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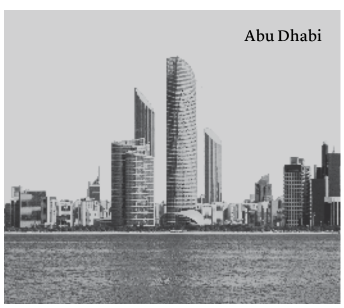
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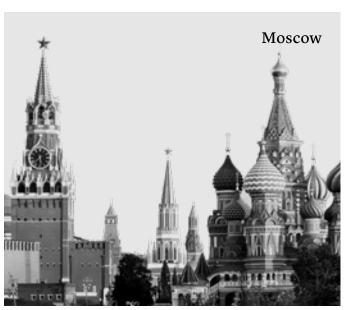
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Selected Issues for Boards of Directors in 2022

Each year, we ask colleagues from around our firm to boil down the issues in their fields that boards of directors will be facing in the coming year. In the following pages, we present the results for 2022 - focused updates on 16 topics that will feature on board agendas throughout the year.

The concerns and practices of public companies are evolving rapidly, driven in part by changing expectations on the part of institutional investors and other stakeholders, in part by cultural and political changes and in part by all the adaptations the pandemic has prompted. We explore this evolution from several different angles with respect to ESG and sustainability, shareholder engagement in general and activist practices in particular.

Other topics stem from the agendas of regulators. We discuss priorities of Biden administration appointees that have come into focus over the past year - notably in the areas of competition law, securities regulation and sanctions practices - but there are longer-term developments at work as well, in areas like international coordination of tax policy. European regulatory developments are also increasingly driving board agendas, in areas like privacy, competition and sustainability. In all these areas, enforcement risk is on the rise and board supervision is more critical than ever.

We hope you will find these materials helpful as you confront the challenges of 2022.

EDITORS

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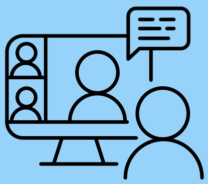

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Almost two years into the COVID-19 pandemic, it is clear that the corporate workplace has changed for good. As the world continues to reopen and companies return to the office, what we are returning to is not business as usual, but a new future of work – a future characterized by a shift from the traditional workplace to remote and hybrid models that provide opportunities to work in effective and efficient ways from anywhere. Companies are faced with challenges as they return to the office and are finding they need to adapt to remain competitive, attract talent and stay prepared for future crises. Boards of directors of public companies should play an important role in defining what this future looks like and ensuring companies are set up for success.

The initial response to COVID-19 taught public company boardrooms important lessons on adaptability and resilience. The rapid spread of the virus and the enactment of lockdown measures meant that directors had no choice but to operate remotely as they worked with management to ensure business continuity in light of the unprecedented challenges companies were facing, from liquidity to operational risks and more. Boardrooms quickly gave way to Zoom rooms as directors got up to speed with the remote work technology and implemented new structures and processes designed to increase corporate resilience.

According to a global survey of over 800 directors and executives by McKinsey & Company, since the beginning of the pandemic, structural and process changes enacted by boards include investing in technology and/or tools to enable more digital collaboration, increasing flexibility in meeting agendas, establishing ad hoc crisis-management committees, adopting new crisis-management processes, evaluating the board's demographic and/or geographic diversity and increasing the frequency of interactions between the board and management in between meetings, thereby increasing collaboration between management and the board.[1]

[1] McKinsey & Company, "How boards have risen to the COVID-19 challenge, and what's next" (April 29, 2021), available here.

Meeting virtually through the initial phases of the pandemic not only made directors more efficient in terms of real-time crisis management, but proved that remote work would be a useful tool for directors in overseeing and collaborating with management going forward.

After getting through the initial hurdles and repeated exclamations of "You're on mute!," it sank in that the future of work, including for boards of directors, would be transformed into a hybrid in-person and virtual approach. Meeting virtually through the initial phases of the pandemic not only made directors more efficient in terms of real-time crisis management, but proved that remote work would be a useful tool for directors in overseeing and collaborating with management going forward. Virtual boardrooms can increase directors' level of involvement, enhance their collaboration with management and provide several overall benefits:

— **Increased attendance and reduced travel** – flexibility in scheduling meetings and reduced need for travel makes it easier to increase attendance at board meetings, while leading to associated cost savings for the company and a reduced carbon footprint.

— **Shorter agendas and crisper presentations** – the ability to schedule shorter and more frequent meetings allows for agendas to be more compact and address specific issues.

— **More inclusive and focused conversations** – alongside shorter agendas, meetings can be more direct and focused, with both full board and committee meetings able to address individual topics on a more timely basis.

— **Broader exposure to key executives and experts** – meeting virtually makes it easier to bring in more members of management beyond the C-suite, providing directors with greater exposure to executives; it also allows for experts to be brought in more easily to give directors detailed information and provide the opportunity to ask questions directly.

While there are clear benefits to the virtual boardroom, unique challenges also arise. As directors navigate the future of work, they should consider the potential drawbacks that may come with an overreliance on the virtual approach and how this can affect the exercise of their duties. Directors owe the corporation a duty of care that requires them to inform themselves of all material information available prior to making a decision and to exercise reasonable care. In addition, the duty of loyalty requires directors to act in good faith and make decisions in the best interest of the corporation rather than for personal benefit. In a fully remote environment, it may be more difficult for directors to stay engaged or foster the relationships among themselves and with management that are necessary to develop a strong corporate culture and effectively collaborate. It may also be more difficult for directors to maintain their duty of confidentiality, as virtual platforms could be exposed to cybersecurity breaches. Directors should keep these duties in mind as they continue to use the virtual tools at their disposal.

