Top 10 Topics for Directors in 2021

Akin Gump
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Introduction

Welcome to Top 10 Topics in 2021: A Brave New World

The world has changed a lot since our 2020 report. A global pandemic; an ongoing reckoning on race, inequality and social justice; a climate crisis; an economic shock; and increased political polarization have created challenging dynamics for companies and boards globally. The role of the board in managing risk and charting the course ahead is more critical today than ever before. This report delves into these wide-ranging and interlocking issues and offers insight on how directors and management must proactively embrace their stewardship roles in this brave new world.

Companies and boards are adapting to the priorities of the Biden administration and Democratic-led House and Senate, with an agenda focused on ending the pandemic, combatting climate change and advancing economic equity and social justice. With more than $17 trillion allocated to sustainable investing strategies at the start of 2020, the new Washington, in many ways, is aligning its agenda with that of investors.

This report looks at:

1. 2020 Election Impact and Anticipated Changes
2. COVID-19: Labor Implications
3. Diversity and Inclusion
4. Board Diversity
5. Environmental, Social and Governance
6. Stakeholder Governance
7. Risk Management
8. Privacy and Cybersecurity
9. Trade Considerations
10. Investigations and Enforcement Trends

You will note that the length of our 2021 Top 10 is notably longer than in previous years. This report is yet another indication of just how much boards have on their plate in our current environment.

Please do not hesitate to contact a member of the Akin Gump team to discuss this report or its findings.

1. 2020 Election Impact and Anticipated Changes

Unified Democratic Control with Narrow Margins

The 2021 Georgia Senate runoff elections resulted in a seismic shift on the federal policymaking front, cementing Democratic control of the Senate with a 50-50 divide and Vice President Kamala Harris able to cast the tie-breaking vote for Democrats. As a result, Democrats now have unified control in Washington—winning the White House and narrowly securing majorities in the House of Representatives and Senate.

While Democrats will be driving the agenda, close margins in the House and Senate will impact the entire policymaking landscape.

In Congress, bipartisanship will be critical to enacting legislation into law. In instances where that fails, Democrats will pursue "budget reconciliation" for high-priority issues. While the budget reconciliation process is cumbersome, time consuming and subject to considerable limitations on the scope of eligible policies, it would potentially allow Democrats to pass two legislative packages with a majority vote in the Senate this year, rather than the 60 votes required for other types of legislation. And while circumscribed by the Senate's arcane budget rules, the process is flexible enough that reconciliation could easily carry matters related to tax, climate, health care and infrastructure.

Tight margins in Congress will likely contribute to a robust regulatory agenda, with the administration turning to agency-driven policy where congressional agreement is not possible. We can also expect Democrats in Congress to engage in active oversight to supplement and amplify the Biden administration's policy agenda.

New Federal Momentum for Integrating ESG Considerations

With the transition from the Trump administration and divided government to a Biden administration with unified Democratic control, continued mitigation of the public health and economic consequences of COVID-19 will take center stage in Washington. The administration views this as a play in two acts: relief and recovery. Particularly in the recovery phase, core Biden-Harris campaign priorities will be integrated into agency policy agendas across the administration, including an agency-wide approach to addressing climate change, reducing racial inequality and leveling the playing field for consumers.

For public companies, this will translate into a sharp retreat from Trump-era regulations and a more aggressive agenda by the Securities and Exchange Commission (SEC), particularly as it relates to environmental, social and governance (ESG) disclosures on climate and diversity. Climate and diversity issues continue to be a top priority for Democrats, and given the current legislative dynamic, we can expect increased activity in this area[1].

Personnel is Policy: A New SEC Chair

The nomination of Gary Gensler to head the SEC provides a strong indicator of the road ahead—a shift towards more aggressive enforcement and increased transparency and accountability for investors.

A 20-year Goldman Sachs executive, Gensler served as Chair of the Commodity Futures Trading Commission (CFTC) in the Obama administration, winning the

1. See Top 10 article Environmental, Social and Governance for further discussion.

respect of progressive Democrats as he worked to reform the $400 trillion swaps market, regulate the over-the-counter derivatives market and actively pursue enforcement after the 2008 financial crisis.

Gensler's confirmation is assured with the Senate's new Democratic majority. Gensler's work in helping to shape the Dodd-Frank legislation, his work at the CFTC and his generally aggressive approach toward the policing of Wall Street helped to endear him to progressives who initially viewed him with some skepticism. At the same time, following his confirmation, we can expect an ongoing dialogue between Gensler and more moderate congressional Democrats in order to help ensure that the SEC strikes the right balance on various policy priorities.

Government-wide Prioritizing of ESG

President Biden, Speaker Pelosi and Leader Schumer are speaking with one voice when they emphasize government-wide commitments to addressing climate change and economic/social inequities. We see these commitments in the linking of climate to infrastructure, international agreements and global financing, and in proposals for increased regulation of the private sector.

Once confirmed, Chairman Gensler will take the lead in developing and executing top-line priorities of President Biden's corporate governance agenda, including company disclosures for climate change risks and boardroom diversity.

At the tail-end of 2020, the SEC adopted amendments to modernize the description of business (Item 101), legal proceedings (Item 103) and risk factor disclosures (Item 105) that registrants are required to make pursuant to Regulation S-K. These amendments touted improved disclosure tailored to reflect registrants' particular circumstances and to reduce disclosure costs and burdens and were ultimately opposed by the Democratic members of the Commission.

Democratic SEC Commissioners Allison Herren Lee and Caroline Crenshaw specifically raised concerns that the amendments failed to adequately address ESG disclosures, including climate change risk, human capital and diversity. These ESG-related priorities were also central to President Biden's corporate governance proposals, and we can expect concerted activity on the ESG front in the coming months.

Specifically, a Democratic-majority SEC will likely prioritize rules to require public companies to disclose climate-related financial risks and greenhouse gas emissions in their operations and supply chains. Similarly, President Biden's racial equity agenda proposed that publicly traded companies disclose data on the racial and gender composition of their corporate boards in order to provide greater transparency for shareholders. Increased disclosure has been a long-standing priority for advocates calling for more diverse and inclusive corporate management structures.

The SEC will have broad administration buy-in on its ESG push, with other agencies similarly committed to these goals. For instance, the Biden administration will revisit the Department of Labor's "Financial Factors in Selecting Plan Investments," which called for fiduciaries of ERISA plans to prioritize financial goals over ESG considerations, only allowing consideration of "non-pecuniary" interests in limited instances. Treasury Secretary Janet Yellen has also indicated that she will seek avenues to promote a climate agenda from her position at Treasury and will continue to develop policies to support the administration's efforts on climate.

Congressional Oversight on Climate and Diversity

The constellation of relevant Democratic committee chairs in the House and Senate will ensure that climate and diversity are central themes in congressional hearings, oversight and legislation. While on the campaign trail, President Biden agreed, "It is way past time we put an end to the era of shareholder capitalism. The idea the only responsibility a corporation has is with shareholders. That is simply not true." In short, the Biden administration will, at a minimum, nudge corporate America and encourage initiatives to accelerate stakeholder capitalism.

Proposals to accelerate corporate diversity garnered increased support from congressional lawmakers during the 116th Congress, including from now-Vice President Kamala Harris. In February 2019, Sen. Robert Menendez (D-NJ), the highest-ranking Latino in Congress and longstanding advocate for greater corporate diversity; Sen. Cory Booker (D-NJ); and then-California Sen. Harris introduced the Improving Corporate Governance Through Diversity Act of 2019 (S.360). Rep. Gregory Meeks (D-NY), Chairman of the

House Financial Services Subcommittee on Consumer Protection and Financial Institutions, introduced companion legislation (H.R.5084) in the House, and the House passed the bill in November 2019. This legislation would require certain issuers of securities to disclose the racial, ethnic and gender composition of their boards of directors and executive officers. As then-Sen. Harris explained, "We must do more to hold companies accountable for living up to their own diversity goals and make sure we have reliable data about their progress."

This uptick in legislation is supported by findings from Sen. Menendez's 2017 Corporate Diversity Survey, which concluded that "Although most Fortune 100 companies believe in the idea of increasing diversity among their senior leadership and corporate boards, few are making tangible progress on the matter." Sen. Menendez will also continue to encourage companies to respond to his survey to ensure greater accountability and relevant data.

In the previous Congress, the House Financial Services Committee, led by Chairwoman Maxine Waters (D-CA), considered ESG disclosures through various hearings and legislative proposals. For instance, in 2019, the House Financial Services Committee held a hearing to examine proposals, including H.R.5084, to increase the diversity of America's corporate boards, as well as a hearing to examine data and research about the social and economic benefits that can be achieved when organizations implement robust diversity and inclusion strategies. Further, the House Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets held a hearing to examine proposals to improve ESG disclosures. The Subcommittee reviewed Rep. Sean Casten's (D-IL) Climate Risk Disclosure Act of 2019 (H.R.3623), a bill that would require public companies to disclose in their annual reports information relating to the financial and business risks associated with climate change.

Ultimately, Congress moves slowly under the best of circumstances, and with a closely divided House and Senate, controversial legislation will be a challenge. However, at the margins, between ordinary appropriations efforts and agency oversight, more-progressive agency heads, and the administration itself, we should expect some movement over the next few years regarding boardroom diversity and disclosures related to climate change. And just as important, President Biden will be confident using his bully pulpit to move corporate America in this direction even in the absence of government action.

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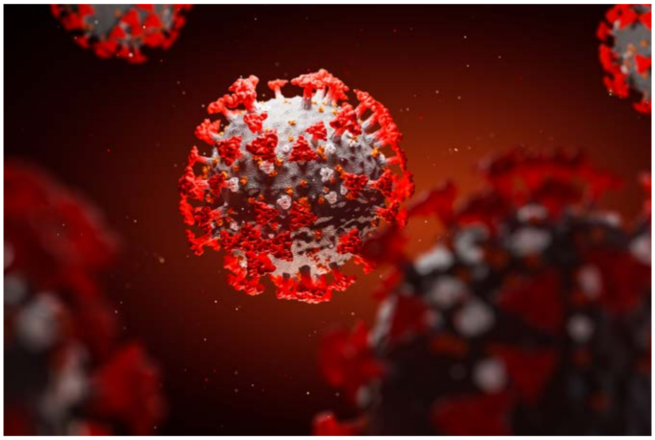
2. COVID-19: Labor Implications



COVID-19: Workplace Implications for the Coming Year

The significant impact of the COVID-19 pandemic, as well as the resulting economic, health and regulatory uncertainties, should prompt board members to evaluate risks and potential opportunities relating to the workforce and develop appropriate business and operational plans in 2021.

