Top 10 Topics for Directors in 2020

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Executive Summary

Election and Impeachment

The presidential race will garner much of the attention during the 2020 election cycle, but there is fierce competition elsewhere, too. Republicans and Democrats are fighting for both U.S. House of Representatives and U.S. Senate seats in the 116th U.S. Congress, with the Republican Party trying to regain House majority. Meanwhile, impeachment proceedings against President Donald Trump are shaping up to be a potential game changer for certain members of the Senate who are running for president. They'll lose valuable time on the campaign trail while serving as jurors for the duration of the impeachment trial.

International Trade

The international trade landscape is poised for change during the opening weeks of 2020. President Donald Trump's trade initiatives—including those dealing with the North American Free Trade Agreement (NAFTA), China, Japan and the World Trade Organization (WTO)—will likely come to fruition, essentially remaking bilateral trading relationships in the New Year. At the same time, the United States and United Kingdom are preparing to navigate a post-Brexit world as of January 31, 2020. We expect trade policy to become a defining issue for the 2020 presidential campaign.

Economic Downturn

Today's economic, regulatory and political climates are uncertain, so members of boards of directors should take steps in 2020 to get ready for an economic downturn and prepare for restructuring. Corporate boards might not be able to fully safeguard against typical economic downturn challenges, like a reduction in access to public and private capital markets. However, they can still prepare. Evaluating and mitigating potential downside risks facing your business is key. Plus, familiarizing yourself with general legal and practical principles associated with operating in a low liquidity environment can go a long way.

Board Diversity

Diversity and inclusion can provide a competitive advantage and enable growth, so many companies have made them a top priority. Despite this, the number of women and minorities serving on boards of directors still doesn't reflect the makeup of the general population. Change starts in the boardroom, where it's important in 2020 for board members to take an active role in guiding a company culture that values human capital. You should review your company's diversity policies, as well as board nomination procedures to ensure they encourage gender and ethnic diversity.

Corporate Reputation

The Internet has made it possible for anyone to falsely attack online the products and brands, leadership, securities, markets and overall integrity of major corporations. So it's more important than ever to protect your company's reputation. The law provides some tools that can be used to deflect an organized attack on reputation, but the best defense in protecting the hard-earned good name of any business is vigilance, caution and a willingness to act when the threat to reputation is real and immediate.

Pay Equity

The legal landscape around pay equity is shifting in the right direction, as recently enacted state and local laws aim to eliminate pay differences. When closing the pay gap in 2020, boards of directors must consider crucial issues. Finding a way to achieve pay equity is a complex endeavor that involves a mix of business decisions and legal considerations. However, determining your company's vulnerability to equal pay claims and making adjustments where needed is one way to mitigate the risk of future claims and create a positive public narrative.

Cybersecurity

The nation's toughest privacy law—the California Consumer Privacy Act (CCPA)—went into effect on January 1, 2020. The law ushers in a new era of data

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governance and data privacy. At the same time, cyber breach activity continues to escalate. So cybersecurity and data privacy should be considered a significant risk area for companies. The CCPA is not limited to companies located in California. It's crucial to evaluate whether your company falls under the CCPA's reach and carefully structure data privacy practices to comply with the many requirements.

Shareholder Activism

Chief executive officer and board representation of women and minorities at public companies is increasing slowly, despite a focus on gender and racial diversity by institutional investors, lawmakers and shareholder activists. A new gender and ethnic diversity initiative implementing a version of the National Football League's (NFL's) "Rooney Rule" calls on companies to adopt a policy requiring the consideration of both women and minorities for every open board seat and CEO appointment. Launched by New York City Comptroller Scott Stringer, the initiative is one component of a broad-based gender and ethnic diversity activism campaign by investors for 2020.

Corporate Innovation

Today's challenging business environment is largely driven by technology, so boards of directors must continually harness strategic innovation to stay competitive.

In 2020, we expect companies to add directors with meaningful technology-related background and experience. Your nominating committee should consider technology expertise as one of the factors in the overall mix of skills that are essential for the board to possess. At the same time, it's essential to think about the potential legal and regulatory implications on the front end, as legislation catches up to emerging technologies.

Environmental, Social and Governance

Whether domestically or abroad, the private sector is reenvisioning its role in society by prioritizing environmental, social and governance (ESG) issues and reporting. The United States and other jurisdictions are moving toward heightened ESG accountability and transparency. Steps taken by major U.S. private sector organizations and the U.S. Chamber of Commerce illustrate that policy and practice are on a path forward in 2020. Meanwhile, the international regulatory trend is farther along toward required ESG reporting. A new European Union (EU) regulation requires higher levels of sustainability-related disclosures in the financial services sector.

#MeToo Movement

Allegations of sexual harassment against a C-suite or other senior executive can have devastating consequences for any company. To minimize damage in 2020, you should have a comprehensive harassment allegation response plan in place *before* an incident occurs. Quickly responding to any allegations can lead to better solutions and reduce the risk of litigation. Additionally, your board of directors should conduct an honest review of company culture, and take steps to put appropriate training and policies in place.

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1. Election and Impeachment

2020 Elections and Impeachment of President Trump

The 2020 election year is officially underway with the Democratic presidential primary heating up in Iowa and New Hampshire while Republicans and Democrats are squaring off in Washington, D.C., over impeachment and the escalating situation with Iran.

President Trump and Democrats in the U.S. Congress have continued to lock horns during the ongoing impeachment inquiry, with a vote on the two articles of impeachment passing on party lines in the U.S. House of Representatives on December 18, 2019. Speaker of the House Nancy Pelosi (D-CA) is currently holding onto the articles of impeachment while Senate Majority Leader Mitch McConnell and Senate Minority Leader Chuck Schumer attempt to negotiate the initial process and procedure for the U.S. Senate trial. Ultimately, Speaker Pelosi and Leader Schumer are demanding that certain documents and witnesses be included as part of the Senate trial, while Leader McConnell argues that the Senate should follow the precedent of the Clinton impeachment trial and consider the question of potential witnesses and documents after the initial presentation by House managers and the President's defense team. The schedule of the Senate remains in limbo until an initial agreement can be reached on the impeachment trial.

Impeachment

Here is a recap of the key events in the impeachment inquiry to date.

On September 24, 2019, Speaker Pelosi announced the House would move forward with a formal impeachment inquiry after a whistleblower complaint regarding a July 25, 2019, phone call between President Trump and Ukraine President Volodymr Zelensky. The whistleblower's complaint alleged that, during the call, President Trump requested President Zelensky to investigate the Biden family, specifically Joe Biden's son Hunter's business dealings with a Ukrainian oil and gas company.

Democrats believe that the evidence shows President Trump attempted to withhold up to $400 million in aid for Ukraine until he received word that the investigation had been launched. On October 31, 2019, the House passed a resolution approving a formal impeachment inquiry and laying out the process for public hearings to begin.

Following Speaker Pelosi's announcement, the House held a series of public and private hearings featuring a wide range of individuals in the Trump administration who have some knowledge of the administration's actions on foreign aid to Ukraine. In early November, the relevant House committees released transcripts from the private testimonies. On December 16, 2019, the House Judiciary Committee released their 658-page report detailing its decision to charge President Trump with two articles of impeachment. The report stated that he had abused the power of the office of the president and also obstructed Congress in its investigation of his ongoing relationship with Ukraine, two charges that became the articles of impeachment on the House floor.

On December 18, 2019, the House voted to impeach President Trump on both articles of impeachment. No Republicans voted in favor of the articles, a couple of Democrats voted against each, and Rep. Tulsi Gabbard

(D-HI), a candidate for the Democratic presidential nomination, voted present.

Once Speaker Pelosi formally sends the articles of impeachment to the Senate, the trial will be presided over by Supreme Court Justice John Roberts with "managers" appointed by the House who will conduct the trial. Two-thirds of the body must vote in favor of impeachment in order to remove the President from office. This number would require Democrats to convince 20 of their Republican colleagues to vote against their own party's president, which is unlikely.

Presidential Elections

As we approach 2020, all eyes turn towards Iowa and New Hampshire for the first indications on who may emerge as the Democratic frontrunner. Former South Bend, Ind., Mayor Pete Buttigieg surged early on in the Iowa polls, but has slowly lost ground as the primary moves closer. In New Hampshire, Sen. Bernie Sander (I-VT) and former Vice President Joe Biden are polling neck-and-neck, with Sen. Elizabeth Warren (D-MA) polling closely behind.

