

# TOP 10 TOPICS

## For Directors in 2017



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## Top 10 Topics for Directors in 2017

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# TOP 10 TOPICS FOR DIRECTORS IN 2017

## EXECUTIVE SUMMARY

### **1. Corporate strategy: Oversee the development of the corporate strategy in an increasingly uncertain and volatile world economy with new and more complex risks**

Directors will need to continue to focus on strategic planning, especially in light of significant anticipated changes in U.S. government policies, continued international upheaval, the need for productive shareholder relations, potential changes in interest rates, uncertainty in commodity prices and cybersecurity risks, among other factors.

### **2. Political changes: Monitor the impact of major political changes, including the U.S. presidential and congressional elections and Brexit**

Many uncertainties remain about how the incoming Trump administration will govern, but President-elect Trump has stated that he will pursue vast changes in diverse regulatory sectors, including international trade, health care, energy and the environment. These changes are likely to reshape the legal landscape in which companies conduct their business, both in the United States and abroad.

With respect to Brexit, although it is clear that the United Kingdom will, very probably, leave the European Union, there is no certainty as to when exactly this will happen or what the U.K.'s future relationship, if any, with the EU will be. Once the negotiations begin, boards will need to be quick to assess the likely shape of any deal between the U.K. and the EU and to consider how to adjust their business model to mitigate the threats and take advantage of the opportunities that may present themselves.

### **3. Shareholder relations: Foster shareholder relations and assess company vulnerabilities to prepare for activist involvement**

The current environment demands that directors of public companies remain mindful of shareholder relations and company vulnerabilities by proactively engaging with shareholders, addressing shareholder concerns and performing a self-diagnostic analysis. Directors need to understand their company's vulnerabilities, such as a de-staggered board or the lack of access to a poison pill, and be mindful of them in any engagement or negotiation process.

### **4. Cybersecurity: Understand and oversee cybersecurity risks to prepare for increasingly sophisticated and frequent attacks**

As cybercriminals raise the stakes with escalating ransomware attacks and hacking of the Internet of Things, companies will need to be even more diligent in their defenses and employee training. In addition, cybersecurity regulation will likely increase in 2017. The New York State Department of Financial Services has enacted a robust cybersecurity regulation, with heightened encryption, log retention and certification requirements, and other regulators have issued significant guidance. Multinational companies will continue implementation of the EU General Data Protection Regulation requirements, which will be effective in May 2018. EU-U.S. Privacy Shield will face a significant legal challenge, particularly in light of concerns regarding President-elect Trump's protection of privacy. Trump has stated that the government needs to be "very, very tough on cyber and cyberwarfare" and has indicated that he will form a "cyber review team" to evaluate cyber defenses and vulnerabilities.

### **5. SEC scrutiny: Monitor the SEC's increased scrutiny and more frequent enforcement actions, including whistleblower developments, guidance on non-GAAP measures and tougher positions on insider trading**

2016 saw the Securities and Exchange Commission (SEC) award tens of millions of dollars to whistleblowers and bring first-of-a-kind cases applying new rules flowing from the protections now afforded to whistleblowers of potential violations of the federal securities laws. The SEC was also active in its review of internal accounting controls and their ability to combat cyber intrusions and other modern-day threats to corporate infrastructure. The SEC similarly continued its comprehensive effort to police insider trading schemes and other market abuses, and increased its scrutiny of non-GAAP (generally accepted accounting principles) financial measure disclosures. 2017 is expected to

bring the appointment of three new commissioners, including a new chairperson to replace outgoing chair Mary Jo White, which will retitl the scales at the commissioner level to a 3-2 majority of Republican appointees. 2017 may also bring significant changes to rules promulgated previously under Dodd-Frank.

**6. CFIUS: Account for CFIUS risks in transactions involving non-U.S. investments in businesses with a U.S. presence**

Over the past year, the interagency Committee on Foreign Investment in the United States (CFIUS) has been particularly active in reviewing—and, at times, intervening in—non-U.S. investments in U.S. businesses to address national security concerns. CFIUS has the authority to impose mitigation measures on a transaction before it can proceed, and may also recommend that the President block a pending transaction or order divestiture of a U.S. business in a completed transaction. Companies that have not sufficiently accounted for CFIUS risks may face significant hurdles in successfully closing a deal. With the incoming Trump administration, there is also the potential for an expanded role for CFIUS, particularly in light of campaign statements opposing certain foreign investments.

**7. Board composition: Evaluate and refresh board composition to help achieve the company’s goals, increase diversity and manage turnover**

In order to promote fresh, dynamic and engaged perspectives in the boardroom and help the company achieve its goals, a board should undertake focused reassessments of its underlying composition and skills, including a review and analysis of board tenure, continuity and diversity in terms of upbringing, educational background, career expertise, gender, age, race and political affiliation.

**8. Executive compensation: Determine appropriate executive compensation against the background of an increased focus on CEO pay ratios**

Executive compensation will continue to be a hot topic for directors in 2017, especially given that public companies will soon have to start complying with the CEO pay ratio disclosure rules. Recent developments suggest that such disclosure might not be as burdensome or harmful to relations with employees and the public as was initially feared. The SEC’s final rules allow for greater flexibility and ease in making this calculation, and a survey of companies that have already estimated their ratios indicates that the ratio might not be as high, on average, as previously reported.

**9. Antitrust scrutiny: Monitor the increased scrutiny of the antitrust authorities and the implications on various proposed combinations**

Despite the promise of synergies and the potential to transform a company’s future, antitrust regulators have become increasingly hostile toward strategic transactions, with the Department of Justice and Federal Trade Commission suing to block 12 transactions since 2015. Although directors should brace for a longer antitrust review, to help navigate the regulatory climate, work upfront can dramatically improve prospects for success. Company directors should develop appropriate deal rationales and, with the benefit of upfront work, allocate antitrust risk in the merger agreement. Merger and acquisition activity may also benefit from the Trump administration, taking, at least for certain industries, a less-aggressive antitrust enforcement stance.

