Top 10 Topics for Directors in 2019

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Executive Summary

1. Corporate Culture

The corporate culture of a company starts at the top, with the board of directors, and directors should be attuned not only to the company's business, but also to its people and values across the company. Ongoing and thoughtful efforts to understand the company's culture and address any issues will help the board prepare for possible crises, reduce potential liability and facilitate appropriate responses internally and externally.

2. Board Diversity

As advocates and studies continue to highlight the business case for diversity, public companies are facing increasing pressure from corporate governance groups, investors, regulators and other stakeholders to improve gender and other diversity on the board. As a recent McKinsey report highlights, many successful companies regard inclusion and diversity as a source of competitive advantage and, specifically, as a key enabler of growth.

3. #MeToo Movement

A responsible board should anticipate the possibility that allegations of sexual harassment may arise against a C-suite or other senior executive. The board should set the right tone from the top to create a respectful culture at the company and have a plan in place before these incidents occur. In that way, the board is able to quickly and appropriately respond to any such allegations. Any such response plan should include conducting an investigation, proper communications with the affected parties and the implementation of any necessary remedial steps.

4. Corporate Social Responsibility

Corporate social responsibility (CSR) concerns remained a hot-button issue in 2018. Social issues were at the forefront this year, ranging from gun violence, to immigration reform, to human trafficking, to calls for greater accountability and action from the private sector on issues such as climate change. This reflects a trend that likely foretells continued and increased focus on environmental, social and governance issues, including from regulatory authorities.

5. Corporate Strategy

Strategic planning should continue to be a high priority for boards in 2019, with a focus on the individual and combined impacts of the U.S. and global economies, geopolitical and regulatory uncertainties, and mergers and acquisitions activity on their industries and companies. Boards should consider maximizing synergies from recent acquisitions or reviewing their companies' existing portfolios for potential divestitures.

6. Sanctions

During the second year of the Trump administration, U.S. sanctions expanded significantly to include new restrictions that target transactions with Iran, Russia and Venezuela. Additionally, the U.S. government has expanded its use of secondary sanctions to penalize non-U.S. companies that engage in proscribed activities involving sanctioned persons and countries. To avoid sanctions-related risks, boards should understand how these evolving rules apply to the business activities of their companies and management teams.

7. Shareholder Activism

There has been an overall increase in activism campaigns in 2018 regarding both the number of companies targeted and the number of board seats won by these campaigns. This year has also seen an uptick in traditionally passive and institutional investors playing an active role in encouraging company engagement with activists, advocating for change themselves and formulating express policies for handling activist campaigns.

8. Cybersecurity

With threats of nation-states infiltrating supply chains, and landmark laws being passed, cybersecurity and privacy are critical aspects of director oversight. Directors must focus on internal controls to guard against cyber-threats (including accounting, cybersecurity and insider trading) and expand diligence of third-party suppliers. Integrating both privacy and security by design will be critical to minimizing ongoing risk of cybersecurity breaches and state and federal enforcement.

9. Tax Cuts and Jobs Act

A year has passed since President Trump signed the Tax Cuts and Jobs Act (TCJA) into law, and there will be plenty of potential actions and new faces on the tax landscape in 2019. Both the Senate Finance Committee and the Ways and Means Committee will have new chairs, and Treasury regulations implementing the TCJA will be finalized. President Trump will continue to make middle-class tax cuts a priority heading into next year. Perennial issues, such as transportation, retirement savings and health care, will likely make an appearance, and legislation improving the tax reform bill could be on the table depending on the outcome of the Treasury regulations.

10. SEC Regulation and Enforcement

To encourage public security ownership, the Securities and Exchange Commission (SEC) has adopted and proposed significant revisions to update and simplify disclosure requirements for public companies. It has taken steps to enhance the board's role in evaluating whether to include shareholder proposals in a company's proxy statement. It has also solicited comments on the possible reform of proxy advisor regulation, following increasing and competing calls from corporations, investor advocates and congressional leaders to revise these regulations. Boards and companies should monitor developments in this area, as well as possible changes in congressional and administration emphasis following the 2018 midterm elections.

Bonus: Midterm Elections

The 2018 midterm elections are officially over. Americans across the country cast their ballots for candidates for the House of Representatives and the Senate in what was widely perceived to be a referendum on President Trump's first two years in office. With Democrats taking control of the House, and Republicans maintaining control of the Senate, a return to divided government will bring new challenges for effective governance. Compromise and bipartisanship will be tested by what is expected to be an aggressive oversight push from House Democrats. However, areas where there may be possible compromise include federal data privacy standards, infrastructure development, criminal justice reform and pharmaceutical drug pricing initiatives.

1. Corporate Culture

The corporate culture of a company starts at the top, with the board of directors. While the board does not manage the operations of a company, it advises the management team and helps set strategy and plans for the company. The directors should be attuned not only to all aspects of a company's business, but also to its people, values and reputation.

To understand a company's culture, the board should interact with the C-suite on a formal and personal level and also engage with other employees of the company. These interactions and potentially a culture survey by a search firm will help the board identify a company's willingness to change, its tolerance for mistakes and its approach to fixing problems, so that the board can make any necessary adjustments. These activities can also help identify any red flags on an individual basis that should be addressed to avoid embarrassing or even criminal behavior.

