RACIAL EQUITY AUDITS: A NEW ESG INITIATIVE POISED TO GAIN TRACTION AND GREATER SHAREHOLDER INTEREST IN THE UPCOMING PROXY SEASON

September 2021

Authors: Ron S. Berenblat, Elizabeth R. Gonzalez-Sussman, Claudia B. Dubón, Rebecca L. Van Derlaske, Ian A. Engoron, Sarah R. Matchett and Nikoleta Jaupi

Practices: Shareholder Activism
Corporate/Securities Law

I: INTRODUCTION

The increasing focus on environmental, social and governance ("ESG") considerations at public companies, including this year's highly publicized proxy contest at Exxon Mobil Corporation ("Exxon"), has demonstrated the growing importance of understanding ESG and the implications it can have for investors and companies. Among the many ESG developments bubbling to the forefront of the markets in recent years is the desire of investors to see companies address social justice concerns. In particular, shareholders have begun to request that companies conduct racial equity audits ("Racial Equity Audits"), which generally seek an independent, objective and holistic analysis of a company's policies, practices, products, services and efforts to combat systemic racism in order to end discrimination within or exhibited by the company with respect to its customers, suppliers or other stakeholders. We anticipate greater interest in Racial Equity Audits and similar initiatives in the upcoming proxy season and accordingly believe companies will be pushed to critically and objectively examine their current internal practices and policies relating to equity and inclusion to identify areas in need of improvement.

A. Overview of the ESG Landscape Today

ESG considerations can be broken down into three categories. First—environmental criteria, which considers a company's actions as a steward of the environment, such as what steps a company is taking to address the depletion of the planet's resources, pollution and greenhouse gas emissions, or the effects of climate change.[1] Second—social criteria, which considers how a company engages with all of its stakeholders (including employees, customers and suppliers) rather than just shareholders, including the treatment and diversity of its employees on the frontline, management and boardroom levels, the effects of a company on the surrounding community, and whether a company is working with suppliers who share similar socially desirable values.[2] Third—corporate governance, which considers how a company governs itself and holds itself accountable taking into account the structure and diversity of a

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[1] *What is ESG?, ADEC Innovations ESG Solutions*, available at https://www.esg.adec-innovations.com/about-us/faqs/what-is-esg/.
[2] *Id.*

company's board of directors, the separation between management and the board of directors, executive compensation, equal and fair pay amongst employees, and the extent to which a company or its management or board of directors are undertaking lobbying efforts, making political and charitable donations, or engaging in corruption or bribery.[3]

With the increasing prominence of ESG awareness, the market has also seen the rise of ESG-specific funds as a new form of investment vehicle. These funds have explicit mandates to make ESG-focused investments, from mutual funds whose portfolio companies must score a high grade on ESG metrics to investment firms dedicated to ESG impact investing. In the U.S. market there are now over 600 ESG funds and exchange-traded funds for investors to choose from with approximately $161 billion in assets under management ("AUM"), which is more than double the AUM of ESG funds in 2010.[4] According to research from Institutional Shareholder Services ("ISS"), "ESG Funds were among the largest winners in 2020, taking in a record $60 billion in net flows, nearly triple their 2019 total."[5]

In the meantime, on November 9, 2020, the Securities and Exchange Commission ("SEC") announced the issuance of new final rules that expanded human capital management disclosure requirements applicable to SEC reporting companies.[6] Since then, SEC leadership has signaled that more comprehensive ESG-related disclosure could be mandated in the near future, with SEC Commissioner Allison Herren Lee issuing statements earlier this year "directing the Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings"[7] and inviting input from "investors, registrants, and other market participants on climate change disclosure."[8] Former Acting Director of the SEC's Division of Corporation Finance John Coates also stated earlier in the year that the "SEC should help lead the creation of an effective ESG disclosure system so companies can provide investors with information they need in a cost-effective manner."[9] Based on these statements, we believe there is a strong likelihood that the current SEC-mandated human capital management disclosures will soon be expanded to require additional disclosures covering environmental and other social initiatives

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[3] *Id.*

[4] *ESG investing: Discover funds that reflect what matters most to you, The Vanguard Group, Inc.*, available at https://investor.vanguard.com/investing/esg/.

[5] *ESG Matters (Part II), ISS EVA, Dr. G. Kevin Spellman and David O. Nicholas, May 18, 2021*, available at https://www.issgovernance.com/library/esg-matters-part-ii/.

[6] *Final Rule: Modernization of Regulation S-K Items 101, 103 and 105*, 17 CFR 229, 239 and 240, Release Nos. 30-10825; 34-89670; File No. S7-11-19, available at https://www.sec.gov/rules/final/2020/33-10825.pdf; *New Human Capital Disclosure Requirements, Harvard Law School Forum on Corporate Governance, Margaret Engel, February 6, 2021*, available at https://corpgov.law.harvard.edu/2021/02/06/new-human-capital-disclosure-requirements/.

[7] *Statement on the Review of Climate-Related Disclosure, U.S. Securities and Exchange Commission, Acting Chair Allison H. Lee*, February 24, 2021, available at https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure.

[8] *Public Input Welcomed on Climate Change Disclosures, U.S. Securities and Exchange Commission, Acting Chair Allison H. Lee,* March 15, 2021, available at https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

[9] *ESG Disclosure—Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets, U.S. Securities and Exchange Commission, John Coates, March 11, 2021*, available at https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121.

and metrics, further supporting a view that ESG awareness, stewardship and reporting at public companies are here to stay.

As the ESG movement gains momentum, and as the new wave of investors who factor ESG concerns into their investment decisions gain a larger share of the market, companies are being advised to revisit their current policies and practices under the ESG lens. Companies that dismiss these concerns or lag behind their peers in addressing ESG matters may find themselves in the crosshairs of investors and proxy advisory firms, or even state legislatures and federal agencies.[10] On the other hand, it has been found that companies that affirmatively adopt meaningful approaches to these issues may not only help progress environmental and societal goals, but may also potentially see improved financial performance.[11]

B. How ESG Ties Into Shareholder Activism

ESG considerations are becoming increasingly relevant to shareholder activists. This is because issues relating to climate change and the environment, racial justice and diversity, human capital and governance may influence companies at large and shareholder investment flows.[12] Governance has long been a key focus of shareholder activists as corporate governance best practices, including accountability of a company's board of directors to its shareholders, robust disclosure on executive compensation and independence of a board of directors from management, have been found to have a readily apparent correlation with increased returns to shareholders.[13] Recently, however, activists have begun to realize that social and environmental issues can also impact their investments, in both negative and positive ways.[14]

ISS and others have published a number of reports that have found that addressing social and environmental concerns correlates with companies either currently experiencing or having the potential to experience increased growth and profitability.[15] As discussed in more detail below, a company's performance on ESG factors, such as investment into renewable energy, promotion of employee health and safety and contributions to the local community, are pressing issues that can either benefit or adversely affect a company's perception in the public eye, operational execution and bottom line.[16] Enhanced performance in these areas can lead to less scrutiny from environmental regulators, increased customer loyalty, more productive employees, reduced employee turnover, more lucrative business partnerships and increased profitability.[17]

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[10] *ESG Activism Becomes the Norm, ESG Activism, Insightia, 2021,* available at https://www.activistinsight.com/wp-content/uploads/dlm_uploads/2021/06/InsightiaESGActivism-1.pdf?utm_source=newsletter&utm_medium=email&utm_campaign=greenfin&utm_content=2021-06-30.

[11] *Supra* note 5.

[12] *Supra* note 10.

[13] *Id*.

[14] *Id.*

[15] *Supra* note 5.

[16] *Supra* note 10.

[17] *Supra* note 5; *see also What Is ESG? Trilinc Global, November 4, 2013,* available at https://www.trilincglobal.com/what-is-esg/. For example, Patagonia, Inc., which has been a vocal public champion of environmental activism and whose founder and chairman once declared that the company

Improved ESG criteria is not a new area for activist investors. Shareholder activists have advocated for increased diversity in corporate boardrooms for a number of years.[18] Concurrently with shareholder activists nominating an increasing number of diverse director candidates, the voting policies of many institutional investors, such as BlackRock, Inc. ("BlackRock"), have been updated to reflect a desire to enhance boardroom diversity,[19] as have the voting guidelines of many prominent proxy advisory firms, such as ISS.[20] State governments have also codified ESG initiatives into law—California leading the charge with the passage of Senate Bill 826 and Assembly Bill 979, which require a certain percentage of directors on the boards of public companies headquartered in the state be composed of females and individuals from underrepresented communities.[21] Most shareholder activists are cognizant of the stance of institutional investors and proxy advisory firms on ESG issues and have increasingly incorporated ESG factors into their proxy campaigns.[22]

C. Recent Push for Racial Equity Audits

Amongst the various ESG developments gaining traction in the markets is the recent push by shareholders for companies to conduct Racial Equity Audits, which generally consist of an objective investigation into a company's practices, policies and histories to determine such

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was in business "to save the planet," has seen its revenues quadruple over the past ten years. *Patagonia's environmental mission hasn't just been good for the planet — it's also boosted the bottom line, Business Insider, Richard Feloni, December 21, 2018*, available at https://www.businessinsider.com/patagonia-mission-environmentalism-good-for-business-2018-12. This is all while donating the greater of 1% of sales or 10% of profits to environmental activism, working to be 100% carbon neutral by 2025 and allowing employees to spend up to two fully-paid months of working time on supporting environmental conservation projects. *What Makes Patagonia A World Leader in Sustainability, Medium, Tom & Jerry, January 13, 2021*, available at https://medium.com/climate-conscious/what-makes-patagonia-a-world-leader-in-sustainability-486073f0daa.

