avail. Companies argued that their policies that allow employees to speak publicly about matters of harassment, discrimination, and other unlawful acts, substantially implemented these proposals. Companies also contended that such proposals concerned the ordinary operations of their business by impacting the management, specifically through contractual arrangements, of the company's workforce. The SEC has not concurred with any of these arguments.

Conclusion

We expect continued robust shareholder support for these types of proposals this proxy season and in the coming years based on the continued strong focus on ESG matters. To prepare, companies will need to formulate approaches for shareholder engagement on these issues.

This preparation may entail working on policies and procedures to preempt such shareholder proposals. For example, a company may consider voluntarily conducting an independent civil rights or racial equity audit, which would allow the company to set the audit's parameters. With respect to concealment clauses, a company may want to assess the risks and benefits of providing the requested explicit carveouts in its agreements with employees.

At a minimum, companies should institute an ongoing process to ensure that they are comfortable with their public positions and statements on ESG matters and stay abreast of stakeholder sentiment. Shareholders are increasingly expressing a desire for companies to back up such positions and statements with actions, which means that companies need to ensure that they are prepared to do so.

For more information, please reach out to the authors of this article.

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[1] Apple 2022 Proxy Statement, Proposal No. 9, available here.

[2] Laura Murphy, "The Rationale for and Key Elements of a Business Civil Rights Audit" (2021) at p. 5, available here.

[3] ISS, "Americas Proxy Voting Guidelines Updates for 2022" (Dec. 7, 202).

[4] Apple 2022 Proxy Statement, Proposal No. 10, available here.

[5] "Unlawful acts" include harassment, discrimination or any other conduct that the employee has reasonable

cause to believe is unlawful.

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