Specifically, one important manifestation of the board's and, by extension, the company's, culture is preparation and readiness for a crisis. Eventually, a crisis will occur, and a board cannot wait until that day to decide how to handle the situation. The board should anticipate likely scenarios, such as the protocol for a cybersecurity breach or an event that is common in the company's industry. For example, in the energy industry, oil spills and other health, safety or environmental issues can occur at any time. The company must know not only how to deal with the physical aspect of recovery and repair, but also how the company and its reputation will be affected by its response. In addition, directors should be aware of the potential criminal and civil liability exposure for both the company and the individuals involved in such events.

Likewise, given the instantaneous relay of information via social media, any company operates in a fishbowl. Accordingly, the board has to set the tone for controlling and maintaining the outbound message, as well as the inbound reactions. News of harassment, boycotts, product promotions or controversial political positions can quickly ignite a public relations nightmare for a company. Often companies designate the CEO to control the messages, even if that is not such individual's strong suit. Alternatively, the board could consider appointing a lead director to communicate with the CEO and assist with such messaging.

Finally, a corporate culture in the boardroom that is inclusive of different experiences and backgrounds can bring tremendous perspective and depth to the management and success of a company. For example, as described elsewhere in this publication, the recent gender diversity requirements enacted in California and other initiatives across different jurisdictions are intended to mandate and support this diversity.

It is difficult to overemphasize the responsibilities and obligations of a board to lead and guide the culture of a company grounded on strong core values. However, the success of a robust corporate economy depends on such foundation of trust, mutual respect, integrity, professionalism and transparency, to name a few elements. A board is, and should be, the vigilant guide for such high ethical standards and accountability.

Authors: Christine LaFollette and Elisabeth Cappuyns

2. Board Diversity

Public companies are facing increasing pressure from corporate governance groups, investors, regulators and other stakeholders to improve gender and other diversity on the board, as advocates and studies continue to focus on the business case for diversity. For example, as a recent McKinsey report highlights, many successful companies regard inclusion and diversity as a source of competitive advantage and, specifically, as a key enabler of growth.

Institutional investors and proxy advisory firms have gained considerable influence over corporate boards. According to a 2018 proxy season review by Broadridge Financial Solutions and PwC, institutional investors own 70 percent of U.S. public companies, and institutional shareholder voting participation is 91 percent. These institutions are increasingly applying pressure on boards to promote diversity, including by engaging with companies and withholding votes for directors.

For example, in 2018, BlackRock, Inc., among the world's largest asset managers, added to its 2018 U.S. proxy voting guidelines an expectation to see at least two female directors on every board and wrote to the nearly 300 companies in the Russell 1000 with fewer than two female directors asking them to explain their board diversity efforts. BlackRock has also voted against directors over diversity concerns in recent years both in the United States and abroad, for example, by voting against directors of 52 companies in Europe, the Middle East and Africa (EMEA) with male-only boards in the first half of 2017. Other stakeholders, including Vanguard, State Street Global Advisors, the New York City Pension Funds, the California Public Employee Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), have also engaged with companies, withheld votes from directors and/or taken similar steps to promote board diversity and accountability.

With respect to proxy advisory firms, Glass Lewis updated its U.S. board gender diversity policy in its proxy paper guidelines to take effect in January 2019. Under the new policy, Glass Lewis will generally recommend voting against the nominating committee chair of a board with no female members and may recommend voting against other nominating committee members depending on other factors. In 2018, Institutional Shareholder Services (ISS) began highlighting boards with no gender diversity, but did not make adverse vote recommendations on director elections on that basis. However, ISS has published new Americas proxy voting guidelines for shareholder meetings of Russell 3000 and S&P 1500 companies held on or after February 1, 2020 (following a "grace period" in 2019). Under the new policy, ISS would generally recommend voting against, or withholding votes from, the chair of the nominating committee (and potentially other directors on a case-by-case basis) at companies with no female directors on the board.

Two of the main approaches taken by governments to promoting board diversity are quotas and disclosure. A number of countries in continental Europe follow the first approach with legislated board quotas, including France, Spain, Norway, Iceland, Italy, Germany and the Netherlands. In addition, California passed a law in September 2018 (SB 826) requiring California-based public companies to have at least one female director by the end of 2019 and at least one, two or three female directors by the end of 2021, depending on the size of the board.

By comparison, the United Kingdom and the United States (with the recent exception of California) follow the second approach, requiring companies to disclose certain information and allowing investors to evaluate the disclosure and underlying policies. In the United States, SEC rules (specifically, Item 407(c)(2)(vi) of Regulation S-K) require public companies to describe the nominating committee's process for identifying and evaluating director nominees (including whether and how diversity is considered) and, if the company has a diversity policy for identifying nominees, how the policy is implemented and how the effectiveness of the policy is assessed.

Corporate governance groups, investors, regulators and other stakeholders continue to focus on board diversity. Externally, companies should review their applicable diversity-related obligations and investor preferences. Internally, companies should assess their diversity policies and the composition, refreshment and nomination processes for their boards.