[18] *BlackRock Investment Stewardship, Proxy voting guidelines for U.S. securities, BlackRock, effective January 2021,* available at https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

[19] *Id*.

[20] *Proxy Voting Guidelines Benchmark Policy Recommendations, ISS, effective for meetings on or after February 1, 2021*, available at https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf.

[21] Cal. Corp. Code §§ 301.3, 301.4.

[22] *Supra* note 10. The most recent and prominent example of the intersection between shareholder activism and ESG was the 2021 proxy contest at Exxon. Exxon has faced pressure from shareholders to shift practices to reduce greenhouse gas emissions. *Exxon faces proxy fight launched by new activist firm Engine No. 1, Reuters, Svea Herbst-Bayliss, Gary McWilliams, December 7, 2020*, available at https://www.reuters.com/article/exxon-shareholders-engine-no-1/exxon-faces-proxy-fight-launched-by-new-activist-firm-engine-no-1-idUSKBN28H1IO. Shareholder activist Engine No. 1 grew impatient with Exxon after years of declining financials and long-continued dependency on fossil fuels, with no indication of future change. *Id.* As a result, Engine No. 1 launched a proxy campaign in December 2020 to effect change on Exxon's board of directors. *Id.* The activist investor nominated a slate of four director candidates with expertise operating energy companies and utilizing clean technology. *Id.* Dismissal and neglect of these concerns led to Engine No. 1's unprecedented victory, with three of its director nominees being elected to Exxon's board at its 2021 annual meeting—sending a clear message that environmental concerns and proactive planning are deeply important to Exxon's shareholders.

company's impact on social issues and areas for improvement.[23] In the aftermath of the killing of George Floyd in May 2020 and the subsequent civil rights movement and unrest, many companies announced a number of initiatives and measures to address social justice issues, including committing financial resources and reviewing their own policies and practices.[24] However, many advocates believe that without objective means to identify areas of improvement and monitor companies' progress, these commitments may be illusory and confirmation that these companies have in fact met their commitments could be difficult.[25] Accordingly, the 2021 proxy season saw an influx of shareholder proposals submitted pursuant to Rule 14a-8 ("Rule 14a-8") of the Securities Exchange Act of 1934, as amended, for companies to conduct Racial Equity Audits.

Just like its environmental and corporate governance counterparts, addressing social concerns can be equally important to companies and investors alike as this can translate into, among other things, value additive results.[26] For example, following a racially-tinged incident at a Philadelphia Starbucks in 2018 where two African-American men who were waiting for a business meeting to begin were arrested, the company performed a Racial Equity Audit, which found that, among other things, racial sensitivity and the elimination of implicit biases are correlated to Starbuck's core business plan of "creating an inclusive and equitable working environment, as well as a welcoming 'third place' between home and work for customers."[27] In addition, the W.K. Kellogg Foundation has found that "[b]y 2050, our country stands to realize an $8 trillion gain in GDP by closing the U.S. racial equity gap."[28]

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[23] *Racial Equity Audits: A Critical Tool for Shareholders, CtW Investment Group*, available at https://www.socinvestmentgroup.com/critical-tool-for-shareholders [hereinafter "*Webinar*"].
[24] *Here's What Companies Are Promising to Do to Fight Racism, The New York Times, Gillian Friedman, August 23, 2020*, available at https://www.nytimes.com/article/companies-racism-george-floyd-protests.html.
[25] *Remarks by New York State Comptroller Thomas P. DiNapoli at SEIU Capital Stewardship Program and CtW Investment Group Webinar Entitled "Racial Equity Audits: A Critical Tool for Shareholders," NYS Comptroller, Thomas P. DiNapoli*, *April 13, 2021,* available at https://nyscomptroller.medium.com/remarks-by-new-york-state-comptroller-thomas-p-397b006d1d5c.
[26] *Supra* note 5.
[27] *Racial Equity Audit Proposal Q&A CtW Investment Group and the Service Employees International Union*, available at https://static1.squarespace.com/static/5d374de8aae9940001c8ed59/t/605cdec4e6861277202f0b46/1616699076603/Racial+Equity+Audit+QA_CtW_SEIU+%28002%29.pdf.
[28] *The Business Case for Racial Equity, a Strategy for Growth, Ani Turner, W.K. Kellogg Foundation,* available at: https://www.wkkf.org/resource-directory/resources/2018/07/business-case-for-racial-equity ("'Closing the gap' means lessening, and ultimately eliminating, disparities and opportunity differentials that limit the human potential and the economic contributions of people of color."); *see also Economist Found $16 Trillion When She Tallied Cost of Racial Bias, Bloomberg, Saijel Kishan, October 20, 2020*, available at https://www.bloomberg.com/news/articles/2020-10-20/racism-and-inequity-have-cost-the-u-s-16-trillion-wall-street-economist-says.

II: BACKGROUND AND OVERVIEW

A. What Are Racial Equity Audits?

A Racial Equity Audit is, at its core, an independent, objective and holistic analysis of a company's policies, practices, products, services and efforts to combat systemic racism in order to end discrimination within or exhibited by the company with respect to its customers, suppliers or other stakeholders. Not only are Racial Equity Audits designed to help inform investors about their current and future investments from a social and financial perspective, but are also intended to help companies craft their policies and practices to achieve their social justice goals.

According to certain proponents, the point of a Racial Equity Audit is not necessarily to critique a company's current platforms and efforts. Rather, as argued by Trillium Asset Management ("Trillium"), a strong proponent of such audits, the point of an audit is to embrace the notion that "if management is truly committed to make racial justice a critical element of its operations then in practice it can and should treat it like any other operations issue and audit it as such."[29] These proponents further argue that Racial Equity Audits should not be viewed as the end of a process for companies and/or shareholders looking to make a change; instead, they can be a "stepping stone" to assist companies in developing and identifying a strategic plan to advance their goals.[30]

B. What Impact Can a Racial Equity Audit Have on a Company's Social Equity Policies and Practices?

The impact a Racial Equity Audit may have on a company may be felt in many ways. Racial Equity Audits can focus on various aspects of a company's business, including the treatment of customers at a company's physical locations, the diversity of senior management, the targeting of products, and even political contributions.[31] Following an audit, some companies have used the findings to develop a strategic plan to capitalize on opportunities to address racial equity moving forward.[32] For example, following the voluntary Racial Equity Audit conducted by Starbucks after the 2018 incident discussed above, the company began requiring implicit bias training for employees, setting public corporate diversity goals and implementing a number of other social initiatives.[33] The public announcement of the Racial Equity Audit and related diversity, equity and inclusion efforts appeared to not only rehabilitate Starbucks' public image after the incident, but helped the company become the "most popular restaurant stock on the

[29] *Webinar,* Susan Baker, Director of Shareholder Advocacy, Trillium Asset Management, *supra* note 23.
[30] *Webinar,* Cyrus Mehri, Founding Partner of Mehri & Skalet, PLLC, s*upra* note 23.
[31] *Webinar,* Susan Baker, Director of Shareholder Advocacy, Trillium Asset Management, *supra* note 23; s*upra* note 27.
[32] *Webinar,* Pamela Coukos, Co-Founder of Working IDEAL, *supra* note 23.
[33] *On the Progress of its Efforts to Promote Civil Rights, Equity, Diversity, and Inclusion, Starbucks, February 24, 2020*, available at https://stories.starbucks.com/uploads/2020/02/Starbucks-Civil-Rights-Assessment-2020-Update.pdf; s*upra* note 27.