**10. Environmental disasters and contagious diseases: Monitor the impact of increasingly volatile weather events and contagious disease outbreaks on risk management processes, employee needs and logistics planning**

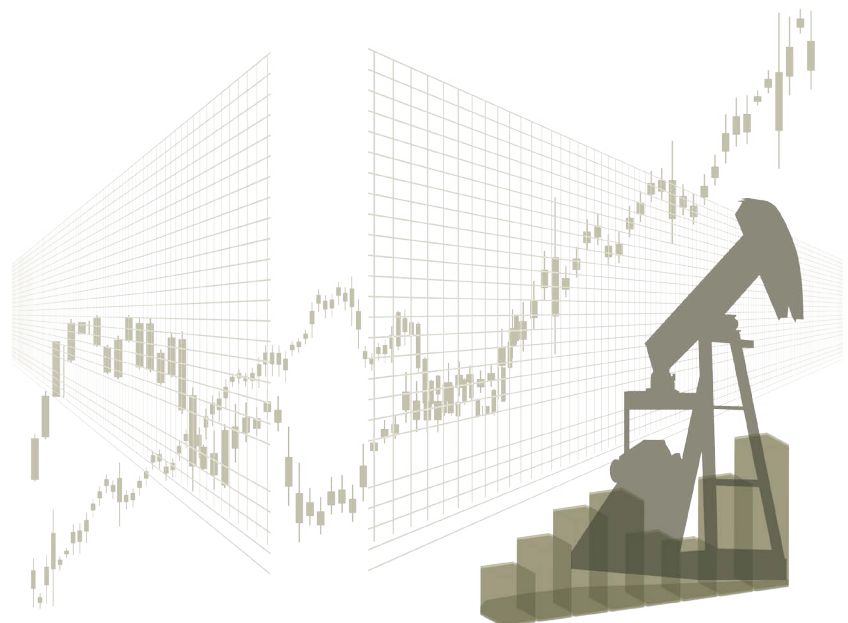
While the causes of climate change remain a political sticking point, it cannot be debated that volatile weather events, environmental damage and a rise in the diseases that tend to follow, are having increasingly adverse impacts on businesses and markets. Businesses will need to account for, or transfer the risk of, the increasing likelihood of these impacts. The SEC recently announced investigations into climate-risk disclosures within the oil and gas sector to ensure that they adequately allow investors to account for these effects on the bottom line. The growing number of shareholder resolutions and suits addressing climate change confirm that investors want this information, regardless of the position of the next administration.

## FULL REPORT

### 1. Corporate strategy: Oversee the development of the corporate strategy in an increasingly uncertain and volatile world economy with new and more complex risks

Strategic planning will continue to be a high priority for directors due to significant anticipated changes in U.S. government policies, continued international upheaval, potential changes in interest rates and uncertainty in commodity prices, among other factors. Boards must reassess their companies' business plans and relative market position in dealing with the following issues:

- a. *Economic/geopolitical outlook.* U.S. economic growth continues to be modest, but also continues to outstrip that of most other major developed economies. The advent of the Trump administration is expected to result in large changes in federal economic policies in the largest parts of the U.S. economy. The confluence of uncertainties arising from the ultimate form of Brexit and non-U.S. bank instability will particularly challenge companies with extensive ties to the U.K. and Europe.
- b. *Short-term vs. long-term; cash stockpiles.* Boards will continue to face pressures on their long-term strategies from activist investors seeking to maximize short-term success, and no company seems immune to these pressures. The tension between the initiatives required to pursue either focus will increase the importance of cultivating productive shareholder relations. U.S. companies continue to hoard cash reserves, both domestically and abroad. At the same time, pressure to use this cash for stock buybacks and dividends has not abated.
- c. *Effect of low oil and gas prices.* Global energy commodity prices have appeared to stabilize at a level far below those in recent years, but the market remains susceptible to volatile swings based on international conflicts, agreements among OPEC and other producer states, and the relationship between the pricing of traditional energy and renewable energy sources. These uncertainties will challenge companies in the development of manufacturing, logistical and marketing plans.
- d. *Prospect of increasing interest rates.* U.S. companies have enjoyed an unprecedented period of below-average interest rates. This period is likely to end in the coming months, resulting in different scenarios for companies planning to refinance existing debt or incur additional debt to fund growth.
- e. *Digital transformation.* As companies continue to grapple with the risks associated with cybersecurity, changes in the overall technological infrastructure will also challenge companies' strategic plans. From the ability to mine Big Data to the transition to all-digitized/no-paper environments, companies will see both opportunities and risks.



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## 2. Political changes: Monitor the impact of major political changes, including the U.S. presidential and congressional elections and Brexit

The results of the U.S. presidential election are historic and unanticipated, and they will have significant economic, political, legal and social implications. As the nation prepares for the Trump administration, many uncertainties remain about how the incoming administration will govern. President-elect Trump has stated that he will pursue vast changes in diverse regulatory sectors, including international trade, health care, energy and the environment. These changes are likely to reshape the legal landscape in which companies must conduct their business, both in the United States and abroad.

While Trump has issued statements about the sweeping changes that he intends to make in his first 100 days in office, he is limited in his ability to act unilaterally through executive orders alone. In many areas and ways, as a matter of U.S. law, regulatory changes will require a process of public notice and comment, pursuant to the Administrative Procedure Act, before they can be implemented. Still others will require congressional legislation to comply with established statutes that constrain the President's power to act unilaterally.