In particular, companies may consider developing a framework to identify and recruit appropriately diverse candidates for the board. For example, Amazon recently joined Facebook, Uber and other high-profile companies by adopting a form of the "Rooney Rule" (a policy first established by the National Football League in 2003) to ensure that the initial candidate list for its board seats includes qualified women and minorities. Finally, although some directors may view board diversity as a "check-the-box" exercise, pressure to meaningfully improve board diversity has increased in recent years, and that trend appears likely to continue in 2019 and beyond.

Authors: Dan Walsh, Jon Pico and Alex Leitch

3. #MeToo Movement

More than ever before, boards are confronted with how to respond when allegations of sexual impropriety are made against C-suite or other senior executives. Fiduciary responsibilities compel a board to take all action necessary to protect the company, including timely and appropriately responding to these types of allegations.

Further, unpreparedness by the board can help foster a workplace environment where sexual harassment is allowed to occur unchecked, which increases associated potential liability for the company. Therefore, a prudent and responsible board should take steps in advance to put a plan in place for responding to situations involving sexual harassment allegations against C-suite and other executives. Then, once a plan is in place, the board should follow certain best practices once it puts the plan into action.

The first step that the board should take to protect the company is to plan ahead. Having a "harassment allegation response plan" in place before a crisis involving a high-level executive occurs, allows for a quicker response, thereby leading to better solutions and reducing the risk of litigation.

Set Tone from the Top/Change the Culture if Needed

In addition to leading by example by not engaging in any inappropriate behavior, members of the board should use their positions to coach senior executives on how to avoid creating unintended liability. It is important that the board remind C-suite executives that reactionary behavior is discouraged and that they must remain inclusive with respect to all employees. For example, senior executives should not exclude women from business or mentorship opportunities out of a fear of being accused of harassment (e.g., an executive who only has one-on-one meetings with men, but refuses to do so with women, creates potential discrimination liability for the company). The board should also conduct an honest analysis of the culture at the company; if a workplace culture exists that allows harassment to occur unchecked, the board should take steps to put training and policies in place and make any necessary improvements.

Review Committee Responsibilities and Written Policies

The board should decide in advance who will handle investigation decision-making when the time comes. For some boards, this will involve assigning the task to an existing committee, such as a governance committee or audit committee. For other boards, it may be appropriate to create a new committee specifically for responding to issues surrounding allegations of impropriety against high-level executives. It is also advisable to review board and company policies, and revise them as needed to ensure they outline investigation procedures in a clear and concise manner.

Develop Shortlist of Outside Counsel with Investigation Expertise

The board should develop a shortlist of pre-approved outside counsel with sexual harassment investigation expertise. If the board already has a shortlist of approved outside counsel, it should re-evaluate the list to identify which firms have this expertise. If a new firm has to be added to the list, they should run a conflicts check in advance, to the extent practicable, so that they can jump into action when the time comes.

Consider Extra Protections

In addition to having legally required policies and procedures in place, consider going beyond what the law requires. For example, some companies are engaging third-party service providers to maintain 24-hour employee complaint hotlines.

When an allegation is brought to light, it is important to act swiftly and put the emergency response plan into action by taking the steps above. A first step should be to contact outside counsel and brief them on the facts so that they can start the investigation. The board should also consider whether a leave of absence for the accused, or change in reporting structure, is appropriate for the duration of the investigation.

Communicate with Those Involved, and Protect Potential Victims

From the start, when speaking with a potential victim of inappropriate behavior, or an individual reporting such conduct, demonstrate appreciation for bringing the claim to light and let them know that a prompt investigation is taking place. Also, remind the individual that board and company policy prohibits retaliation against anyone who raises these types of issues. When communicating with the accused executive, be direct concerning the fact that the board takes the allegations seriously, but also emphasize that the investigation process was developed with due process rights in mind. After the investigation concludes, be sure to communicate the outcome to the individuals who were the subject of the investigation so that they are not left wondering what happened. Be sure to explain any steps being taken in response, and again remind the individuals about the company's policy prohibiting retaliation.

Maintain External Confidentiality

While it is important to communicate with the individuals who are part of the investigation, caution should be taken to avoid sharing details of the investigation, or investigation results, with anyone other than essential parties. For example, the board should not ask outside counsel to share copies of any report it develops with uninvolved company officials, as it may waive work-product or attorney-client privilege between outside counsel and the board. Additionally, it is important to respect and protect the privacy of the individuals involved in the investigation.

Remain Flexible as to Remedial Steps

Work closely with outside counsel to determine how to act on the information generated by the investigation. Keep in mind that termination is not the only outcome for employees accused of sexual impropriety. Obviously, if the results of the investigation clearly show that unwanted and improper conduct occurred, immediate action should be taken. Depending on the severity of the conduct, it may even be appropriate to contact law enforcement. If the investigation is inconclusive, it may still be safest to consider a change in reporting structure and to implement additional harassment prevention training. Even if the allegations are not sustained by the investigation, it is important that any response is not carried out in a way that undermines existing protections and policies, or discourages employees from reporting wrongful misconduct in the future.

Review Process and Outcome, Solicit Feedback and Seek to Improve

After each investigation, take time to evaluate how things went. Consider what went right that can be amplified and where any breakdowns occurred that can be improved. For example, if an allegation did not come to light through the reporting channels the company has in place (e.g., the victim only felt comfortable confiding the details to a friend, who then "leaked" the information to the board), steps should be taken to identify why the individual did not feel comfortable using the company's designated reporting channels to evaluate what can be done to remove that obstacle. Other sets of facts may suggest that workplace culture can be improved by implementing new harassment prevention training or policies, or by developing better employee monitoring and feedback so that issues come to light in a more expedient manner.