2021 Workplace Considerations

The continuing impact of the COVID-19 pandemic should be considered a significant risk area for companies in 2021. At the beginning of the pandemic, the vast majority of states across the country implemented "stay at home" orders requiring closing or severely restricting nonessential business operations. Over time, states gradually relaxed these restrictions and issued phased reopening orders, outlining specific limitations and safety requirements for businesses to resume in-person operations. However, in response to surging infection rate numbers, reopenings in many states have, by now, been paused, and business restrictions reimposed. Companies need to be ready to adapt to emergency state and local orders and pivot on a moment's notice, as well as determine how best to handle new issues relating to vaccines and potential return to in-person work environments. Given the complexity and unchartered territory facing businesses in this area, it is imperative for board members to take an active role.

Reopening Orders

The Trump administration left regulation of business to state and local governments. What resulted was a potpourri of orders across the United States, at both the state and local levels, with each jurisdiction adopting different standards, including with respect to social distancing, mask mandates, limitations on gatherings and in-person operation of businesses. While there has been more federal involvement with the Biden administration, actions taken at the federal level will necessitate even more adept legal analysis of what is required of employers.

Key areas that directors should be overseeing include:

- Level of reopening allowed: Orders at the state and local level have moved forward and back—sometimes in the same week—on the level of in-person operations allowed, depending on the industry. Ensuring a company is being made aware of these legal updates is important, as sometimes there is less than a day's notice of changes, and risks of noncompliance can include lawsuits, fines, revocation of business licenses and/or closure by government agencies. Adding to the difficulty of the situation is the somewhat inconsistent enforcement stemming from the variety of agencies tasked with ensuring compliance.

- Health protocols: Employee safety precautions required in order to reopen in-person operations can include HVAC requirements, reduced maximum occupancy thresholds, mask mandates for employees and customers or visitors, employee health screening practices, workspace and office-wide disinfection requirements, limitations on shared use of equipment, required employee training, contact tracing and reporting obligations, and maintenance of related logs to prove compliance. Third parties have rushed to this space to aid companies in compliance, but the responsibility ultimately falls on the employer.

- Cost-benefit analysis: While some jurisdictions have enacted legislation or issued orders shielding businesses from COVID-19-related tort liability or expanding workers' compensation laws to allow for coverage of COVID-19-related claims for some industries, these protections have not been enacted in all jurisdictions or to the same degree. Thus, board members should educate themselves as to any potential exposure for claims related to negligence or failure to comply with best practices or mandates should an employee return to work and contract the virus. In addition, companies should have a plan in place for reviewing and responding to requests for accommodation from certain employee populations, such as those who are immunocompromised or of advanced age, in the event such employees do not want to or cannot return to the workplace due to health risks.

Considering Mandatory Vaccinations

The exciting news of approval for emergency-use COVID-19 vaccines (with likely full FDA approval to follow) and the promising clinical trials of other potential vaccine candidates raise the question: Should employers mandate vaccination? Board members should play an active role in considering this very important question.

The analysis relating to mandatory employee vaccinations is two-fold: First, can employers legally require employees be vaccinated? and second, should employers require employees be vaccinated?

Once a vaccine receives full FDA approval, the answer to the first question is: Yes, employers can legally require employees be vaccinated as long as they are complying with applicable laws. The Equal Employment Opportunity Commission recently released guidance confirming this and noting that asking whether an employee has been vaccinated would not be considered a medical inquiry. Still, certain employee populations will require exemption from any such mandate under currently applicable laws, including those employees who cannot be vaccinated due to a disability or other health-related reason, such as a compromised immune system, pregnancy or severe allergies, or due to religious beliefs. If companies implement mandatory vaccination policies, they should be prepared to receive an influx of reasonable accommodation requests for such exemptions, which may create an administrative burden. These requests will include personal employee information employers were not previously privy to, which could expose the company to significant liability in the future in connection with, for example, employment discrimination claims. Other legal risks to requiring employee vaccinations include claims by employees who suffer acute adverse reactions to the vaccination. Finally, there are still many unknowns, including whether the vaccine will prevent transmission and how often a booster will be required to maintain immunity, all of which add to the practical concerns associated with mandating vaccination.

All of the above leads to the second question of whether companies should require vaccines. While the safety benefits of a workplace that is 100% vaccinated is alluring, from a practical standpoint, with the required accommodations and resistance being reported, it is unlikely that a mandate will result in every member of the workplace being vaccinated. In addition, even after being vaccinated, health protocols such as social distancing and mask wearing will still be required and/or recommended. Further, based on current projections in most states, the level at which vaccine distribution currently is being decided (although that may change under the new administration as well), most workers in the U.S. will not have access to a vaccine until the second half of 2021.

Balancing the legal risks and business considerations, companies may see more of an upside in encouraging employees to get vaccinated, rather than mandating employee vaccinations. In connection with this, employers may partner with vaccine distribution sites (or, if allowed, offer onsite) to provide voluntary vaccinations, cover the costs of vaccination and/or implement a strategy to educate employees on the benefits of vaccination such that it promotes a team mentality in which fellow employees support each other in getting vaccinated.

Cultural Shift to Remote Working Arrangements

Over the past few years, there has been a significant trend toward providing flexible and remote working arrangements for employees. COVID-19 has dramatically accelerated that trend, and it has now become the day-to-day reality for many, resulting in a cultural shift toward a virtual workplace that is likely here to stay. This shift likely will lead employees to seek, and/or companies to implement, longer-term or permanent work-from-home arrangements.

With only essential employees or a skeleton staff currently present in the workplace, board members should take this opportunity to evaluate the legitimate need to return to a fully in-office workforce—and any operational efficiencies that presents—against cost-saving considerations, such as potentially reduced operational and real estate costs, of having a fully or partially remote workforce. Providing more flexibility to employees with respect to remote working arrangements also has the potential to boost employee morale and assist in key talent recruitment and retention.

If considering remote working arrangements as the long-term reality or a permanent option for all employees or employees in particular positions or departments, board members should take an active role in ensuring the company has a strategic plan that includes the following:

- Technological tools: Ensure that the tools the company put into place at the outset of the pandemic, when decisions may have been hastily made to ensure continued operations following state and local mandates to close offices and storefronts, are the right ones for the business long-term. There are numerous programs that allow companies remotely and unobtrusively to monitor employees; collaboration tools that offer workers visibility into what their colleagues are doing; and platforms that provide an opportunity for employees to meet and engage in water-cooler chat, as well as many tools that provide more than one of these capabilities. Collectively, such tools can provide the oversight capabilities necessary to ensure employee productivity and accountability and maintain the collegial atmosphere present when employees are working together in person.
- Training: Confirm training is provided that is directed toward supporting remote work. In addition to any technology training necessary for employees to use remote working tools, training can help managers craft plans for rewarding productive employees, supporting employees facing challenges and addressing poor performance and can help employees with time management, stress or burnout.

Executive Compensation Implications

During 2020, many companies implemented cost-saving measures, including with respect to executive compensation, in order to ensure continued company viability during the pandemic. For 2021, boards should review (or continue to review) executive compensation levels to confirm they align with the current and projected goals and performance of the company.

To the extent not already effectuated, board members should consider temporary, broad-based salary cuts, in the range of 10-20%, for executives. Should such a salary cut present a challenge to incentivizing or retaining a key employee population, companies could explore other options for cost-savings measures, such as providing compensation in the form of equity or equity-based awards, instead of cash, in order to conserve cash reserves. To the extent permitted by executive employment agreements and/or any applicable plan documents, companies also could consider potentially delaying setting metrics and/or goals for compensation tied to performance or consider setting quarterly or semiannual goals to provide greater flexibility as the situation continues to be fluid.

Board members also should review the language in current and future executives' employment agreements and consider amending or entering into new agreements with executives in the new year. Specifically, executives' employment agreements should contain language to both allow for broad-based temporary salary reductions during times of economic duress for the company (which could be limited to during a pandemic or other periods of declared public safety or health emergencies or could be more broadly worded to capture other situations such as a depressed economy or distressed company operations) and provide that any such broad-based salary reduction shall not be deemed "good reason" for an executive's resignation.

Boards should discuss the above with their legal counsel to ensure their companies achieve, and remain in, compliance with the various and continuously changing legal requirements and restrictions relating to COVID-19. Given the continued importance of this topic throughout the coming year, it is essential that board members remain vigilant in ensuring their companies have strategies and contingency plans in place, and that such plans are based on current (and evolving) best practices and up-to-date research.

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3. Diversity and Inclusion

Corporate Climate Amid Social Unrest

In today's workplace, corporate social responsibility has taken center stage and is swiftly becoming a business imperative. The horrible death of George Floyd and the growing support for the Black Lives Matter movement have shined a spotlight on racism, implicit bias and the myriad ways Black and brown people are disadvantaged in the United States.

In response, companies—both large and small, and regardless of industry—are receiving an influx of demands from regulators and stakeholders about their diversity and inclusion efforts. Investors are asking companies to disclose demographic data on the race, ethnicity and gender composition of their workforce. For, example, the New York City comptroller—a fiduciary to five large and influential New York City pension funds—reported that, in response to his request, 34 S&P 100 companies have agreed to disclose race and ethnicity data from otherwise nonpublic EEO-1 forms that they are required to file with the U.S. Equal Employment Opportunity Commission (EEOC).

Along with requests for transparency, companies also are facing pressure from lawmakers and regulators to take broader diversity actions. In December 2020, NASDAQ filed a proposed rule with the U.S. Securities and Exchange Commission (SEC) that would require all companies listed on NASDAQ's U.S. exchange to publicly disclose their board diversity statistics. California also expanded its board diversity efforts by requiring public companies headquartered in the state to elect at least one director from an underrepresented community (in addition to at least one female director) by the end of 2021, with this number to increase for larger boards thereafter. Individual and institutional investors have also mass-mailed letters to asset management firms, companies and boards, setting forth their expectations around diversity and inclusion, such as pressing companies to adopt the Rooney Rule, which requires at least one woman and one underrepresented minority group member to be considered on a candidate slate when filling positions.

While stakeholder requests for diversity information are not new, companies and firms historically have been circumspect in their responses. Today, however, the pressure is mounting as more and more companies and firms disclose their Equal Employment Opportunity (EEO) data and make public commitments to increase the representation of minorities and women in their leadership ranks and workforce.

Diversity Commitments and Their Consequences

In response to heightened scrutiny, and hoping to get ahead of the curve, many companies are implementing wide-ranging diversity and inclusion programs, often accompanied by public proclamations about achieving certain minority representation goals within a set timeframe. For example, more than a dozen companies have pledged to add a Black director to their boards within one year, and many large corporations have publicly committed to reach a specific percentage of minority and female leaders by 2025 or sooner.