Moreover, Trump's transition team has identified several candidates to fill the open Cabinet positions. These selections provide insight into how the new administration will begin to implement its policies in the months ahead, including the extent to which Trump will pursue his policy positions stated during the campaign. (See the [Akin Gump 2016 Postelection Regulatory Report](#) for more details about possible regulatory changes in a number of areas, including antitrust, cybersecurity, energy and the environment, financial services/investment management and international trade.)

With respect to Brexit, in an uncertain world, British Prime Minister Theresa May offers a little certainty: “Brexit means Brexit”. Although it is clear that the United Kingdom will, very probably, leave the European Union (EU), there is no certainty as to when exactly this will happen, what the U.K.'s future relationship, if any, with the EU will be, or even what the opening position of the respective negotiators of the U.K. and the EU will be.

May has repeatedly stated that she will formally notify the EU of the U.K.'s intention to leave no later than March 31, 2017. This formal notification will trigger the now-infamous “Article 50,” which will commence a two-year negotiation between the U.K. and the EU as to the terms of the U.K.'s exit. If, as appears likely, the U.K. Supreme Court confirms in January that PM May cannot make this notification through the exercise of the royal prerogative—or executive power—her government will have to force enabling legislation through Parliament in order to meet this timetable.

Once the negotiations do begin, it is likely that a clearer picture will begin to emerge of what the future relationship between the U.K. and the EU might be. Issues at stake will be wide-ranging. For business, the most

pressing is likely to be whether the U.K. will continue to participate in any meaningful way in the European single market and, assuming not, on what basis the trade in goods and services between the U.K. and the EU can be conducted. The answer to this question will begin to inform the answer to many others—for example, the application of EU competition law and financial services regulation in the U.K., the imposition of customs tariffs, the ability of European nationals to continue to live and work in the U.K., and the freedom of the U.K. to enter into trade agreements with other non-EU countries. As negotiations progress, boards will need to be quick to assess the likely shape of any deal between the U.K. and the EU and to consider how to adjust their business model to mitigate the threats and take advantage of the opportunities that may present themselves.

### 3. Shareholder relations: Foster shareholder relations and assess company vulnerabilities to prepare for activist involvement

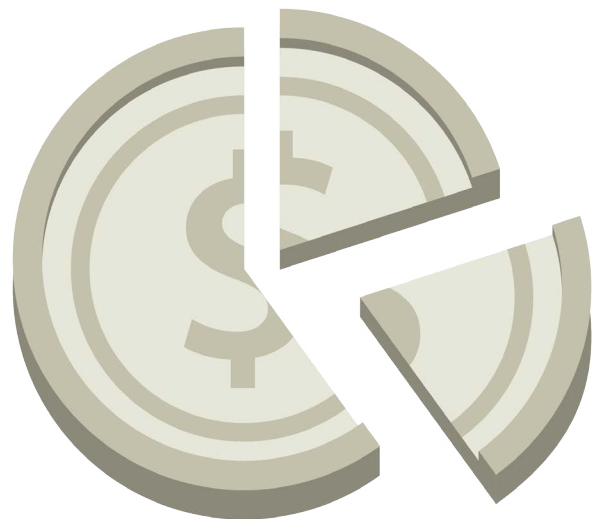
While activist campaigns in 2016 may have leveled off among traditional activist funds, funds and other investors that have not historically taken activist actions continue to enter the activist or suggestivist realm. Additionally, proxy advisory firms and institutional investors continue to be more receptive to activist demands and campaigns. As a result, this environment demands that directors of public companies remain mindful of shareholder relations and company vulnerabilities.

In the past, scholarly articles, panels and other sources of information for directors of public companies have focused on corporate governance and defensive measures. While such discussions have merit and utility, the paradigm is shifting to suggest that a more proactive approach is increasingly appropriate. In other words, while winning a proxy contest or reaching a settlement with an activist investor is good, avoiding the situation altogether is better.

The primary advice for a board of directors to foster shareholder relations is to address shareholder concerns. This means proactively engaging with shareholders and performing self-diagnostic analyses. A director should be cognizant of underperformance in relation to industry peers and other lagging performance areas. Un- and underutilized capital and assets can, for example, be sold and returned to shareholders to avoid future fights. Even if the decision is made not to make material changes to a company's plan, having thoughtfully considered shareholders concerns will mean the board is more prepared when the activist arrives. Not only that, but other shareholders are likely to show deference to a board that actively considers their concerns. Thus, making sure to engage shareholders is of the utmost importance.

If engagement and relations prove ineffective, a board may still need to go to the mat with an activist shareholder. In such a situation, a director will be playing catch-up unless he or she properly understands governance vulnerabilities. For example, a board may be vulnerable as a result of de-staggered boards, lack of access to a poison pill and a shareholder right to vote by written consent and to call special meetings. Understanding that such vulnerabilities exist, and being mindful of them in the negotiation process, can be the key to success in any contest.

Generally speaking, these factors boil down to one primary axiom in the activist arena: a director should take a common-sense approach. Shareholders demand value and a voice. Meeting those demands can turn a foe into an ally. If that approach fails, preparation is key.



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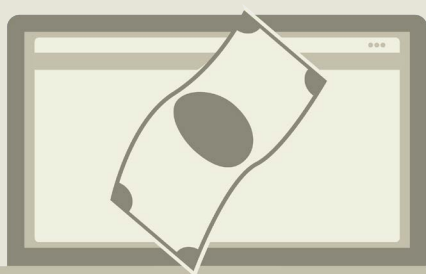
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#### 4. Cybersecurity: Understand and oversee cybersecurity risks to prepare for increasingly sophisticated and frequent attacks

Cybercrime will cost the global economy an estimated \$445 billion in 2016. Cybercriminals and hackers continue to evolve targets and methods. C-level executives are targeted by hackers, with an estimated \$2 billion in losses in the last two years from fake CEO emails, according to the FBI. Directors must be vigilant in continuing to assess risk and monitor progress in the ever-changing cyber defense arena. In addition, President-elect Trump has stated that the government needs to be “very, very tough on cyber and cyberwarfare” and has indicated that he will form a “cyber review team” to evaluate cyber defenses and vulnerabilities.