Given these pros and cons, the boardroom's future is likely not in either extreme, but in a hybrid approach that combines aspects of virtual and in-person meetings. Hybrid meetings come in different shapes and sizes, and boards should consider the particular advantages and disadvantages of different models.

One hybrid approach is combining in-person and virtual attendance, with some directors meeting in person and others joining remotely. This approach allows for directors in the room to build personal relationships without sacrificing attendance, as directors unable to travel can join the meeting remotely. Challenges include leveling the playing field and ensuring that virtual members remain engaged and actively participate in the conversation, as it can be difficult to manage the dynamics between those in person and those on screen. Minimizing technology issues and ensuring the proper setup can help overcome these challenges. For example, establishing clear communication protocols and providing individual cameras and microphones for those directors who are attending in person can help create a more inclusive environment for those attending virtually and lead to more productive conversations.

Another hybrid approach involves having a certain number of in-person meetings per year, with the rest held virtually. Complex or more strategic discussions can be saved for in-person meetings, while issues that are dealt with on a regular basis or more time-sensitive matters that would have otherwise been dealt with telephonically can be the focus of virtual meetings. This approach puts all directors on the same playing field and saves the more important strategic discussions for the face-to-face encounters that more clearly benefit from personal interaction. However, it can also highlight some of the drawbacks of meeting in person, such as increased costs, lower attendance and potential health concerns.

In either scenario, companies with hybrid meetings should be mindful of how their director attendance policy defines "attendance" and ensure that remote meeting attendance fulfills the requirements of the policy. If directors choose the hybrid approach of having a number of meetings in person per year, in-person attendance at those meetings should be strongly encouraged. Companies should also consider disclosing whether board meetings were fully remote or hybrid in their proxy statements and measures taken to ensure directors remain engaged.

Boards can take several approaches to maximize engagement and efficiency in a virtual environment:

— **Maximize preparedness and discussion** – provide directors with detailed pre-work materials and use the meetings for actual discussion and debate rather than introducing and/or summarizing topics for the board.

— **Monitor engagement** – the Chair of the board or a specific committee should play an enhanced role in guiding the conversation and ensuring that all board members are focused and participating. Consider using virtual tools (breakout rooms, polls, chat boxes) to increase participation.

— **Focus on timing** – consider scheduling shorter and more frequent meetings or breaking up sessions to have targeted, topic-driven discussions instead of potentially drawn-out or all-day meetings.

— **Manage technology** – establish a communications protocol and ensure the platforms used for meeting remotely work properly and are secure; provide directors with clear instructions and IT assistance in case of technical challenges.

— **Recreate the in-person experience** – organize social events outside meetings to the extent possible, to recreate the in-person dynamic and relationship building that may be lost in the virtual environment.

Regardless of the specific approach boards take towards their own operations in a hybrid environment, it is crucial that boards build on the lessons from the pandemic on risk oversight and preparedness. An effective board is an informed board, and directors should understand the entire ecosystem in which their companies operate and the interconnection between different risks and the strategies developed to address them, particularly when it comes to risks arising from how business operations are changing with the future of work in the form of hybrid-based models.

As companies adapt and make changes to business operations, it is important to ensure there are robust reporting systems and controls in place to keep the board informed of key developments, including plans for reopening and returning to traditional work environments, creating new opportunities for remote and hybrid work, adopting effective communication strategies and developing and implementing communicable disease policies to mitigate the legal risks associated with returning to the office in the current environment. Boards should exercise their core oversight and risk-management duties through thorough discussions and ensuring decisions and actions are properly recorded in the board's minutes and records to help mitigate risks of potential *Caremark* claims.

Aside from developing ways to maximize the benefits of remote and hybrid work for directors themselves, boards should play a role in working with management to clearly define return to office strategies that properly account for the importance of workplace culture and are flexible toward the future of work.

How companies approach returning to the office and adapting to the future of work can have long-lasting impacts. Aside from developing ways to maximize the benefits of remote and hybrid work for directors themselves, boards should play a role in working with management to clearly define return to office strategies that properly account for the importance of workplace culture and are flexible toward the future of work. This process will require that directors make sure they fully understand the risks involved in operating in the current environment, from the increased cybersecurity risks associated with the infrastructure supporting remote work to the growing supply-chain and resource management issues associated with the continuation of the pandemic, emergence of new virus variants and employee burnout. Directors should more closely oversee talent management and human capital policies to ensure that corporate culture in the post-pandemic era is strengthened by the lessons learned from the pandemic, with an increased focus on the creation of long-term value.

2022 Shareholder Engagement Trends and Considerations: ESG and Investor Outreach

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As ESG remains a mainstay of board and investor focus, effective shareholder engagement is as important as ever, and as complex as ever, for ensuring that companies have the external support necessary to advance their long-term strategy. Failure to manage shareholder engagement could result in a company losing majority support on a shareholder proposal, having low director support or even losing a proxy battle.

An Edelman survey of 700 global institutional investors revealed that 88% of investors polled indicated that they subject ESG data to the same scrutiny as operational and financial considerations, while 82% of those polled believe that companies frequently overstate or exaggerate their ESG progress when disclosing results.[1] In order to promote a successful ESG agenda, boards may need to acknowledge investors' skepticism of current ESG disclosure and accede to their demand for standardized transparency, a demand the SEC itself is expected to embrace in forthcoming mandatory ESG disclosure rules.

In a similar vein, given that smaller institutional investors and activists have made clear that ESG engagement is a priority, boards would do well to reevaluate their criterion for investor outreach – and look beyond just the top 20 largest shareholders to establish and cultivate ongoing relationships with a broader group of shareholders in an effort to anticipate specific proxy season concerns.

Below, we discuss considerations for companies and their board members in crafting and executing an effective strategy for investor outreach and communication during both the proxy season and the off-season, with a particular focus on navigating shareholders' interest in ESG initiatives and developments.