S&P 500 with actively managed funds that are dedicated to ESG investing," according to RBC Capital Markets.[34]

Racial Equity Audits may also find that a company's existing policies and practices are not sufficient to address or may be perpetuating systemic social issues. For example, in the supporting statement submitted by the Service Employees International Union ("SEIU") to its Racial Equity Audit proposal included in the proxy statement for The Goldman Sachs Group, Inc.'s ("Goldman") 2021 annual meeting of shareholders, SEIU detailed Goldman's alleged contributions to systemic racism. Specifically, SEIU stated that "Goldman underwrites municipal bonds whose proceeds pay police brutality settlements."[35] Similarly, Trillium, on behalf of Christopher and Anne Ellinger, submitted a Racial Equity Audit proposal that was included in Johnson & Johnson's proxy statement for its 2021 annual meeting of shareholders, in which Trillium expressed concerns with claims that the company continues to market its talc-based baby powder to "Black and Brown women after its talc supplier included the WHO's 'possibly carcinogenic' label on shipments."[36] Proponents of Racial Equity Audits argue that a reassessment of internal policies and practices via such audits can identify the right levers to pull to begin to shrink these racial divides.

C. What Is the Democracy Case For Racial Equity Audits?

Civil rights advocates and proponents of social justice have long touted the moral and ethical considerations of closing the racial divide in America. Recently, investors and companies have also begun to appreciate that positive financial returns are often associated with investing in initiatives working towards racial equality. Beyond the moral case and business case for conducting Racial Equity Audits, and fighting systemic racism in general, is the "democracy case" espoused by social justice advocates[37] and that corporations can at times act more swiftly and have a more profound effect on current social issues than the government; therefore, these advocates argue that corporations have a responsibility to address issues affecting our democracy.[38] Racial Equity Audits can be designed to help identify if and where these issues exist within a company so that management can address them most effectively.

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[34] *Starbucks Steps Up Its Racial Justice Outreach With $100 Million Pledge, Forbes, Kori Hale, January 20, 2021,* available at https://www.forbes.com/sites/korihale/2021/01/20/starbucks-steps-up-its-racial-justice-outreach-with-100-million-pledge/?sh=53b94b63389c.

[35] *The Goldman Sachs Group, Inc., 2021 Notice of Annual Meeting and Proxy Statement, Schedule 14A, filed with the SEC on March 19, 2021,* available at https://www.sec.gov/Archives/edgar/data/886982/000119312521087020/d88664ddef14a.htm [hereinafter "*Goldman Sachs Proxy Statement*"].

[36] *Johnson & Johnson, 2021 Notice of Annual Meeting & Proxy Statement, Schedule 14A, filed with the SEC on March 10, 2021*, available at https://www.sec.gov/Archives/edgar/data/200406/000020040621000011/jnjproxy2021.htm [hereinafter "*J&J Proxy Statement*"].

[37] *Webinar*, Cyrus Mehri, Founding Partner of Mehri & Skalet, PLLC, s*upra* note 23.

[38] *See e.g., Opinion: Companies Have a Duty to Defend Democracy, NPR, Brett Bruen, July 7, 2020*, available at https://www.npr.org/2020/07/07/887628306/opinion-companies-have-a-duty-to-defend-democracy (discussing corporations' ability to be more responsive to critical issues to voters on the macro-level, such as gun control and climate change, as well as on a more personal level including

D. How Racial Equity Audits May Boost Financial Returns and Growth

Some studies have shown that "promoting racial justice can increase profitability and competitive advantage."[39] A study by McKinsey & Company found that implementing or improving racial justice policies can positively affect a company's bottom line.[40] As illustrated in the study, companies with the highest degrees of ethnic/cultural diversity were 33% more likely to outperform their less diverse peers and companies with the most ethnically/culturally diverse boards of directors are 43% more likely to experience higher profits than their less diverse peers.[41] A study by a Citigroup, Inc. ("Citi") global economist found that addressing racial disparities can have even broader macro benefits. According to this study, "closing racial gaps would have generated an additional $16 trillion in economic output since [the year] 2000," and "by closing the various gaps between Blacks and Whites, the U.S. could stand to gain an additional $5 trillion in economic activity over the next five years."[42] Racial Equity Audits could therefore prove to be a critical tool for companies looking to capture some of these unrealized gains.

E. How Investment Managers, Especially Pension Fund Trustees, Pushing to Address Racism May Be Consistent With Their Fiduciary Duties to Maximize Returns for Investors

A fiduciary's duty is to act in the best interest of their beneficiaries and traditionally translates to acting to obtain the highest return on investment, but it can be equally important that fiduciaries seek to minimize risk.[43] Accordingly, it has been argued that working to ensure that systemic risk in the marketplace is proactively addressed via, for example, a Racial Equity Audit, is consistent with a fiduciary's duties.[44] Advocates of Racial Equity Audits believe that they are essentially intended to be implemented in furtherance of risk management and risk tolerance, criteria that fiduciaries may choose to measure in order to protect their investments.[45]

In addition, there has also been a rise in ESG-specific funds as well as a growing number of ESG-specific products at mutual funds and other financial institutions. Beyond fund managers' typical fiduciary duties to minimize risk and achieve positive returns, these fiduciaries are explicitly mandated with making investments into companies that "aim to have a sustainable and societal impact in the world"[46] based on ESG criteria or that "meet stringent environmental,

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"Twitter, Uber and Blue Apron announc[ing that] they would give employees a paid day off when their country holds elections").

[39] *Id*.

[40] *Delivering through Diversity, McKinsey, Vivian Hunt, Sara Prince, Sundiatu Dixon-Fyle and Lareina Yee, January 2018*, available at https://www.mckinsey.com/~/media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity_full-report.ashx.

[41] *Id.*

[42] *Supra*, *Kishan*, note 28.

[43] *Webinar,* Vivian Gray, SEIU Pension Fund Trustee, *supra* note 23.

[44] *Id.*

[45] *Id.*; *supra* note 27.

[46] *Best ESG Funds: High-Rated and Low-Cost Options, NerdWallet, Alana Benson*, *May 9, 2021,* available at https://www.nerdwallet.com/article/investing/best-esg-funds.

social and governance standards."[47] As the usefulness of Racial Equity Audits as a tool for ESG-conscious shareholders to measure a company's adherence to ESG prerogatives becomes more mainstream, it would be no surprise to see support for these audits grow.

F. How Professionals in the Area Believe Audits Should Be Conducted and the Importance of Independent Third Party Reviews

No two companies are identical. Every company has a different mix of products, operations and services; therefore, according to practitioners in the area, it is important for participants in a Racial Equity Audit to identify the scope of the audit and benchmarks prior to conducting the audit.[48] New York State Comptroller Thomas F. DiNapoli, a staunch advocate of Racial Equity Audits, has stated that such an audit should ascertain at least three things:

> First, whether a company's policies, practices, and products are equitable and nondiscriminatory for employees, customers, and the communities in which they operate. Second, whether any changes to existing programs or new measures or initiatives, would help a company become more equitable and inclusive. And lastly, whether a company has sufficient mechanisms in place to monitor effectiveness.[49]

Practitioners also stress the importance of auditors using the right methodology, including both quantitative and qualitative methods, and for such auditors to review not only information provided by the company but to gather its own information.[50] Accordingly, auditors are encouraged to solicit information directly through surveys and interviews, and to review historical records and a company's performance against its peers.[51]

Practitioners also believe that the audit process can be important for companies as a way to build trust with their stakeholders. To that end, they believe companies should clearly disclose and explain the processes and personnel roles within a Racial Equity Audit and undertake to publicly share the results of the audit.[52] Practitioners also stress the importance of identifying and engaging the "process owners" (*e.g.*, the Chief Executive Officer, Chief Legal Officer or Chief Diversity, Equity and Inclusion Officer) as the persons who will actually drive the implementation of recommended initiatives.[53] Advocates believe it is critical that the audit be conducted by an independent third party in order to ensure integrity and credibility throughout the process.[54] Comptroller DiNapoli has observed that discrimination can be "deep-seated" within a company, and "internal self-reviews have the potential to reinforce current structural

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[47] *The Best ESG Funds for Great Returns & Low Costs, Forbes, Rob Berger and Benjamin Curry, July 1, 2021*, available at https://www.forbes.com/advisor/investing/best-esg-funds/.
[48] *Webinar,* Pamela Coukos, Co-Founder of Working Ideal, *supra* note 23; *supra* note 27.
[49] *Supra* note 25.
[50] *Webinar,* Pamela Coukos, Co-Founder of Working Ideal, *supra* note 23; *supra* note 27.
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] *Webinar,* Thomas DiNapoli, New York State Comptroller, *supra* note 23.

impediments and biases," which is why he believes it is necessary for audits to be an independent assessment.[55]