- a. *Ransomware.* In the first quarter of 2016, phishing email campaigns pushing ransomware increased by almost 800 percent compared to the last quarter of 2015. The FBI estimates that reported ransomware attacks cost their victims a total of \$209 million in the first three months of 2016, but when accounting for unreported incidents and lost productivity, one estimate shows a financial impact of \$75 billion annually. Ransomware attacks follow a similar pattern: a virus is downloaded by an employee and encrypts a company’s data; then, a message appears demanding a ransom, often in bitcoin, ranging in value from a few hundred to millions of dollars—if the ransom is timely paid, then the information is restored.
- b. *Cybercriminals have weaponized the Internet of Things.* Cybercriminals have diversified their targets, with a large percentage of all targets being user devices and individuals. As more information is stored on smartphones and as more devices connect to the Internet through the expansion of the Internet of Things (IoT), cybercriminals have hacked these devices to obtain information, as well as use them as weapons. The October 21, 2016, Dyn attack revealed this vulnerability. The attackers used malware to take control of hundreds of thousands of devices across the country—printers, baby monitors, Apple TV devices, etc.—and used these to begin a distributed denial-of-service (DDoS) attack on Dyn, a DNS provider that links a domain name to its corresponding IP address (i.e., you type in amazon.com, and it sends you to the Amazon IP address). As a result, websites across the country and around the world—including those of Amazon, CNN, BBC, HBO, PayPal, Pinterest, Spotify, Walgreens, The Wall Street Journal and many others—shut down for hours. We anticipate that attacks like these will continue to rise.
- c. *Increased regulation at home.* U.S. regulators have recognized the growing importance of cybersecurity, and there is no shortage of pressure on directors to get this right. The New York State Financial Services Department led the way in creating a more prescriptive cybersecurity regulation, to be effective in January 2017.





Other regulators have also continued their enforcement activities. The Federal Trade Commission (FTC) has prosecuted more than 50 enforcement cases for data security issues. The SEC has emphasized the critical risk presented, as outgoing U.S. SEC chair Mary Jo White commented, “Cybersecurity is one of the greatest risks facing the financial services industry.” The SEC continues to focus on investment advisors and broker-dealers, with enforcement actions for failure to safeguard information. The Yahoo data breaches may also provide a baseline for the SEC’s investigation and enforcement of disclosures from public companies regarding data breaches, with calls for a formal investigation from the Senate.

- d. *Increased regulation abroad.* Data transfer to the EU continues to be challenging. With the overturn of the U.S.-EU Safe Harbor by the *Schrems* decision, companies turned to model clauses/contracts to transfer data. In 2016, Privacy Shield—the successor framework to Safe Harbor—went into effect, providing additional procedural protections for citizens of EU member states. Privacy Shield has already been challenged by privacy advocates in Europe and will continue to face significant legal challenges, particularly in light of concerns regarding President-elect Trump’s protection of privacy, so its future remains unclear. Data transfers between the U.S. and the U.K. also faced concerns after Brexit, but it is likely that the U.K. Data Protection Authority will follow the Privacy Shield framework.



The EU's General Data Protection Regulation (GDPR) provides material changes to the data protection framework in Europe. The GDPR was finalized in 2016 and becomes finally applicable in May 2018. Unlike the predecessor EU Directive, it applies to organizations based outside of the EU if they process personal data of EU residents. The GDPR includes mandatory data breach notification requirements, "privacy by design," appointment of a data protection officer and rights to erasure, with severe penalties for noncompliance of up to €20 million or 4 percent of worldwide turnover (whichever is higher). Multinational companies have significant work to do to comply with the framework by 2018.

- e. *Employees as assets to combat cyber risks.* With experts estimating that 90 percent of all data breaches are caused by people, it is easy to view a company's employees as its biggest threat. The sophisticated use of phishing, spear phishing, personal email, device loss, improper cloud storage and the intentional use of information for profit, sabotage or revenge threatens every company. In 2016, the Internal Revenue Service was forced to issue a special alert warning of W-2 tax fraud phishing schemes, with agents reporting hundreds of compromised companies daily in the first few months of the year. Despite this, employees can become a company's biggest asset. Providing advanced cybersecurity training, running phishing exercises and building a top-down culture of cyber awareness can be the best detection device and countermeasure against cybercriminals.
- f. *Checklist for directors.* Directors should continue to keep cybersecurity at the top of the agenda by doing the following:
  - establish a clear governance structure for cybersecurity
  - analyze top risks facing the company and changing threats
  - review the incident response plan and ensure retained cybersecurity legal advisor and forensic team
  - review the existence and testing of a disaster recovery plan to minimize ransomware threats
  - conduct annual tabletop exercises to practice incident response and ensure coordination across departments
  - provide regular reports to the board with clear cybersecurity dashboards evaluating key audit and compliance metrics; outstanding high-risk findings from prior assessments; benchmarking against established cybersecurity framework such as NIST (National Institute of Standards and Technology) or ISO (International Organization for Standardization); and provide an overview of cybersecurity operational metrics
  - monitor director communications over the Internet and leave all devices outside of the boardroom when sensitive information is to be delivered
  - perform a legal update on regulatory risks and new requirements
  - update vendor access and compliance plans
  - review insurance coverage in the event of a cyber incident