Looking farther down the road at Nevada and South Carolina, former Vice President Joe Biden leads the pack with strong support from voters in each state. Each candidate seems to attract his or her own unique group of voters, with Sanders and Warren splitting the most progressive. Former New York City Mayor Michael Bloomberg and former Massachusetts Gov. Deval Patrick both have jumped into the presidential race recently with an eye toward the moderate lane of the Democratic Party. Mayor Bloomberg is laying low in the early states and banking his personal war chest on the Super Tuesday states. Wins in the early states, particularly on Super Tuesday (March 3, 2020), will lead to much-needed momentum. All of that being said, the ultimate winner of the nomination may not be decided until the Democratic Party Convention in July 2020.

Back in Washington, D.C., the Senate impeachment trial will have a direct impact on the members of the Senate running for president. Senators Michael Bennet (D-CO), Cory Booker (D-NJ), Amy Klobuchar (D-MN), Bernie Sanders (I-VT) and Elizabeth Warren (D-MA) will have no choice but to act as jurors for the duration of the trial, losing valuable time on the campaign trail. How long the proceedings will last is unknown, but expect at least a two- to four-week process.

Congressional Elections

While much of the attention will be on the office of the commander in chief in 2020, there are still fierce battles being fought for both House and Senate seats in Congress. In the Senate, incumbent Sens. Martha McSally (R-AZ), Cory Gardner (R-CO), Susan Collins (R-ME) and Doug Jones (D-AL) are in tight races that will help to determine control of the Senate in the next Congress. Should Democrats knock off these three incumbents and hold onto the Jones seat in Alabama, the current 53-47 seat split in the Republicans' favor would be reduced to 50-50, leaving control of the Senate up to the vice president of whichever party's ticket wins the White House in November. Republicans also face tough races for seats they currently hold in Georgia, Iowa and North Carolina.

All 435 House seats are on the ballot every two years, but the attention will be focused on a much smaller number of races. Democrats currently control the House by a margin of 233-197 seats (with one independent and four vacancies), so Republicans need to flip 21 seats from "D" to "R" to regain the majority. At this point in the election cycle, 18 Democratic seats and six Republican seats are deemed as "tossup or worse" by the Cook Political Report. The Grand Old Party (GOP) would essentially run the table in the battleground districts to have any hope of regaining control of the House. The chances of Republicans retaking control of the House are also decreased by the more than two dozen GOP members who have announced their retirement (or are running for a different office) at the end of this Congress.

Authors: Hunter Bates, Lauren O'Brien and Alex Monié

2. International Trade

Trade Policy in 2020: The Trump Era Takes Hold

With almost three years behind President Donald Trump to launch, negotiate, and complete his most ambitious trade initiatives, 2020 may come to be seen as the first year that the Trump era in trade policy was fully in place. In the opening weeks of 2020, the renegotiation of the North American Free Trade Agreement (NAFTA) will likely see final passage, the details of an interim deal with China will be fully revealed, a narrow agreement with Japan will be implemented and the World Trade Organization Appellate Body (WTOAB) will remain incapable of issuing rulings. In short, this will weaken the multi-lateral system and embolden a United States President to remake bilateral trading relationships to his own advantage.

Looking ahead to new initiatives, the United States and United Kingdom appear increasingly likely to negotiate a new trade agreement with great urgency following the completion of Brexit by January 31, 2020 while trade tensions with the European Union (EU) are set to escalate.

This trade record will be a cornerstone of his "Promise Made, Promises Kept" campaign message where trade may once again be a defining issue. Here is a review of 2019 trade policy and what to expect in the coming year:

- *United States-Mexico-Canada Agreement (USMCA).* In the closing legislative days of 2019, Speaker of the U.S. House of Representatives Nancy Pelosi and U.S. Trade Representative Robert Lighthizer reached a historic deal to amend the USMCA in ways that secured not only the support of the House Democratic Working Group and Congressional leadership, but also the American Federation of Labor and Congress of Industrial Organizations (AFLCIO). This marks the first time in almost 20 years that the nation's largest union has supported a trade deal. The changes include, among others, provisions to ensure stronger enforcement through state-to-state arbitration panels and on-the-ground facility inspections, as well as the elimination of intellectual property protections for biologic drugs. The U.S. Senate is now slated to take up the agreement after the Finance Committee passed it by an overwhelming bipartisan margin of 25-3. With the impeachment trial delayed, the Senate may pass the agreement as early as next week if procedural hurdles can be overcome. *China*. The President also reached an end-of-year agreement with China, stabilizing relations with the U.S.' largest bilateral trading partner after 18 months of tit-for-tat tariff escalation. Under the President's direction, the U.S. levied tariffs of 15 to 25 percent on roughly $360 billion worth of imports from China by mid-December 2019. The goal was to secure structural reforms to China's model of state capitalism. Ultimately, the President agreed not to impose tariffs set for December 15, 2019, on the $160 billion in remaining imports from China, as well as to reduce from 15 percent to 7.5 percent the additional tariffs implemented on September 1, 2019, on $112 billion of clothes, shoes, consumer electronics and many other products. In return, China committed to, among other disciplines:
  - Curb its technology transfer practices
  - Lift foreign ownership limits on financial services
  - Buy $200 billion in additional American agriculture, energy and manufactured goods.

The full text of the 86-page document detailing the deal will likely be made public in early January 2020 concurrent with its planned signing on January 15. The remainder of the year will test the enforcement mechanism to raise and resolve any questions about fulfillment and compliance.

- *Japan*. In the fall of 2019, the U.S. and Japan reached an agreement on digital trade and reciprocal market access for a limited number of each other's agricultural products and industrial goods, which led the President to hold back on levying tariffs against imports of Japanese autos. This deal, which opens the Japanese market to U.S. beef, pork and certain fruit, was implemented by both sides on January 1, 2020. The administration was careful to negotiate an agreement that would not require congressional approval, causing bipartisan concern about its narrow scope and lack of consultations. Both countries also pledged to continue negotiating toward a second phase of the agreement after four months of consultations on its scope. The intent is that the scope of the phase two talks beginning in May 2020 will be comprehensive, covering all issues traditionally included in a U.S. trade agreement. But it remains to be seen how serious these negotiations will be with a difficult political calendar in the U.S. and reluctance among the Japanese to continue negotiating on a bilateral basis—rather than recruiting the U.S. back into a revised Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).
- *U.K.* Following a decisive victory in the December 12, 2019, general election, Boris Johnson now enjoys the mandate to—as the campaign slogan went—"Get Brexit Done" by the January 31, 2020, deadline previously agreed to with the European Union. However, the passage of the Brexit agreement through Parliament will mark the end of only one chapter of the Brexit story and kick off the so-called "Transition Period." For the remainder of 2020, the U.K. will remain subject to the EU's rules and regulations but will not formally be a member of the economic bloc. During this time, Britain and the EU will negotiate the rules that will govern its trading relationship in 2021 and beyond. At the same time, Britain may begin formal negotiations with the U.S. on a free trade agreement, which both Prime Minister Johnson and President Trump have publicly committed to completing as quickly as possible. Although the new political context will give the talks great urgency and transform the previous informal consultations into formal talks, completing a comprehensive bilateral agreement between the U.S. and U.K. will be difficult before the U.S. elections in November. As a result, it is possible that the countries reach a narrow 'phase one' deal that harvests early 'wins' that the President can tout on the campaign trail similar to the approach taken last year with Japan.
- *EU*. Tensions are set to rise between the U.S. and EU on trade in the year to come. After winning a long-running case at the World Trade Organization (WTO) against EU subsidies to aircraft manufacturer Airbus, the U.S. moved forward with tariffs against sensitive European exports and even threatened to raise those tariffs due to Europe's failure to comply with the ruling. The U.S. has also proposed tariffs of up to 100 percent on imports of sparkling wine, cheeses, handbags and other French products in retaliation for that country's Digital Services Tax. The U.S. argues that the tax discriminates against American tech companies. In its notification of the retaliation against France, the Office of the United States Trade Representative (USTR) noted that it is "exploring" whether to retaliate against similar tax measures proposed by Austria, Italy and Turkey. Tired of President Trump's trade unilateralism and tariff threats, the EU is also set to become more confrontational in 2020. The European Commission (EC) will consider a proposal to update its enforcement regulation and impose tariffs against countries that violate WTO rules while at the same time preventing the WTO from operating—a definition squarely aimed at the U.S. It will take nine months for the proposal, which was informally referred to as a "bazooka" by EU leaders, to complete the EC's legislative process. But the proposal could lead to more tariffs between the U.S. and EU.
- *WTO*. To borrow a sports analogy, 2020 will be a "rebuilding year" for the WTOAB after the U.S.' blockage of all nominees finally led to an insufficient number of panelists to make decisions on cases and issue rulings. Without a final binding dispute settlement mechanism, WTO members with disputes face several options, including simply accepting the initial panel's rulings without appealing. However, the remaining players are not standing still. The EU proposed a temporary alternative appellate system to resolve disputes that would exclude the U.S., which is now supported by China, further isolating the U.S. in the WTO. The failure of the WTOAB injects greater urgency into the effort to reform its operations, but also invites other countries to move forward with WTO-inconsistent policies knowing that they may not be stopped.