While commitments to increase the representation of minority board members can be achieved simply by taking race into account, the same is not true in the employment context, where antidiscrimination laws protect Caucasian employees and applicants just as they do minorities. As a result, well-intentioned efforts to promote diversity in the workforce may expose an employer to liability for reverse discrimination. Indeed, the Department of Labor's Office of Federal Contractor Compliance Programs recently has made inquiries of at least two Fortune 500 companies that publicly pledged to double their Black leadership, citing concerns that the companies' potential use of "quotas" violated their antidiscrimination obligations.

Companies also are seeing fallout when promised commitments to diversity and inclusion are not attained. More than 15 shareholder derivative lawsuits have been filed in federal court seeking to hold directors and officers of major corporations accountable for allegedly misleading investors when making public commitments to foster a diverse and inclusive environment. The claims primarily allege (i) fraud on the part of the board and C-suite for authorizing false proxy statements that include commitments to diversity and equal opportunity and (ii) breach of fiduciary duties for failure to adequately monitor compliance with anti/harassment and anti/discrimination laws. While some of these claims have been dismissed, others have survived dismissal, and at least three companies have agreed to settlements valued at more than $90 million to resolve these lawsuits.

The Difference Between Diversity and Affirmative Action

As noted above, white employees and applicants are protected from discrimination to the same extent as minorities. As such, a white male applicant or employee can assert a viable discrimination claim if he suffers an adverse consequence in the name of diversity. In fact, there are only two circumstances where employers can lawfully engage in affirmative action that takes race into account when making consequential employment decisions: (i) when an employer creates a written affirmative action plan that documents a "manifest imbalance" in "traditionally segregated" jobs, and the affirmative action being taken is "narrowly tailored" to cure the imbalance without "unnecessarily trammeling" the interests of non-minorities, or (ii) when a court orders an employer to implement a race-conscious remedy in response to claims of egregious discrimination. Courts have consistently struck down affirmative action efforts that are aimed solely at achieving diversity rather than remedying specific past or ongoing discrimination.

Lawful Diversity Initiatives

Unlike affirmative action, diversity initiatives promote inclusiveness and respect for differences without placing non-minorities at a disadvantage. For example, employers lawfully can take steps aimed at recruiting from a more diverse applicant pool or encouraging the development of minority employees so that they are better positioned for advancement opportunities.

One way to distinguish lawful diversity initiatives from potentially problematic affirmative action is to consider whether the initiative is "inclusive" or "exclusive." Inclusive initiatives, such as intentionally recruiting at locations known to have more minority job seekers, expand opportunities for minorities without, at the same time, diminishing opportunities for non-minorities. Intentional recruitment and other inclusive initiatives do not affect ultimate selection decisions. Rather, inclusive techniques level the playing field by seeking to ensure that as many qualified candidates as possible make it to the selection process.

By contrast, exclusive initiatives are more akin to zero-sum games, where advantaging minority employees operates to exclude non-minority employees. Exclusive techniques include setting fixed quotas for the percentage or number of minorities that will fill vacancies or displacing workers of a particular race through layoffs to avoid affecting overall workforce diversity. Exclusive initiatives, to varying degrees, have the potential to help minorities at the expense of non-minorities. The harm caused to third parties makes exclusive techniques legally problematic.

Mitigating Risk When Implementing Diversity Programs

- Counsel and the Protection of Privilege: As an initial matter, companies implementing new diversity initiatives should actively involve legal counsel from the outset, including in designing, creating, implementing and assessing diversity programs. Counsel can help ensure that such initiatives comply with applicable laws and also can take appropriate steps to try to ensure the protections of the attorney-client privilege. While well intentioned, communications and analyses regarding the need for diversity initiatives, the shaping of a program, the implementation of the program, progress toward goals, the effectiveness of the relevant initiatives, and data measuring the success (or failure) can be self-critical and can be used offensively by plaintiffs' attorneys in any ensuing litigation. Experienced counsel can help a company appropriately shroud an internal review in the attorney-client privilege, thus limiting the risk that the company's laudable efforts will not subsequently be punished.

- Affirmative Recruiting: One of the most effective ways to lawfully increase the representation of minorities in the workforce is to focus recruiting efforts on expanding the number of qualified minority applicants who apply for open positions. However, targeted recruiting should be used to supplement traditional recruiting methods rather than replace them. Solely targeting minority populations and sources could serve as evidence of a predetermined directive to fill a particular opening only with a minority candidate at the expense of qualified non-minority candidates. Recruiters, interviewers and decision-makers also should not engage in any oral or written communications that reference a particular candidate's race or gender, such as noting in interview evaluations or emails that hiring or promoting the minority candidate will add diversity or support the company's diversity goals.

- Properly Implementing Diverse Slates: A diverse slate policy requires a certain number or percentage of diverse candidates when filling job openings. If qualified white or male candidates are bypassed or excluded from moving forward in the hiring process in order to meet the slate diversity requirement, an employer could face legal challenges, especially if other evidence suggests a discriminatory hiring preference. Likewise, sorting candidates by race to compose a diverse slate can be problematic because the most qualified minority candidate who is chosen to move forward may be less qualified than a non-minority candidate who ends up being bypassed. On the other hand, an employer could successfully defend a diverse slate requirement by showing that only **inclusive** techniques were used to meet the diversity requirement, such as by expanding the slate with the best-qualified candidates until the diversity requirement is satisfied. However, where a dearth of minority candidates exists in a particular field or geography, exceptions to a diverse slate requirement should be made, as it serves nobody's interest to move forward a diverse candidate who has no chance of being selected.

- The Certified Pools Approach: An alternative to diverse slates that is gaining traction among companies involves the certification of applicant pools by an employer's diversity officer or EEO department before the selection process can proceed to the next step. In a typical "certified pools" program, job postings are accompanied by a diversity recruitment plan that sets forth specific efforts that the hiring manager will take to attract diverse candidates. The diversity recruitment plan then is reviewed and approved by the company's diversity or EEO expert. Once the candidate pool is set, the diversity or EEO expert reviews the racial and ethnic demographics of the pool and either (i) certifies the pool because it is sufficiently diverse or because good-faith recruiting efforts were made (even if unsuccessful) or (ii) informs the recruiter or hiring authority that additional affirmative efforts should be undertaken to expand the pool with more qualified diverse candidates. In this way, diversity can be factored in at every step up until the pool is set, while avoiding the risk of race-based decisions about who should advance in the selection process.

- Setting Representation Goals: Aspirational goals do not violate antidiscrimination laws. A goal, by itself, is lawful, so long as it is not a quota and, instead, merely is an objective that can be worked toward over time through lawful diversity initiatives. Some companies, however, are going beyond aspirational goals and making firm commitments to achieve a goal within a set timeframe. In addition, sometimes these goals are set in a manner that is unrelated to the percentage of qualified minorities in the labor force, i.e., goals based on achieving parity between white and minority employees or having a workforce that mirrors the general population or the community that the organization serves. Setting goals in this manner is inconsistent with the goal-setting method that has been endorsed by federal government enforcement agencies. According to these agencies, such a method, **first**, requires an employer to determine the benchmark of qualified, available and interested protected group members in a particular reasonable recruiting area for a specific job or job group and, **second**, requires an analysis of the workforce to determine whether minorities are being "underutilized" in the job-applicable group(s) when compared to their prevalence in the relevant labor pool. When goals are not created via a determination of underutilization, they could support a claim of illegal quotas or be viewed as pressuring managers to make unlawful race-based decisions. Likewise, goals that overpromise and underdeliver (because they are not based on underutilization) could result in shareholder derivative claims. The risks associated with setting goals can be significantly reduced with thoughtful planning on the front end to ensure that goals are realistic and achievable, which means they can be accomplished without violating antidiscrimination laws.

- Implementing Accountability Measures: Employers can hold managers accountable for encouraging diversity and inclusion. However, monetary rewards, incentives or penalties that are tied to selection outcomes can create legal risk because they encourage decision-makers to prefer protected group members over potentially more qualified non-protected group candidates. Therefore, when rolling out such programs, companies should carefully consider how directly to link an incentive—such as a bonus—or a penalty—such as a rating category on performance evaluations—to a specific diversity outcome such as hiring or promoting a certain percentage of minorities. Employers should avoid any incentives or accountability measures that encourage managers to select less-qualified minorities and should not otherwise exert pressure on managers to hire minority candidates. Instead, companies can consider rewards or rating categories based on a manager's diversity **efforts**, such as expanding recruiting efforts, attending management trainings and/or diversity events and participating in other outreach programs. Accountability also could be measured through employee feedback, satisfaction surveys, exit interviews and/or retention rates.

Authors: Esther Lander, Richard Rabin and *Imani Forbes*

4. Board Diversity

Rising Pressure for Board Diversity in Unprecedented Times

2020 was a difficult year for many—not least for corporate directors. In addition to safeguarding companies' financial health in a truly unpredictable economic landscape, directors were expected to steer their institutions through a slow-burning health and safety emergency, a rapid lurch to virtual and remote work, and a renewed focus on social and racial justice. Furthermore, many have argued that the sole focus of maximizing shareholder returns should be supplanted by a multistakeholder model, which takes into account other factors, including environmental impact, labor issues and the larger community in which a business operates.[1]

Faced with these high stakes, board diversity is more relevant than ever. Boards of directors need to ensure they have the right experience to meet these challenges, which will require a broader mix of perspectives. Diverse boards may also help companies improve results. A May 2020 study by consultancy firm McKinsey analyzed over 1,000 large companies across 15 countries and found that companies with the most gender and ethnic diversity on their boards are 28 percent more likely than their peers to outperform financially, when earnings before interest and taxes (EBIT) is compared against a control group.[2] A leading private equity firm found that, from 2016 to 2019, portfolio companies with two or more diverse board members had nearly 12 percent higher average earnings growth per year than companies with no diverse board members. The report also found that companies with diverse boards generated earnings growth five times faster, on average, than companies lacking board diversity.[3]

Evolving Legal and Regulatory Requirements

Against this backdrop of rising social pressure, legislators and regulators are increasingly focused on board diversity. In December 2020, Nasdaq submitted a proposal to the Securities and Exchange Commission (SEC) that would require (i) all listed companies to publicly disclose their director diversity statistics and (ii) most listed companies to have, or explain why they do not have, at least one director who self-identifies as female and one who self-identifies as either from an underrepresented minority or LGBTQ+. The proposal is currently under SEC review and may take effect during 2021.[4] Nasdaq also announced plans for a partnership with Equilar, a provider of corporate leadership data solutions, to enable Nasdaq-listed companies to access a larger pool of highly qualified, diverse director candidates.

Earlier in 2020, the European Commission proposed, but has not yet enacted, a quota requiring companies to fill at least 40 percent of non-executive board seats with women, or face fines.[5] Several European countries, including France, German, Italy and Belgium, already impose mandatory quotas requiring gender diversity on the boards of directors of certain companies.