## 5. SEC scrutiny: Monitor the SEC's increased scrutiny and more frequent enforcement actions, including whistleblower developments, guidance on non-GAAP measures and tougher positions on insider trading

- a. *Whistleblower Protections.* 2016 saw the SEC's whistleblower program hit full stride, with multiple whistleblower awards exceeding \$20 million, bringing the total amount of awards in the whistleblower program's brief history to well over \$100 million. The SEC also brought several first-of-a-kind cases applying new rules flowing from the protections now afforded to whistleblowers of potential violations of the federal securities laws. In addition, the SEC brought its first "stand-alone" whistleblower retaliation case against a public issuer, in which the agency did not allege or find an underlying violation of the federal securities laws. The case involved a whistleblower report to an internal corporate hotline and the SEC's Office of the Whistleblower regarding suspected improprieties in the company's accounting practices and financial reporting. The whistleblower—previously the recipient of favorable performance reviews—was terminated within two months of his reports. The SEC's order, which contained no findings as to whether the whistleblower had a reasonable, good faith belief for his reports or whether the company had a nonretaliatory reason for terminating the employee, sends a clear message that the agency will fight to protect whistleblowers of potential violations of the federal securities laws from employment decisions that could be perceived as either retaliatory or adverse following a whistleblower action. The SEC has similarly taken a skeptical view of employment agreements that could impede an employee's ability to file whistleblower reports with the SEC. These actions reflect the granular approach that the SEC will take to ensure that there are no restrictions on terms of employment that could interfere with the strong whistleblower protections enacted by Dodd-Frank.
- b. *Non-GAAP Financial Disclosures.* During 2016, the SEC has dramatically increased its scrutiny of non-GAAP disclosures, commencing with SEC Division of Corporation Finance comment letters to companies and, more recently, through the May 2016 issuance of 12 new and updated Compliance & Disclosure Interpretations. Subsequently, beginning in August 2016, the Division of Enforcement staff of the SEC's Philadelphia regional office sent letters to select issuers titled "Re: Certain Non-GAAP Financial Measure Disclosure Deficiencies." The letters request issuers to voluntarily provide information and documents regarding an issuer's non-GAAP disclosures. This enforcement "sweep" resembles past enforcement crackdowns in the areas of Section 13 and 16 reporting and is both in its early stages and evolving. Issuers should closely monitor all their communications, not merely their SEC filings, for compliance with the SEC's non-GAAP disclosure rules, including the May 2016 Compliance & Disclosure Interpretations.
- c. *Accounting controls preventing cyber-related fraud.* The SEC has also been active in its review of internal accounting controls and their ability to combat modern-day threats to corporate infrastructure. Recently, with the increase of cyber fraud, including so-called "business email compromise fraud," which has affected scores of issuers and led to millions of dollars of shareholder money being transferred fraudulently overseas, the SEC has begun investigating whether affected issuers had internal accounting controls designed to prevent such scams. Some of these frauds have resulted in tens of millions of dollars of losses to public issuers. The SEC's decision to apply securities law requirements regarding internal accounting controls to these fact patterns places companies in the difficult position of not only having to disclose the embarrassing loss of corporate funds, but also defending negligent employee conduct that did not stop the fraud.
- d. *Insider Trading.* The U.S. Supreme Court's December 2016 opinion in *Salman v. United States*—its first opinion regarding the law on insider trading in nearly 20 years— provided federal prosecutors and the SEC with a significant victory. The Court held that gifts of material nonpublic information by tippers to friends or relatives rise to the level of "illegal insider trading" irrespective of any tangible personal benefit to the tipper. During the pendency of the *Salman* case, the SEC stepped up its investigatory efforts in insider trading cases, searching for expansive webs of tippers and tippees through advanced analytical tools developed in the Division of Enforcement's Market Abuse Unit's Analysis & Detection Center. Under this "trader-based" approach to insider

trading investigations, the SEC looks for patterns of trades and the tipping source through additional analytical tools that help establish connections between people. These tools digest enormous volumes of data, from credit history to brokerage records, and telephone records to emails, thereby speeding up investigations and sharpening the SEC's ability to prosecute insider trading. The evidence developed by these tools also serves as the foundation for the SEC's referral of many well-developed insider trading cases to the Department of Justice for criminal investigation. When the initial tip of material nonpublic information originates with a corporate insider, the SEC will often rely on any certifications by that corporate insider of the public issuer's compliance policies and code of ethics, which should prohibit the misuse of material nonpublic information, as evidence of the tipper's wrongful intent. The SEC's use of advanced in-house analytical tools—both human and automated—should push public issuers to redouble efforts regarding the protection of confidential information regarding all corporate activities, including scheduled periodic reports regarding financial results and unscheduled announcements of events such as mergers and acquisitions.

In addition, 2017 is expected to bring the appointment of three new SEC commissioners, including a new chairperson selected by President-elect Trump to replace outgoing chair Mary Jo White. After the completion of the Senate confirmation process, Republican appointees will hold a 3-2 advantage over Democrat appointees. The new chairperson will also appoint a new Director of Enforcement. The new commission could also seek to make significant changes to rules promulgated previously under Dodd-Frank.

## 6. CFIUS: Account for CFIUS risks in transactions involving non-U.S. investments in businesses with a U.S. presence

Over the past year, the Committee on Foreign Investment in the United States (CFIUS), an interagency committee chaired by the Department of the Treasury, has been particularly active in reviewing and, at times, intervening, in non-U.S. investments in U.S. businesses to address national security concerns. CFIUS has the authority to impose mitigation measures on a transaction before it can proceed. It may also recommend that the President block a pending transaction or order divestiture of a U.S. business in a completed transaction. Consequently, companies that have not sufficiently accounted for CFIUS risks may face significant hurdles in successfully closing a deal. With the incoming Trump administration, there is also the potential for an expanded role for CFIUS, particularly in light of campaign statements opposing certain foreign investments.