Author: Joshua Teitelbaum

3. Economic Downturn

Significant economic, regulatory and political uncertainties in 2020 should prompt board of directors members to evaluate, and take steps to mitigate, potential downside risks facing their businesses. Certain challenges commonly associated with economic downturns, such as a reduction in access to public and private capital markets, may be difficult for corporate boards to fully hedge against.

To prepare for these challenges, directors should be familiar with general legal and practical principles associated with operating in a low liquidity environment.

Evaluate Evolving Conditions

Directors should ensure that informational systems and controls are reviewed and established to ensure that management provides timely, accurate and complete financial and operational information to board members. Corporate directors should carefully review any information provided by management and insist upon clear and unambiguous answers to any questions raised by such review and consider whether the timing and content of board updates should be modified to address the evolving situation.

Any early signs of financial distress should be addressed with appropriate operational and reporting changes, and may merit an evaluation of available restructuring options with independent advisors.

Understand Fiduciary Duties

While directors are undoubtedly aware of their fiduciary duties, they should also consider that a weak economic environment may enlarge the group of stakeholders with standing (and motivation) to bring a derivative claim for breach of fiduciary duty.

In Delaware, for example, creditors gain standing to bring such a claim when a company becomes insolvent as judged by the company's balance sheet. Against the backdrop of such suits and the shifting group of stakeholders to whom corporate directors may become responsible, they should rely on external counsel to provide advice on the scope of their duties.

An important defense against allegations of breached fiduciary duty lies in scheduling regular board meetings and keeping well-developed records showing the board's consideration of various alternatives and input from advisors.

Review Access to Capital and Existing Restrictions

To decrease the likelihood of a liquidity crunch or crisis, corporate directors should understand the contractual restrictions imposed on their business's ability to raise capital. These include limitations arising from lending agreements or agreements with shareholders.

Further, debt covenants under financing documents should be continually reviewed to provide warning signs regarding defaults or thin cushions, and/or to prompt early negotiations in the event of changing financial conditions.

Retain Independent Advisors

Retaining experienced, independent advisors in advance of a financial emergency can help preserve enterprise value and prevent worst-case scenarios. Restructuring attorneys, turnaround advisors and financial advisors each have a role in navigating

complicated financial situations and creating or evaluating potential restructuring plans.

Review Terms of D&O Insurance

Working with knowledgeable subject matter experts, corporate directors should carefully review their directors and officers (D&O) insurance policies to identify provisions which may be implicated by financial distress or a potential restructuring.

Side A coverage, which provides direct coverage for individual directors and officers when the company is legally unable or unwilling to indemnify them, may be reviewed to:

- Identify whether Side A payments have priority over payments under Side B (reimbursement to a company for indemnity payments it makes on behalf of directors or officers) or Side C (payments to the company for securities claims) coverages
- Ensure that any proceeds related to Side A coverage are explicitly the property of the covered director
- Confirm that such coverage will not be impacted or rescinded by a potential restructuring transaction.

It's also a good idea for corporate directors to examine the coverage exceptions to insured-versus-insured (IvI) exclusions to determine whether potential suits commenced in connection with a restructuring transaction would be subject to the exclusion (and thus exempted from coverage). And corporate directors should consider seeking appropriate tail coverage in the event of a restructuring transaction that may trigger the termination of a D&O policy.

Plan an Orderly Restructuring

Transactions that impact a company's capital structure can take a variety of forms and should be specifically tailored to fit a business' needs and circumstances. Whether implemented as an out-of-court transaction (such as a debt-for-equity exchange or capital commitment transaction) or a Chapter 11 filing (prepackaged, pre-arranged or otherwise), restructuring transactions can take significant time and resources to plan, negotiate and implement.

Out-of-court negotiations with creditors and stakeholders can be contentious and complicated, while in-court deliberations will be subject to public and judicial scrutiny. As a practical matter, corporate directors should plan for restructuring transactions to take several months to complete. This timeframe, in the context of immediate capital needs and possibly worsening financial situations, makes early preparation and a clear, orderly process essential to maintaining control throughout a restructuring transaction.

Authors: Daniel Fisher and Stephen Kuhn

4. Board Diversity

Board Diversity: A Reflection on Improvement and a Look Ahead for the Coming Decade

In the second half of this decade, diversity and inclusion rose to the forefront of top priorities for many companies. Due to evolving social norms, companies began to acknowledge that diverse environments are key factors for promoting growth and competitive advantage. The unique perspectives brought by diverse individuals help companies and boards of directors build a better mousetrap, identifying and evaluating a variety of risks, alternatives and advantages. The results are better decision-making and demonstrated stronger financial performance.

Some Strides for Women, Fewer for Minorities

In 2010, women held only 16 percent of board of directors seats at Standard & Poor's (S&P) 500 companies and 9 percent of board seats at Russell 3000 companies, while minorities held just over 8 percent of board seats at Russell 3000 companies. In 2019, records were set for board diversity: Women held over 20 percent of board seats at Russell 3000 companies, every company on the S&P 500 had at least one female director (and women held 26 percent of all directorships), and minorities held more than 10 percent of board seats at Russell 3000 companies for the first time.

While significant progress has been made, there's still work to be done. One woman holding a seat on a large board may not impact decision making and, often, there is overlap with the same women holding board seats for multiple companies.

Much of the energy in promoting diversity has been geared towards adding women to boards, so the progress of minority representation on boards has been slower than gender diversity. For example, in the S&P 500, women were voted into 46 percent of new board seats in 2019, while minorities were voted into 21 percent of new board seats. Despite this growth, representation of both women and minorities serving on boards does not nearly reflect the makeup of the general population.

Change Starts in the Boardroom

To effect change, board members should take an active role in guiding a company culture that values inclusion and human capital. Although 72 percent of male directors believe that their investors are too focused on board diversity (according to PwC's 2019 Annual Corporate Directors Survey), it continues to be a focal point for investors, employees, customers and other stakeholders. It's unlikely that efforts to improve diversity will wane any time soon.

Institutional investors only seem to be pushing harder for diversity through investment stewardships and affirmatively taking action when they do not see progress. Investment management companies actively seek board diversity based on a number of factors—gender, ethnicity, age and professional experience.

Recent years have held promise:

- In the 2019 proxy season, a global investment management company held true to its 2018 commitment to promote gender diversity by voting against board members at 52 Russell 1000 companies with boards that had fewer than two women on their boards or no other diverse directors.

- In the same time period, another investment management company published standards requiring companies to disclose their perspectives on board diversity, the makeup of their boards and measures to improve diversity, and to conduct broader searches for director candidates in order to add diversity.
- In 2017, State Street Global Advisors ("State Street") launched the "Fearless Girl" campaign, calling out companies that did not have at least one female director. State Street furthered this campaign in 2019 by announcing that, as a direct result of 57 percent of the companies failing to take action, during 2020 it will vote against all members of the nominating and governance committees in target markets where they have not seen improvement in gender diversity for four consecutive years and have not been able to engage in productive dialogue. (Note that 43 percent of the companies identified in the Fearless Girl campaign responded to the call for action.)