California followed their lead, and, by December 31, 2021, all publicly traded companies with principal executive offices in California must have (i) at least two women on boards of five members and at least three women on boards of six or more directors and (ii) one

1. *Harvard Business Review*: Covid-19 Is Rewriting the Rules of Corporate Governance (Link).
2. McKinsey & Co. Diversity Wins Report (May 2020) (Link).

3. *Carlyle 2020 Impact Review* (Link).
4. Nasdaq to Advance Diversity through new Proposed Listing Requirements (December 1, 2020) (Link).
5. Jennifer Rankin, "EU revives plans for mandatory quotas of women on company boards" (March 5, 2020) (Link).

director from an underrepresented community. By the end of 2022, California companies must have at least two directors from an underrepresented community on boards of five to eight members and three such directors on boards of nine or more members.[6] (*Link* to previous Akin Gump coverage of California's quotas). California is, so far, the only state to impose a mandatory quota system—but Hawaii, Massachusetts, Michigan, New Jersey and Washington state are also considering imposing quotas for female directors, and Colorado previously passed a nonbinding resolution urging corporations to have a minimum number of female directors by December 2020.

Mandatory Disclosure on Board Diversity

Other U.S. states use disclosure-based legislative regimes to encourage board diversity. Maryland requires business entities with corporate headquarters in Maryland to disclose in their annual reports their total number of directors and the total number of female directors. By January 2021, all Illinois-headquartered, publicly listed corporations must include in their annual reports (i) data on the specific qualifications, skills and experience the corporation considers for directors and executive candidates; (ii) the self-identified gender of its directors; (iii) whether any of its directors self-identifies as a minority person and their applicable race or ethnicity; (iv) the corporation's process for identifying, evaluating and appointing director and executive candidates, including whether and how demographic diversity is considered; and (v) the corporation's policies for promoting diversity, equity and inclusion among its board of directors and executive officers.

Shareholders Accelerate Calls for Board Diversity

In addition to keeping abreast of the evolving legal requirements for board diversity and related disclosure, companies should take note of increasingly exacting expectations from institutional shareholders. For example, BlackRock now advises its portfolio companies to include at least two woman directors on their board and recommends that companies consider personal factors such as gender, ethnicity, race and age, as well as professional characteristics, when selecting director candidates. BlackRock also expects companies to disclose their (i) preferred mix of competencies, experience and other qualities of board and management; (ii) candidate selection process; (iii) board self-evaluation processes; and (iv) board diversity demographics.[7]

Other shareholders may embrace similar standards, as proxy advisory firms Glass Lewis and ISS each include recommendations regarding board diversity in their 2021 proxy guidelines, summarized in the chart below:

6. Glass Lewis 2021 Proxy Paper Guidelines for the U.S. (*Link*)

7. BlackRock 2021 Proxy voting guidelines for the U.S. (*Link*)

	Glass Lewis Proxy Paper Guidelines (US) [8]	ISS 2021 Proxy Voting Guidelines (US) [9]
Gender Diversity	Beginning in 2021, note as a concern boards consisting of fewer than two female directors. Beginning with shareholder meetings held after January 1, 2022, generally recommend voting against the nominating committee chair of a board that has fewer than two female directors (or one for boards with six or fewer total directors).	For companies in the Russell 3000 or S&P 1500 indices, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies where there are no women on the company's board. An exception will be made if there was a woman on the board at the preceding annual meeting and the board makes a firm commitment to return to a gender-diverse status within a year.
Other Diversity	Beginning in 2021, note as a potential concern instances where the average tenure of non-executive directors is 10 years or more and no new directors have joined the board in the past five years. On occasion, age or term limits can be used as a means to remove a director for boards that are unwilling to police their membership and enforce turnover.	For companies in the Russell 3000 or S&P 1500 indices, highlight boards with no apparent racial and/or ethnic diversity and, after February 1, 2022, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) where the board has no apparent racially or ethnically diverse members (except if there was racial and/or ethnic diversity on the board at the preceding annual meeting and the board makes a firm commitment to appoint at least one racial and/or ethnic diverse member within a year).
Disclosure	Beginning 2021, track the following proxy disclosure: (i) the board's current percentage of racial/ethnic diversity; (ii) whether the board's definition of diversity includes gender and/or race/ethnicity; (iii) whether the board has a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees; and (iv) board skills disclosure.	Generally vote for requests for reports on a company's efforts to diversify the board unless: (a) the gender and racial minority representation of the company's board is reasonably inclusive in relation to companies of similar size and business; and (b) the board already reports on its nominating procedures and gender and racial minority initiatives on the board and within the company.

8. Glass Lewis 2021 Proxy Paper Guidelines for the US (*Link*).
9. *ISS 2021 Proxy Voting Guidelines for the US* (*Link*).

In comparison, the Glass Lewis Proxy Guidelines for 2020 expected only one female board member, and neither Glass Lewis nor ISS addressed racial/ethnic diversity among directors or requested diversity disclosure in their respective 2020 Proxy Guidelines.[10]

Conclusion

Companies seeking to meet shareholder expectations and stay ahead of legal and regulatory requirements should make board diversity a priority in 2021. By enlisting directors from diverse personal and professional backgrounds and openly disclosing such efforts in regular corporate communication, companies can ensure that their strategy and management are fit to meet the challenges of doing business in a society—and market—that may be forever changed by the unprecedented pandemic and social unrest we experienced in 2020.

Authors: Dan Walsh, Alex Leitch and *Elizabeth Atkins*

10. Glass Lewis 2020 Proxy Paper Guidelines for the US (*Link*); ISS 2021 Proxy Voting Guidelines for the US (*Link*).

ESG: Speaking the Language of Your Investors and Preparing for the Road Ahead

The onset of the pandemic increased the focus on several environmental, social and governance (ESG) issues, including human capital, diversity and inclusion, and climate change. Investors, market-watchers and regulators want to understand the short- and long-term impact of the current environment and pandemic on companies and carefully review ESG disclosures, as many have identified them as critically important—although sometimes frustratingly difficult to decipher—indicators of the health and long-term prospects of a company. The need for boards to stay actively engaged continues to increase, as ESG considerations can influence all levels of company operations and increasingly call for direction and oversight from the board with regard to priority, definition and company commitment.

Current ESG Disclosure Landscape

Mandatory Disclosure

Under current U.S. Securities and Exchange Commission (SEC) regulations and guidance, the disclosure of ESG issues is required if "material" or to the extent there is a substantial likelihood that a reasonable investor would consider them important in deciding how to vote or make an investment decision. The current principles-based disclosure requirements provide companies with the flexibility to determine whether information is material and, to the extent it is, how to disclose that information.

Certain states, however, are directly engaging in ESG policy and requiring disclosure around board diversity and inclusion. For example, as discussed in the Board Diversity section above, Illinois and New York are among the states that have enacted legislation targeting diversity disclosure at the board level. Illinois Public Act 101-0589, signed by Gov. J.B. Pritzker on August 27, 2019, requires companies to include data on specific qualifications, skills and experiences that the corporation considers for its board, board nominees and executive directors in its annual reports. Self-identified gender and race or ethnicity characteristics, among other items, are also required. In addition, as of June 27, 2020, Section 408 of New York's Business Corporation Law requires both domestic and foreign corporations "authorized to do business" in the state to report the number of directors on the board and how many of those directors are women. State legislatures can be expected to increasingly utilize disclosure requirements as a tool to drive greater diversity on corporate boards and potentially other ESG-related initiatives, such as concerning climate change.

Voluntary Disclosure

Likewise, investors are increasingly pressing company leadership and boards for more information on how they are managing climate-related risks and opportunities and adapting to a low-carbon economy. Institutional investor giants such as BlackRock, Vanguard and State Street have loudly voiced their support for disclosures aligned with the reporting frameworks developed by the Task Force on Climate-related Financial Disclosures (TCFD) and the standards put forward by the Sustainability Accounting Standards Board (SASB) as benchmark frameworks. Company leadership should regularly and proactively engage with investors to identify their concerns and requests regarding additional disclosure on ESG-related topics. The information, presented in a structured and comparable format, can be important to investors as they compare companies, identify which companies can further their sustainable investing goals and assess climate and environmental risks for a particular company or across multiple companies or industries. Whether or not disclosure is required per SEC rules or state legislation, investors can be expected to continue to push companies for more, and increasingly more uniform, disclosure, and companies who are less transparent may compare unfavorably to their peers.

As described in the Board Diversity and Diversity and Inclusion sections, and in parallel with the state requirements discussed above, internal and external pressure for boards to reflect meaningful racial and gender representation, as well as diverse thoughts, backgrounds and experiences, is growing. As we have previously discussed, pressure to disclose diversity metrics and increase board diversity has continued to gain traction among a broadening base of institutional investors and advisory firms. ISS, Glass Lewis and certain asset managers have addressed gender and racial/ethnic diversity as well as other ESG-related topics within their 2021 proxy voting guidelines.

So, what and how should a company report under current best practices? There is an alphabet soup of ESG standards, including those developed by the TCFD, SASB, the Global Reporting Initiative (GRI), the International Integrated Reporting Council, (IIRC), the Carbon Disclosure Project (CDP), the Workforce Disclosure Initiative (WDI), Climate Disclosure Standards Board (CDSB), the U.N. Principles for Responsible Investment (PRI) and the World Economic Forum (WEF), among others. While new frameworks continue to be developed, in response to a demand for uniformity, some established frameworks have signaled a desire to work together and harmonize, if not consolidate. For example, GRI and SASB issued a joint statement in 2020 announcing a collaborative workplan to demonstrate how some companies have used both sets of standards together, and in late November, SASB and the IIRC announced they will merge into one organization by mid-2021. Indeed, GRI, SASB, IIRC, CDP, and CDSB all embraced the WEF's September 2020 framework, discussed further here, and have pledged to work together to produce a "comprehensive corporate reporting system."

Company leadership and the board should review the various frameworks and standards and align themselves with those most relevant to their industry and investor interests, maintain a dialogue with investors to ensure that they are meeting expectations and stay current on ESG trends, including those related to consolidation of the standards. When selecting a framework, consideration should be paid to whether any ESG reporting frameworks provide for comparison with peers. Finally, company leadership and the board should establish clear oversight and accountability for ESG goals and initiatives, either through the creation of a new ESG committee or by placing it within the mandate of an existing committee and updating the committee charter accordingly. See Risk Management for guidance on managing risk oversight.