With that in mind, below are a few key CFIUS considerations:

- a. *Is the deal subject to CFIUS review?* Definitional issues, such as what constitutes “covered transactions” or “control” of a “U.S. business” by a foreign person are critical to this analysis. Transactions between two companies headquartered and primarily operating outside the United States can even be subject to CFIUS review. For instance, President Obama recently blocked the proposed acquisition of Aixtron SE's U.S. business by Grand Chip Investments GMBH, a German company ultimately owned by Chinese investors. Even though Aixtron SE is a German company, CFIUS asserted jurisdiction in this case because the target has a U.S. business. On December 8, 2016, Grand Chip announced that it was abandoning the entire transaction, apparently because it could not be accomplished without acquiring the blocked U.S. business.
- b. *Does the deal pose potential national security concerns?* In making this determination, CFIUS analyzes the interplay between whether (i) the foreign buyer poses a threat and (ii) the U.S. business exposes a vulnerability. The threat analysis focuses on the nationality of the buyer, foreign government control over the buyer and specific concerns about the identity of the buyer (e.g., association with sanctioned parties, criminal history, etc.). In particular, Chinese buyers have been a recent focus of CFIUS scrutiny. The vulnerability analysis focuses on various attributes of a U.S. business, including whether the U.S. business involves sensitive technology, U.S. government contracts, “critical infrastructure” (e.g., certain energy assets) and/or facilities located near sensitive government facilities, among other potential concerns.

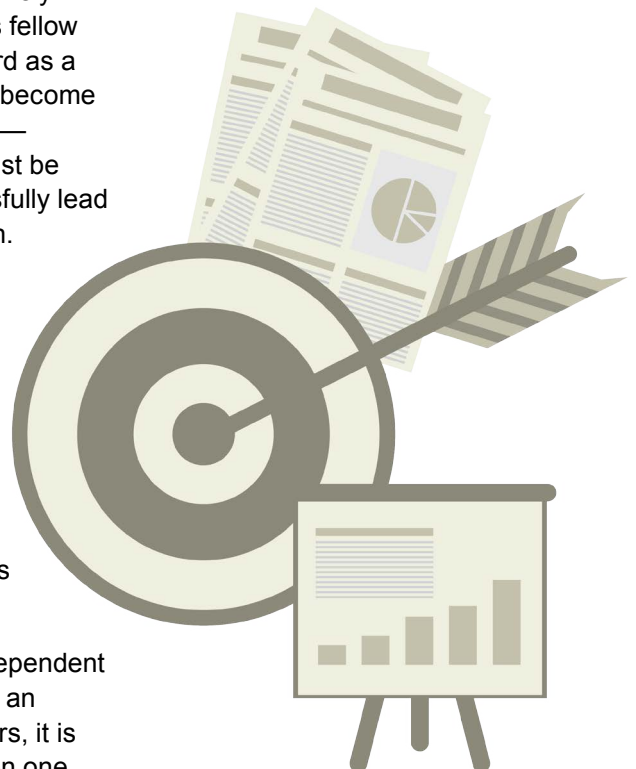
- c. *Should the parties notify the Committee?* CFIUS has the ability to intervene in a transaction and compel the parties to submit to a review. In such cases, CFIUS may begin its review with a negative impression of the transaction as well as doubt regarding the transparency of the parties, which could put the transaction at greater risk of being blocked. Parties would, consequently, be prudent to consider filing a voluntary notice of the transaction with CFIUS in situations where potential national security concerns are present. Submitting to the notification process allows the parties to obtain a “safe harbor” determination for the transaction to proceed. This determination can eliminate the uncertainty surrounding CFIUS risks and position the deal to successfully close.
- d. *What is the timing of the CFIUS review?* Parties will typically submit a voluntary notice to CFIUS after signing and in advance of closing. After preparing the required information for the notice, CFIUS encourages the parties to submit a “pre-filing” to allow the Committee time to review and comment on the draft notice in advance of filing. The Committee may extend the process for review. Most transactions are cleared (i.e., “safe harbor” is granted) during these statutory periods, although CFIUS may require a mitigation agreement to address national security concerns identified in certain transactions. However, in particularly complex and/or difficult transactions, CFIUS may direct the parties to withdraw and refile the notice, starting the clock over with a fresh review period, to allow more time for the national security assessment and/or negotiation of mitigation terms. This development can significantly extend the transaction timeline.

## 7. Board composition: Evaluate and refresh board composition to help achieve the company’s goals, increase diversity and manage turnover

The role of the board of directors and the scrutiny it receives seemingly increase every day. While the primary purpose of the board is to enhance shareholder value through the establishment of strategic priorities, select key members of management and oversee emerging risks and opportunities, the board, as a functioning body, comprises individuals who must function cohesively and productively. Each member’s ability to trust and be comfortable with her or his fellow board members is paramount to the ultimate success of the board as a whole. However, as is often the case, comfort zones, when they become too comfortable, can lead to stagnation. The threat of stagnation—particularly in a fast-moving world with a sluggish economy—must be regularly assessed and carefully avoided if a board is to successfully lead the enterprise to sustainable growth and shareholder satisfaction.

Focused reassessment of the underlying composition and skills of the board, including review and analysis of board tenure and diversity of personal and educational background, career expertise, gender, age, race, political affiliation and otherwise, is paramount to the promotion of fresh, dynamic and engaged perspectives in the boardroom. In addition, continuity of successful board dynamics must be considered as well. Arbitrary and inflexible term and age limits are not perfect solutions to stave off stagnation, as they can force the retirement of valuable directors and inadvertently negatively disrupt board dynamics.