Along similar lines, in October 2019, New York City Comptroller Scott Stringer issued a letter to 56 companies urging them to adopt the "Rooney Rule," which originated in the National Football League (NFL) and requires companies to consider at least one female or minority candidate for each position (see *Shareholder Activism* starting on page 21). The comptroller also published a matrix that can be used by companies to assess the composition of their boards and director nominees.

Diversity in the Age of #MeToo

A diverse board can also greatly improve a company's ability to proactively address issues that impact corporate culture and reputation, such as the #MeToo movement. A board unimpeded by gendered group think is more likely to investigate and/or take actions in the event of allegations of sexual harassment or assault, and even remove officers or directors subject to these accusations.

Confronting these issues up front can help to preserve and increase shareholder value by mitigating the reputational, legal and financial harm caused by such accusations. A company that prioritizes a corporate culture intolerant of sexual harassment will be a more attractive candidate in a mergers and acquisitions (M&A) transaction. It will be in a better position to provide representations and warranties about these matters—which are being requested by buyers more often—and deliver greater value to shareholders by avoiding separate remedies and holdbacks to protect buyers from liability related to sexual harassment lawsuits. The company will also have a competitive advantage in attracting executive talent and employees.

No Sure Path

While there is general agreement that board diversity is important, there is no proven strategy to increase diversity. Governments typically use quotas or disclosure requirements. Many European countries (including France, Germany and Norway) have imposed quotas for several years, and the European Commission (EC) is considering a quota for women to hold 40 percent of nonexecutive director positions of large, publicly-listed companies. As of November 2019, the directive had not been passed and is scheduled to be addressed in the next mandate of the EC.

New Laws in California

California was the first state in the United States to implement quotas in 2018, with bills in Massachusetts, Washington and Pennsylvania under consideration.

California's law (SB 826) was passed in September 2018. It requires public companies headquartered in California to have at least one female director by the end of 2019 and two to three female directors by the end of 2021, determined by the overall size of the board.

On July 1, 2019, the California Secretary of State Alex Padilla published a report, required under the law, listing the companies whose principal executive offices are located in California and who had at least one female director. The report listed 537 corporations that would be subject to the law, of which 184 had at least one female director on the board. The report did not specify the total number of female directors on a board.

To eliminate data gaps between Securities and Exchange Commission (SEC) filings and the California Corporate Disclosure Statement (which is required to

be filed annually by all public companies in California within 150 days after the end of their fiscal year), in May 2019, the secretary of state updated the form of the California Corporate Disclosure Statement to require companies to report whether or not the board has at least one female director.

The next mandated report from the secretary of state, which is due on March 1, 2020, is required to contain information about the number of companies that:

- Are compliant
- Moved to or from California in the prior year
- Ceased to be publicly-traded.

Another potential data point helpful in evaluating the impact of California SB 826 is more detailed information about the number of women on boards and what percentage of overall board size they make up.

Action on Other Fronts

Other states' federal agencies and the United Kingdom have taken action requiring disclosure. An Illinois law passed in August 2019 requires public companies headquartered in Illinois to submit annual reports about the demographics of their boards and their plans for promoting diversity. The first disclosure deadline is January 1, 2021.

In addition, in February 2019, the SEC clarified the disclosure requirements under Item 401(e) and Item 407(c)(2)(vi) of Regulation S-K. Under these new compliance and disclosure interpretations, a company must discuss if and how any self-identified diversity characteristics were considered in assessing the fitness of an individual to serve as a director and selecting nominees for the board. The goal of these disclosure laws is that transparency will encourage companies to evaluate and improve their diversity efforts.

Will Quotas Work?

Both approaches have potential downfalls. Statutes imposing quotas are still being implemented and it is too soon to gauge whether they have a meaningful impact on improving diversity.

Mandated quotas could potentially be interpreted as violating the Equal Protection Clause of the U.S. Constitution and similar provisions of state constitutions, by facially discriminating based on sex.

Also, quotas are not necessarily supported by members of the business community, even women. They have been criticized as micromanaging business and adding "token" women to boards over other qualified candidates. In addition, companies can often comply by expanding the size of the board by one member to add a woman without any meaningful impact. On the other hand, while disclosure laws help shed light on board composition, they do not require any specific actions for improvement.

Progress, but More Work Lies Ahead

Although leaps and bounds have been made in improving diversity, companies must be proactive to keep making progress. While gender diversity has been the main focus during recent years, tackling ethnic diversity ought to and will be the goal for the next decade.

Companies should consider implementing the Rooney Rule and considering a woman or minority candidate for each open board position. They can further diversify board makeup by searching for candidates with expertise that goes beyond the traditional financial skill set deemed attractive for board members—think chief executive officers and chief financial officers. Technology, sales, marketing, regulatory, and environmental, social and governance (ESG) matters will be areas where board skills are in demand.

To keep up with the various trends impacting boards, companies should continue to review and update their diversity policies and board nomination procedures. This includes term limits, refreshment and greater flexibility in requirements for directors.

Authors: Kerry Berchem, Christine LaFollette and Courtney Matsuishi

5. Corporate Reputation

Anybody over the age of 40 can recall a time when news was delivered by television, radio and newspapers. Two things that each of those mediums have in common are a substantial capital investment and an existential desire for editorial integrity. The equation was simple. Income was generated primarily through advertising revenue. Advertisers would purchase space in a newspaper or commercial time on a radio station or television network. The larger the number of readers, listeners or viewers—the more advertisers were willing to pay for access to that audience.

The thing that attracted the largest collection of subscribers—and so drew advertising dollars—was editorial integrity. People understood that when their news came from a major newspaper, news magazine or broadcast network, they were getting the product of sophisticated reporting, experienced editors and a publisher with a reputation to protect. While a tabloid with screaming headlines about UFO landings in Nevada might be found at a supermarket newsstand next to *The New York Times*, everyone knew the difference. One was about inexpensive entertainment and the other was about hard, fact-checked news and editorial content. The broadcast world followed the same rules. The evening network news broadcast was a mainstay of popular American journalism. The late night FM radio talk show was where the conspiracy theorists prowled the airwaves.

News about business was no different than any other kind of print or broadcast journalism. When an investigative piece in a major newspaper or a television documentary exposed dangerous products, consumer rip-offs or corporate corruption, readers and viewers understood that they were getting the news. False claims rarely made it through the filter of skilled professional reporters and editors and onto the newswires or airwaves.

The Internet has changed everything. What once required automated printing presses and broadcast towers—conveying news and information to a large audience—can be done on a computer or even a smartphone. A recent study by the Pew Research Group reported that 45 percent of Americans get their news from a single social media platform. The sinister manipulation of social media is now viewed as a serious threat to democratic institutions and is at the center of public policy debates.

The capacity of businesses to protect their reputation has not been spared. False attacks on the products and brands, leadership, securities, markets and overall integrity of major corporations can now originate on an obscure electronic bulletin board—and be "trending" on social media in a matter of hours. From there, Internet news providers, with none of the checks and filters of the mainstream media, can give an online media assault legitimacy that would have been unimaginable a generation ago. False attacks on corporate reputation may originate with commercial competitors, political activists, protectionist foreign governments or just someone with an axe to grind.

The law provides some tools that can be used to deflect an organized attack on reputation, but there are some important steps that should first be taken to understand and respond to the threat.

- *Monitor the electronic marketplace.* Knowing what is being written and said about your company is a simple task and worth the effort. Orchestrated online attacks may start as public electronic bulletin board entries or Tweets from obscure accounts.

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Dealing with false allegations before they expand into a broader forum and threaten real harm requires a high level of vigilance—and an appreciation of the fact that the Internet never sleeps.