Future of ESG Disclosure

Additional mandatory ESG disclosure obligations continue to be recommended at the state and federal levels as well as at national securities exchanges. On December 1, 2020, Nasdaq announced the submission of a proposal to advance board diversity and enhance transparency of diversity statistics through new proposed listing requirements in Nasdaq Rule 5605(f) (Diverse Board Representation) and 5606 (Board Diversity Disclosure), discussed further here and here. If approved, the rules will require companies to have, or explain why they do not have, at least two diverse directors on their boards and provide additional information on board diversity. Companies would be required to annually disclose information on each director's voluntary self-identified characteristics in a Board Diversity Matrix within the company's proxy statement or information statement for its annual meeting of shareholders or on the company's website and, after the first year of disclosure, would be required to show the current and prior years' statistics as well.

Although the SEC has not yet proposed any rules or amendments that would require mandatory ESG disclosure, boards will need to remain ever vigilant for updated guidance and/or the adoption of new rules or amendments to current disclosure requirements, particularly in light of President Biden's promise to require public reporting companies to "disclose climate risk and the greenhouse gas emissions in their operations and supply chains." Prior to adoption, recent Regulation S-K amendments elicited many comments urging mandatory ESG disclosure. As noted by SEC Commissioner Lee in her statement regarding the amendments, thousands of commentators sought disclosure on workforce development, diversity and climate risk, areas in which the final rule did not ultimately require specific disclosure. Furthermore, the SEC's Asset Management Advisory Committee (AMAC) has established an ESG subcommittee whose task it is to generally review matters concerning ESG investment products and make recommendations for consideration by AMAC. This subcommittee recently provided three potential recommendations for issuer disclosure of material ESG risks. These suggestions include that the SEC should (i) require the adoption of standards by which corporate issuers disclose material ESG risks, (ii) utilize standard-setters' frameworks to require disclosure of material ESG risks and (iii) require that material ESG risks be disclosed in a manner consistent with the presentation of other financial disclosures. The SEC subcommittee advocated for the application of standards that are material, that are limited by industry and that provide clear guidance on relevant metrics and noted that the standards put forward by the SASB currently meet these requirements. As noted in 2020 Election Impact and Anticipated Changes, if confirmed as SEC Chair, it is likely that Gary Gensler (along with the SEC's newly established Senior Policy Advisor for Climate and ESG) will take the lead in developing and executing top-line priorities of President Biden's corporate governance agenda, including mandatory ESG disclosure requirements.

Regulators and governments around the world are also increasingly focused on climate-related disclosures, as efforts are made to pursue a sustainable low-carbon future in alignment with the goals of the Paris Agreement. Various multinational efforts have been made to facilitate improvements in the quality and comparability of information disclosed to meet investor needs, and many individual national markets have advocated for voluntary disclosure or adopted mandatory ESG-related reporting requirements. For example, as of March 10, 2021, new disclosure requirements for investment managers and advisers will apply in the European Union. See our alerts to investment managers here and here for additional information. Additionally, on December 17, 2020, Hong Kong's Green and Sustainable Finance Cross-Agency Steering Group released its "Strategic Plan to Strengthen Hong Kong's Financial Ecosystem to Support a Greener and More Sustainable Future," available here, and agreed to implement five near-term action points, available here. One of the five action points is to mandate TCFD-aligned climate-related disclosures across relevant sectors no later than 2025. We anticipate that international disclosure requirements, like those mentioned, will influence the form of any regulation ultimately approved by the SEC.

Impact of ESG Disclosure

In addition to seeking feedback on ESG metrics directly from companies, artificial intelligence and analytical resources continue to evolve and make it easier for investors to evaluate ESG factors within company disclosures. Long-term value retention and creation can be signaled by not only proper corporate governance and planning, but also proper disclosure highlighting that planning. A study conducted by MSCI indicated that stocks with high environmental scores outperformed low-scoring companies by about 60% over a 13-year period. However, beware the temptation to exaggerate your company's ESG prioritization and initiatives. Greenwashing can reduce market confidence, encourage market skepticism, damage a company's reputation and result in litigation.

ESG investing generally seeks to receive positive returns and make a positive long-term impact on society, the environment and the performance of the business. Investments are made through a variety of vehicles, some of which, like green bonds, were initially made in areas such as renewable energy but have expanded to apply to a wider range of sectors and activities. According to US SIF, sustainable investing strategies have grown from $12 trillion at the start of 2018 to $17.1 trillion at the start of 2020, increasing by 42 percent, and total green bond issuance topped $1 trillion. As identified on its website, 15 financial institutions headquartered in the United States with $5.5 trillion in financial assets have joined the Partnership for Carbon Accounting Financials (PCAF), an industry-led partnership developed to facilitate transparency and accountability of the financial industry to the Paris Agreement and committed to measure and disclose the greenhouse gas emissions associated with their portfolio of loans and investments.

There is no time like the present to take a step back and assess where your company stands with regard to ESG disclosure. Freshly examine what is being posted on your company website, discussed with investors and disclosed within company filings. Is the message you want to portray regarding company values and sustainability accurately coming across? Confirm that communications are consistent and transparent to allow interested parties to use the information efficiently. Companies may want to think globally, taking into account international disclosure requirements and collaboration efforts and regularly taking stock of peer disclosure, while acting locally by listening to investors and watching for disclosure obligations stemming from federal and state regulatory bodies.

Authors: Cynthia Mabry, Stacey Mitchell, Lucas Torres and *Cynthia Angell*

6. Stakeholder Governance

Harnessing a Holistic Approach to Corporate Governance

Boards of directors will forever be tasked with setting the "tone at the top," overseeing strategic direction, monitoring business developments and opportunities, overseeing known and newly identified risks and dictating risk tolerance levels. However, in light of the dynamic dislocation of 2020, including a worldwide pandemic, increasing evidence of climate change, the acceleration of income inequality, a heightened awareness of racial injustice and 24/7 political divisiveness, will boards continue to be principally motivated to maximize value for shareholders?

Shareholder primacy, and the empowerment of shareholders in pursuit of short-term agendas, has long dominated the business culture of the United States. Popularized by economist Milton Friedman in a 1970 essay in *The New York Times* with a headline of "The Social Responsibility of Business Is to Increase Its Profits," shareholder primacy became the trademark of American capitalism and fueled takeover activity of the 1970s and 1980s. Greed was declared good and, for all intents and purposes, dictated the evolution of corporate governance and behavior.

Today, a half century later, Friedman's outsized influence on corporate culture continues to remain relevant, albeit more divisive. Following the 2008 financial crises, business leaders and policy-makers have pondered, speculated and attempted to mitigate the effects of excessive risk-taking in the singular pursuit of higher stock prices. Calls have been made to adopt longer-term objectives with the intent to benefit the general health of both our economy and society—effectively, a rebuke of Friedman's views, which were blamed for leading to a generation of profiteering companies and the detriment of the greater good.

Illustratively, in August 2019, the Business Roundtable, an industry group that included the leaders of Apple, Amazon and Walmart, abandoned the shareholder primacy principles it had adopted in 1997. In its stead, they announced their support for "stakeholder governance," the fundamental premise of which is that directors should be encouraged—and given the latitude—to make decisions that both:

- Promote sustainable, long-term business success of the company, as a whole.
- Reasonably balance the interests of all constituencies, including employees, communities and customers.

Politicians similarly gave credence to stakeholder capitalism. In 2018, Sen. Elizabeth Warren introduced the Accountable Capitalism Act, declaring that "If Jamie Dimon thinks it's a good idea for giant corporations like JP Morgan Chase to have multiple obligations, he and I agree." In July 2020, then-presidential candidate Joe Biden put this stake in the ground: "It's way past time we put an end to the era of shareholder capitalism." The theme of the 2020 Davos conference became "Stakeholders for a Cohesive and Sustainable World." And, yet, notwithstanding widespread discussion on the merits, and demerits, words and actions regarding stakeholder capitalism have yet to become equal parallel components.

In large part, the drum beat toward stakeholder capitalism has been consistent and increasing, but so too have contrary public cries to action. In an article titled "The Illusory Promise of Stakeholder Governance," Lucian Bebchuck and Roberto Tallarita described stakeholder governance as "naive" and attempted to demonstrate that the acceptance of stakeholderism will not make stakeholders better off and may impose substantial costs on shareholders, stakeholders and society at large.

Whether as result of the opposition or simply inertia, prioritization of shareholder returns from a legal and economic policy standpoint have largely continued notwithstanding the fact that there is no statutory or case law that specifically requires directors to manage and oversee a company's operations with the paramount objective of maximizing share price. Of course, changing old habits can be hard and, apparently, past practice and historic logic have continued to dictate that if a company is not making profits for its shareholders, it is not well positioned to tend to the care of other constituents.

In 2021, in light of a meteoric stock market that has defied wide-ranging macro operational, societal and governance challenges that have seismically shifted previously settled expectations, we have to question: Is it even possible for boards to maximize share price if the interests of other stakeholders are ignored?

We believe that recent events have served to highlight the duty of boards to implement long-term perspectives that support the threshold proposition that businesses can and, indeed, should, make the world a better place. We believe that, in this day and age, boards have to start with a holistic perspective that the purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business and that doing so is essential in order to ensure corporate success and growth of value for investors over the long term. In other words, we believe that the consideration of the interests of all the stakeholders is a critical and essential part of the sum required to fulfill corporate purpose in a manner consistent with the board's fiduciary duties.

As economic stewards, we ask whether boards can afford to resist the call to serve their mission as not only serving shareholders but also customers, suppliers, workers and communities? If boards neglect to cultivate and, participate in, the evolution of a business ecosystem that is co-dependent on the survival of other stakeholders, do they do that at the peril of top-line growth? Will they risk the optimization of investment and assets utilization, and, therefore, risk lower performance outcomes? Does dismissing the interest of stakeholders other than shareholders stagnate income for most of the population? Does income inequality lead to increased risk of greater political upheaval? We believe the answer to each of these questions is, unequivocally, yes.

Accordingly, we believe that boards are well advised to define their company's mission and purpose and to weave oversight of sustainability strategy and environmental, social and corporate governance (ESG) issues into the annual board agenda. Corporate guidelines should be reviewed and, if necessary, amended to assert stakeholder interests in addition to shareholder interests. Such changes provide for transparency, as well as metrics for accountability. Boards should be prepared to comprehensively disclose their approach to oversight and ensure at least one director is well positioned to articulate the board's role in setting and tracking stakeholder-focused goals, particularly as they relate to environmental performance, diversity and inclusion metrics, executive compensation objectives incentives and compensation disparities.

By harnessing a holistic approach to corporate governance through decisions based upon careful consideration and deliberations that take into account a self-identified corporate purpose, in addition to industry, regulatory, geographic and other specific company-related factors, boards will be afforded the protections of the business judgment rule. More importantly, by taking into account stakeholder interests as well as shareholder interests, boards will lessen the likelihood of government intervention and legislation, be rewarded with the respect of their employees and, we believe, be better drivers of long-term value creation and broad-based prosperity in 2021 and beyond.