G. Which Companies Have Already Conducted Racial Equity Audits, How Were They Conducted and What Were the Results?

Some companies have independently engaged in Racial Equity Audits or similar internal reviews, usually in response to external pressures. As discussed earlier, Starbucks undertook a Racial Equity Audit in 2018. Facebook, Inc. ("Facebook") also conducted its own version of a Racial Equity Audit in 2018. The audit was led by Laura W. Murphy, a civil rights advocate, with help from a civil rights law firm. The Facebook audit began "at the behest and encouragement of the civil rights community and some members of Congress, proceeded with Facebook's cooperation, and [was] intended to help the company identify, prioritize, and implement sustained and comprehensive improvements to the way it impacts civil rights."[56] The audit process included interviewing over 100 civil rights organizations, several hundred more advocates as well as members of Congress.[57] The aspects of Facebook that the audit focused on were informed by the aforementioned interviews, which led to a holistic review of the entire company and not just a single aspect such as employment practices.[58] The audit produced three reports, which ultimately described how Facebook utilized the audit process "to listen, plan and deliver on various consequential changes that will help advance the civil rights of its users" in a number of categories and also recommended implementation of specific action items, including to (1) "continue to onboard expertise", (2) "build out the civil rights leader's team", (3) "expand civil rights product review processes", (4) "require civil rights perspectives in escalation of key content decisions" and (5) "prioritize civil rights."[59] The thoroughness of the audit and the response and subsequent actions taken by the company have led to the Facebook audit being heralded by many as a big success.[60]

H. Pushback to Racial Equity Audits

A number of other high-profile companies and financial institutions have been approached either by shareholders or civil rights advocates about conducting Racial Equity Audits. However, not all companies have been as eager and willing to comply with these requests. As discussed further below, several financial institutions, including Citi, JPMorgan Chase & Co. and Goldman have resisted shareholder proposals requesting Racial Equity Audits, stating that they would either fold such measures into their existing human rights assessments or that they didn't believe it was the appropriate time for such an endeavor.[61]

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[55] *Supra* note 25.
[56] *Facebook's Civil Rights Audit—Final Report, Facebook, July 8, 2020*, available at https://about.fb.com/wp-content/uploads/2020/07/Civil-Rights-Audit-Final-Report.pdf.
[57] *Id.*
[58] *Id*.
[59] *Id*.
[60] *Supra* note 27.
[61] *Supra* note 27.

III: RULE 14a-8 PROPOSALS—THE INITIAL STAGES OF ADVOCACY

A. Shareholder Proposals

Pursuant to Rule 14a-8, shareholders may submit proposals to be included in a company's proxy materials for its annual or special meetings of shareholders.[62] Under Rule 14a-8, a company is required to include a shareholder proposal and related supporting statement in its proxy statement and list the shareholder proposal on its proxy card to be voted on with the company's proposals if: (a) the shareholder satisfies specified eligibility and procedural requirements; and (b) the proposal is not excludable under Rule 14a-8(i).[63] If the company determines that it is not in the best interests of the company to include a Rule 14a-8 shareholder proposal in its proxy materials, it can (i) seek no-action relief from the SEC staff (the "Staff") that, if granted, would allow the company to exclude the proposal without the threat of Staff recommendation of an enforcement action based on a procedural deficiency or a substantive exclusion under Rule 14a-8; (ii) take legal action in court to exclude the proposal; and/or (iii) negotiate with the proponent to withdraw the proposal. Shareholder proposals come from a variety of proponents, including individual investors, labor unions, public pension funds, shareholder activists and institutional investors and such proposals often focus on the environment, corporate governance, executive compensation and social issues. According to Forbes Magazine, the past proxy season "set new records with at least 467 shareholder resolutions on environmental, social and governance (ESG) issues."[64]

The Sustainable Investments Institute reports that 28 shareholder proposals dealing with racial justice had been included in proxy statements filed with the SEC as of April 27, 2021.[65] Certain of these racial justice proposals submitted by shareholders included proposals calling for Racial Equity Audits. For example, the SOC Investment Group, formerly known as the CtW Investment Group ("CtW"), a group that works with pension funds sponsored by unions affiliated with Change to Win, a federation of unions representing nearly 5.5 million members, submitted the following proposal to Bank of America Corporation for inclusion in its proxy statement:

> RESOLVED that shareholders of Bank of America Corporation ("BofA") urge the Board of Directors to oversee a racial equity audit analyzing BofA's adverse impacts on nonwhite stakeholders and communities of color. Input from civil rights organizations, employees, and customers should be considered in determining the specific matters to be analyzed. A report on the audit, prepared at

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[62] *See* 17 C.F.R. § 240.14a-8.
[63] *Id.*
[64] *What You Need To Know About The 2021 Proxy Season, Forbes, Bhakti Mirchandani, June 28, 2021,* available at https://www.forbes.com/sites/bhaktimirchandani/2021/06/28/what-you-need-to-know-about-the-2021-proxy-season/?sh=2e475fae7f5e.
[65] *All things (not) being equal, IR Magazine, Ben Maiden, Summer 2021,* available at https://content.irmagazine.com/story/ir-magazine-summer-2021.pdf.

> reasonable cost and omitting confidential or proprietary information, should be publicly disclosed on BofA's website.[66]

Similar Racial Equity Audit proposals were submitted by shareholders at several public companies during the 2021 proxy season with substantially the same resolution clause copied above, but with different issues highlighted. In general, Racial Equity Audit proposals ask the board of directors of a company to oversee such audits analyzing the company's "business models—from policies to products and services—to determine whether they cause, reinforce or perpetuate discrimination."[67]

B. Why Proponents Submit Racial Equity Audit Proposals

According to public policy analysts, racial violence and the COVID-19 pandemic sparked an increase in Rule 14a-8 shareholder proposals focused on racial justice.[68] Several of the supporting statements for Racial Equity Audit proposals stated that:

> High-profile police killings of black people—most recently George Floyd—have galvanized the movement for racial justice. That movement, together with the disproportionate impacts of the COVID-19 pandemic have focused the attention of the media, the public and policy makers on systemic racism, racialized violence and inequities in employment, health care, and the criminal justice system.[69]

Proponents contend that Racial Equity Audits would help public companies "identify, prioritize, remedy and avoid adverse impacts on nonwhite stakeholders and communities of color"[70] and would help a company's board of directors assess such company's "behavior through a racial equity lens in order to obtain a complete picture of how it contributes to, and could help dismantle, systemic racism."[71]

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[66] *Bank of America Corporation, 2021 Notice of Annual Meeting and Proxy Statement, Schedule 14A, filed with the SEC on March 8, 2021*, available at https://about.bankofamerica.com/annualmeeting/static/media/BAC_2021_ProxyStatement_ADA.612694a6.pdf.

[67] *Google Pressured on Racial Equity Audit After AI Ethics Collapse, Bloomberg, Naomi Mix, April 27, 2021*, available at https://www.bloomberg.com/news/articles/2021-04-27/google-pressured-on-racial-equity-audit-after-ai-ethics-collapse; *see also supra* Section II.A.

[68] *Supra* note 64.

[69] *Citigroup Inc., 2021 Notice of Annual Meeting and Proxy Statement, Schedule 14A, filed with the SEC on March 17, 2021*, available at https://www.sec.gov/Archives/edgar/data/831001/000120677421000735/citi3828191-def14a.htm [hereinafter "*Citigroup Proxy Statement*"]; *see also CoreCivic Inc. Proposal, Service Employees International Union (SEIU),* available at https://exchange.iccr.org/node/88686/text.

[70] *Citigroup Proxy Statement*, *supra* note 69; *JPMorgan Chase & Co., 2021 Notice of Annual Meeting of Shareholders and Proxy Statement, Schedule 14A, filed with the SEC on April 7, 2021,* available at https://www.sec.gov/Archives/edgar/data/0000019617/000001961721000275/a2021proxystatement.htm [hereinafter "*JPMorgan Proxy Statement*"].

[71] *Id.*

The chart below lists the proponents who submitted Racial Equity Audit proposals to public companies pursuant to Rule 14a-8 during the 2021 proxy season and the number of proposals they submitted:

2021 Proxy Season	
Proponent of Racial Equity Audit	**Number of Submissions**
Change to Win (CtW)	4
New York State Common Retirement Fund et al.	1
Services Employees International Union (SEIU)	5
Trillium Asset Management LLC	2
Total:	**12**

Source: ISS Corporate Solutions and SEC Filings

C. Public Company Resistance to Racial Equity Audit Proposals

Boards of directors of public companies are "[i]ncreasingly . . . called upon to navigate the challenges presented by climate change, racial injustice, economic inequality, and numerous other issues that are fundamental to the success and sustainability of companies, financial markets, and our economy."[72] After the May 2020 killing of George Floyd, 66% of S&P 500 companies posted statements on their websites or social media accounts, 36% made financial contributions to racial justice organizations and 14% stated in their communications that "Black Lives Matter."[73] While it has been observed that these companies were "quick to issue statements supporting Black Lives Matter and promis[ed] to do more to be responsive to non-white consumers, employees and communities,"[74] most companies on the receiving end of a Rule 14a-8 proposal to implement a Racial Equity Audit have actively resisted such proposal by seeking no-action relief from the SEC to exclude the proposal from their 2021 proxy statements, negotiating with proponents to withdraw their proposals, and, when the company had been unsuccessful with the foregoing, recommending that shareholders vote against the proposals. In doing so, these companies have argued that they have already taken measures to address racial justice, such as "investing in Black entrepreneurs, expanding credit and working to boost diversity within their ranks."[75]

Companies Sought No-Action Relief. Companies that sought to exclude Racial Equity Audit proposals from their 2021 proxy statements by requesting no-action relief from the SEC argued that the exclusions set forth in sections (i)(3), (i)(7) or (i)(10) of Rule 14a-8 applied.

