Harvard Law School Forum on Corporate Governance

Directors' Oversight Role Today: Increased Expectations, Responsibility and Accountability—A Macro View

Posted by Peter A. Atkins, Marc S. Gerber, and Kenton J. King, Skadden, Arps, Slate, Meagher & Flom LLP, on Monday, May 10, 2021

Editor's note: Peter A. Atkins, Marc S. Gerber, and Kenton J. King are partners at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum. Related research from the Program on Corporate Governance includes The Illusory Promise of Stakeholder Governance by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum here); For Whom Corporate Leaders Bargain by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita (discussed on the Forum here); Socially Responsible Firms by Alan Ferrell, Hao Liang, and Luc Renneboog (discussed on the Forum here); and Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy—A Reply to Professor Rock by Leo E. Strine, Jr. (discussed on the Forum here).

I. The Current State of Play

The subjects falling within the purview of U.S. public company board of director oversight have grown to encompass virtually any subject that an investor, stakeholder or other party raises as being potentially material to a company and, therefore, needing board attention.[1] Many issues—often under the umbrella of "environmental, social and governance" (ESG) or "stakeholder" issues—have become well known to directors and are viewed as broadly applicable to most companies. Pressure from investors and others, in various forms and with increasing intensity, has been and continues to be applied to boards to address these issues promptly and more effectively. The failure by a board to deal with any such identified subject, or a board's perceived

[1] The broad range of matters today—the oversight of which directors are now viewed by many as responsible and accountable, beyond mere satisfaction of their legal duties—includes: **(a)** ***traditional oversight areas*** (*e.g.,* shareholder voting rights; board structure, membership, succession and operation; "control" relationships and interested (conflicted) party transactions); **(b)** ***"corporate purpose" and "stakeholder governance"***; **(c)** ***corporate culture*** (*e.g.*, establishing, communicating and adhering to the "tone at the top;" identifying/assessing the impact of generational considerations and other external influences); **(d)** ***the "E," "S" and "G" components of ESG issues*** (*e.g.*, climate change and sustainability risks; identity equity (based, for example, on race, gender, ethnicity or disability); board diversity (based, for example, on identity, skill sets, experience or age); workforce diversity and inclusion; human capital management, including work-force compensation/pay equity, safety, health and well-being; human rights; corporate political contributions and activities; and supply chain compliance with many of the foregoing); **(e)** ***oversight of risk management and corporate compliance*** (*e.g.*, myriad areas of compliance with state, federal and foreign laws, including a flow of new or modified laws and regulations requiring compliance, which may affect materially a company's activities; overseeing the design and monitoring implementation of risk identification, risk management and corporate compliance programs, and whistleblower programs; considering near and long-term effects of the COVID-19 pandemic, including on work patterns, data protection, cybersecurity and fraud risks, talent retention and hiring, real estate needs, health and safety planning, supply chain and supplier issues, and balance sheet and operating performance; allocating resources (presumably not unlimited) to reasonably prioritized identified risks; crisis management; communicating clearly with senior company management regarding all of the foregoing; **(f)** ***existential or major business risk*** (*e.g.*, cybersecurity failure; data protection breach; supply chain disruption; natural disaster scenarios, including pandemics; liquidity adequacy; reputational damage derived from a broad range of circumstances; avoiding/defending material claims; **(g)** ***shareholder activism*** and shareholder proposals; **(h)** ***mergers and acquisitions***.

inadequacy in doing so, often leads to questions being raised about the board's performance of its oversight function.

In sum, directors remain the targets when investors or others look to hold companies responsible and accountable for perceived missteps relating to a constantly growing range of oversight subjects, many of which not long ago would have surprised public company boards of directors as being their responsibility.

II. The Macro Picture: Defining Circumstances and Perspectives

Accordingly, we believe that:

- Boards today, in exercising their oversight function, need to pay much more attention to a far broader range of issues than they ever have before.
- Boards need to identify which issues are relevant and material to their companies and to put in place oversight mechanisms that will allow the board to monitor the issues, receive inputs and track company progress.
- This is a dynamic process that, in some ways, requires boards to go back to basics and to assess what it is they should be tracking and monitoring and how they determine which matters require their oversight time and attention, and then periodically to revisit and reassess those decisions.

To facilitate these efforts, set forth below are what we view as key circumstances and perspectives that define the oversight role of U.S. public company directors today, together with some brief comments.