In light of the dynamic dislocation of 2020, rather than posing the question "Will boards continue to be principally motivated to maximize value for shareholders?," we, and indeed shareholders, must ask, with all due respect to Mr. Friedman, "How can they?"

Author: Kerry Berchem

7. Risk Management

Insights for Boards Overseeing Risk Management in 2021

Given the disruptive events in 2020, it is now more critical than ever for businesses and their leadership to manage enterprise risk and to anticipate and proactively address not only risks endemic to their specific organizations, but also systemic risks in an ever-changing global landscape. Risk oversight is one of the many responsibilities of the board of directors, based, in part, on:

- The fiduciary duty of oversight under corporate law, which requires directors to implement and oversee reasonable information and reporting systems and controls designed to inform them of material risks.
- Regulations (and related commentary) promulgated by the U.S. Securities and Exchange Commission.
- Stock exchange requirements and credit rating agency influence.
- Dodd-Frank Act requirements to create board-level risk committees (applicable only to the largest financial institutions).

Structuring the Risk Oversight Function at the Board Level.

Boards are increasingly delegating the risk oversight function to a committee. A recent ERM Professional Insights study[1] of 565 organizations, including 164 financial services entities, 157 not-for-profit organizations, 150 large organizations and 132 publicly traded companies, found that approximately 54 percent of the boards that were surveyed delegated risk oversight to a committee (including 83 percent of the boards of the publicly traded companies surveyed). Of those boards delegating the risk oversight function, approximately 49 percent assign the function to the audit committee, while 27 percent create a separate risk oversight committee.

There are costs and benefits to delegating the risk oversight function to a separate committee. On the one hand, a separate committee allows its members to focus solely and consistently on enterprise risks, which tend to be numerous and complex. A separate committee can also reduce the burden placed on the audit committee, whose members may not have relevant expertise outside of finance and audit matters. Conversely, a separate committee may create redundancies with respect to risks overseen by the audit, governance and compensation committees and create additional board responsibilities, consuming valuable board time and resources, diluting the board's focus and potentially increasing board expenses if directors are granted additional compensation for serving on committees.

Forefront of Identifying and Addressing Potential or Actual Risks and Anticipating Future Risks.

Whether or not your organization has a separate risk oversight committee, review and management of enterprise risk remains a critical role of the board, which should be at the forefront of identifying and managing actual and threatened risks and anticipating future risks. To meet this goal, a board should consider:

- How it will identify emerging risks. Does it have appropriate feedback loops at different levels within the organization to ensure comprehensive assessments and streamline future processes? Or will it rely on third-party advisors with respect to certain types of risk (e.g., environmental and other ESG (environmental, social and governance) risks)?

1. Available at https://www.aicpa.org/content/dam/aicpa/interestareas/businessindustryandgovernment/resources/erm/downloadabledocuments/aicpa-erm-research-study-2020.pdf

- Whether it will develop a formal "risk appetite statement" (similar to a whistleblower policy) in order to standardize the decision-making process with respect to taking on enterprise risks.
- How it is integrating technology and social media to identify emerging risks and trends that can impact the enterprise.
- If it is accurately identifying how risks intersect.

Specific Risks to Address in 2021

The impacts of the COVID-19 pandemic, political and economic instability, and racial and social justice events of 2020 continue into 2021. In light of the recent riot and attack on the U.S. Capitol, boards should be attentive to their political activity, political donations and lobbing activities. Moreover, boards should focus on the following risks, each of which closely overlaps with (a) corporate purpose, strategy and culture, (b) ESG, (c) stakeholder governance and activism, (d) political and regulatory changes, (e) business accountability and (f) board composition and succession planning.[2]

Diversity and Inclusion[3]

As companies learned from the #MeToo and gender-diversity movements, "tone at the top" is critical, especially with respect to diversity and inclusion (D&I). Companies should be cognizant of the internal and external risks associated with D&I matters, which are not solely limited to recruitment and retention of diverse talent. Given the potential virality of social media and the 24-hour news cycle, one small misstep can spell both PR and economic stress for a company. Companies are now evaluated by consumers not solely with respect to the utility of their product, but also with respect to their messaging and actions. Boards are increasingly expected to set the tone at the top by prioritizing policies that increase D&I at their companies and should thoroughly consider how action (or inaction) on D&I will be perceived by internal and external audiences. Examples include public pressure to discontinue use of racist sports team mascots (e.g., the Washington Football Team) and consumer boycotts of businesses that failed to express support for the Black Lives Matter movement or prohibited employees from wearing associated paraphernalia. Failure to address D&I risks could lead to damage to brand value, loss of confidence from institutional investors, increased shareholder activism, disillusionment of employees and consumer boycotts or protests.

To mitigate D&I risks, boards must establish D&I as a critical component of a business's culture—simply hiring a diversity officer and mandating diversity trainings are no longer sufficient to avoid public scrutiny. Boards should also take an intersectional approach by addressing all aspects of D&I and not emphasizing some over others. For example, recent studies (including PwC's 2020 Annual Corporate Directors Survey) indicate that boards tend to value gender diversity over racial/ethnic diversity in the context of adding value to corporate strategy and risk oversight[4], which could result in blind spots that inadvertently and unnecessarily risk damage to brand value. Additionally, risk oversight bodies should assess whether current company leadership has the requisite expertise, availability and range of experiences to provide effective day-to-day oversight of enterprise risks. Crisis communications from leadership must demonstrate cultural competence to deliver informed and genuine messaging to a variety of constituents, including stockholders, customers and employees.

Internally, boards should work with management to:

- Decentralize implementation of D&I initiatives to empower all employees.
- Prioritize wage, benefits and opportunity equity through elimination of discriminatory practices in the hiring, pay and promotion of diverse talent.
- Strengthen the recruitment, retention, training and promotion of diverse talent.
- Reject consulting firms that offer generic, one-size-fits-all D&I programming that does not provide tools to achieve greater equity.

Externally, boards should prioritize:

2. Please see the following Top 10 articles: 2020 Election Impact and Anticipated Changes; Environmental, Social and Governance and Board Diversity for further discussion
3. See Top 10 article Diversity and Inclusion for further discussion.

4. 71 percent of respondents agreed that gender diversity on the board improves strategy/risk oversight, while only 34 percent believe racial/ethnic diversity is very important to a board's composition. To access the full 2020 Annual Corporate Directors Survey please see: https://www.pwc.com/us/en/services/governance-insights-center/library/annual-corporate-directors-survey.html

- Creating feedback loops and metrics from customers and employees to capture pressing issues and better understand impacts on different communities.
- Expanding business ventures with minority-owned businesses, including by diversifying supply chains to create more opportunities for minority-owned businesses.
- Publicly sharing quantitative and qualitative milestones with respect to D&I.
- Reimagining marketing and sales to reflect intersectionality.

Working Remotely and the COVID-19 Pandemic[5]

The sudden pivot to virtual work environments introduced long-term effects on business needs, work preferences and human capital. With employees more dispersed and, in some cases, moving to less-populated areas, businesses are grappling with balancing the health and safety of their employees with the growing trends of, and dependence on, working-from-home and virtual work. To mitigate risks associated with working remotely, risk committees should work with management to oversee employee health and safety, virtual private network configurations, cybersecurity, privacy, communications and other workforce management issues.

These trends also impact risk oversight bodies' ability to maintain an understanding of and oversee existing compliance culture, policies, controls and procedures to identify, prioritize, manage and mitigate risks and regularly reevaluate their alignment with key compliance risks facing the company. Maintaining such an understanding in a remote work environment may be more challenging than usual; boards should therefore be that much more proactive in liaising with management to maintain a regular and timely flow of accurate information to the board and its risk oversight body to facilitate informed judgments concerning the company's compliance with laws and oversight of risk.

Risk oversight bodies should also review and confirm the accuracy of the company's public disclosures in light of not only the COVID-19 pandemic, but also the shift to remote and virtual work (e.g., updating risk factors, withdrawing or modifying earnings guidance and revising management discussion and analysis and financial statements). It is important that leadership also benchmark those disclosures with similar disclosures made by peers and competitors. Further, risk oversight bodies can demonstrate their diligent efforts to oversee risks associated with the shift to working-from-home by ensuring that board and committee agendas, minutes and meeting materials reflect discussions on compliance issues with respect to ongoing oversight of a remote workforce, periodic reviews of risks associated with remote/virtual work and deeper dives into special situations that arise as a result of working remotely. It appears that the remote/virtual work environment is here to stay; as such, risk oversight bodies should be prepared to navigate the challenges of identifying and mitigating risks associated with an ever-increasing remote workforce.

Cybersecurity, Technology and Artificial Intelligence[6]

Cybersecurity and technological advancements (including artificial intelligence) will continue to present risks (and opportunities) to businesses in 2021. While cyberattacks have been flagged as a key "concerning risk" for doing business globally in the coming decade, the COVID-19 pandemic seemingly coincided with increased cyberattacks, presenting significant challenges and risks as the shift to working-from-home exploded.

Moving forward, boards must balance the faster speeds of decision-making by automated processes, with the increased vulnerability to cybercrime. Boards should consider significant investments in R&D, capital assets and employee training, especially when using third-party technology or suppliers. With increased attention from international regulators and oversight authorities, boards should also consider cybersecurity risks and risk-mitigation programs, cyber-attack disclosures, data and system testing procedures and cyber incident response plans. Notably, the views of the audit, compliance, human resources, information technology, legal, public affairs and risk management departments should all be discussed with leadership to assess whether the company reacts appropriately.

5. See Top 10 article COVID-19: Labor Implications for further discussion.

6. See Top 10 article Privacy and Cybersecurity for further discussion.

Additional Guidance

A robust risk oversight framework should take into account the interconnectedness of social, health and environmental issues; disruptive technology; changing regulations; and a fluctuating economy. Further, boards and their risk oversight committees should regularly discuss both strategic goals and benchmarks with management, including:

- Solidifying business risk-mitigation plans related to health and safety, financial, operational and compliance issues and updating the company's risk-management programs and activities as necessary.
- Guaranteeing timely and accurate dataflow to leadership in order to ensure that business judgments about "mission critical" risks are well informed and in compliance with laws.
- Assessing whether current leadership has the requisite expertise, availability and complementing backgrounds to provide effective oversight of the company's risks.

Conclusion

The winners of 2020 were those boards and organizations that quickly adapted to changing conditions and timely addressed myriad risks that arose throughout the year. In 2021, boards should remain focused on business continuity and opportunities, while minimizing risks through the exercise of broad and effective oversight. Where the board does not currently delegate the risk oversight function to a separate committee (either stand-alone or part of the audit committee), serious consideration should be given to whether directors are best positioned to execute their fiduciary duty of overseeing the wide range of possible risks facing the modern corporate enterprise.