All boards should be aware that allegations of sexual harassment against high-level executives are increasingly prevalent in the current-day workplace, and employees expect that the company at which they work will be ready to respond and remedy these situations. By having the right plans and procedures in place beforehand, and responding appropriately when the situation arises, the board can reduce potential liability for the company.

Authors: Lauren Leyden and Dustin Stark

4. Corporate Social Responsibility

While CSR efforts have long been under discussion by many boards, 2018, in many respects, represented a turning point in how such efforts are being viewed by consumers, shareholders, fund managers and governments.

Increasingly, there is a recognition that CSR efforts have impacts well beyond reputational concerns and that they can, and do, impact bottom lines. Moreover, several non-U.S. jurisdictions have enacted legislation, for instance, mandating reporting on CSR-related considerations. The private sector, meanwhile, is organizing its actions in the absence of U.S. federal regulations in the environmental space, particularly with regard to addressing climate change. Across issues, shareholders, investors and limited partners are demanding action, often requiring policies and programs that engage with these issues.

The January 2018 "Letter to CEOs" from the chairman and CEO of BlackRock, Inc., Larry Fink, represents a crucial milestone where these trends are concerned. In this letter, Fink describes the fiduciary responsibility that BlackRock undertakes as including global stewardship concerns. He states affirmatively that Blackrock portfolio companies must be able to articulate their "strategic framework for long-term value creation," which explicitly includes integrating the management of environmental, social and governance matters into the investment process. As noted elsewhere in this publication, BlackRock's own voting and asset management strategies have already implemented these principles.

Topics raised in the Fink Letter have already had tangible impacts in 2018. For example, U.S. and international pension funds, in particular, have responded to pressures specifically related to gun control and immigration issues, with shareholder and investor pressure, in some cases, resulting in divestments by those funds from entities involved in those contentious debates. While issues such as a company's efforts to address diversity and inclusion, including in the context of the #MeToo movement, have not yet produced the same effects, institutional investors are likely to seek information regarding such efforts in the context of their decisions going forward, as Larry Fink hints in his letter. Of course, as noted in more detail above, the very real reputational concerns engendered by failures to address diversity and anti-harassment issues remain at the forefront of the public mind.

The trend is towards greater efforts to address CSR issues, including from legal and regulatory perspectives outside the United States. 2018 saw the first round of reporting under the EU Non-Financial Reporting Directive for companies subject to those laws. Disclosures related to companies' risks and opportunities in the context of climate change are already required for some companies in the United Kingdom, and other jurisdictions such as Canada and Australia are considering measures to mandate certain disclosures in response to efforts through the G-20. U.S. stakeholders, including state treasury officials, are advocating for the SEC to adopt a framework for mandatory reporting on environmental, social and governance issues, to build on and standardize what companies are already doing voluntarily. Legislation passed in Australia at the end of November 2018 requires reporting on human rights issues in an entity's supply chain, similar to the law passed in the United Kingdom in 2016. With regard to the U.K. law, civil society has consistently pushed for greater detail in reporting from those obligated to do so, as well as suggested that the law be enhanced to include requirements that companies take proactive steps to address human rights issues, rather than merely report on their efforts.

It remains to be seen whether such efforts result in legislative changes, as well as whether penalties associated with these laws are enforced, but their presence sends a clear signal that regulators all over the world are taking CSR concerns seriously. Prudent boards will take proactive steps to develop or revise policies and programs that strengthen measures to address these hot-button issues, including those described in greater detail throughout this publication.

Authors: Stacey Mitchell and Anne Kolker

5. Corporate Strategy

Strategic planning should continue to be a high priority for corporate boards in 2019. Boards should consider the individual and combined impacts of the U.S. and global economies, geopolitical and regulatory uncertainties and mergers and acquisitions activity on their industries and companies.

According to Ernst & Young's Global Capital Confidence Barometer, covering the second half of 2018, business executives continue to have high confidence in the U.S. and global economies over the next 12 months. This is in contrast to economists' predictions that a U.S. recession may occur in the next two years. Outside of the United States, major economies began to slow in 2018, including those of Japan and the United Kingdom. Heading into 2019, volatile stock markets, geopolitical and regulatory uncertainties and interest rate increases may impact strategic plans. The Federal Reserve has provided "mixed signals" as to whether it plans to increase interest rates further. It was initially expected that the Federal Reserve would increase interest rates up to three times in 2019; however, Federal Reserve Chairman Jerome Powell indicated at the end of November 2018 that interest rates are "just below" estimates that are considered neutral, which may imply that the Federal Reserve may not raise interest rates as aggressively as anticipated by the markets. Companies are beginning to experience the effects of previous interest rate rises, including higher leverage multiples and interest rates on new debt. As a result, companies may postpone or reduce acquisition activity, consider alternative sources of capital (in lieu of incurring new debt) or apply conservative foreign exchange rates to financial forecasts.