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[72] *Climate, ESG, and the Board of Directors: "You Cannot Direct the Wind, But You Can Adjust Your Sails," U.S. Securities and Exchange Commission, Commissioner Allison H. Lee, June 28, 2021,* available at https://www.sec.gov/news/speech/lee-climate-esg-board-of-directors.
[73] *As You Sow: Racial Justice*, available at https://www.asyousow.org/our-work/social-justice/racial-justice.
[74] *Big US companies pushed to tally progress on racial justice, Yahoo! News, John Biers, May 22, 2011*, available at https://news.yahoo.com/big-us-companies-pushed-tally-014418300.html.
[75] *Goldman, Citi Stave Off Investor Calls for Racial Audits (1), Bloomberg Law, Saijel Kishan and Jeff Green*, *April 29, 2021,* available at https://news.bloomberglaw.com/banking-law/goldman-citi-stave-off-investor-calls-for-racial-audits-1.

Under Rule 14a-8(i)(10), a company is permitted to exclude a shareholder proposal if the company has already substantially implemented the proposal. The Staff has stated that "substantial" implementation under the rule does not require the company to have implemented the proposal in full or exactly as proposed by the shareholder.[76] To demonstrate that they had substantially implemented the audit proposals, companies argued they had (i) made pledges and commitments towards racial justice initiatives and made such information publicly available; [77] (ii) issued ESG and/or diversity focused reports;[78] (iii) issued press releases and public disclosures addressing racial inequality;[79] (iv) implemented initiatives to advance racial equity;[80] or (v) financially committed to racial justice initiatives and causes.[81]

Rule 14a-8(i)(7) allows exclusion of proposals related to a company's ordinary business operations. SEC interpretations of this rule provide that proposals that concern ordinary business matters but focus on significant social policy issues would not be excludable because "the proposals would transcend the day-to-day business matters."[82] In seeking to exclude Racial Equity Audit proposals, companies argued that these audits concerned day-to-day aspects of their ordinary business operations, including: (i) "product sales and advertising;"[83] (ii) "customer relationships;"[84] (iii) the "nature of the company's public relations, messaging, and communications with its shareholders and other constituents;"[85] (iv) "workforce management;"[86] (v) "relationships with suppliers;"[87] (vi) "community impacts;"[88] or (vii) "decisions regarding the

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[76] *See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018*, *May 28, 1998*, available at https://www.govinfo.gov/content/pkg/FR-1998-05-28/html/98-14121.htm.
[77] *Rule 14a-8 No Action Letter re: JPMorgan Chase & Co.—2021 Annual Meeting, Supplemental Letter dated January 11, 2021, Relating to Shareholder Proposal Submitted by CtW Investment Group, Skadden, Arps, Slate, Meagher & Flom LLP*, *February 16, 2021*, available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2021/ctwjpmorgan032621-14a8.pdf [hereinafter "*JPMorgan No-Action Letter—February"*].
[78] *Rule 14a-8 No-Action Letter re: Stockholder Proposal to Citigroup Inc. from CtW Investments Group, Citigroup Inc., December 23, 2020*, available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2021/ctwcitigroup022621-14a8.pdf [hereinafter "*Citigroup No-Action Letter*"]; *Rule 14a-8 No Action Letter re: Johnson & Johnson—2021 Annual Meeting, Omission of Shareholder Proposal of Christopher and Anne Ellinger and co-filers, Skadden, Arps, Slate, Meagher & Flom LLP*, *December 16, 2020*, available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2021/ellingeretaljohnson021221-14a8.pdf [hereinafter "*J&J No-Action Letter"*].
[79] *See Citigroup No-Action Letter, supra* note 78; *JPMorgan No-Action Letter—February, supra* note 77.
[80] *See J&J No-Action Letter, supra* note 78.
[81] *See Citigroup No-Action Letter*, *supra* note 78.
[82] *See Final Rule: Amendments to Rules on Shareholder Proposals, Release No. 34-40018; IC-23200; File No. S7-25-97,* available at https://www.sec.gov/rules/final/34-40018.htm *(citing Reebok Int'l Ltd. (Mar. 16, 1992)).*
[83] *See Rule 14a-8 No-Action Letter re: Amazon.com, Inc. Shareholder Proposal of CtW Investment Group Securities Exchange Act of 1934—Rule 14a-8, Gibson Dunn, January 25, 2021*, available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2021/nyscrfamazon012521-14a8-incoming.pdf [hereinafter "*Amazon No-Action Letter*"]; *J&J No-Action Letter, supra* note 78.
[84] *See J&J No-Action Letter, supra* note 78.
[85] *See Amazon No-Action Letter, supra* note 83.
[86] *See J&J No-Action Letter*, *supra* note 78.
[87] *Id.*
[88] *See JPMorgan No-Action Letter—February*, *supra* note 77.

products and services [the company] offers."[89] Furthermore, these companies contended that the proposals did not focus on a significant policy issue that transcended their ordinary business.[90]

Under Rule 14a-8(i)(3), a shareholder proposal may be excluded from a company's proxy materials if the proposal or the supporting statement accompanying the proposal is contrary to any of the federal proxy rules, including Rule 14a-9, which prohibits a company from disclosing materially false or misleading statements in its proxy materials.[91] The Staff has recognized that exclusion is permitted pursuant to Rule 14a-8(i)(3) if "the resolution contained in the proposal is so inherently vague or indefinite that neither the stockholders voting on the proposal, nor the company in implementing the proposal (if adopted), would be able to determine with any reasonable certainty exactly what actions or measures the proposal requires."[92] Johnson & Johnson, the only company to invoke Rule 14a-8(i)(3) during the 2021 proxy season to attempt to exclude a Racial Equity Audit proposal, argued that the proposal was impermissibly vague and indefinite because "neither Johnson & Johnson nor shareholders would be able to determine with any reasonable certainty what actions or measures the proposal requires."[93]

The SEC considered the arguments described above to exclude the shareholder proposals on Racial Equity Audits, and, in each case, the SEC did not concur with the company that the shareholder proposal should be excluded. Below is a chart listing the shareholder proposals submitted at various companies during the 2021 proxy season, the proponent, the regulatory basis to exclude the proposal invoked by the company and the SEC's response to the company's request for exclusion.

Company	**Proponent**	**Regulatory Basis Asserted by the Company to Exclude Shareholder Proposal**		**SEC Response to Company Request**
Amazon.com, Inc.	New York State Common Retirement Fund et al.	Rule 14a-8(i)(7)	Ordinary Business Exception	Unable to concur that Rule 14a-8(i)(7) provides a basis to exclude
Citigroup Inc.	CtW Investment Group	Rule 14a-8(i)(10)	Substantially Implemented Exception	Unable to concur that Rule 14a-8(i)(10) provides a basis to exclude
JPMorgan Chase & Co.	CtW Investment Group	Rule 14a-8(i)(7)	Ordinary Business Exception	Unable to concur with exclusion on any of the bases asserted
		Rule 14a-8(i)(10)	Substantially Implemented Exception	

[89] *Id.*
[90] *See e.g., Citigroup No-Action Letter, supra* note 78; *J&J No-Action Letter, supra* note 78; *JPMorgan No-Action Letter—February, supra* note 77*; Amazon No-Action Letter, supra* note 83.
[91] *See SEC, Division of Corporate Finance Staff Legal Bulletin No. 14B, September 15, 2004,* available at https://www.sec.gov/interps/legal/cfslb14b.htm.
[92] *Id.*
[93] *See J&J No-Action Letter*, *supra* note 78.