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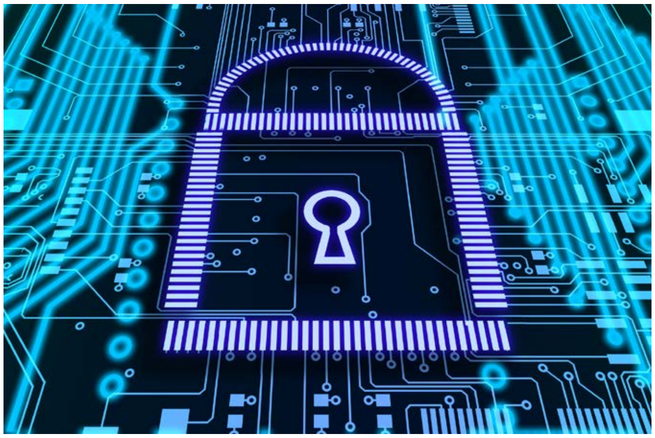
8. Privacy and Cybersecurity



As data takes on a transformational role for businesses, boards of directors must treat data privacy and cybersecurity as top priorities.

State and Federal Privacy Regulation

The one constant in privacy legislation in the United States is change. In its first year of enforcement, the California Consumer Privacy Act (CCPA) shaped a new phase of privacy compliance. Plaintiffs filed more than 60 CCPA class actions, and the California attorney general issued compliance warnings to countless companies, in part based on consumer complaints on social media that tagged the attorney general.

But just as companies began to get comfortable with CCPA requirements, Californians voted in favor of a ballot proposition—the California Privacy Rights Act (CPRA)—that draws California closer to European data privacy requirements. The CPRA extends privacy requirements by, for example, providing new rights for consumers related to "sensitive personal information" and creating the nation's first independent state privacy enforcement agency, the California Privacy Protection Agency.

As companies emerge from a year of forced transformation due to the COVID-19 pandemic, state legislators seem anxious to pass new privacy legislation, with New York, Washington and Minnesota already introducing new legislation. The federal government continues to debate dozens of privacy bills, with many anticipating that the Biden administration will increase efforts to develop a national standard around privacy.

Privacy compliance, including CPRA, will require significant organizational efforts, so companies should start now to assess the steps they need to take for compliance.

Biometric Privacy

Biometric privacy violations are a big-ticket risk point. If your company uses any type of biometrics—from fingerprints for clocking in to facial recognition for security—it likely has a target on its back. Biometric litigation has exploded around the country, as have state, local and federal regulations governing the use and sharing of biometric data. The Illinois Biometric Information Privacy Act (BIPA), for example, has served as the basis for settlements valued at more than a half a billion dollars.

The Federal Trade Commission has even required companies to delete the user content and also the algorithms and models developed using improperly obtained user content. Directors should be aware of whether their company collects biometric information and, if so, how it is used, shared and ultimately destroyed or face the risk that some of its most important intellectual property will be lost.

European Privacy & Cybersecurity

After years of allowing companies to develop General Data Protection Regulation (GDPR) compliance programs, European regulators levied total fines exceeding €170 million in 2020, including data breach settlements with British Airways and Marriott. Even though most of these fines seem slight compared to their U.S. equivalents, it is clear that the regulators are willing to impose significant penalties for noncompliance.

Europe continued to raise the stakes for international data transfers with its decision in *Schrems II*, where it invalidated the EU-U.S. Privacy Shield, putting a cloud over data transfers between Europe and the United States. In response, the European Data Protection Board recently issued draft recommendations on data transfers, proposing that companies adopt supplementary measures (contractual, technical and/or organizational) to protect data in addition to the standard contractual clauses (SCC). Directors should ask probing questions about what the company's data flows are and if their data crosses international boundaries—it could lead to significant fines if data sharing and data protection agreements are not adopted.

Mandatory Cybersecurity Requirements

Cybersecurity legislation, setting black-and-white standards for minimum cybersecurity protections, is fast replacing the old approach of voluntary compliance with recommended cybersecurity standards. Congress recently passed legislation—the IoT Cybersecurity Improvement Act of 2020—requiring minimum cybersecurity standards for Internet of Things (IoT) devices owned or used by the federal government.

Cybersecurity exploits continued in 2020, with business email compromise and wire transfer fraud becoming an endemic threat to businesses and remote work resulting in increased cyber risk. But the surprise of the year came from the supply chain hack related to Solar Winds' Orion software. Threat actors from Russia infiltrated Solar Winds and managed to embed malware in Solar Winds' software update, resulting in thousands of companies leaving a backdoor for Russian cybercriminals. This widespread supply chain criminal cyberattack revealed what many have been warning about for years: The current interrelated supply chain network can be a significant weakness if not properly managed.

Directors should insist on regular cybersecurity updates to ensure that management is constantly assessing cyber risk, responding to risks unique to the industry and allocating appropriate resources to protect against intrusion.

Privilege Protection for Data Breach Reports

Last year highlighted prominent decisions regarding privilege in cybersecurity investigations. The federal court in the *Capital One Customer Data Security Breach Litigation* held that privilege did not apply to one forensic report but did apply to another forensic report, providing a roadmap for how to protect and lose privilege.

The board should be mindful to protect the privilege of the cybersecurity forensic report. If properly conducted, the data breach investigation can be a privileged investigation, with lawyers retaining the forensic experts in order to assist with their legal analysis regarding notification obligations and to analyze any other legal obligations that flow from the breach. Unfortunately, if the report is not treated as confidential, but, instead, disseminated to auditors, insurers and others, some courts have held that the report—which is often used by plaintiff lawyers as a roadmap of information security failures—is not privileged. The board should carefully consider whether and how a report from a privileged investigation is shared with the board.

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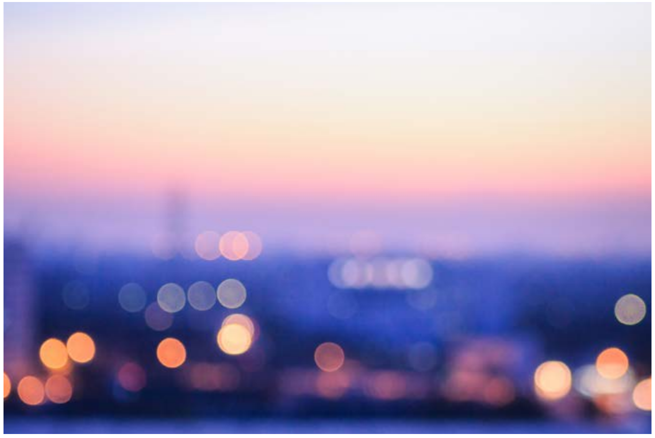
9. Trade Considerations



Supply Chain Domestication

Last year brought an intense focus on the limitations of domestic supply chains as exacerbated by COVID-19 and notable breaches of cybersecurity by foreign nations. From stark shortages in U.S.-made supplies of personal protective equipment, ventilators and certain pharmaceuticals to the abrupt shutdown of the Chinese consulate in Houston related to allegations of spying and theft of intellectual property, 2020 highlighted significant shortfalls in the domestic supply chain and the protection of domestic assets and resources.

Looking to 2021, directors should expect a continued focus on the removal of Chinese technology from the supply chain of U.S. companies and government agencies and on Buy American-type preferences, investment incentives/funding for domestic production and a continued hardening of U.S. information technology assets.

Removal of Chinese Technology

The federal government will continue to move forward in two critical areas related to Chinese technology: (i) the rigorous enforcement of Section 889 of the National Defense Authorization Act for Fiscal Year 2019, which generally prohibits all federal contractors (among others) from providing or using equipment, systems or services produced by certain named Chinese entities (e.g., Huawei); and (ii) the prohibition on the use of Chinese technology in the U.S. bulk-power systems (i.e., the electrical grid).

Section 889

With Congress intent on protecting national security from alleged Chinese spying efforts and the continued theft of U.S. intellectual property, no pullback is expected related to the Section 889 prohibitions. Companies can expect continued demands to remove covered Chinese telecommunications and video surveillance equipment and services from the U.S. government's supply chain with only limited waivers available from the Director of National Intelligence and individual U.S. government agencies. To the extent that a company supplies any products or services to a U.S. federal government end user, it should thoroughly understand the applicability, requirements and enforcement of Section 889 and its implementing regulations.

Bulk Power Executive Order

On January 16, 2021, the Department of Energy's prohibitions under the "Securing the U.S. Bulk-Power System" executive order took effect. Last year, using the International Emergency Economic Powers Act, the President severely restricted transactions (including the installation of equipment or associated technology) related to certain equipment manufactured or supplied by persons owned by, controlled by, or subject to the jurisdiction or direction of the government of, the People's Republic of China. Entities supplying electricity to U.S. "critical defense facilities" are the first to be affected, with certifications of compliance due to the Department of Energy by March 17, 2021.

New Cybersecurity Requirements for Department of Defense Prime Contractors and Subcontractors

After years of scrutiny and concern about the protection of controlled but unclassified information by contractors and subcontractors to the U.S. Department of Defense (DoD), on November 30, 2020, DoD released new and extensive requirements for the security of contractor information systems. Every prime contractor and subcontractor (at every tier) to the DoD that receives or will receive controlled unclassified information is now required to complete and submit a "basic" self-assessment of compliance with security requirements outlined in National Institute of Standards and Technology Special Publication 800-171, "Protecting Controlled Unclassified Information in Nonfederal Information Systems and Organizations." DoD will use the new assessments system to demand increased cybersecurity among the defense industrial base. DoD will also move forward with "pilot" contracts under a more-rigorous Cybersecurity Maturity Model Certification (CMMC), which will require independent third-party assessments and, with some exceptions, will extend to all DoD contractors by 2026. Directors should anticipate that DoD will, ultimately, create a leading model for the protection of information, and that other departments and agencies may replicate CMMC.

United Kingdom National Security and Investment Bill

The U.K. is one of the only major Western economies not having an existing stand-alone foreign direct investment regime. That, however, is set to change. The U.K.'s long-awaited National Security and Investment Bill ("Bill") was introduced in Parliament on November 11, 2020. The Bill empowers the Secretary of State (SoS) to review a broader range of investments in the U.K. on national security grounds, replacing the existing public interest regime as it pertains to national security interests.

The scope of the Bill is even broader than other regimes, including CFIUS (Committee on Foreign Investment in the U.S.). The regime applies to all investors, foreign and domestic, and extends not only to investments in U.K. companies and assets, but also to foreign companies and assets that carry on activities or supply goods/services in the U.K., with no minimum target turnover or market share thresholds.

The Bill will be an important consideration for current and future investment and will need to be factored into deal feasibility, contractual conditionality and transaction timetables.