[1] Edelman, "2021 Trust Barometer Special Report: Institutional Investors" (November 17, 2021), available here.

Considerations for the 2022 Proxy Season

In preparation for the 2022 proxy season and engagement with shareholders, companies and boards should consider the following in developing a strategy for engaging with shareholders and communicating with other stakeholders.

Strategize on Long-Term Plan

— Consider and be ready to discuss how key ESG and sustainability topics that are salient to the company and the industry relate to the company's long-term plan. In PwC's 2021 Annual Corporate Directors Survey, 64% of directors surveyed said ESG is linked to their company's long-term strategy, but only 25% think their board understands ESG risks very well.[2] Know who at the company is most knowledgeable and best positioned to respond to substantive requests from shareholders on ESG hot topics, and prepare them for more external-facing exposure if needed.

A unified and consistent message with robust shareholder communication builds support for the company's long-term plan.

— Consider not just the risks that ESG-related issues present to the company's operations but also potential opportunities that ESG goal-setting can present to the business. Consider opportunities where meeting sustainability targets will also contribute to increasing efficiencies or decreasing expenses, and be prepared to communicate these opportunities both externally to investors and internally to employees.

— Ensure there is consistent messaging among all constituencies (*e.g.*, investors, employees, customers and suppliers) as well as across all channels of communication including securities filings, sustainability or other ESG reports and the corporate website. A unified and consistent message with robust shareholder communication builds support for the company's long-term plan.

— Identify specific, quantifiable ESG-related measures that are aligned with the company's corporate purpose and culture, and be prepared to demonstrate how these measures inform the company's plans for growth and financial performance.

Know Your Investors

Reevaluate shareholder outreach priorities. Continue to pay particular attention to the company's largest shareholders and key stakeholders for regular outreach, but given the rise to prominence of smaller activist investors on ESG campaigns, consider broadening outreach efforts.

— Review investors' stock holdings, published guidelines, policies, statements, voting history and involvement in campaigns for shareholder proposals, governance initiatives or activism, and focus on any recent adjustments, particularly with respect to ESG topics. Prepare to engage with investors on how the company is adapting to said adjustments and how key areas of focus for the investor fit into the company's long-term plan.

— Understand the roles of different stakeholders within institutional investors. If management and directors are engaging with the portfolio manager but have no relationship with the investment stewardship team, shareholder engagement becomes less effective in anticipating concerns that may lead to proxy voting concerns.

— Consider how institutional investors' policy changes may impact future shareholder voting. As BlackRock announced in late 2021, it will now give many of its institutional clients the ability to make their own voting decisions. While these investors likely have guidelines similar to BlackRock's own, any

[2] PwC "2021 Annual Corporate Directors Survey" (2021), available here.

differences should be areas of focus for companies in anticipating future voting trends.

Directors often view a shareholder proposal as a line of attack or an escalation tactic, but more and more investors think of submission of a shareholder proposal as another strategic approach to engagement.

— To the extent a company receives a shareholder proposal, keep an open mind. Directors often view a shareholder proposal as a line of attack or an escalation tactic, but more and more investors think of submission of a shareholder proposal as another strategic approach to engagement. Once an investor opens the line of communication with the company, the investor may be willing to discuss the issue and come to a resolution that results in a withdrawal of the proposal.

— If the company has received shareholder proposals from certain investors in the past or is aware that certain investors are known for submitting shareholder proposals, consider prioritizing shareholder engagement with those investors earlier in the season to gauge any particular concerns or objectives for this proxy season.

Review and Revise Disclosure

— Include voluntary disclosure regarding the company's shareholder engagement efforts, feedback received from shareholders and how the company responded. Many companies are providing this information in their proxy statements in the summary, corporate governance and executive compensation sections and it is an area of focus for some investors.

— Consider feedback from stakeholder engagement when creating and updating public information, including disclosure, presentations, websites, sustainability reports, CSR reports and other publicity vehicles, including social media. Address topics about which there are misunderstandings or controversies (whether raised by analysts, media or shareholders, or conveyed privately to the company), whether company- or industry-specific.

— Ensure that the board, management and other members of the company coordinate to maintain current and consistent disclosure and communication with investors and other stakeholders.

Focus on Key Topics

— In the absence of mandated ESG disclosure requirements, benchmark ESG-related governance and other practices against similarly situated issuers, including competitors, others in the sector or index and others in a specific investor's portfolio.

— Consider adding disclosure and reporting on key ESG-related concerns for investors, such as climate change and human capital management, that is consistent with existing frameworks and standards recommended by investors, such as the TCFD and SASB. Morrow Sodali's findings in its 2021 Institutional Investor Survey point to climate risk as investors' number one engagement priority, with human capital management a close second.[3]

— Consider whether to link executive compensation practices to ESG-related or other sustainability measures, and whether investors may expect companies in your industry to do so, either based on competitor practice or apparent company ties to climate risk (*e.g.*, oil and gas; transportation). If ESG measures have already been incorporated into executive compensation targets, continue to monitor progress throughout the year toward achieving these measures (similar to other financial and operational metrics).

[3] Morrow Sodali, "Institutional Investor Survey 2021" (May 11, 2021), available here.

— Board refreshment continues to be an area of investor focus with respect to corporate governance, and Nasdaq's and California's director diversity requirements reinforce a regulatory focus on board composition. Both ISS and Glass Lewis have also emphasized prioritizing racial/ethnic and gender diversity. For additional information, please *see* Diversity Issues Remain at Center Stage, and the Show is Just Getting Started in this memo.

Other Process Considerations for Engagement

— Determine who will be best-positioned to engage directly with investors on a particular topic or issue:

- Management participants usually include an IR officer and the CFO, the general counsel or corporate secretary to discuss governance items; the CEO if there are controversies in the market relating to strategic direction; and, in some cases, the heads of specific business units of interest. In light of increased interest in ESG-related issues, consider including the chief sustainability officer, if there is one. Prior to any engagement efforts, ensure that there is a record of refreshed Regulation FD training for management participants who will be regularly interfacing with stakeholders.