In addition, company performance and mergers and acquisitions activity is expected to be challenged by geopolitical and regulatory uncertainty. For example, although President Trump reached an agreement with the governments of Canada and Mexico to replace the North American Free Trade Agreement (NAFTA) with the U.S.-Mexico-Canada Agreement (USMCA) in the fall of 2018, Congress is not expected to consider the USMCA until 2019. In Europe, the United Kingdom is expected to leave the European Union on March 29, 2019; however, the formal, withdrawal agreement is not expected to be in place until December 2020. Real estate and financial services are among the industries more sensitive to post-Brexit uncertainty. On November 29, 2018, Brookfield Property Group pulled a multibillion-dollar bid to take Intu, a British retailer, private as a result of economic uncertainty and potential volatility across global markets.

One of the more unpredictable variables is the outcome of the continued trade negotiations between the U.S. and Chinese governments. U.S. levies of 10 percent on $200 billion in Chinese goods took effect on September 24, 2018. During the G-20 Summit in Buenos Aires in December 2018, the United States agreed to postpone a scheduled increase in tariffs to 25 percent on an expanded list of goods worth more than $250 billion until approximately March 2019 in exchange for China lifting restrictions on the purchase of U.S. farm, energy products and cars, to allow both sides to continue discussions. This is consistent with similar agreements the United States has recently reached with the European Union and Japan; however, it remains unclear whether the temporary stay on increased tariffs will lead to a long-term agreement. As a result of the current Chinese import duties, United States businesses have already begun to reduce orders, negotiate price decreases and request accelerated production runs.

Despite continued confidence in the mergers and acquisitions market over the next 12 months, corporate appetite to actively pursue acquisitions is the lowest in four years, primarily due to geopolitical and regulatory uncertainty over the next 12 months. For companies inclined to "pause" acquisition activity, boards may consider maximizing synergies from recent acquisitions or review their companies' existing portfolios for potential divestitures, which can also be an alternative source of capital.

Authors: Zach Wittenberg and Sarah Kaehler

6. Sanctions

U.S. sanctions include two types of sanctions: (1) primary sanctions, which impose criminal or civil penalties on U.S. persons (and, in certain cases, foreign entities owned or controlled by U.S. persons) who deal with sanctioned countries or persons; and (2) secondary sanctions, which threaten non-U.S. persons with sanctions for engaging in proscribed activities involving sanctioned countries or persons. 2018 provided an avalanche of changes for both types of sanctions, and we can expect even more changes in 2019. Directors must be aware of the new changes to U.S. sanctions to avoid risk for themselves and the companies they oversee.

U.S. sanctions risks are particularly acute for U.S. persons who serve on the boards of non-U.S. companies. Although non-U.S. companies are not generally subject to primary U.S. sanctions, U.S. directors at these companies must comply with these restrictions, and non-U.S. companies can be held criminally liable for causing U.S. employees to violate U.S. sanctions. Accordingly, non-U.S. companies should consider establishing blanket recusal policies that require U.S. directors to exclude themselves from engaging in any activities that might implicate U.S. sanctions and to wall them off from meetings discussions, decisions or other dealings related to such activities.

Furthermore, the United States has increased its use of secondary sanctions to target non-U.S. companies that engage with proscribed business with sanctioned countries, such as Iran, North Korea, Syria and Russia, as well as sanctioned individuals and entities. Non-U.S. companies targeted with secondary sanctions can face serious repercussions, including being completely cut off from business with the United States. Given this risk, directors are well advised to be mindful of whether the activities of their companies could put them at risk of secondary sanctions, even if they do not have a visible U.S. nexus or U.S. person officers, directors or employees.

Continuing the trend from last year, 2018 ushered in significant changes in the complex U.S. sanctions environment with an expansion of both primary and secondary sanctions that are of particular relevance:

- President Trump's decision to withdraw the United States from the Joint Comprehensive Plan of Action (JCPOA) (i.e., the Iran nuclear agreement) triggered the reimposition of secondary sanctions targeting non-U.S. companies that engage in business involving Iran's automotive, energy, shipping, shipbuilding, metals and mining, and financial sectors, and renewed primary sanctions that prohibit foreign subsidiaries of U.S. companies from engaging in business with Iran.
- In April 2018, the United States imposed sanctions on seven key prominent Russian businessmen and companies that they own or control, making these the toughest and most far-reaching sanctions measures that the Trump administration has imposed against Russia. U.S. persons are prohibited from engaging in transactions with these persons, and non-U.S. persons can face the risk of secondary sanctions for engaging in significant transactions with them. Additionally, the U.S. Department of State announced in November 2018 that the United States would impose additional sanctions on Russia related to its chemical weapons activities, creating additional risk for business involving Russia.

- The United States tightened sanctions on Venezuela, restricting certain transactions involving debt owed to, and digital currency issued by, the government of Venezuela, and further tightened restrictions on direct financial transactions with certain Cuban military and intelligence entities.

Combined with these significant changes, the Trump administration has increased enforcement of secondary sanctions to discourage non-U.S. companies from engaging in business with sanctioned countries and persons. In particular, the United States imposed secondary sanctions against a large number of foreign persons engaging in prohibited trade with North Korea and Iran, and recently sanctioned a Chinese company and its director for engaging in significant transactions with the Russian military.