- *Know the facts.* The First Amendment to the U.S. Constitution and the legal doctrines that flow from it protect the truth and provide broad bounds for editorial opinion. Sometimes allegations that begin to circulate online are offensive, unsavory and seem fundamentally unfair, but are basically true. In these circumstances, trying to fight the facts will rarely lead to a happy and satisfactory result. When the facts are bad, go to work on fixing the underlying problem and make no secret of what you are doing.
- *Understand when a threat is real.* The kind of damage that can flow from an organized reputational attack is a serious matter. Equally important, however, is the long-term harm that can result from treating every unhappy murmur on the Internet as a potential four-alarm fire. Knowing the difference—and separating online rumbles that signal a real and documented threat from adverse stray chatter—is a skill that anyone charged with protecting corporate reputation should work to refine.
- *Choose your targets.* "When you got nothing, you got nothing to lose." When Bob Dylan wrote those lyrics in 1965, he could have been describing many of the Internet goblins of the 21st century. Sources of false accusations, dressed up as Internet news, frequently originate in a basement bedroom of a parent's house or a table in a coffee shop. A letter from a large law or crisis management firm, instead of conveying a clear and appropriate warning, may instead suggest that the purveyor of the untrue tales of corporate misconduct has reached the big leagues. A good question to ask before pushing the "send" button on a typical "cease and desist" letter: If this letter is published online and even finds its way into the mainstream press, will we have done more good or more harm to the goal of protecting our reputation?
- *Act when necessary – and play to win.* When faced with an adverse story, rooted in a false narrative that may threaten real harm to corporate reputation, aggressive legal action may provide the best and most direct road to a solution. One of the most effective tools of civil litigation in the United States is the discovery process. Whether intentionally false reporting is the product of business competitors or Internet conspiracy theorists pursuing their own agenda, civil discovery offers the best available avenue for exposing the truth. The civil suit brought in 2017 against Alex Jones and his Internet platform *Infowars* by the yogurt company Chobani, LLC—that resulted in a full public retraction and apology by Jones—is one example of the effective use of legal action in the corporate fight against fake news.

Another generation may pass before the necessary legal and regulatory tools emerge to address the abuse of public media platforms for false attacks on corporate reputation—in the broader context of a free society and the protections of the First Amendment. In the meantime, the best defense in protecting the hard-earned good name of any business enterprise is vigilance, caution and a willingness to act when the threat to reputation is real and immediate.

Author: Mark MacDougall

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6. Pay Equity

Corporate Pay Equity

When competing for top talent, equal pay matters. Boards of directors are increasingly demanding proactive measures to ensure equal pay, and many Fortune 500 companies are publishing the results of their equal pay studies.

The legal landscape around pay equity is also shifting. A patchwork of recently enacted state and local laws make it more difficult to justify any pay difference between men and women, and different races who are performing similar work, even when there is no discriminatory motive and the pay difference is based on nondiscriminatory reasons.

Knowing your company's vulnerability to equal pay claims and making adjustments where needed—under the protection of privilege—can both mitigate the risk of future claims and create a positive public narrative.

Recognize Ongoing Pay Inequity Issues

Boards play an important role in identifying the risks, opportunities and processes related to pay inequities. Increasingly, investors, employees and the public are looking at companies, private and public, small and large, to address pay disparities domestically and internationally among different genders and races in the workplace.

In an age where information is freely and anonymously circulated, more and more compensation information is shared online among different demographics. Pay equity discussions usually focus on hourly wages, salaries, bonuses and promotions. Several companies now tout having 100 percent pay equity among men and women, including Nordstrom, Starbucks and Adobe.

Although it's recently made headlines, pay equity has received its fair share of attention for decades. In 1963, the U.S. Congress passed the Equal Pay Act, amending the Fair Labor Standards Act and aiming to abolish wage disparities between men and women in "substantially equal" jobs within the same "establishment," which cannot be explained by a reason other than sex. Title VII of the Civil Rights Act of 1964 (Title VII) prohibits compensation discrimination. And many state and local governments have passed laws that are equally, or more, protective than the Equal Pay Act or Title VII, including California, New York City, Connecticut, Illinois, Washington and Massachusetts.

In spite of all this legislation, the U.S. Census Bureau found that in 2018 women were paid about 82 cents to every dollar made by men. When comparing the intersection of gender and race, the disparities are even more drastic with the lowest paid group. Hispanic women made 54 cents for every dollar made by the highest paid group: white, non-Hispanic men. These numbers showcase the difference in median wages between men and women. They do not reflect pay differences between men and women who are performing similar jobs, where the differences in pay are typically much smaller. The Census statistics highlight, however, another potential problem that companies face: steering women into lower paying jobs and promoting fewer women into senior positions than their male counterparts.

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Take Note of Current Landscape for Investors

In the last five years, there have been more than 100 shareholder resolutions for at least 64 companies addressing the gender pay gap, with shareholders increasingly voting for these measures. Institutional Shareholder Services Inc. and other proxy advisory firms, considering shareholder proposals related to gender pay equity, have begun to broaden their policies to include pay equity issues related to race or ethnicity, as well.

While the terms often get conflated, "pay equity" and "pay gap" are different:

- Pay equity usually refers to compensation for similar work, for which the difference between men and women is very small.
- Pay gap refers to the difference between the median compensation of men and women, which is much larger due to a variety of factors. Only a small portion of these factors are due to pay inequity.

Keep Track of Efforts to Change Regulation

Lawmakers continue to introduce legislation aimed at further reducing pay inequities. The Paycheck Fairness Act that has been presented, in some form, to Congress every year since 2009. Its most recent iteration would require an employer to demonstrate "bona fide job-related factors" accounting for any gender-based pay differences between men and women performing equal work, rather than the current Equal Pay Act defense of "any factor other than sex."

Regulators also are increasingly scrutinizing companies based on current laws, including New York City's pension funds, which hold significant shares of Oracle Corp. stock. The Securities and Exchange Commission (SEC) is being called upon to investigate Oracle for misleading investors regarding pay inequities within its workforce, as alleged in an administrative lawsuit against Oracle being pursued by the Department of Labor's (DOL's) federal contractor watchdog, the Office of Federal Contractor Compliance Programs (OFCCP).

Understand Effects of Pay Inequities

Aside from litigation risk and negative publicity, perceived pay inequality and lack of transparency create a variety of problems within companies. Employees may feel undervalued, which can decrease productivity, stifle innovation, increase turnover and create a toxic us-against-them culture. As the work force struggles, a company's bottom line also suffers.

By fixing problems of pay inequity, or at least actively working toward pay equality, companies can be more transparent with the workforce about their efforts. As many are discovering, pay transparency can improve morale, increase productivity and positively impact profitability.

Consider Several Issues When Closing Pay Gap

Finding a way to achieve pay equity is a complex endeavor that involves a mix of business decisions and legal considerations. Plan carefully to avoid creating discoverable evidence that could be used against your company in future litigation. For example, before undertaking any pay equity analysis, a crucial first step is to affirmatively cloak the pay equity study as attorney-client privileged. Deliberately document the study as centered upon obtaining legal advice about vulnerability to equal pay claims—not simply to review current pay and make pay adjustments. Consider how to group employees for analysis and what explanatory factors are relevant and should be included. Also, give careful consideration to applicable legal standards. Before performing a pay equity study, the board also should ensure that their company and key parties are committed to correcting pay inequality. Consider these issues next:

- A key factor is making pay adjustments without alerting anyone to the fact that they may have been underpaid. Consider a situation where a company performs a pay equity study and identifies some women are paid, on average, 18 cents less per dollar than men in substantially similar positions. If no action is taken and an Equal Pay Act lawsuit is filed, companies may be unable to avoid an automatic

doubling of back pay as liquidated damages. These are presumed unless the company waives its attorney-client privilege and shows it acted in good faith with reasonable grounds for believing that it was not in violation of the law.

- Closing the pay gap might not require immediately increasing the compensation of some women so that the female average is raised by 18 cents, but a short-term and long-term action plan will need to be developed that ultimately aims to close the gap through merit increase cycles and when setting starting pay for those hired or promoted.
- It's also important to consider that pay equity is not just between women and men, but also between black men and white, non-Hispanic men, Hispanic women and black men, and the many other variations of race and gender. To avoid trading one problem for another, before any equity adjustments are made, you should also consider their impact on race and national origin.

In 2020 and beyond, pay equity issues will draw the attention of the many stakeholders of companies. Boards and their management teams should consider the numerous positive impacts on a company that come with correcting pay inequality, and the risks associated with not evaluating their employee compensation structure. Beyond correcting disparities, companies reaching parity at a single point in time must vigilantly continue their efforts as they continue to grow and change and as employees are hired, promoted and depart.