- Many large institutional investors, especially top shareholders, increasingly expect to be able to directly engage with directors, in particular on questions regarding strategy. Navigate the balance of director involvement in shareholder engagement with the board's relative expertise. For example, it is important to make sure that directors are not placed in situations where they are unable to adequately respond to particular investor concerns on the technical nuances of ESG developments. Instead, consider who in the company is best positioned to have conversations on ESG objectives. The chief sustainability officer or general counsel may be able to more effectively manage shareholder concerns on ESG progress.

- If director involvement is necessary, directors should be joined by a member of management familiar with the shareholder and trained on how to most effectively engage on these issues. Prepare directors for shareholder engagement with key talking points and potential topics that may run into securities law issues, including Regulation FD.

The Materiality Debate and ESG Disclosure: Investors May Have the Last Word

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In 2021, investors and regulators continued to focus on the scope and quality of public company disclosure of environmental, social and governance (ESG) information. In the background, the controversial debate intensified over whether ESG information, while of interest to many stakeholders, should be considered "material" for the purposes of the securities laws such that disclosure of inaccurate or misleading ESG information could be a basis for liability. Some commentators have recently defended the traditional view of financial materiality that focuses on the impact of disclosure on the economic value of a company, for which share price is often used as a proxy, whereas others have suggested a broader notion of materiality that would include any information investors decide is important to them.

While the debate rages on, however, market trends may well bypass the discussion altogether, with implications for risk assessment by boards and management. As ESG considerations become mainstream investment criteria for larger numbers of investors, the potential for ESG information to impact investment allocations (and therefore share price), and thus meet the traditional definition of financial materiality, increases significantly. If these trends continue into 2022 and beyond, public companies could face potential legal exposure concerning the accuracy of their voluntary ESG disclosure – even if the legal definition of materiality remains unchanged.

The Materiality Debate

ESG disclosure is on the rise. More investors are asking for it than ever before, an increasing number of companies are producing it voluntarily and the SEC is expected to require it in some form in the near future. Practitioners, scholars and regulators have not been shy in debating whether the emergence of ESG as a mainstream concern should impact the legal definition of materiality under the U.S. federal securities laws.

Some practitioners have defended the traditional view of financial materiality, arguing that ESG information should not be deemed to be material unless it directly impacts the company's economic valuation.[1] On the other hand, certain SEC commissioners have recently discussed materiality as a broader concept encompassing any information that investors ask for or deem important.[2] In Europe, the concept of "double materiality" has also been proposed, which would require companies to consider the impact of their activities on the environment and society, in addition to any impact on investors.[3]

In the meantime, regardless of which side of the debate prevails over time, changes in the practices of investors may be important for companies to consider as they continue to make materiality assessments with respect to their voluntary ESG disclosure.

Bypassing the Debate

The standard legal definition of materiality, which remains in effect today, is whether there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[4] The impact of any given piece of information on a company's stock price thus remains a key element of the materiality analysis under current law.[5] And yet, over the past few years, the scope of information that investors are calling for has expanded beyond purely financial information, as many investors are now using more and more ESG information to inform their valuation determinations and investment decisions.

Stakeholders at every level – investors, customers, suppliers, etc. – are increasingly incorporating ESG information into their business decisions. Climate change and environmental sustainability issues remain paramount, while social issues related to diversity and workplace culture continue to attract attention as well. What this means for companies is that more of their ESG information is likely to be "decision-useful" than ever before.

Materiality and Financial Performance

The most obvious way in which ESG information may become material is by having a direct and significant impact on a company's business performance and financial results. Some ESG-related issues have long fit this description, such as the regulatory and litigation risk associated with a company's environmental practices and disclosures. To give a dramatic example, the Deepwater Horizon oil spill resulted in enormous civil and criminal penalties to BP for gross negligence and willful misconduct in its practices leading up to the accident,[6] and BP also settled claims that it deceived shareholders about the severity of the spill.[7] It is not hard to see how the burden on management of defending lawsuits of this type, in addition to whatever settlement or penalty they may ultimately result in, could be viewed by the reasonable investor as having an impact on the valuation of the company and otherwise significantly altering the "total mix" of information made available about the company.

The point applies to social and governance issues as well. For example, shareholder lawsuits involving allegations relating to a "culture of harassment" in the workplace, and the role of senior executives in concealing it, have become increasingly common and have resulted in settlements that include both financial

[1] David A. Katz and Laura A. McIntosh, "Corporate Governance Update: 'Materiality' in America and Abroad" (April 29, 2021), available here.

[2] Chair Gary Gensler, "Testimony Before the United States House of Representatives Committee on Financial Services" (October 5, 2021), available here ;Commissioner Allison Herren Lee, "Living in a Material World: Myths and Misconceptions about 'Materiality'" (May 24, 2021), available here.

[3] *See* European Commission, "Proposal for a Corporate Sustainability Reporting Directive (CSRD)" (April 21, 2021), available here; *see also* European Commission "Non-Binding Guidelines on Non-Financial Reporting Update" (June 20, 2019), available here; and United Kingdom "Companies Act 2006" (August 12, 2017), available here.

[4] Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

[5] However, it is important to note that volatility of stock price, by itself, is typically considered insufficient for the relevant information to be deemed material. *See*, e.g., SEC Staff Accounting Bulletin "No. 99 – Materiality" (August 13, 1999), available here; *see also* ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co., 553 F.3d 187, 205 (2d Cir. 2009).

[6] Reuters, "BP Deepwater Horizon costs balloon to $65 billion" (January 16, 2018), available here.