The U.S. government also continues to track the actions of high-ranking officials in companies to assess penalties. Specifically, an individual's knowledge of, or involvement in, a prohibited transaction is a factor that may influence civil penalty amounts, and a finding that an individual acted willfully in violation of sanctions laws could trigger a referral to the Department of Justice for criminal prosecution.

Given the constant evolution of U.S. sanctions and the current unstable geopolitical environment, directors of companies with a global footprint are well served to identify and monitor areas of current and future sanctions risks.

Authors: Christian Davis and Dallas Woodrum

7. Shareholder Activism

Growth in Activism

There has been a general increase in activism campaigns in 2018, with industry studies documenting rises in both the number of companies targeted in 2018 compared to 2017 and the number of board seats won by these campaigns. As one may expect, changes to the board composition and mergers and acquisitions initiatives continue to be the primary aims of these campaigns.

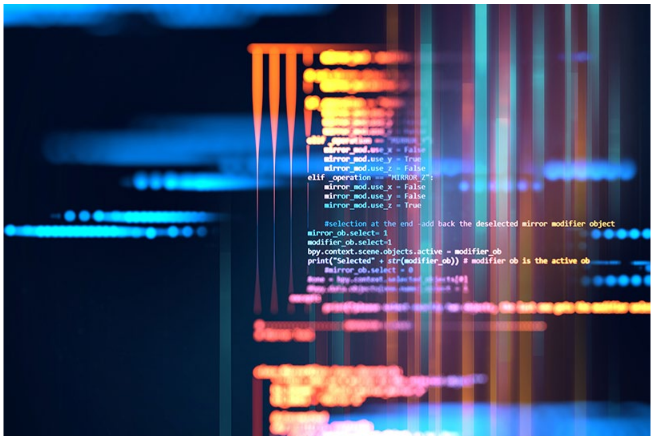
Institutional Investors and Long-Only Funds

This year has also seen an uptick in traditionally passive and institutional investors who have played an active role in encouraging company engagement with activists, advocated for change themselves and formulated express policies for handling activist campaigns. As studies have noted, the top 10 institutional investors owned over 30 percent of the S&P 500 in 2017. As a result, an activist's success may often depend on gaining the support of institutional investors, who themselves have taken more proactive measures over the past year, including the following:

- T. Rowe Price published its "Investment Philosophy on Shareholder Activism," which establishes its approach to handling activist matters and attempts to strike a balance between acting independently while also not initiating campaigns on its own accord.
- AllianceBernstein issued a report advocating for support of activist investors, stating that "active equity managers are best positioned to stimulate change, to promote corporate improvements—and to increase the power of activist investing in the future."
- BlackRock's Larry Fink's letter to CEOs, noted that issuers "must be able to describe their strategy for long-term growth," and, specifically, "in the United States, . . . companies should explain to investors how the significant changes to tax law fit into their long-term strategy."
- Vanguard also took an active role in campaigns, supporting activist investors in five out of 13 proxy contests that went to a vote in the United States.

Authors: Jeff Kochian, Gerald Brant and Jason Sison

8. Cybersecurity



With threats of nation-states infiltrating supply chains and landmark laws being passed, cybersecurity and privacy are critical aspects of director oversight. Recent court decisions and speeches from the SEC have made it clear that directors are not able to delegate cybersecurity oversight: directors each have the responsibility to personally understand cybersecurity risk and ask appropriate questions. Directors must focus on internal controls to guard against cyber-threats (including accounting, cybersecurity and insider trading) and expand diligence of third-party suppliers. Integrating both privacy and security by design will be critical to minimizing ongoing risk of cybersecurity breaches and state and federal enforcement.

Improve Disclosures and Controls

Directors should pay close attention both to cybersecurity disclosures and to internal controls related to cybersecurity vulnerabilities. In addition to publishing formal Commission-level guidance on cybersecurity disclosures and controls, the SEC has recently warned that it may consider certain cybersecurity vulnerabilities as actionable violations of federal securities laws, which require robust internal controls. In a rare Section 21(a) report, the SEC reported that companies continue to fall victims to billions of dollars in fraudulent wire transfers due to business email compromise and indicated that such failures may violate Section 13(b)(2)(B) of the Securities Exchange Act of 1934.

Be Vigilant in Supply Chain Management

With a spike in supply-chain cyber attacks, directors should ask probing questions on third-party relationships. Conducting proper due diligence, developing robust contractual security requirements and following up to ensure compliance are all critical aspects of any supply-chain relationship and, in some cases, are legally required pursuant to certain state laws (such as New York's Department of Financial Services Cybersecurity Regulation, which mandates third-party diligence compliance by March 2019).

Provide Oversight of Privacy and Security by Design

Emerging technologies have brought new risks: artificial intelligence, Internet of Things (IoT) and biometrics are changing the face of business. Directors should be forward-looking in their oversight of controls and should implement privacy and security by design into new technologies. With rigorous requirements imposed in newly passed California IoT legislation (SB 327) and Illinois's Biometric Information Privacy Act, that has more than 100 lawsuits challenging alleged improper use of biometrics, companies will likely save money and decrease regulatory risk by anticipating privacy and security needs at the inception of any new project. Blockchain (the security technology that underlies Bitcoin) provides another emerging method to secure transactions and will likely evolve as companies adopt it more broadly.