Authors: Alice Hsu, Esther Lander and Joshua Wright

7. Cybersecurity

Cybersecurity and Privacy

Despite cries from corporations and privacy advocates across America for a unified federal privacy law, the nation's toughest privacy law—the California Consumer Privacy Act (CCPA)—went into effect on January 1, 2020. The CCPA will likely usher in a new era of data governance and data privacy, with data becoming a currency that is regulated more closely by both states and the federal government. At the same time, cyber breach activity continues to escalate, so cybersecurity and data privacy should be considered a significant risk area for companies.

Know Your Privacy Pitfalls Under New Regulations

With the U.S. Congress' failure to pass uniform privacy and cybersecurity regulation, California's privacy law becomes, in reality, the privacy law in the United States. The CCPA creates new requirements for identifying, managing, securing, tracking, producing and deleting consumer privacy information. It also provides extensive rights to consumers to take control of their data. The CCPA is not limited to companies located in California, but rather it generally applies to most for-profit companies doing business in California. This can include simply selling to California residents.

Companies must evaluate whether they fall under the CCPA's reach and carefully structure data privacy practices to comply with the many requirements.

The CCPA is not as onerous as the European Union's (EU's) General Data Protection Regulation's (GDPR's) 4 percent of worldwide revenue penalty, but it does impose penalties of $2,500 per negligent violation and $7,500 per intentional violation.

However, the likely game changer is the private cause of action: Individuals can now sue for certain data breaches where companies did not have "reasonable security," with statutory damages of $100 to $750 per incident, per consumer.

The coming year could bring copycat legislation across the country. Creative plaintiffs will certainly seek out ways to hold companies accountable for ever-changing requirements, whether they are under the Illinois Biometrics Information Privacy Act's (BIPA's) facial recognition protection, or the soon-to-be-forthcoming revised regulations related to the Children's Online Privacy Protection Act's (COPPA's) consent restrictions or other legislation.

Use Internal Controls to Stop Wire Fraud in Its Tracks

With an estimated $5.3 billion in fraud committed globally since the Federal Bureau of Investigation (FBI) began tracking in 2013, business email compromise impacts companies across the country and across all industries. The basic scheme is simple: hack into the email system, watch for planned money transfers and swap the wire instructions so that the money is wired to the hacker rather than the intended party.

The Securities and Exchange Commission (SEC) has warned that it may consider significant wire fraud a "books and records" violation of Section 13(b)(2)(b). Companies "must calibrate their internal accounting controls to the current risk environment and assess and adjust policies and procedures accordingly."

Stay Current on Cybersecurity Compliance

Just as privacy has been prioritized by legislators, cybersecurity regulations are becoming increasingly proscriptive.

- *SHIELD*. In 2019, New York enacted the Stop Hacks and Improve Electronic Data Security (SHIELD) Act. It contains a new "reasonable security requirement" that requires businesses that are not regulated by and compliant with another New York state or federal data security regime to adopt a program that includes certain very specific data security safeguards.
- *IoT*. On January 1, 2020, California's Internet of Things (IoT) law became the first in the nation to impose liability for failure to reasonably secure devices.

Global research and advisory firm Gartner estimates that more than *26 billion* IoT devices relying on connectivity will be deployed by 2020. The FBI piled on by warning that hackers have been using devices to spy on employees in their own offices or homes. Directors should make sure that their company has a strong cybersecurity program, compliant with the many recently released cybersecurity regulations.

Seek Cybersecurity Insurance to Mitigate Risk

Most companies are mitigating risk by purchasing cyber and privacy insurance. But buyer beware: Directors should carefully consider whether the insurance is sufficient and provides coverage for a company's particular risks. Gaps in coverage could include:

- Lack of regulatory compliance coverage
- Absence of cyber fraud coverage
- Insufficient business disruption coverage
- No third-party coverage
- Rejection of claims based on accidental errors and omissions.

In a recent case, multinational corporation Mondelez sued its insurer for nonpayment under its cyber insurance policy because the insurer refused to pay based on the "war exclusion" after the ransomware attack was attributed to Russia. Similarly, directors should assess whether coverage exists for emerging threats, such as penalties under the CCPA or the GDPR. Directors should carefully evaluate coverage and question the sufficiency of coverage.

Establish Board Oversight on Privacy and Cybersecurity

Directors play a key oversight role in enterprise risk management, and cybersecurity and data privacy remain high-stakes risk areas for companies of all sizes and all industries. Directors must take care to properly exercise their *Caremark* duties—putting in place adequate internal control systems. Alternatively, they could be held liable for failing to properly monitor the company, as the Delaware Supreme Court recently found in *Marchand v. Barnhill*, where it allowed the matter to proceed past the directors' motion to dismiss.

Specifically, directors must be able to show that they made a good faith effort to establish appropriate reporting systems and reporting procedures that enable the board of directors to discharge its privacy and cybersecurity oversight responsibilities. Fiduciary oversight is not just a focus of derivative plaintiffs, but also a key focus of federal and state regulators.

Directors should follow a rigorous review protocol of the company's cybersecurity and privacy program that:

- Establishes clear risk management framework for cybersecurity and data privacy, ensuring proper governance, reporting and assessments
- Obtains reports on cyber and privacy risks specific to the company, considering emerging threats and risks from systemic company shifts, such as mergers and acquisitions
- Understands new and material regulations, such as the CCPA, that impact data flow and data practices
- Requires risk mitigation through a practiced incident response and effectively constructed insurance program.

Author: Michelle Reed

8. Shareholder Activism

As discussed in our Board Diversity section (see page 11), gender and racial diversity on the boards of public companies, and in chief executive officer searches, continue to be central points of focus for institutional investors, lawmakers and shareholder activists. In recent months, diversity issues have been brought to light by New York City Comptroller Scott Stringer, who on October 11, 2019, launched the third stage of the Board Accountability Project.

Aim for Board Diversity with 'Rooney Rule'

The third stage calls on companies to adopt a policy requiring the consideration of both women and minorities for every open board seat and CEO appointment—a version of the National Football League's (NFL's) "Rooney Rule." To start the new initiative, letters were delivered to 56 Standard & Poor's (S&P) 500 companies that do not currently have a Rooney Rule policy, regardless of the current diversity of their board or CEO.

The comptroller also noted that he will file shareholder proposals at companies with a lack of apparent racial diversity at the highest levels. The comptroller serves as investment advisor to, and custodian and trustee of, the New York City Retirement System (NYCRS), which has more than $200 billion in assets under management and is a substantial long-term shareowner in more than 3,000 public companies in the United States. Thus, the comptroller's launch of this initiative represents a broad-based activism campaign that seeks to influence the governance policies of numerous public companies simultaneously.

The comptroller states that "[d]espite the increased focus on diversity by both investors and companies, the data show that CEO and board representation of women and minorities is increasing at a slow rate and remains unacceptably low." He especially notes the lack of hiring of women and minorities in CEO searches, where in 2018 the proportion of S&P 500 company CEOs who are women was 5.4 percent and fewer than 1 percent of Fortune 500 CEOs were black. In support of his initiative—specifically, the implementation of a Rooney Rule—the comptroller's office cites the positive impact of the rule on NFL hiring of minority head coaches and general managers. The office also noted studies by McKinsey and the Harvard Business Review finding that the odds of hiring a woman were 79 times greater when there were at least two women in the finalist pool. The studies found that the odds of hiring a minority were a staggering 193 times greater when there were at least two minority candidates in the finalist pool.

Increase Advocacy Efforts for Women, Minorities

The comptroller's call for a board and CEO Rooney Rule is one of several efforts advocating for increased female and minority representation in boardrooms, including:

- The State of California's legislation (SB 826) requiring a public company whose principal executive offices are in California to have a minimum of: (i) one female on its board of directors by December 31, 2019; and (ii) two female board members at companies with five directors or at least three female board members at companies with six or more directors by December 31, 2021. On July 1, 2019, California issued a report indicating that over 500 public

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companies are subject to these requirements. One hundred eighty-four reported themselves as being in compliance with SB 826.

- A global investment management company's 2019 proxy voting guidelines state that "[i]n addition to other elements of diversity, we encourage companies to have at least two women directors on their board."
- Glass Lewis's 2020 proxy guidelines state that it will consider recommending voting against the nominating committee chair of a board that has no female members and has not provided sufficient rationale or disclosed a plan to address the lack of diversity on the board.