1. Expectations regarding the scope of board oversight responsibility have dramatically expanded.

The burgeoning number and the broadened nature of asserted director oversight subjects is a central feature of the oversight environment directors are facing today. Coupled with elements noted below, it raises significant new expectations about board conduct and new areas of asserted board responsibility and accountability. A number of important factors have contributed to today's larger director oversight stage (and to more—and more powerful—voices on it).[2]

[2] These factors include:

- ***The coming of age of the so-called millennial generation*** (persons born between 1980 and 2000, roughly 80 million Americans) as an economic, political and social force—including, broadly speaking, its support for protecting the environment and for social responsibility, fairness and equality, its disenchantment with a narrowly defined public company shareholder primacy corporate governance model, and its "demand" that asset managers seeking to manage millennial money adopt a stewardship approach toward their investments that emphasizes promoting stakeholder governance by investee companies.
- ***The sharpened focus on ESG issues by shareholders and nonshareholder groups*** (super-sharpened due to the COVID pandemic and exposed heightened racial and other identity group treatment disparities in areas such as law enforcement treatment, housing, education, health care and social services, job opportunities and pay).
- ***The availability of social media and websites*** that, among other uses, enable groups to organize quickly, chastise publicly, and implement boycotts of and demand resignations of senior management and board members of companies perceived as inadequately responsive to various ESG issues.

2. Many more constituencies today are proposing or supporting board oversight subjects.[3]

It is not news that the voices of many constituencies have joined the director oversight chorus in parallel with the sharpened focus on corporate responsibility for an expanding universe of ESG issues. In developing their awareness of today's director oversight landscape, directors should understand the breadth of, and the types of the significant participants in, that universe of voices. And for directors making assessments and decisions regarding particular oversight issues facing their companies, it is important to have a clear view of the relevant voices vis-a–vis those issues, including their identities, oversight positions and modes of behavior, as the directors prepare for or react to specific challenges.

3. Constituencies today have a wide range of tools to make their voices heard by and influence brought to bear on directors.

Long gone are the days when director oversight played out within the narrow confines of shareholder votes and shareholder litigation, focused principally on traditional director oversight subjects. Today, perceived failure by a board in dealing with any of the many substantive issues and board processes identified as board oversight matters can—and often does—lead to pressure ranging from relatively mild to outright attacks on the company, its board and/or individual directors. These can be pursued in various forms, including requests from large shareholders for stewardship engagement; shareholders or other parties publishing negative public commentary regarding and rankings of the company and/or targeted directors; shareholders affirmatively proposing dissident directors in election contests, engaging in withhold vote campaigns targeted against specific directors or submitting shareholder proposals; and issue-specific entities or groups initiating protest activity, such as consumer boycotts. The potential impact of these efforts needs to be assessed in light of other considerations, including the major increased concentration of share ownership of U.S. public companies and the high level of public commitment to many of the director oversight subjects encompassed within ESG/corporate responsibility principles.

4. Directors are expected to play a central role in exercising corporate oversight.

In connection with the ever-expanding expectations regarding oversight of particular subjects, there is an over-arching expectation by many constituencies that directors will engage actively in:

- oversight of strategic planning (including the incorporation of applicable risks and opportunities, such as climate change and diversity, equity and inclusion matters) and

---

- ***The concentration of stock ownership of U.S. public companies coupled with an enhanced stewardship focus of many asset managers and institutional investors***, which back up their suggestions and expectations regarding corporate policies and actions with both (a) use of their voting power to support shareholder proposals and to vote against the election of some or all directors and (b) in the case of active managers, the potential for divesting their position, which may be detrimental to the company's stock price.

[3] Parties registering their voices today include shareholders (*e.g.*, activist hedge funds, public pension funds, active and passive money management funds, socially responsible funds and retail shareholders); employees, communities and special interest groups (including ESG proponents); proxy advisory firms; private equity funds; standing and ad hoc governmental and private oversight or watchdog entities; ESG rating firms; trade groups; stock exchanges; politicians; regulators; academia and academics; governance publications, blogs, seminars and training programs; and print and electronic reporting and opinion media.

oversight of operational execution to achieve the company's goals, with a focus on long-term, sustainable value; and
- oversight of setting goals, establishing appropriate metrics for measuring achievement of them (including on a comparative basis with peers and generally) and making robust public disclosure articulating how those goals align with achieving long-term, sustainable value and how their companies are faring in pursuing their goals.