[7] The Guardian, "BP to pay $175m to investors over Deepwater Horizon spill" (June 3, 2016), available here.

and governance-enhancement components.[8] While it may be unlikely that the legal definition of materiality in the United States will be modified in the near future to include impact on employees, the importance of these concerns *for investors* should not be underestimated.

The days in which investors could be satisfied with companies' generalized statements and commitments on ESG issues seem to be behind us – investors now often seek quantitative information about companies' goals and performance with respect to certain key ESG issues.

Materiality and Stock Price

Even when ESG information does not appear to directly impact a company's business results or financial performance, there are more subtle ways in which it could nonetheless be alleged to be material. Two related trends may increase the likelihood that ESG information will directly impact companies' stock prices in ways that have not previously been typical, which may strengthen arguments that such ESG information is material even under the existing legal definition of materiality:

1. In response to demand from investors, companies have started to produce ESG disclosure that is specific and concrete. The days in which investors could be satisfied with companies' generalized statements and commitments on ESG issues seem to be behind us – investors now often seek quantitative information about companies' goals and performance with respect to certain key ESG issues (*e.g.*, carbon emissions, board diversity, etc.).
2. As disclosure becomes more concrete, investors are increasingly making portfolio allocation decisions or creating investment guidelines based on ESG information that dictate trading and voting activity. Some of the biggest institutional investors like BlackRock and State Street have revised their proxy guidelines such that they will now typically vote against sitting directors on all-male boards, in an attempt to pressure companies to nominate women as directors.[9] And there are an increasing number of mutual funds and ETFs that use a variety of criteria to deploy capital toward companies that perform well in the categories of gender and diversity.[10] It is now conceivable that a company's stock could be immediately excluded from the portfolios of large funds or institutional investors – for no other reason than the company's failure to meet certain gender or diversity metrics. A drop in stock price for these reasons may be no less likely to attract the attention of enterprising plaintiff's attorneys.

This scenario, while hypothetical, introduces new considerations to the traditional discussions of materiality described above – without any change to the legal definition. In the past, it was more or less a safe assumption that investors bought and sold a company's stock based primarily on their assessment of its business outlook and prospects for financial performance. Thus, the disclosure of an ESG issue that did not impact financial results – *e.g.*, information concerning a company's environmental impact that did not result in any underlying regulatory exposure – was unlikely to have been seen as material. Today, the emergence of ESG as a basis for investor capital allocation calls that assumption into question.

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8 Reuters, "L Brands inks deal with shareholders to exit workplace harassment cases" (July 30, 2021), available here; Reuters, "Signet Jewelers in $240 million settlement over sexual harassment, loan portfolio" (March 26, 2020), available here.

9 Bloomberg, "How Boardroom Diversity Has Evolved in the #MeToo Era" (October 18, 2021), available here.

10 ETF Stream, "Gender equality ETFs in the spotlight for International Women's Day" (March 8, 2021), available here.

What matters, as always, is not simply whether the ESG information has an immediate impact on the company's business outlook, but whether it has a substantial likelihood of being viewed by the reasonable investor as having significantly altered the 'total mix' of information available about the company.

As more and more investors begin to make investment decisions based on ESG information that appears to have limited or no direct impact on a company's financial valuation, ESG information is more likely to be considered material even under the current legal definition of materiality. What matters, as always, is not simply whether the ESG information has an immediate impact on the company's business outlook, but whether it has a substantial likelihood of being viewed by the reasonable investor as having significantly altered the 'total mix' of information available about the company. As the concerns of investors continue to expand, though, the type of information that meets this standard can be expected to expand as well.

Conclusion

Boards and management of public companies should be mindful of these emerging trends as they evaluate their potential disclosures under the current materiality standard. Regardless of how the materiality debate plays out, these trends are already expanding the amount of ESG information that investors and courts may consider to be material.

If the ESG concerns of investors continue to cohere around specific and concrete criteria, the overlap between information that has an impact both on stock price and on society or the environment will continue to grow as well. A company can be proactive in this area by engaging key shareholders and becoming familiar with their main ESG priorities, paying particular attention to shareholder concerns about the company's:

— environmental impact and efforts to implement sustainable practices;

— supply chain management, including with respect to suppliers' environmental practices;

— treatment of employees, especially with respect to issues of diversity, equity and inclusion; and

— considerations toward customers and surrounding communities.

Regular shareholder engagement on ESG issues will allow companies to monitor these trends and be well-positioned to make informed assessments about the materiality of potential ESG disclosure. In turn, the level of freedom and boldness with which companies voluntarily disclose ESG information should be tempered to reflect these developments. And to the extent that the SEC mandates ESG disclosure in the future, the landscape of materiality assessments is likely to shift once again.

Public companies should think holistically about their ESG disclosure to balance investor wishes with sound risk assessment. ESG disclosure should be subject to the same rigorous review, including verification and disclosure controls, as other public disclosures in SEC filings.

Key Practices for Board Organization and Oversight of ESG

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Introduction

Robust interest in ESG-related matters and growing demands from shareholders, regulators and various other stakeholders during 2021 have put management and boards of public companies firmly on notice that strong ESG policies, practices and commitments are key components to long-term organizational success, business resiliency and value creation.

As the relevance of ESG continues to accelerate, boards need to examine whether they are keeping pace. A PwC survey from 2021 found that 47% of executives believed their boards lacked expertise in the ESG area.[1] A Willis Towers Watson survey of directors and executives from 2020 also found that while 78% of respondents believed that ESG is a key contributor to strong financial performance, only 48% believed they have incorporated these plans into all aspects of their company.[2] Moreover, stakes for failing to appropriately deal with ESG matters are getting higher. Investors are increasingly asking how boards are overseeing material risks, opportunities and reporting related to ESG and may bring litigation or engage in activism to hold companies accountable to public statements or if they think their boards are lagging behind.