Monitor Rapidly Changing Privacy and Cybersecurity Requirements

The patchwork of state, federal and international laws makes a challenging path forward for cybersecurity and privacy compliance for companies and their directors. In 2018, at least 35 states introduced more than

265 bills or resolutions related to cybersecurity. The California Consumer Privacy Act is arguably the most expansive, requiring covered businesses to provide General Data Protection Regulation (GDPR)-like rights to Californians and creating a narrow private right against companies that fail to implement reasonable security controls. Although not effective until 2020, it requires covered businesses to start tracking data and data practices as of January 1, 2019, to comply with a one-year look back provision. Other states, such as Colorado, Ohio, South Carolina, Connecticut and New York, have enacted privacy- and cybersecurity-specific laws and regulations affecting myriad different industries. The SEC has pursued enforcement and issued additional guidance surrounding Bitcoin. The international landscape is also evolving, with complaints to Data Protection Authorities in the European Union skyrocketing after implementation of the GDPR, including more than 1,100 complaints in a single month in the United Kingdom alone. In response, companies have banded together to seek federal legislation in the United States to preempt the patchwork of state laws, but, with contentious Senate hearings on proposed legislation, the prospects for a quick solution remain elusive.

Directors should insist on regular cybersecurity briefings. Such briefings should include updates on the adequacy of incident response plans, a review of budgets, tabletop exercises with the incident response team and a review of cybersecurity training (including statistics on phishing exercises). As cybersecurity risk issues continue to threaten companies worldwide, delegation to a committee, a CIO/CISO or a director who is a cybersecurity specialist will likely be deemed insufficient to discharge fiduciary duties.

Author: Michelle Reed

9. Tax Cuts and Jobs Act

A year after President Trump signed the TCJA into law, there will be plenty of potential actions and new faces in the tax landscape in 2019. Both the Senate Finance Committee and the Ways and Means Committee will have new chairs, Treasury regulations implementing the TCJA will be finalized, and President Trump has continued to make middle-class tax cuts a priority heading into next year.

Perennial issues, such as transportation, retirement savings and healthcare, will likely make an appearance, and legislation improving the tax reform bill could be on the table, depending on the outcome of the Treasury regulations.

The tax-writing Senate Finance and House Ways and Means Committees will have a different look to them in the 116th Congress as both will have new chairmen. Rep. Richard Neal (D-MA) will take the gavel of the Ways and Means Committee. Rep. Neal will approach the Committee with an eye towards building a legacy of legislative wins, along with a more robust approach to oversight. The Ways and Means Committee will likely begin the year by focusing on three key areas with potential tax implications: (1) infrastructure, (2) pensions and retirement security, and (3) strengthening of the Affordable Care Act. These efforts will be supplemented by oversight designed to set the stage for future legislation, including hearings on the TCJA.

On the Finance Committee, Sen. Chuck Grassley (R-IA) will re-take the gavel after the retirement of prior Chairman Orrin Hatch (R-UT). This will be Sen. Grassley's second tour of duty as Chairman, having previously served as either Ranking Member or Chairman of the Committee from 2001 through 2010.

In his prior stint as Chairman, Sen. Grassley focused on the prevention of tax avoidance and job creation. Examples can be seen in the Section 199 domestic production activities deduction and anti-inversion provisions included in the American Jobs Creation Act of 2004. Thus, aside from potentially working with the House on retirement, transportation and TCJA corrections, it would not be surprising to see Finance's oversight arm become more active once again.

From an administration perspective, the first half of next year will be focused on finalizing regulations implementing the TCJA. While the Treasury Department hopes to finalize the deemed repatriation, full expensing and 199A pass-through deduction regulations by the end of 2018, regulations implementing the global intangible low-tax income (GILTI), base erosion and anti-abuse tax (BEAT) and foreign derived intangible income (FDII) provisions will not be finalized until 2019. Much of Congress's focus from a TCJA corrections perspective will likely be based on what the final regulations, especially in the international tax space, look like. President Trump has also made a 10 percent "middle-class" tax cut a priority for the start of the 116th Congress.

Boards will want to be particularly watchful of the finalization of tax reform regulations. While the regulatory process is not glamorous, and will not see many headlines, it could have a dramatic effect on corporate effective tax rates in 2019 and the years ahead. Also, depending on whether the regulations come out "good" or "bad" from Congress's perspective, the regulatory outcome could drive much of Congress's TCJA corrections agenda.

Authors: Zach Rudisill and Lauren O'Brien

10. SEC Regulation and Enforcement

Disclosure Updates and Simplification and Regulations S-K and S-X

The SEC has adopted and proposed rule changes to reduce burdens on public companies and encourage broader securities ownership by "Main Street" investors. Among other things, the SEC has adopted significant revisions to the main body of corporate disclosure requirements under Regulation S-K and proposed revisions to simplify financial reporting in connection with debt financing transactions under Regulation S-X. In addition, the new Congress may continue recent legislative initiatives to simplify the burdens of being a public company.