Company	Proponent	Regulatory Basis Asserted by the Company to Exclude Shareholder Proposal		SEC Response to Company Request
Johnson & Johnson	Trillium Asset Management LLC	Rule 14a-8(i)(3)	Materially False and Misleading Exception (Vague or Indefinite)	Unable to concur with exclusion on any of the bases asserted
		Rule 14a-8(i)(7)	Ordinary Business Exception	
		Rule 14a-8(i)(10)	Substantially Implemented Exception	

Source: SEC Filings

Companies Negotiated with Shareholders to Withdraw the Racial Equity Audit Proposal. BlackRock, the world's largest asset management firm, and CoreCivic Inc. ("CoreCivic"), an operator of private prisons, have agreed to conduct independent Racial Equity Audits after receiving shareholder proposals for such audits, resulting in the proponents withdrawing their proposals.[94] In the financial industry, BlackRock's decision distinguishes it from other financial institutions that have asked shareholders to vote against similar audit proposals and/or have sought no-action relief from the SEC.[95]

Companies Recommended Voting Against Racial Equity Audit Proposals. Most companies who may have been unsuccessful in seeking no-action relief from the SEC to exclude the proposal or in negotiating a resolution with a shareholder to withdraw the proposal have recommended that shareholders vote against the proposals. These companies have asserted that they disagree with the "approach" of Racial Equity Audit proposals, but are "aligned with [their] stated goal of addressing racial inequity in the financial sector."[96]

For example, the board of directors of Citi recommended a vote against the Racial Equity Audit proposal included in its 2021 proxy statement, noting that "[a]s recently as September

[94] *CoreCivic, Inc., Form 8-K, filed with the SEC on May 18, 2021,* available at https://www.sec.gov/ix?doc=/Archives/edgar/data/1070985/000119312521165313/d184269d8k.htm.

[95] For a detailed discussion of BlackRock's decision to implement a Racial Equity Audit, see Section IV.A.

[96] *See e.g., Goldman Sachs Proxy Statement, supra* note 35 ("We share the proponent's focus on advancing racial equity."); *Citigroup Proxy Statement, supra* note 69 ("While we disagree with the overall approach in this Proposal, we are completely aligned with its stated goal of addressing racial inequity in the financial sector."); *see also Lawmakers debate bill mandating racial equity audits at firms, The Hill, Abigail Goldberg-Zelizer, June 30, 2021*, available at https://thehill.com/policy/finance/561026-lawmakers-debate-bill-mandating-racial-equity-audits-at-firms; *Shareholders want to hold corporate giants accountable for their commitments to racial equity and justice. The banks are fighting back., Markets Insider, Marguerite Ward, April 7, 2021*, available at https://markets.businessinsider.com/news/stocks/bank-leaders-buck-shareholder-call-third-party-racial-equity-audit-2021-4 ("'We believe our progress on the issue of racial equality, and our regular reporting of that progress, make the proposal's requested audit unnecessary,' a Bank of America spokesperson told Insider.").

2020, Citi released a 104 page report on the economic cost of Black inequality in the United States titled *Closing the Racial Inequality Gaps*," and said its efforts on these issues are available to the public.[97] Wells Fargo Co. ("Wells Fargo") said it is conducting a "human rights impact assessment," and that it will update its Human Rights Statement to better align with the expectations of companies under the United Nations Guiding Principles on Business and Human Rights.[98] Wells Fargo also said it is making efforts toward "expanding [its] diversity and inclusion commitments with a focus on hiring, promotions, and turnover, with increased accountability across all of those areas and [is] taking specific actions in support of these commitments."[99] The board of directors of Goldman recommended that shareholders vote against the shareholder proposal on a Racial Equity Audit, saying it has taken additional steps toward racial equity in the past year, including assessing its "shortcomings" and committing to hiring more analysts from "historically Black colleges and universities, while maintaining [its] existing programs focused on other diverse populations."[100] Goldman also pointed out that it is "[b]uilding upon more than $200 million of grants in minority communities and to minority-owned businesses over the past two decades" and "in 2020 [Goldman] created the Fund for Racial Equity to support the vital work of leading nonprofits that are addressing racial injustice, structural inequity and economic disparity, which has committed $10 million from GS Gives in addition to matching employee contributions to recipient organizations."[101]

D. Proxy Advisors' Positions on Racial Equity Audits

The two leading proxy advisory firms, ISS and Glass Lewis & Co. LLC ("Glass Lewis"), have generally taken opposing views on Racial Equity Audits. According to Bloomberg, Glass Lewis "has broadly said conducting the audits would help companies reduce risks of high-profile controversies that may result in customer and employee attrition, regulatory inquiries and significant fines," and that "'[g]iven broad societal changes, it is particularly important for consumer-facing companies,' which depend on their customers' trust and loyalty, 'to address issues of racial equity.'"[102] On the other hand, according to Bloomberg, ISS has stated that "racial audits aren't warranted because companies are taking 'sufficient meaningful actions' to address racial inequities such as expanding opportunities for people and communities of color, as well as improving the diversity and inclusion of its workforces."[103] The following chart sets forth the recommendations ISS and Glass Lewis made with respect to each Racial Equity Audit proposal in the 2021 proxy season:

[97] *Citigroup Proxy Statement, supra* note 69.
[98] *Wells Fargo & Company, Notice of Annual Meeting and Proxy Statement, Schedule 14A, filed with the SEC on March 16, 2021,* available at https://www.sec.gov/Archives/edgar/data/72971/000119312521082907/d71313ddef14a.htm [hereinafter "*Wells Fargo Proxy Statement*"].
[99] *Id.*
[100] *Goldman Sachs Proxy Statement, supra* note 35.
[101] *Id.*
[102] *Shareholder-Advisory Firms Take Opposing Views on Racial Audits, Bloomberg Law, Saijel Kishan, April 17, 2021,* available at https://news.bloomberglaw.com/banking-law/shareholder-advisory-firms-take-opposing-views-on-racial-audits?context=article-related (quoting Glass Lewis).
[103] *Id.* (quoting ISS).

2021 Proxy Season					
			Proxy Advisory Firm Recommendation		
Company	**Proponent**	**Board Recommendation**	**ISS**	**Glass Lewis**	**Voting Results**
Amazon.com, Inc.	New York State Common Retirement Fund et al.	Against	For	For	Failed
Amgen Inc.	Trillium Asset Management	—	—	—	Withdrawn
Bank of America Corporation	CtW Investment Group	Against	Against	For	Failed
BlackRock, Inc.	Service Employees International Union	—	—	—	Withdrawn
Citigroup Inc.	CtW Investment Group	Against	Against	For	Failed
CoreCivic Inc.	Service Employees International Union	—	—	—	Withdrawn
The Goldman Sachs Group, Inc.	Service Employees International Union	Against	Against	For	Failed
JPMorgan Chase & Co.	CtW Investment Group	Against	Against	For	Failed
Johnson & Johnson	Trillium Asset Management LLC	Against	Against	For	Failed
Morgan Stanley	CtW Investment Group	—	—	—	Withdrawn
State Street Corporation	Service Employees International Union	Against	Against	For	Failed

2021 Proxy Season					
			Proxy Advisory Firm Recommendation		
Company	**Proponent**	**Board Recommendation**	**ISS**	**Glass Lewis**	**Voting Results**
Wells Fargo & Company	Service Employees International Union	Against	Against	Against	Failed

Source: ISS Corporate Solutions and Proxy Insight

E. AMAZON'S RESPONSE TO A RACIAL EQUITY AUDIT PROPOSAL—A CASE STUDY

During the 2021 proxy season, Amazon.com, Inc. ("Amazon") faced a shareholder proposal requesting the company to conduct a Racial Equity Audit.[104] The proposal was submitted by Comptroller DiNapoli, as trustee of New York State's Common Retirement Fund for public employees, which owns shares in Amazon.[105] Comptroller DiNapoli was joined by other Amazon shareholders[106] in requesting Amazon's board of directors to commission a Racial Equity Audit that would analyze two main issues: (1) Amazon's "impacts on civil rights, equity, diversity, and inclusion," and (2) the "impacts of those issues on Amazon's business."[107] In response, Amazon sent a letter to the SEC seeking to exclude the proposal from its 2021 proxy materials.[108] Amazon argued that, regardless of the proposal being "framed in the form of a request for a report," this did not change the fact that the "subject matter of the proposed report is within [Amazon's] ordinary business" and thus excludable under Rule 14a-8(i)(7).[109]

Amazon argued the proposal's call to review its impact "on civil rights, equity, diversity and inclusion" is a "broad survey on the impact of the Company's policies, practices, products and services on societal issues," which implicates "routine business issues," such as "the products and services that the Company offers to its customers, the Company's business practices and operations, the Company's strategic decisions, and the Company's choice of