Investors are increasingly asking how boards are overseeing material risks, opportunities and reporting related to ESG and may bring litigation or engage in activism to hold companies accountable to public statements or if they think their boards are lagging behind.

[1] PwC, "Board effectiveness: A survey of the C-suite" (November 2021), available here.

[2] Willis Towers Watson, "2020 ESG survey of board members and senior executives" (December 16, 2020), available here.

Accordingly, as ESG matters continue to gain in importance in 2022, boards should be prepared to navigate the developing ESG landscape, regulatory requirements and shareholder engagement and demands by critically evaluating their companies' organization and oversight around ESG and ensuring that they are well-positioned to engage and communicate on ESG matters. Below are key reminders for boards reflecting on ESG matters.

Assess ESG Drivers of Long-Term Strategy and Adoption of Meaningful and Realistic ESG Goals

Investors are increasingly looking for companies to be able to articulate and consider key material ESG risks and opportunities. In response, boards and management should take into account ESG factors when making decisions, especially those that could have a material reputational or financial impact on the company.[3] To do so boards should assess their ESG strategies, receive regular updates from management and other experts with respect to relevant ESG risks and opportunities and build ESG consideration and updates into the regular cadence of board meetings in order to drive an ESG-informed long-term strategy.

In addition, boards should understand management's decision making around performance indicators, targets and goals – why specific ESG metrics were chosen for tracking reporting and performance measures. Boards should review ESG metrics to ensure they are tailored and meaningful to the company and relevant to the board-developed strategy.

Implement a Tailored Oversight Organization

Boards should assess and consider revising their governance documents, including their corporate governance principles and board committee charters, in order to memorialize their commitments and responsibilities in relation to ESG and clarify which bodies have oversight over ESG matters. Taking such steps to clearly delineate each body's role with respect to ESG prevents responsibilities from getting lost in the absence of clear delegation and ensures regular inclusion of ESG matters on board and committee agendas. Boards should give consideration to their directors' strengths and experiences and their existing board/committee organization when considering the "right" framework for ESG oversight.

While there is no one-size-fits-all approach, thoughtful consideration of organization can help ensure that consistent and effective coordination exists among management and the board. In some cases, no committee is tasked with responsibility for certain areas; for example, cybersecurity and climate change risk sometimes fall to the whole board for consideration. In such situations, it is important to ensure those matters are regularly on meeting agendas, potentially through inclusion in corporate governance guidelines or specific board oversight guidelines.

We also note that some boards delegate full ESG oversight to the nominating and governance committee, often out of evolution from historical practice. While this can be a good fit for some companies, we recommend that boards reevaluate whether it remains the best solution given the pervasiveness and diversity of ESG considerations and the heightened focus of investors and other stakeholders.

Similarly, some companies may choose to form a standalone ESG or sustainability committee to supervise all matters relating to ESG. While support for a standalone ESG committee appears low among

[3] Materiality assessment may be based on financial analysis and investor interest for specific ESG matters. Reporting frameworks like SASB and TCFD are useful for consideration; for example, SASB has a Materiality Map (available here) that identifies, by industry, ESG issues that are most likely to affect the financial performance of a company. For additional details on materiality, *see* The Materiality Debate and ESG Disclosure: Investors May Have the Last Word in this memo.

directors[4] and only 11% of Fortune 100 companies currently have a dedicated sustainability committee to oversee corporate responsibility matters,[5] at least one study suggests that companies with a standalone ESG committee demonstrate better ESG performance than those where oversight is carried out by the full board or split among existing committees.[6] However, whether having a standalone ESG committee is beneficial would depend on the company's particular circumstances, including whether the company operates in a sector with heightened ESG risk and scrutiny.

Finally, as in other areas, boards should ensure that their ESG oversight includes a robust recordkeeping practice that will anticipate stockholder demands for books and records, potentially as a precursor to derivative complaints relating to ESG performance.

Establish a Strong Disclosure and Reporting Framework

Given the increased emphasis on disclosure and reporting, building an effective ESG reporting infrastructure is critical to effect accurate and relevant disclosure. In preparing relevant disclosure and assessing the impact of ESG factors on financial and other ESG reporting, whether it is within the periodic reports filed with the SEC or in a standalone report, boards should pay particular attention to the disclosure controls and procedures.

Companies should implement or maintain systems to ensure that ESG disclosures, whether available on company websites or contained in company filings with regulatory authorities, are assessed for accuracy, are not misleading and meet any regulatory requirements. The development of strong controls with established systems of assessment allows for rigorous review and vetting of material disclosures. According to a 2019 McKinsey study, 97% of investors want sustainability disclosures to be audited in some way and 67% believes that sustainability audits should be as rigorous as financial audits.[7] A 2021 survey also found that investors had significant reservations about the quality of ESG-related information contained in company disclosures.[8] While audit firms are beginning to prepare ESG review procedures, there has not been large-scale adoption of audit-type procedures for ESG disclosures. Notwithstanding the lack of formal audit, it is important that a company's internal procedures include robust review by various stakeholders, including controllers or internal audit, legal and sustainability departments and outside advisors, in similar fashion to periodic reports.

Conclusion

Investors are actively engaging with boards on their oversight of ESG and seeking transparency on the organization of a company's ESG review processes. Boards should spend time in 2022 assessing how ESG matters drive long-term strategy and planning, how management is using ESG performance indicators, metrics and goals to assess and move the business forward and how effectively the board's organization and oversight covers ESG risk, opportunity and disclosure. A focus on oversight and controls can help companies develop ESG metrics that effectively connect operations with the board's strategy and produce disclosure that is meaningful to investors and supported by reasonable grounds.

4 According to PwC's 2021 Corporate Directors Survey (available here), only 11% of directors believe that their board should have a standing committee dedicated to ESG issues.