In August 2018, the SEC adopted significant rule changes in its ongoing disclosure update and simplification program. Companies and boards will want to ensure that accounting and disclosure controls are in place for the upcoming annual report and proxy season to take advantage of these rule changes. Most of these revisions reduce disclosure requirements that are duplicative or are no longer considered important to investors. However, some amendments expand existing requirements, and companies will want to implement any changes necessary to comply with the revised rules, including the expanded requirement to provide quarterly, in addition to annual, statements of changes in stockholders' equity and disclosure of the amount of dividends per share for each class of shares with respect to interim financial periods. In addition, the SEC plans to seek comment on President Trump's proposal to shift from quarterly to semiannual reporting, as well as earnings guidance and related matters. Boards will want to monitor developments in this area and the ongoing development of investor and regulator views, including the formal SEC request for comment on earnings releases and quarterly reports.

Proxy Voting, Proxy Advisors and Shareholder Proposals.

In November 2018, the SEC conducted a proxy roundtable on the proxy voting process and solicited comments for possible rule revisions, including amendments to the regulation of proxy advisory firms, such as ISS and Glass Lewis. Possible amendments include increased regulation of potential conflicts of interest on the part of proxy advisors, due to their relationships with investor groups and companies, and satisfaction of investment advisors' fiduciary duties when they rely on proxy advisor recommendations. The proxy roundtable also addressed the Rule 14a-8 shareholder proposal process. As with the subject of proxy advisor regulation, this builds on the SEC's 2010 Concept Release on the proxy system and follows on SEC Staff Legal Bulletins in 2017 and 2018 emphasizing the role of the board's analysis in determining whether shareholder proposals may be excluded from a company's proxy statement under the "ordinary business" exclusion of Rule 14a-8. While the SEC staff has provided interpretations that may reduce the burdens of the shareholder proposal process on public companies, significant institutional investors and advocates have proposed expanding the shareholder proposal process and submitted an October 2018 petition for rulemaking to mandate increased environmental, social and governance (ESG) disclosures, including expanded requirements relating to gender and other diversity measures, climate change, executive compensation and human capital management. These and other aspects of the proxy system have been the subject of ongoing legislative initiatives that would increase regulation of the activities of proxy advisory firms, such as the proposed Corporate Governance Reform and Transparency Act, H.R. 4015, and Corporate Governance Fairness Act, S. 3614, and we expect the new Congress will also consider these topics. Boards will want to consider appropriate responses to developments in this area, considering the increased emphasis on ESG matters by proxy advisors and institutional investors when voting on director elections, and the potential for changes in emphasis following the midterm elections.

Securities Litigation and Enforcement

The Supreme Court is expected to continue its recent trend of deciding significant securities law cases in Lorenzo v. Securities and Exchange Commission. In Lorenzo, the Court will revisit the question of whether a secondary actor can be held liable under Rule 10b-5 for a false or misleading statement, even if they are not the "maker" of the statement under the Court's 2011 decision in Janus Capital Group Inc. v. First Derivative Traders. In addition, the Court will consider whether secondary actors can be held liable under Rule 10b-5 in SEC enforcement actions, in contrast to private causes of action, where the Court's decisions have explained that "secondary actor" and "aiding and abetting" liability is generally not available. Newly-appointed Justice Kavanaugh has recused himself from the appeal because he heard the case in the D.C. Circuit. This could lead to a 4-4 split decision that would effectively affirm the D.C. Circuit decision that Rule 10b-5 scheme liability can attach in this context. However, the situation is likely to recur, and the Court's decision may be informative in this area. As a result, boards and compliance professionals will want to carefully consider the implications of this case when evaluating potential exposure to securities litigation.

Author: Dan Zimmerman

Bonus: Midterm Elections

The 2018 midterm elections are officially over. Americans across the country cast their ballots for candidates for the House of Representatives and the Senate in what was widely perceived to be a referendum on President Trump's first two years in office. Akin Gump has compiled a comprehensive report that explores the results of the election and the outcomes in the battles for overall control of the House, Senate and state governors' mansions. The report also looks ahead at what to expect in the coming weeks in the lame duck session of the 115th Congress and in the 116th Congress (which begins on January 3) when Democrats will control the House, and Republicans maintain their control of the Senate.

Based on CNN projections as of December 7, Democrats flipped 41 seats currently held by Republicans, while the GOP captured three seats from Democrats, House Democrats only needed a couple of dozen seats to retake the majority, and thus, when the 116th Congress convenes in January, the Democratic Party will have well over 230 seats, returning the party to power for the first time in eight years. In the Senate, where roughly a third of seats were up for re-election, Republicans maintained their majority. The Senate GOP had a net gain of two seats, giving them 53 headed into the new Congress.

A return to divided government will bring new challenges for effective governance. Democrats, in large part, ran against the policies and style of President Trump, potentially leaving little room for the White House, Democratic House and Republican Senate to advance a unified policy agenda. Areas where there may be possible compromise include federal data privacy standards, infrastructure development, criminal justice reform and pharmaceutical drug pricing initiatives.

Compromise and bipartisanship will be further tested by what is expected to be an aggressive oversight push from House Democrats. Already, the incoming House Democratic majority has laid out plans to investigate the Trump administration's policies and activities. Furthermore, industries and individual businesses with close ties to the administration, or that are perceived to have benefited from the administration's agenda, are also likely to face scrutiny in the new Congress.

Authors: Chase Hieneman and Lauren O'Brien

For our full analysis, see our "2018 Midterm Elections: Analysis and Outlook for the 116th Congress" report here.

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