However, given that in 2015, the average age of all S&P 500 independent directors was 63.1, with nearly half of all S&P 500 boards having an average age between 60 and 63 and average tenures of 8.5 years, it is no wonder that board refreshment is a hot topic, particularly when one considers that the average age of top hedge fund managers is 51.



Companies are turning to more robust director evaluations and nomination processes and adding more language to proxies that include skills matrices, but are these processes sufficient to detect problems or implement corrective action, if deemed necessary? Skin can be thin, and asking a board member to step down can be a difficult conversation. If not handled with care and strength, it can do more harm than good to the working dynamics and collegiality of the board.

Notably, neither Institutional Shareholder Services nor Glass Lewis has adopted favorable stances on term limits. Indeed, Glass Lewis, in its [2016 proxy guidelines](#), states that there is no evidence of a connection “between either length of tenure or age and director performance.” However, certain institutional investors, evidently concerned with the question of whether board members are adequately monitoring themselves, either through adoption of hard-and-fast tenure rules or through an effective evaluation process, have adopted their own explicit director tenure and succession requirements that, if not satisfied, may result in votes against long-tenured directors and/or governance committees. Therefore, it is important for boards and their counsel to know who the company’s significant investors are, determine the import of such investor proposals and proactively address any deviations from such policies, either through compliance conducted by the alteration of board composition or explanation in the proxy. A well-thought-out “comply-or-explain” approach may assist in avoiding votes against not only long-tenured or mature directors, but also the governance committee chair and lead director. Directors and counsel who ignore the movement toward refreshment do so at their own peril.

Each individual who sits on a board owes it to the shareholders for whom he or she works to make refreshment and diversity part of an ongoing discussion, where issues relating to tenure and diversity of perspective are raised and addressed not less than annually and where hurt feelings, if not eliminated, are, at least, mitigated and not disruptive. Active and engaged boards reassess and scrutinize strategic plans year after year. No good strategic plan remains stagnant, nor should any board.



## 8. Executive compensation: Determine appropriate executive compensation against the background of an increased focus on CEO pay ratios

Executive compensation will continue to be a hot topic for directors in 2017, especially given that public companies will soon have to start complying with the CEO pay ratio disclosure rules. These rules require companies to disclose the annual total compensation of the CEO, the median of the annual total compensation of all employees other than the CEO and the ratio of these two numbers, largely to give shareholders more context on how a company pays its executives. While some have questioned the utility of this disclosure or bemoaned the potentially negative public/employee relations impact that this arguably arbitrary calculation may have, and while it certainly can be viewed as a procedural and costly burden, it may not be as negative as it seems.

Some companies have been getting ahead of the impending deadline with surprising results. A recent survey conducted by Mercer suggests that many companies have gotten a jump start on estimating their pay ratios and that such ratios might, on average, not be as high as previously reported. Of the more than 100 companies surveyed by Mercer, 60 percent had estimated their ratios, and the majority of those respondents had ratios of less than 200:1. This is a substantial dip from ratios of 335:1 reported in previous studies.

A company has to determine the following three things in calculating the pay ratio: (i) the “median employee,” (ii) the annual total compensation of its CEO and (iii) the annual total compensation of its “median employee.” All determinations of total compensation must be made in accordance with proxy disclosure rules. “Median employee” may also be determined using proxy disclosure rules on total compensation, but the use of those rules would likely be highly burdensome for a company, so the pay ratio rule allows for greater ease and flexibility by permitting companies to use an alternative measure in making this determination.



“*Increased regulation, including aggressive antitrust enforcement, was cited by nearly 70 percent of Fortune 500 CEOs as the most frequent concern among their top three or four challenges.*”



Companies will be required to disclose this pay ratio information for their first full fiscal years beginning on or after January 1, 2017. Consequently, companies with a December 31 fiscal year-end must present the pay ratio disclosures beginning with their Form 10-Ks or proxy statements filed in 2018. In light of the impending effectiveness of the rule, those companies that have not yet begun to take steps toward compliance would be well advised to begin making the necessary decisions and implementing the appropriate procedures to determine their pay ratios, as the rule requires ongoing disclosure. A company generally must identify its median employee once every three years and calculate total compensation for that employee each year. However, once systems are in place for initial compliance, the process is likely to become routine.

The SEC has also proposed other rules that could affect executive compensation and the disclosure thereof. However, these rules are not finalized, and their future is uncertain, given the incoming administration.

## **9. Antitrust scrutiny: Monitor the increased scrutiny of the antitrust authorities and the implications on various proposed combinations**

“Increased regulation,” including aggressive antitrust enforcement, was cited by nearly 70 percent of Fortune 500 CEOs as the most frequent concern among their “top three or four challenges.” These fears are heightened by the wake of recent antitrust litigation challenging mergers both big and small—transactions such as Deere & Company/Monsanto, Energy Solutions/Waste Control Specialists, Staples/Office Depot, Sysco/US Foods, Halliburton/Baker Hughes, Comcast/Time-Warner Cable, Aetna/Humana, and Anthem/Cigna, to name a few.

The data bears out these concerns. The Antitrust Division of the Department of Justice (Division) and the FTC are taking more time to investigate transactions and are expanding their review beyond traditional theories to determine whether transactions raise concerns for narrow customer groupings and upstream and downstream participants, more of which are resulting in litigation. And while the new administration may reduce the frequency of litigation, it will continue to apply the same analytical framework. Especially in the near term, the pace of investigations is unlikely to change materially.