[104] *Amazon.com, Inc., Notice of 2021 Annual Meeting of Shareholders and Proxy Statement, Schedule 14A, filed with the SEC on April 15, 2021,* available at https://www.sec.gov/Archives/edgar/data/1018724/000110465921050333/tm2035374-1_def14a.htm [hereinafter "*Amazon Proxy Statement"*].
[105] *Id.; see also Comptroller DiNapoli Wants Audit of Amazon's Racial Justice Practices, Times Union, Rick Karlin, December 21, 2020,* available at https://www.timesunion.com/news/article/Comptroller-DiNapoli-wants-audit-of-Amazon-s-15815322.php.
[106] Other shareholders joining the proposal were: (1) the Praxis Growth Index Fund; (2) CommonSpirit Health; (3) the Adrian Dominican Sisters; (4) Catherine Donnelly Foundation; (5) Monasterio Pan de Vida; (6) Reynders, McVeigh Capital Management, LLC; (7) the Congregation of the Sisters of St. Joseph of Peace; (8) the Sisters of the Holy Names of Jesus and Mary U.S.-Ontario Province Corporation; and (9) Newground Social Investment on behalf of the Robert H. and Elizabeth Fergus Foundation and Eric Menninga.
[107] *Amazon Proxy Statement*, *supra* note 104.
[108] *Amazon No-Action Letter*, *supra* note 83.
[109] *Id.* (citing *Exchange Act Release No. 20091 (August 16, 1983)*).

technologies."[110] Similarly, according to Amazon, such an audit would "necessarily implicate[] a multitude of ordinary business matters relating to the Company's day-to-day operations," which Amazon argued included decisions relating to, among other things, its charitable donations, hiring decisions, diversity and recruitment initiatives, customer relations, advertising, public relations and communications with its shareholders and the kinds of products it sold.[111] Despite the laundry list of examples Amazon cited in its No-Action Letter, the SEC did not concur that the proposal was excludable under Rule 14a-8(i)(7).[112]

In a webinar hosted by CtW, Comptroller DiNapoli explained the importance of racial equity at Amazon and why shareholders should vote in favor of the proposal, and argued that "racial inequity is harming the United States economy."[113] DiNapoli argued that "the pattern and magnitude of issues repeatedly facing the company demonstrate a need for a more in-depth review . . . Concerns related to workforce diversity, treatment of minority workers, environmental justice in communities of color, surveillance, and civil rights are just some of the controversies that have troubled Amazon."[114] For example, current and former Amazon employees have accused the company of allowing racism to permeate its operations.[115] The company's environmental impact has also been called out for allegedly disproportionately affecting minority communities.[116] Comptroller DiNapoli expressed concern with Amazon's alleged lack of transparency, stating that while the company has put policies in place to address this issue, it "has not reported to investors the effectiveness or the process for completing its ongoing policy review."[117] In 2020, Amazon conducted its first human rights assessment, which

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[110] *Id*.
[111] *Id*.
[112] *Shareholder Proposal No-Action Responses, SEC, Staff's Response, April 7, 2021,* available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/shareholder-proposal-no-action-responses.htm; *see also U.S. SEC blocks Amazon effort to stop shareholder votes on racial equity audit*, *Reuters, April 7, 2021,* available at https://www.reuters.com/article/us-amazon-com-sec-vote/u-s-sec-blocks-amazon-effort-to-stop-shareholder-votes-on-racial-equity-audit-idUSKBN2BU38U.
[113] *See Webinar,* Thomas DiNapoli, New York State Comptroller*, supra* note 23.
[114] *Id.*
[115] *See, e.g.*, *Bias, disrespect, and demotions: Black employees say Amazon has a race problem, Vox:Recode, Jason Del Rey, February 26, 2021*, available at https://www.vox.com/recode/2021/2/26/22297554/amazon-race-black-diversity-inclusion; *Black Amazon manager sues the e-commerce giant, accusing it of race and gender discrimination, Washington Post, Jay Greene, March 1, 2021*, available at https://www.washingtonpost.com/technology/2021/03/01/amazon-race-discrimination-lawsuit/; *Five women sue Amazon, accusing e-retailer of race and gender discrimination and retaliation, Washington Post, Jay Greene, May 19, 2021*, available at https://www.washingtonpost.com/technology/2021/05/19/amazon-suit-race-gender-discrimination/.
[116] *See How Amazon's Emissions are Hurting Communities of Color, Amazon Employees for Climate Justice, May 26, 2020*, available at https://amazonemployees4climatejustice.medium.com/environmental-justice-and-amazons-carbon-footprint-9e10fab21138; A*mazon workers demand end to pollution hitting people of color hardest, NBC News, April Gleiser and Leticia Miranda, May 24, 2021*, available at https://www.nbcnews.com/tech/tech-news/amazon-shareholders-demand-end-pollution-hitting-people-color-hardest-n1268413.
[117] *See Webinar,* Thomas DiNapoli, New York State Comptroller*, supra* note 23.

it referenced to support its position that there was no need to conduct a Racial Equity Audit.[118] However, Comptroller DiNapoli noted "a human rights assessment is not the same as an independent racial equity audit, and shareholders should be weary of equating the two."[119]

On May 26, 2021, Amazon shareholders rejected eleven shareholder proposals at the annual meeting.[120] Among these, the proposal for a Racial Equity Audit garnered the most support, with 44% of the votes cast on this proposal voting in favor.[121] Comptroller DiNapoli described the vote as "an immense success for a first-time proposal . . . [i]f CEO Jeff Bezos' shares (70,616,270 shares, 14%) were to be removed from those voting 'against' it, the proposal received majority support."[122]

IV: THE FOCUS OF RACIAL EQUITY AUDITS ON THE FINANCIAL INDUSTRY

Financial institutions and asset management firms have become the focus of Racial Equity Audit shareholder proposals. According to CtW, this focus is based on the belief that:

> the finance industry has played a critical role in perpetuating unequal wealth distribution to communities of color. Whether it be modern day 'redlining' techniques related to mortgage loans, to excessive checking account fees, to most recently, Payday [sic] Protection Program distribution, communities of color have faced decades of discrimination as a result of the financial industry's policies and practices.[123]

While the financial institutions that have received Racial Equity Audit proposals have recently made philanthropic and strategic investments, along with other commitments to racial equity, CtW has stated that "the only way to effectively address racial injustice and economic inequality is careful study of how the industry's products and services have contributed to this imbalance,"[124] which includes analyzing mortgage issuances, the number of bank branches in

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[118] *Id.; see also Human Rights*, *Amazon,* available at https://sustainability.aboutamazon.com/people/human-rights?workerCount=true&engagementProgram=true&productCategory=true.

[119] *See Webinar,* Thomas DiNapoli, New York State Comptroller*, supra* note 23.

[120] *Amazon investors reject New York retirement fund's call for a racial-equity audit, 10 other shareholder proposals, MarketWatch, Levi Sumagaysay, May 28, 2021,* available at https://www.marketwatch.com/story/amazon-investors-reject-new-york-retirement-funds-call-for-a-racial-equity-audit-10-other-shareholder-proposals-11622242863.

[121] *Id.*

[122] *NYS Comptroller DiNapoli Statement on Major Support for Racial Equity Audit at Amazon, Office of the New York Comptroller, May 28, 2021,* available at https://www.osc.state.ny.us/press/releases/2021/05/nys-comptroller-dinapoli-statement-major-support-racial-equity-audit-amazon.

[123] *Racial Equity Audit*, *SOC Investment Group, 2021*, available at https://www.socinvestmentgroup.com/racial-equity-audit.

[124] *Id.*

minority neighborhoods or "banking deserts" and whether charitable contributions are "fully aligned with . . . public statements."[125]

A. An Outlier in the Financial Industry—BlackRock Agrees to a Racial Equity Audit

BlackRock's response to the Racial Equity Audit proposal that SEIU submitted for inclusion in its proxy statement was an outlier among the other financial and asset management firms that faced similar proposals. Like the other companies that received shareholder proposals on Racial Equity Audits in the 2021 proxy season, SEIU's proposal urged BlackRock to "assess its behavior through a racial equity lens to identify how it contributes to systemic racism," including where its stated values are misaligned with the impact of its actions.[126] The resolution included in SEIU's proposal also noted that:

> A 2020 report on proxy voting found that BlackRock did not use its clout as a significant owner to advance racial justice. BlackRock opposed nearly all shareholder proposals directly addressing racial justice issues, including two proposals at Amazon seeking disclosure regarding hate-promoting products and effects of its facial recognition technology on people of color.[127]

According to SEIU, BlackRock "decided that the SEIU proposal is too important to wait until they are voted on at their shareholder meetings"[128] and announced its plans to voluntarily conduct an independent racial audit of its operations.[129] As a result, the shareholder proposal was withdrawn and SEIU announced that it was currently working with BlackRock to bring about "needed change within the company and the financial services industry."[130] Commentators anticipate that BlackRock's commitment to a Racial Equity Audit "could sway other financial services companies to follow in its footsteps."[131]

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[125] *Rule 14a-8 No Action Letter, CtW Investment Group*, *November 12, 2020*, available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2021/ctwjpmorgan032621-14a8.pdf.
[126] *BlackRock Audit Proposal*, available at https://static1.squarespace.com/static/5d374de8aae9940001c8ed59/t/60216432f41c694416fcceb5/1612801075053/BlackRock+2021+racial+equity+audit+proposal+final+%281%29.pdf.
[127] *Id.*
[128] *SEIU and Change to Win's investment funds pushing for racial diversity in financial institutions,* available at https://www.seiu.org/blog/2021/4/seiu-and-change-to-wins-investment-funds-pushing-for-racial-diversity-in-financial-institutions.
[129] *BlackRock Breaks Wall Street Ranks With Planned Racial Audit (1), Bloomberg Tax, Saijel Kishan, April 5, 2021,* available at https://news.bloombergtax.com/financial-accounting/blackrock-breaks-ranks-with-wall-street-in-performing-race-audit.
[130] *Supra,* note 128.
[131] *BlackRock pledges to conduct a racial audit of its business, Fortune, Marco Quiroz-Gutierrez, April 6, 2021,* available at https://fortune.com/2021/04/06/blackrock-racial-audit-corporate-diversity-inclusion-race-at-work/.