5 EY, "What boards should know about ESG developments in the 2021 proxy season" (August 3, 2021), available here.

6 Morrow Sodali, "The Relationship Between ESG Oversight and Performance" (October 29, 2021), available here.

7 McKinsey Sustainability, "More than values: The value-based sustainability reporting that investors want" (August 7, 2019), available here.

8 PwC, "The economic realities of ESG" (October 28, 2021), available here.

Diversity Issues Remain at Center Stage, and the Show Is Just Getting Started

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Diversity, equity and inclusion (DE&I) has received unprecedented support in the past year, and trends show that it is here to stay at the forefront of focus areas for corporations and key stakeholders alike.

Some key 2021 highlights in the DE&I space include:

- Support for diversity and representation on boards has again made strides, building on the momentum from past years. 2021 saw a greater focus on racial diversity than gender diversity, and we expect this focus to continue in 2022.

- Diversity-related shareholder proposal numbers increased, and many proposals deviated from the traditional disclosure-based proposals and were more action-oriented. Support for shareholder proposals was also higher than ever before, and with the SEC's new guidance on no-action letter requests, public companies face increased pressure to engage with proponents and agree to their requests.

- Corporate disclosure of diversity and broader DE&I efforts has increased in tandem with the general trend in increased human capital management and ESG disclosure in the market in response (in part) to increased shareholder demand. The Nasdaq diversity disclosure rules were also approved and set to take effect in 2022, and many NYSE companies are voluntarily following suit.

Unsurprisingly, such rapid progress is also being met with some concern, as the increased momentum stress-tests corporate disclosure and hiring practices and capabilities, and the increased demand for board diversity information raises considerations about data privacy and the sensitivities surrounding some of the information being requested.

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Board Diversity in 2021: Significant Progress With Room to Grow

Significant Improvement of Diversity on S&P 500 Boards

We saw the most diverse class of S&P 500 directors in 2021: 72% of all new directors identified as being either female[1] or from a historically underrepresented racial/ethnic group.[2] Racial and ethnic diversity in particular made substantial strides, with 47% of new independent directors identifying as racially/ethnically underrepresented, compared to 22% in 2020.[3] Specifically, 33% of all new independent directors in the 2021 proxy year identified as Black/African American, a huge jump from just 11% the previous year.[4] New independent directors identifying as Asian or LatinX lagged behind new Black/African American independent directors at 7% each.[5] Looking at all S&P 500 directors in 2021, one-fifth identified as racially/ethnically underrepresented[6] – while there is still plenty of room for further diversity, these numbers show unprecedented progress with no signs of slowing down in 2022.

Unfortunately, at the same time we also saw a decrease in new female directors. Only 42% of new independent directors in the S&P 500 identified as female in 2021, a 5% decrease from 2020, when almost half of all new S&P independent directors identified as female.[7] Overall female representation on S&P 500 boards increased to 30%, up from 28%, but it will be interesting to see whether this growth continues to slow in the coming year.[8] Racially/ethnically underrepresented female directors did not gain as much traction as other demographic groups, with only 18% of the new S&P 500 independent directors identifying as both female and racially/ethnically underrepresented and comprising 10% of the overall representation on S&P 500 boards.[9]

Taken together, these statistics have given rise to the concern by some that board representation may be viewed as a zero-sum game – even though it clearly does not have to be (nor should it be). Given the increasing focus on racial/ethnic diversity, we expect that we may see racially/ethnically underrepresented men continue to outpace women and racially/ethnically underrepresented women in gaining new board appointments in 2022. As the focus on board diversity continues, we hope that fewer people will see director appointments as strictly being limited to only when existing directors retire, and more opportunities will be created for women, racially/ethnically underrepresented professionals and other historically underrepresented groups alike to gain a seat at the table.

Key Obstacles: Director Vacancies, Diverse Candidate Pools and the Board Leadership Glass Ceiling

One key obstacle that companies have increasingly encountered when trying to further their DE&I initiatives is the lack of open board seats that can be filled with underrepresented candidates (and perhaps the reason that some may be taking the zero-sum game approach to board diversity). Despite age caps, tenure caps and other board policies and approaches companies use to promote refreshment, boards still generally have

[1] Statistics on other historically underrepresented gender groups is not yet readily available, as the current focus of the market remains on (cis)female gender diversity and racial/ethnic diversity.

[2] Spencer Stuart, "2021 U.S. Board Index" (October 2021), available here.

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

very low turnover rates.[10] While there is significant benefit to having longer tenured directors on the board, companies will need to be creative about how they can allow for continued diversification in the meantime. One idea that has gained some momentum is the approach of increasing the size of boards (permanently or temporarily) in order to increase representation while sitting members have not yet retired.[11] However a company chooses to proceed, it has become clear that a "sit and wait" strategy for current directors to retire will not be sufficient in the long-term, and given institutional investor pressure, companies will need to think about how to be more proactive in their diversity efforts.

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Another common concern voiced by companies has been the lack of an adequately diverse candidate pool. Despite various diversity recruitment efforts, new white male independent directors every year still far outpace every other demographic group.[12] Building a more diverse candidate pool will require expanding the search beyond the traditionally white male-dominated CEO/C-suite backgrounds and including individuals who have other relevant and valuable skillsets and experience. An analysis done by Deloitte and the Alliance for Board Diversity showed that "women and minority board members currently are more likely than white men to bring experience with corporate sustainability and socially responsible investing, government, sales and marketing, and technology in the workplace to their boards. These skills are on the forefront of growth in a post pandemic economy and less than 55% of board members in the Fortune 500 report having any one of these skills."[13] As companies have increasingly seen, working to identify which non-traditional skillsets and experiences would most benefit the company and curating candidate pools with more holistic criteria in mind (*e.g.*, thinking about what other benefits, perspectives and value that underrepresented candidates can bring to the table) generally also makes for a more effective board.