For some constituencies today this expectation represents a strong belief that publicly traded business corporations have been a major factor in creating or enabling and should be a major factor in mitigating an array of serious societal ills and concerns, and a parallel belief that holding directors (who manage the basic strategy and direction of these corporations) responsible and accountable for mitigating those ills and concerns is an important and necessary component of the effort to get this critical job done, independent of company/shareholder value considerations. Many others tie their support of the effort to the need to achieve long-term, sustainable value for the company/shareholders as a driving imperative—but are also focused on holding directors responsible and accountable.

5. Directors need to identify and prioritize the company's key issues.

In today's world, with many more issues for boards to consider than in prior years, questions of prioritization in selection and resources devoted to those priorities can become more sharply focused. Some issues necessarily have to be addressed, because legally mandated (*e.g.*, maintaining reasonable internal controls over disclosure and financial reporting) or because the failure to do so can have predictable, serious consequences (*e.g.*, maintaining adequate training and oversight programs for compliance with a broad range of laws). However, many issues considered today, particularly under the broad umbrella of corporate responsibility, are not statutorily mandated as matters requiring board consideration, and the relevance of those issues to the long-term, sustainable value of different companies may vary considerably. Directors will need to make important, considered judgments regarding which (if any), how and to what extent these issues will be taken on and actively overseen by the board or a board committee.

6. Boards, on a continuing basis, will need to be alert for (a) identified issues that should be the focus of ongoing, active board oversight and monitoring and (b) new oversight issues that may arise.

As events constantly reinforce, identifying subjects appropriate for board oversight is not a static, one-and-done exercise. Boards are expected, as part of their oversight function, to have processes in place to enable them to determine whether identified oversight issues will require continuing, active board oversight and monitoring. Boards also are expected to have processes in place to alert them to new issues. Each board committee should remain attuned to developments and risks within its areas of focus and directors need to be alert for new issues that may not fall within the scope of any particular committee. Staying abreast of topics of concern raised in the investment community, and making sure that the company is keeping the board informed of concerns raised by investors, analysts and other stakeholders are critical endeavors in this regard.

7. Boards need to have systems in place that allow them to evaluate their own ongoing oversight and monitoring controls for particular areas of risk and focus.

When a board has oversight responsibility for a particular company function, it needs to be satisfied that (a) the company has a process in place that will communicate the applicable rules of conduct for that function and provide for oversight of compliance and (b) there is in place a monitoring process permitting the board periodically to assess whether the company's process is working as it should. Depending on the situation, the failure to implement these arrangements can result in, among other things, harsher treatment of the company under the federal sentencing guidelines, a determination of breach of fiduciary duties by directors under state law, claims in litigation regarding the adequacy of the company's disclosure about its commitment to the particular goal involved (*e.g.*, commitments to diversity, supply chain responsibility or protecting the environment) or ammunition for challenges aimed at the board's stewardship, including via election contests. Recent developments in Delaware law signaling greater shareholder access to company books and records may support increased probing by shareholders seeking to challenge directors and/or the company on one or more of these bases. Directors should expect more shareholder demands for books and records seeking to determine whether directors are living up to publicly stated corporate commitments in a wide range of areas.

8. Boards should be prepared to demonstrate and document their identification of, engagement on and considered decision-making regarding board oversight subjects.

Directors should recognize the importance of demonstrating and documenting the entire robust process followed in dealing with board oversight issues. If and when asked to explain themselves, whether in court, in a one-on-one conversation with a large shareholder, in a public dispute with an activist or in other circumstances, directors will want and need the credibility that comes from having a contemporaneous record of proactive, thoughtful and informed decision-making.

9. Boards should recognize increased demands for transparency and disclosure of verifiable metrics against which progress on specific ESG goals can be assessed.

To a great extent, approaches to addressing these subjects are works in progress, with companies, regulators and others actively discussing and suggesting presentation approaches and standardized methodologies for measuring progress and success. Some have begun to challenge the accuracy or reliability of claims of some companies regarding their achievement of particular ESG objectives, in part due to the lack of credible evidential data for benchmarking progress and success. In moving forward in support of particular ESG and other objectives, directors should be aware that their efforts may well face scrutiny and even skepticism that companies are pursuing them in good faith. Directors should have a reasonable level of confidence that the company will have the means to demonstrate the reality and efficacy of its efforts.