V: DEVELOPMENTS FOR FUTURE PROXY SEASONS

A. Racial Audits May Be Here to Stay

ESG initiatives, including Racial Equity Audits, are likely to continue to gain momentum during the coming proxy seasons. As ESG issues garner more media attention and as younger generations move into the investing space, these issues and related disclosures may become increasingly important to consumers, investors and other stakeholders. Racial Equity Audits could emerge as a critical tool for companies to evaluate their current social impact and provide an objective method for investors to monitor their investments and potentially identify new companies that could benefit from increased social and economic engagement.

While we witnessed an increase in shareholder proposals related to Racial Equity Audits in the 2021 proxy season, all such proposals were either withdrawn or defeated.[132] However, as Racial Equity Audits become more commonplace and enter the cultural norm, these proposals may begin to resonate with more stakeholders and be approved by shareholders as early as the next proxy season.

B. Proactive Companies May Try to Cut These Initiatives Off at the Pass

In light of the anticipated increase in the number of Racial Equity Audit proposals in the coming proxy seasons, we may see a corresponding rise in the number of companies that follow BlackRock's lead and voluntarily conduct their own Racial Equity Audits. Proponents of Racial Equity Audits warn that such audits should be conducted in a robust manner by fully independent third parties, and that the subject companies take action to address deficiencies, shortcomings and concerns uncovered by the audits. Otherwise, these proponents posit, a lackluster or hastily conducted Racial Equity Audit or failure to take meaningful action in response to an audit may actually have the opposite effect for the implementing institution—instead of insulating the company from potential proposals demanding Racial Equity Audits, faulty or perfunctory audits may instead create a target on the institution's back for ESG activists in the following years.

C. Proxy Advisory Firms Likely to Weigh In

No major proxy advisory firm has issued official voting guidance on the implementation of Racial Equity Audits—and the two largest advisory firms, ISS and Glass Lewis, have been split on their support for shareholder proposals requesting such audits.[133] However, in the coming years, we believe this is an area in which the proxy advisory firms may issue official voting guidance. On July 28, 2021, ISS launched its Annual Benchmark Policy Survey, which included requests for feedback on Racial Equity Audits.[134] ISS will use the results from its Annual Benchmark Policy Survey as a "key component of ISS' annual policy development

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[132] *See Section III.D.*
[133] *Id.*
[134] *ISS Opens Global Annual Benchmark Policy Survey and Separate Climate Survey, ISS, July 28, 2021,* available at https://insights.issgovernance.com/posts/iss-opens-global-annual-benchmark-policy-survey-and-separate-climate-survey/.

process to assess potential policy changes across regions and markets for 2022 and beyond."[135] While ISS has largely appeared hesitant to support Racial Equity Audits in the circumstances presented in the 2021 proxy season, the results from its Annual Benchmark Policy Survey could change its future guidance and recommendations on such audits. As the area develops (and if more companies voluntarily implement these audits), Racial Equity Audits could become viewed as good corporate governance, particularly if top proxy advisory firms issue official guidance supporting the implementation of such audits.

The proxy advisory firms' level of guidance may take varying forms—at the low end, proxy advisory firms may increase a company's ESG or corporate governance "score" for having in the past or recently conducted a Racial Equity Audit. At the higher end, proxy advisory firms may offer official guidelines on what they believe are minimum actions a company should take with respect to Racial Equity Audits in order to receive the advisor's support. For example, such guidelines may provide for a minimum frequency of Racial Equity Audits and indicate parameters on what attributes an audit must possess to be considered sufficient. In this case, failure to have a Racial Equity Audit policy or refusal to implement such a policy after shareholders have approved a proposal to implement one may become a criteria an advisory firm would consider in making a recommendation for or against the re-election of a company's chairperson of the governance committee and/or the re-election of other directors at the company's annual meeting.

Clear guidance from proxy advisory firms would also be beneficial to companies considering implementing Racial Equity Audit policies by offering indications on what parameters constitute "best practices" and how frequently these audits should occur. By offering such guidance, companies may find it easier to voluntarily implement Racial Equity Audit policies.

D. Potential Legislative or Regulatory Mandates

Even with an increase in the number of shareholder proposals requesting Racial Equity Audits, it is possible that companies may not adopt them as quickly or as widely as the public and/or certain legislative bodies would prefer. If this occurs, legislators and/or regulatory authorities may at some point in the future step in to close the gap between investor demand and practical implementation. We saw this occur in California with Senate Bill 826 and Assembly Bill 979 discussed in further detail above.[136] As the general public's views evolve on ESG issues, public pressure for certain actions—in this case, increased diversity in public boardrooms—often influence not just shareholder advocacy but legislative action. The California legislature recognized the public desire to move towards greater diversity on public boards and codified set requirements. In this way legislatures and/or regulatory authorities have the ability to serve as the catalyst for change and wider-reaching adoption by forcing companies that might have been unlikely or slow to act on their own to adopt such policies.

Indeed, the House Financial Services Subcommittee on Diversity and Inclusion is currently reviewing legislation that would require banks to conduct Racial Equity Audits every

[135] *Id.*
[136] *See Section I.B.*

two years in an effort to promote diversity and equity.[137] The proposed Diversity and Inclusion Data Accountability and Transparency Act would require such audits by independent third parties of the subject companies' "policies and practices pertaining to civil rights, equity, diversity and inclusion."[138] The initial debates on the draft legislation also considered adding to the draft bill penalties for non-compliance, including fines of up to $20,000 a day for failure to engage in such audits.[139] The draft legislation would also require banks to investigate what ties they may have to slavery and disclose steps such institution would take to reconcile profits it may have received from slavery.[140] The legislation is sponsored by Rep. Joyce Beatty and co-sponsored by Reps. Nikema Williams and Jesus G. Garcia and is currently under committee review.[141]

Other external forces that may prompt public companies to adopt Racial Equity Audit policies are the SEC and the securities exchanges. Currently, neither the SEC nor the major U.S. securities exchanges mandate publicly traded companies to make disclosures regarding Racial Equity Audit initiatives. However, on August 6, 2021, the SEC approved new listing rules proposed by The Nasdaq Stock Market LLC ("Nasdaq") requiring each Nasdaq-listed company to disclose certain information about the diversity of its board of directors and generally include a minimum number of members of its board of directors who are Diverse (as defined within the new listing rules).[142] Accordingly, as Racial Equity Audits become an increasingly important area for investors, it is possible that the SEC and the major exchanges may eventually require companies to make further diversity, equity and inclusion disclosures, which may include the existence and frequency of a company's Racial Equity Audits.

Legislative or regulatory requirements are not without their own risks, and compliance with any such minimum standards would not be fool proof to insulate a company from potential ESG proposals and proxy campaigns. Racial Equity Audits and similar equity and inclusion initiatives that are not robust or designed with the aid of independent third party consultants may risk being perceived as mere "window dressing" and invite criticism from shareholders.

E. Companies Should Stay Informed in This Area

Given current trends in ESG, public companies should stay informed on Racial Equity Audits and their adoption, crafting and implementation. Further, companies wishing to stay ahead of the curve may start by critically and objectively looking at their current internal practices and policies relating to equity and inclusion and identifying areas in need of improvement. If a company lags behind in this quickly developing area, we believe shareholders

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137 *Supra*, *Goldberg-Zelizer*, note 96.
138 *See H.R.2123—Diversity and Inclusion Data Accountability and Transparency Act, Congress Bill Tracker,* available at https://www.congress.gov/bill/117th-congress/house-bill/2123/committees?r=61&s=1 (as of July 15, 2021).
139 *Id.*
140 *Id.*
141 *Id.*
142 *SEC Approves Nasdaq's New Listing Rules Designed to Advance Greater Boardroom Diversity, Elizabeth Gonzalez-Sussman and Ron Berenblat, August 2021,* available at https://www.olshanlaw.com/resources-alerts-Nasdaq-SEC-boardroom-diversity-rule.html.

may become more willing to launch shareholder campaigns focused on ESG issues, including demanding objective results through Racial Equity Audits.

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