But mergers and acquisitions offer opportunities for significant synergies and the chance to transform a company’s prospects. So, how can directors navigate deals through increasingly hostile antitrust waters? Engaging counsel early on—far before signing—to evaluate antitrust risk is a necessity, not only to understand prospects for regulatory approval, but also to protect vital business interests. Based on our review of recent enforcement trends, we offer the following recommendations to help provide a path forward to realize the synergies produced by strategic transactions:



- *Develop a deal rationale that is centered on customer benefit.* From the outset, parties should articulate (and reinforce) a transaction rationale that is predicated upon customer benefit in order to ensure that documents are written accurately and that key constituencies hear a consistent message about the purpose of the deal.
- *Brace for longer antitrust review.* Parties must build time into the definitive agreements to allow for agency investigation, including, if necessary, additional time to signal a credible threat of litigation against the government.
- *Carefully allocate risk in the merger agreement and be prepared to use the provisions as a sword or a shield.* Lawyers allocate risk using levers such as defining the conditions to closing, outlining efforts that parties must take to secure clearance, defining divestiture obligations and describing the consequences for failing to obtain clearance.

As antitrust enforcement agencies turn up the heat on mergers and acquisitions, businesses must adapt to manage antitrust risk. While we anticipate that the Trump administration may be more willing to accept that market forces will cure fears of consumer harm—and likely more receptive to structural and creative settlements—Trump himself has made statements that also point to continued scrutiny of business combinations. As directors consider the promises of synergies that business combinations bring, they should remain mindful of the potentially lengthy timelines for antitrust clearance, particularly where there are overlapping business segments and other interrelationships between the merging parties. Only then can businesses navigate the increasingly choppy antitrust waters.

## 10. Environmental disasters and contagious diseases: Monitor the impact of increasingly volatile weather events and contagious disease outbreaks on risk management processes, employee needs and logistics planning

While the causes of climate change remain a (slightly decreasing) point of debate in political circles (particularly for the incoming administration), science (and even politics) are beginning to coalesce around the devastating effects of climate change to businesses and markets through volatile weather events, environmental damage and a rise in the diseases that tend to follow. In the United States, for example, the years between 1983 and 2012 marked the warmest documented period of the last 1,400 years, and, since 1950, there has been an increase in both the number of warm days and nights, and, more importantly for our purposes, the number and/or intensity of heavy precipitation events. Europe, Asia and Australia saw similar increases over that time period.

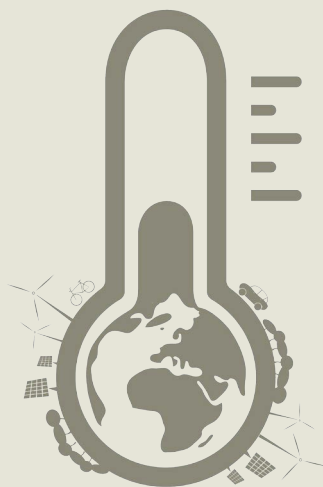
One of the lessons learned from Hurricane Matthew, which hit the U.S. in September and October of 2016, is that severe rainfall can result in flooding, damage to important infrastructure, power outages and agricultural shortages. While the final cost of Matthew will not be known for some time, preliminary estimates begin in the tens of billions of dollars. Unfortunately, we need not look back far to get a clearer picture of the potential damage, because another effect of climate change is the growing number of “500-year” storms that occur far more frequently than every 500 years. Between April 2015 and August 2016, the United States Weather Service recorded at least eight separate 500-year flooding events. During one 14-hour period in



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*The growing number of shareholder resolutions and suits addressing climate change confirm that investors want this information, regardless of the position of the next administration.*

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April 2016, one Texas county reported what it deemed to be a 10,000-year precipitation event.

In 2012, Hurricane Sandy affected approximately half of the U.S. states and many Caribbean countries, causing more than \$50 billion in damage and economic losses, including \$19 billion in New York alone. More sobering, an October 2016 report in the Proceedings of the National Academies of Science concluded that similar flooding is now likely to occur every 20 years in New York City, an area situated in what was previously considered a 500-year flood plain.

Businesses will need to account for, or transfer the risk of, the increasing likelihood of these costs. During the first nine months of 2016, the National Oceanic and Atmospheric Administration reported 12 weather and climate disaster events with losses exceeding \$1 billion each across the United States, exceeding the five-year annual average of 10.8 events between 2011–2015 and more than doubling the 35-year annual average of 5.2 events between 1980–2015. Presumably, it will become harder to insure against these costs as they become more commonplace, increasing not only the threat to businesses, but also the capital and consumer markets on which they rely. Management would be wise to obtain insurance as early as possible, before these trends threaten to preclude it.

Beyond these direct impacts lie secondary impacts that may be equally disruptive, as increases in instances of disease threaten the labor supply and customer bases. Hurricanes, flooding and other environmental disasters can compromise drinking water sources and public health infrastructure, creating polluted, unsanitary conditions that foster waterborne and mosquito-borne disease. In the wake of Hurricane Matthew, for example, cases of cholera have spiked on the hard-hit island of Haiti/ Hispaniola, and the Centers for Disease Control and Prevention (CDC) has warned of risks from infections and diseases in flooded areas of the U.S. Mud, debris, and chemical and farm waste, including animal carcasses, are now entering the water supply in North Carolina as a result of historic flooding there. Studies also indicate that changing climate patterns are increasing the northern range of disease-carrying insects, such as the *Aedes aegypti* mosquito species, a known carrier of the West Nile virus, dengue fever, yellow fever and the Zika virus. Once confined to tropical areas, a 2016 CDC report estimated that *A. aegypti*'s range now extends as far north as New York City.

Likely as a response to the above, the SEC recently announced investigations into climate-risk disclosures within the oil and gas sector to ensure that they adequately allow investors to account for these effects on the bottom line. The growing number of shareholder resolutions and suits addressing climate change confirm that investors want this information, regardless of the position of the next administration.

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