Regime overview

The Bill provides for a hybrid system consisting of a mandatory pre-closing notification obligation accompanied by a "call-in" mechanism enabling the government to review transactions that fall outside the mandatory notification regime but nevertheless may present national security concerns.

A notification must be made to, and clearance obtained from, the SoS prior to the closing of an acquisition of 15 percent or more of the shares or voting rights of a company that is active in one or more of the following 17 specified sectors: civil nuclear; communications; data infrastructure; defense; energy; transport; artificial intelligence; autonomous robotics; computing hardware; cryptographic authentication; advanced materials; quantum technologies; engineering biology; critical suppliers to government; critical suppliers to the emergency services; military or dual-use technologies; and satellite and space technologies. These sectors were initially drafted broadly, but their exact scope is not yet set in stone; the definitions are expected to be refined following the government's consultation on the definitions, which closed on January 6, 2021. The sectors remain subject to constant review, at least every five years, after the Bill comes into effect.

The government's call-in power is far-reaching. It enables the government to review qualifying acquisitions, including material increases in shareholding or voting rights, and acquisitions of material influence over companies active in any sector up to six months from when the government is deemed to have become aware of the investment (e.g., via a press release) (five years otherwise) where the transaction presents national security concerns. "National security" is not defined by the Bill, but will be guided by a Statement of Policy Intent, which will be updated from time to time. The government is also able to call in and review acquisitions of control over assets (including land and intellectual property). As such, the new regime may not only impact mergers and acquisitions, but also certain financing arrangements, licensing or transfer of IP and real estate deals or other asset transactions. In addition, the government will have retroactive powers to review qualifying transactions that closed between November 12, 2020 and the commencement of the regime.

Mitigating uncertainty

Given the breadth of the regime and ambiguity concerning the concept of national security, parties will likely want to mitigate any uncertainty surrounding the potential impact of the Bill on deal timetables, structure and feasibility. Investors and sellers can gain greater certainty on how the new regime will likely apply to their transaction through proactive, early engagement with the new Investment Security Unit (part of the Department of Business, Energy and Industry Strategy (BEIS)). Even where the parties do not engage in discussions with BEIS, they are nevertheless encouraged to make the SoS aware of the transaction, thus reducing the retrospective call-in power to six months.

For transactions that fall outside the scope of the mandatory regime or were concluded prior to the commencement of the Bill, the parties may wish to make a voluntary notification to BEIS if they are concerned that the transaction may be called in. This puts the SoS "on the clock" to review the transaction and entitles the parties to receive a binding decision on whether or not the SoS will call in the transaction. Proceeding with completion of such transactions, without having contacted BEIS or voluntarily notifying, risks the transaction nevertheless being called in, at which point an interim order could be imposed to prevent further integration and, ultimately, (in a worst-case scenario) remedies could be imposed requiring an unwinding of the transaction. Complementary regulations can extend the scope of the mandatory regime to also include certain asset transactions (currently not subject to the mandatory regime).

Impact on deal timelines

Parties may want to factor the review process into the deal timetable and longstop date, particularly where the transaction falls within the mandatory notification regime and cannot be closed without obtaining prior clearance. Once an acceptable notification has been made to BEIS, the SoS has 30 working days to decide whether or not to call in the transaction. If a transaction is called in (either following a notification or of the SoS's own volition), the review process consists of an "initial period" of 30 working days, extendable by an "additional period" of 45 working days and further by a "voluntary period" as agreed between the SoS and acquirer. The government expects, however, that, in the majority of cases, the initial period will allow for a full assessment and for the SoS to decide whether to clear the transaction or impose remedies.

Remedies and deal structure

Although the government anticipates that only 1 percent or fewer of all filings each year would be subject to remedies, the government has a broad range of remedies at its disposal, ranging from behavioral to a full unwinding of the transaction. Parties may, therefore, want to proactively consider early on the acceptability of potential remedies and the impact of such remedies on deal rationale and feasibility, particularly following discussions with BEIS. Parties may also consider whether to preempt, through contract conditionality and pre-transaction structuring, the potential for the finding of national security concerns and the imposition of remedies. For example, acquirers could consider the extent to which their existing investment structure and documentation could be revised to reduce regulatory risk, such as by ring-fencing investor access to sensitive information or modifying investor rights.

Parties should not expect to have much influence over remedies; by contrast to the merger remedies process before the Competition and Market Authority, the parties will be involved in the process, but the government has stated that it will make a deliberate and formal decision on the remedies it believes are required.

Sanctions for noncompliance

Penalties for noncompliance are severe. In addition to the risk of the transaction being void if completed before obtaining clearance, noncompliance may result in fines of up to 5 percent of worldwide turnover or £10 million (whichever is the greater), imprisonment of up to five years and director disqualification for up to 15 years.

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10. Investigations and Enforcement Trends

Preparing for Post-Pandemic Enforcement

The change in presidential administration, new leadership at federal regulatory agencies and disruption to the economy and business operations caused by the COVID-19 pandemic all point to a dynamic period for government investigations and enforcement. While the factors contributing to the 2008 financial crisis and the resulting economic volatility are different in nature from those of the COVID-19 recession and downturn, corporate boards should look to the pattern of enforcement and oversight following the 2008 financial crisis, and the bursting of the dot-com bubble in 2001, as indicative of the type of possible government investigations that we anticipate over the next few years.

Past is Prologue

Corporate boards should accept as fact that government investigations and enforcement will ramp up during and following the COVID-19 crisis.

In the recent past, economic downturns have prompted federal regulators and prosecutors to launch extensive investigations of the corporate conduct that played a role, or that the public perceived played a role, in causing or exacerbating the crisis. For example, in the early 2000s, investigations were launched by the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) of insider trading and accounting practices. Enron, WorldCom and AOL Time Warner, just to name a few, were the prime subjects of this heightened enforcement effort. During the fallout from the 2008 financial crisis, federal investigators trained their sights on the banks and financial firms who packaged, insured and sold mortgage securities to investors that failed to meet credit standards.

But these investigations were not limited to traditional federal and state law enforcement. Congress also got in the game after both crises. Multiple committees held dozens of public hearings, often with testimony from senior company executives and chief executive officers, both to determine the factors that led to the dot-com and the 2008 financial crises and to inform the legislation developed to address gaps in the law: the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Further, during the 2008 financial crisis, Congress created special oversight bodies, including a Special Inspector General for the Troubled Asset Relief Program (SIGTARP), to oversee federal funding provided to assist in recovery. The SIGTARP's entire mission was to audit and investigate those financial institutions that received federal assistance looking for any indicia of fraud or misconduct and referring subjects to law enforcement for prosecution.

One difference in the current financial market is that COVID-19 has caused significant disruption in certain sectors while other industries have boomed. Nevertheless, we expect that companies at either end of the spectrum will draw the attention of government investigators.

Why Do Market Downturns Prompt Enforcement Scrutiny?

A declining market and economic volatility can reveal certain business conduct and practices that a company would not have engaged in normally—exposing a company to a variety of risks, including criminal prosecution, civil litigation and shareholder suits.

For those companies that have suffered financially, a market downturn can result in investors seeking redemptions, either because the investors themselves need liquidity or because company performance is poor. Unexpected redemptions in a time of financial crisis can cause a run on funds. The collapse of the Madoff investment firm following the 2008 financial crisis is a chief example of this. In addition, in a weakened economy, fund managers may be tempted to exaggerate performance or investment returns or engage in valuation fraud in order to conceal the effect of the downturn on investments.

A declining economy can also reveal accounting issues if the company altered its financial statements in order to conceal its financial position. For WorldCom, which overbuilt its networks in an attempt to capitalize on the dot-com boom, the bursting of that bubble uncovered that the company had created billions of dollars in fraudulent balance sheet entries in an effort to hide its expenses. Similarly, before the 2001 dot-com bust, Enron had engaged in complex financial transactions tied to the company's stock price and taken on too much debt. Once the stock price collapsed that year, the company's accounting problems were exposed, and debt payments were accelerated—leading to the company's collapse and bankruptcy.

What Does This Mean for Enforcement in the Pandemic Environment?

The pandemic has caused fundamental changes in how companies do business. Some have been able to adjust and thrive, while others have struggled and been forced to lay off employees, assume additional debt or curtail operations. Due to the degree of volatility and dislocation in the market, and the over $3 trillion in pandemic relief that has been appropriated by Congress, companies should expect numerous investigations to be launched, both civil and criminal, by various federal regulatory agencies, the SEC and DOJ, and Congress.

Already, the SEC is paying increased attention to company disclosures. Companies should expect that the SEC will examine how COVID-19-related impacts are disclosed in filings. As in previous financial crises, accounting inquiries, in particular, will be a top priority for both the SEC and DOJ. A downturn might expose financial problems that a company was able to cover in a rising market—and regulators will review disclosures to determine whether a company's expenses and assets have been properly accounted for over time.

During the pandemic, as companies and the government have raced to develop new vaccines, therapeutics and products to assist in the response, information about the progress of these innovations and the likelihood of their success has been highly sought. In this environment, companies must ensure that confidential information is highly protected, as the SEC is likely to closely focus on insider-trading issues.

Frauds are an evergreen target for government investigators in economic downturns. Whether it is representations to potential investors regarding COVID-19-related products or services, or information and reports submitted to government contracting partners, companies should anticipate that prosecutors and regulators will scrutinize these documents for any false or inaccurate statements. Any company that has received government funding from the COVID-19 relief packages enacted over the last year or that has contracted with the federal government in any way with respect to the response should prepare for possible inquiries or audits from inspectors general, the Government Accountability Office and the oversight bodies created by the Coronavirus Aid, Relief and Economic Security (CARES) Act legislation last year, including the Special Inspector General for Pandemic Recovery, the Pandemic Response Accountability Committee and the Congressional Oversight Commission.

As with the 2001 and 2008 crises, congressional committees have already held a number of hearings and initiated investigations to examine the pandemic, receiving testimony and requesting information from private companies that played some role in the response. This oversight is expected to continue to be a top priority in the next two years as the new administration seeks to examine how the CARES Act legislation has been implemented and whether the funds appropriated by Congress have been spent the way Congress intended or whether companies contracting with the government have engaged in fraud, waste or abuse, and to lay the foundation for further legislative reforms.

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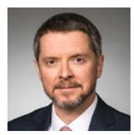

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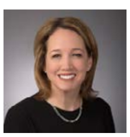

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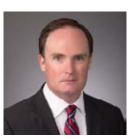

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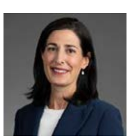

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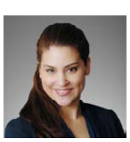

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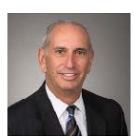

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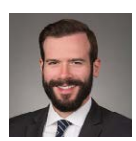

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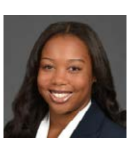

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