Authors: Jeffrey Kochian, Gerald Brant and Jason Sison

9. Corporate Innovation

Corporate Innovation and Emerging Technologies

Successful boards of directors play a critical role in overseeing a company's technology and innovation strategy. Emerging technologies impact almost all industries. To effectively guide corporate innovation, directors should devote attention to understanding these disruptors and related operational and legal trends.

Use Board's Oversight

A board's role includes oversight with respect to technology spending and strategy. To do so effectively, some technological expertise is often necessary to fully understand the risks and benefits of adopting an innovation and emerging technologies course of action.

The task of understanding the complexities of emerging technologies can be daunting to some directors. There is certainly no shortage of buzzwords—blockchain, artificial intelligence (AI), Internet of Things (IoT), Fifth Generation Wireless Networking Technology (5G), drones, augmented reality, big data, edge computing and digital assets, to name a few. Staying informed of potential business advancements and use cases is crucial to the board's strategic oversight with respect to technology. (*A brief explanation of some of the most significant emerging technologies and examples of use cases in various industries is included at the end of this article.*)

Access to outside experts as well as technology resources within the company is essential to board education. An emergent best practice for boards involves regular updates from the company's chief information officer or chief technology officer. These communications are an instructive tool for directors to better understand the company's technology opportunities and challenges.

While many boards initially focused on the need for director technology expertise in the context of evaluating cybersecurity and data privacy risks, some companies are starting to appreciate the benefits that tech-savvy board members can bring to the boardroom. These experts assist not only in protecting against risks, but also in guiding innovative strategies and opportunities that positively impact the company's business. A 2019 study conducted by the Massachusetts Institute of Technology's Center for Information Research concluded that companies with boards that included at least one director with technology expertise outperformed those that did not in several financial metrics—including revenue growth.

In a challenging business environment, many companies are looking to emerging technologies to create efficiencies, improve consumer experience and, ultimately, drive revenue. Companies with boards that are not actively evaluating strategic innovation opportunities now likely will find themselves behind their competitors in the coming years.

In 2020, we expect a growth in the desire of companies to add directors with meaningful technology-related backgrounds and experiences. When selecting new director candidates, nominating committees should consider technology expertise as one of the factors in the overall mix of skills essential for the board to possess. We also expect more companies to create technology committees to focus on both risk mitigation and opportunistic strategy.

Consider Legal and Regulatory Implications

To help guide a company's technology strategy, it's critical that boards think about the potential legal and regulatory implications on the front end.

It's no secret that legislation often has difficulty keeping pace with new technologies. However, in 2019, we saw a number of developments that either implemented or signaled impending regulations impacting many emerging technologies, and we expect this trend to continue in 2020. A key driver for this regulatory increase is these technologies' implications for national security, as well as ethical or other novel concerns.

Regulatory considerations include legislation aimed at specific emerging technologies (such as IoT and AI) and legislation impacting technology more generally. This legislation includes the Children's Online Privacy Protection Act (COPPA), import/export control, foreign investment laws and data privacy regulations. Other developments include the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC) and Internal Revenue Service (IRS) efforts relating to digital assets and cryptocurrencies.

Boards may also need to consider the implications of existing regulations with no context in emerging technologies so they can work with regulators in a collaborative manner, and steer the company's technology strategy.

Become Familiar with Key Emerging Technologies

Directors should be familiar with the most significant emerging technologies:

- *AI, Deep Learning/Machine Learning and Predictive Analytics* – AI is the ability of computer systems to perform tasks that normally require human intelligence, such as the ability to reason and make decisions, learn from past experiences, recognize speech and utilize visual perception. Applications of AI abound for companies that use or have access to large amounts of data. For example, AI is being used by corporations in multiple industries to implement fraud detection strategies, as well as targeted advertising campaigns. Other applications range from the decision-making abilities of autonomous vehicles to AI-assisted robotics used in surgery.
- *Blockchain* – At the most basic level, a blockchain is a distributed (meaning viewable or editable on multiple devices called "nodes") digital list (or ledger) of transactions (blocks) chained together in chronological order in a manner such that alteration of the chain is detectable.
  While cryptocurrencies—which typically utilize public ledgers—were the first use of blockchain technology, many industries are finding compelling enterprise use cases for permissioned (or nonpublic) blockchains. Use cases of enterprise blockchain implemented to date include:
  - Payment transactions (for example, to net settle payments between insurers)
  - Content licensing and royalty distribution in the media industry
  - Supply chain management to track food safety and management
  - Security of patient records and pharmaceuticals in the health care industry.

However, directors should be aware that blockchain is not a cure-all. Blockchain use cases that solve a failure in coordination are most likely to be successful in the enterprise context.

- *Extended Reality* – Extended Reality (XR) refers to a range of digital enhancements to the real world, including virtual, augmented and mixed reality. While e-gaming and other forms of entertainment are the most obvious uses of XR today, there are a wide variety of potential uses across industries. Augmented reality is being used in the retail industry to enhance the consumer experience—for example, customers can now virtually try on make-up or clothing. Virtual reality is being used in numerous industries to implement effective employee training programs designed to enhance safety or simulate human interaction, as well as in the medical industry to treat chronic pain.

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- *IoT and Edge Computing* – IoT refers to the interconnection of computing devices embedded in objects so they are capable of sending and receiving messages. Edge computing is, in general, the capability of those devices to compute in or near the source of the data—rather than sending information back and forth from the cloud—which decreases delay or latency.

  As businesses deploy connected consumer and industrial devices to implement opportunistic strategies, more and more devices are becoming a part of the IoT and changing the way businesses and end users conduct everyday activities. As with other emerging technologies, IoT and edge computing have a wide assortment of potential uses that will impact companies in a variety of industries, such as health and fitness, home appliances, autonomous vehicles, insurance and energy.

- *Unmanned Aircraft Systems (UAS or Drones)* – UAS are unmanned aircraft and the equipment used to remotely pilot them. There are a growing number of businesses seeking to utilize UAS as part of their business strategies. Companies are using the technology for:
  - Inspection of energy and telecommunications infrastructure
  - Damage assessments in the insurance industry
  - Fulfillment and logistics for the retail industry
  - Monitoring and planting agricultural crops
  - Filming entertainment and sporting events
  - Personal transportation (or urban air mobility).

- *5G* – Fifth-generation wireless networking technology, or 5G, promises significantly faster data speed, lower latency, increased network capacity and increased connection reliability. In addition to impacting the communications industry, 5G will increase the capabilities of many of the other emerging technologies (particularly IoT and XR) and, in turn, have implications across numerous industries in 2020, including:
  - Media and entertainment
  - Retail and manufacturing
  - Energy and utilities
  - Health care
  - Insurance
  - Transportation.

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10. Environmental, Social and Governance

Environmental, Social and Governance (ESG) issues have been a growing focus for regulators, investors and consumers for the past several years. There has been a trend toward greater efforts to address such issues from a variety of perspectives both within and outside the United States. For example, investors and stakeholders are seeking out companies that have fully integrated their ESG risks and opportunities into their corporate strategy. Chief executive officers are redefining the corporation's fundamental purpose to extend beyond maximizing shareholder value. In addition, regulators around the globe are proposing and implementing regulations aimed at heightened transparency for ESG issues.

Key developments in 2019 reinforce this trend and forecast an even greater focus on ESG issues in 2020 and beyond.

Stay Current on Private Sector

In August 2019, the Business Roundtable released a headline-making statement signed by over 180 CEOs that, in its essence, redefined the purpose of the corporation. The document states a broad commitment to focus on maximizing value for all stakeholders, representing a significant shift away from traditional shareholder primacy. The specific commitments include:

- Delivering value to customers
- Investing in employees through fair compensation and benefits
- Providing training and continuing education and fostering diversity and inclusion
- Dealing fairly and ethically with suppliers
- Supporting communities in which companies work by respecting the people and protecting the environment through sustainable practices
- Generating long-term value for shareholders.

Despite the aspirational nature of this statement, it demonstrates that the private sector is reenvisioning its role in society and highlights a budding consensus among executives that ESG is central to that evolution.

Subsequently, the U.S. Chamber of Commerce released a guide to best practices for voluntary ESG reporting, a fundamental aspect of any company's ESG program. The guide encourages reporting to focus on:

- Identifying the long-term impact of ESG issues
- Considering the audience
- Coordinating between internal departments for accurate disclosure
- Clarifying the terminology for laymen
- Tailoring reporting to the company explaining utilized metrics and why they were chosen
- Making reports readily available and describing a rigorous review or audit process.

The Chamber framed this guide as encouraging a system of "private ordering" in lieu of further regulation and as a complement to the existing U.S. legal requirement that public companies disclose all *material* information in Securities and Exchange Commission (SEC) filings.

Other commentators have disagreed with the Chamber's position and advocated for further required disclosures. Indeed, the SEC itself has proposed rules requiring additional human capital disclosures.

Keep Up with SEC Developments

The SEC has proposed regulatory modernizations that would require enhanced business and risk factor disclosures. It also is undertaking additional steps that may result in required disclosures pertaining to ESG.

For example, on August 8, 2019, the SEC proposed revisions to Regulation S-K, including to Item 101(c), which would require an enhanced narrative description of the business, including the company's human capital resources. This would address any measures or objectives that management focuses on, to the extent material to an understanding of the business "measures or objectives that address the attraction, development and retention of personnel."

In response to an earlier concept release, the SEC received multiple comment letters advocating for greater human capital disclosure, with the majority tending to be in favor of the proposal. In many cases, additional disclosure or inclusion of a non exhaustive list of items that may impact a company were also favored.

Many companies address human capital management in public disclosures outside of those filed with the SEC, such as website disclosures, ESG or sustainability reports. A number of others are addressing items such as board of directors oversight of human capital management in proxy disclosures and general efforts around human capital issues such as:

- Diversity and inclusion
- Compensation
- Culture
- Health and safety
- Skills and stability.

Investors and market participants advocating for the inclusion of additional disclosure argue that companies with poor management of human capital could face operational, legal and reputational risks, giving companies with strength in the area a competitive advantage. Opponents suggest that retaining human capital disclosures in voluntary publications, rather than requiring specific metrics in SEC filings, provide each company with flexibility. That is, a company's discussion could evolve as investors' focus continues to develop and it could include a broad discussion of considerations specific to its business. Those against the measure also argue that the inclusion of human capital disclosures are already required, to the extent they are material to the understanding of a company's business, with the same threshold required under the proposed rules.

Whether or not the change to S-K Item 101(c) occurs, boards should consider what, if any, additional human capital disclosures would be helpful to their investors and continue to review the scope of their oversight of company human capital management practices.

Having a clear internal view of what management focuses on, in connection with the company's human capital, is increasingly critical to addressing any new disclosure requirements, as well as engaging with investors. As the SEC noted in its proposed rule, each industry, and each company within a specific industry, has its own evolving human capital considerations, and boards will likely continue to shift in their engagement and oversight of the company practices in this area.

At the same time, the SEC's Office of Compliance Inspections and Examinations (OCIE), which handles examinations of SEC-registered investment advisers and broker-dealers, appears to be engaged in a broad sweep examination effort of ESG reporting practices and related disclosure in investment-related materials. Specifically, OCIE has requested, among other things, that a number of registered entities provide:

- Information about their ESG-related policies and procedures
- Information regarding how the regulated entity measures its progress against previously made ESG-related commitments
- Copies of policies, procedures, compliance/internal audits, and pitch, promotional and advertising materials that discuss ESG.

While these requests for information are being made in the context of examinations, and thus may or may not lead to SEC enforcement action, they highlight the SEC's overall interest in, and attention to, ESG issues.

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And, given the fact that many sweep examination efforts lead to public risk alerts from OCIE, the OCIE's staff may soon issue a pronouncement regarding its views of ESG-related issues in the regulated entity space.

Be Aware of EU Trends

Outside the U.S., the regulatory trend is farther along toward required ESG reporting. For example, a new European Union (EU) regulation, scheduled to come into effect in February 2021, will require higher levels of sustainability-related disclosures in the financial services sector that articulate climate risks and opportunities as part of a company's fiduciary duties. The new rule intends to harmonize the EU approach to integration of sustainability risks and opportunities into the procedures of institutional investors. A wide range of financial entities regulated by the EU or one of its Member States will be subject to this new regulation when it comes into effect in February 2021.

Transparency provisions on ESG issues are not new to the industry, but the regulation here contains some of the first mandatory provisions relating to transparency around how ESG is considered from a fiduciary perspective. It aims to strengthen reporting obligations by asset managers to their clients and other market participants, enhancing transparency on sustainability risks and green investment strategies.

The EU is, in part, seeking to root out and eliminate so-called greenwashing of investments, creating greater transparency on which entities are taking sustainability concerns seriously. Financial actors will ultimately be required to publicly disclose their sustainability policies, as well as the principal adverse impacts affecting their investments (taking into account their size, their nature and the scale of their activities). Pre-contractual disclosures will also be required in order to inform clients of how sustainability risks are integrated in investment decisions and advice.

While some of the details of the regulation are yet to be determined, the basic parameters will apply to EU-regulated entities in the near future. The process by which the regulation was developed and issued means that individual Member States will have little ability to vary implementation of the regulation.

The EU's finance ministers formalized the regulation at their November 2019 meetings, and the regulation is indicated as coming into effect 15 months following its official publication— meaning that the regulation will apply in February 2021.

Follow Best Practices in Coming Year

ESG issues are becoming increasingly important to stakeholders, domestic and abroad. The U.S. and other jurisdictions are taking tangible steps toward heightened ESG accountability and transparency. Overall, the focus on ESG by major U.S. private sector organizations like the Business Roundtable and the Chamber illustrate that ESG issues and reporting are a growing area of scrutiny and reflection, and that domestic policy and practice are in the process of determining a path forward.

U.S. regulators have yet to take as prescriptive an approach. Despite the status of U.S. domestic policy, U.S. entities and investors with a global footprint must remain cognizant of ESG obligations imposed by other jurisdictions currently leading in this space, as well as trends and proposed rules that may signal a forthcoming changing of the tide domestically.

Prudent boards will take proactive steps to align with emerging best practices in the private sector while monitoring whether U.S. legislators will establish further regulatory mandates, as the EU has done and the SEC proposes to do.

Authors: Stacey Mitchell, Lucas Torres, Kimberly Myers, Cynthia Angell, Jenn Thunem and Mary Kate Thompson

Bonus: #MeToo Movement

In calls from clients, all over the news and just about everywhere is #MeToo. More than ever before, boards of directors are taking an active role in protecting their companies and timely responding to allegations of sexual impropriety made against C-suite or other senior executives.

We've said it before, and we'll say it again: Having a harassment allegation response plan in place *before* a crisis involving a high-level executive occurs is critical. It allows for a quicker response, leads to better solutions and reduces the risk of litigation.

Some key takeaways from the past year:

- *Set a Tone from the Top/Change the Culture if Needed.* The board should lead by example, conduct an honest review of company culture, and take steps to put training and policies in place.
- *Review Committee Responsibilities and Written Policies.* Know how the board will handle such allegations.
- *Develop Shortlist of Outside Counsel with Investigation Expertise.* Have an action plan.
- *Consider Extra Protections.* Does the company have a 24-hour hotline?
- *Communicate with Those Involved, and Protect Potential Victims.* Explain any steps being taken in response, and protect against retaliation.
- *Maintain External Confidentiality.* Have a process. Don't inadvertently waive privilege.
- *Remain Flexible as to Remedial Steps.* Avoid one-size-fits-all solutions.
- *Review Process and Outcome, Solicit Feedback and Seek to Improve.* What went right that can be repeated? How can any breakdowns be avoided in the future?

Given the strong and continued importance of this topic, we invite you to join a webinar on this topic on January 15, 2020. This webinar launches our Board Leadership Series, and will offer tips on board preparedness and lessons learned from the front lines.

Our Board Leadership Series will continue to deliver practical resources on a quarterly basis, covering the most sensitive issues that boards of directors face. Click here for additional details.

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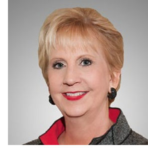

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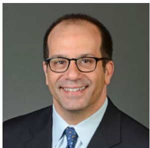

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