Despite the progress we have seen with respect to overall board representation, diversity in key leadership roles at the board is still an area in which stakeholders are looking for improvement. In 2021, 96% of S&P 500 boards included two or more female directors (compared to 58% a decade ago), and 72% had three or more female directors.[14] When looking at board leadership positions, however, female directors accounted for only 8% of independent board chairs and 14% of lead directors across all S&P 500 boards.[15] Fortune 500 boards have not fared much better: between 2012 and 2020, there has only been a modest 5% increase in the number of chair positions held by female and racially/ethnically underrepresented directors.[16] At the committee level of Fortune 500 boards, while there have been modest increases in female director appointments to the audit committee and compensation committee chair positions, the rate for racially/ethnically underrepresented directors has stagnated since 2012 and even slightly decreased since 2016 for audit committee chair appointments, and it has only increased by approximately 2% for compensation committee chair appointments.[17]

10 Maria Moats and Paul DeNicola, "You Say You Want a More Diverse Board. Here's How to Make It Happen" Harvard Business Review (March 11, 2021) ("According to a recent report, nearly half of America's largest publicly-traded companies made no changes to the makeup of their board of directors in the last year."), available here.

11 *See*, *e.g.*, *id.*; The Conference Board, "Corporate Board Practices, 2021 Edition" ("In addition, directors could temporarily increase the size of the board, introduce (and adhere to) overboarding restrictions, and adopt guidelines on expected board tenure."), available here.

12 *Id.*

13 Alliance for Board Diversity & Deloitte, "Missing Pieces Report: The Board Diversity Census of Women and Minorities on Fortune 500 Boards, 6th edition" (2021), available here.

14 Spencer Stuart, "2021 U.S. Board Index" (October 2021), available here.

15 *Id.*

16 Alliance for Board Diversity & Deloitte, "Missing Pieces Report: The Board Diversity Census of Women and Minorities on Fortune 500 Boards, 6th edition" (2021), available here.

17 *Id.*

None of these obstacles should undermine or overshadow the significant progress that has been made in the DE&I space in a relatively short period of time, but it does highlight that there is still more work to be done, and DE&I issues and initiatives will remain at the forefront of stakeholders' minds as a key area of focus on their governance agendas.

Shareholder Activity: Support For Diversity Proposals Skyrockets in 2021

2021 saw a significant increase in diversity and anti-discrimination proposals, with unprecedented shareholder support averaging 44% (compared to 22% in 2020).[18] Eleven diversity-related proposals passed in 2021, more than doubling from the year prior, and support reached as high as 94% (at IBM, for a proposal requesting a report on the effectiveness of workforce DE&I efforts, which also passed at a few other companies).[19] Other board diversity report proposals that passed also received overwhelming support (between 71% and 91%).[20] Two proposals on EEO-1 disclosure policies from the NYCC also passed at DuPont and Union Pacific in 2021, receiving 84% and 86% support, respectively.[21]

The laser focus that stockholders have shown regarding diversity has only increased in the past year with the introduction of proposals requesting companies to conduct racial equity audits, which "generally seek an independent, objective and holistic analysis of a company's policies, practices, products, services and efforts to combat systemic racism in order to end discrimination within or exhibited by the company with respect to its customers, suppliers or other stakeholders."[22] In their inaugural year, eight of these proposals made it to a vote and averaged approximately 33% support[23] – a level of support that the market has rarely seen for new ESG proposals. While none passed last year, the proposals at Amazon and JPMorgan Chase received the highest support at 44.2% and 40.5%, respectively, which is approaching majority support.

Given the significant support we saw in 2021 for racial equity audit proposals and the likely possibility that we will see majority support for these proposals in 2022, we expect companies will face increased pressure to engage with proponents of racial equity audit proposals in the coming months.

Given the significant support we saw in 2021 for racial equity audit proposals and the likely possibility that we will see majority support for these proposals in 2022, we expect companies will face increased pressure to engage with proponents of racial equity audit proposals in the coming months. Companies like BlackRock and Morgan Stanley have both committed to conducting racial equity audits after receiving shareholder proposals requesting them last year, and we expect more companies will follow suit in the wake of the 2022 proxy season.

Although social proposals typically experience higher rates of withdrawal after successful shareholder engagement than exclusion upon being granted no-action relief,[24] the pressure to engage with proponents rather than try to exclude diversity proposals by requesting no-action relief from the SEC is further increased by new Staff Legal Bulletin 14L[25] released in November 2021, which eliminated the nexus requirement between a significant policy issue and the company's business for purposes of arguing for exclusion under Rule 14a-8(i)(7) (management functions/ordinary business operations). Under the new guidance, any proposal that "focuses on a significant social policy" will not be excludable under Rule 14a-8(i)

[18] Data sourced from Proxy Analytics.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] Harvard Law School Forum on Corporate Governance, "Racial Equity Audits: A New ESG Initiative" (October 30, 2021), available here.

[23] Data sourced from Proxy Analytics.

[24] *Id.*

[25] SEC, "Staff Legal Bulletin 14L" (November 3, 2021), available here.

(7), regardless of whether the significant social policy has a meaningful connection to the company's business. There is little doubt that DE&I initiatives broadly fall within the SEC's rubric of significant social policy for purposes of Rule 14a-8(i)(7), which limits the possible grounds under which companies may argue for exclusion of any DE&I-related proposals they receive.

Disclosure Trends: When It Comes to Diversity, More Is More

In response to increased shareholder demand, developing laws and regulations and stock exchange rules, companies have noticeably increased their diversity disclosures over the past year. Looking at S&P 500 companies, 59% disclosed the racial composition of their boards in 2021, up from 24% in 2020.[26] We expect to see even higher numbers in the coming year, as pressure continues to be placed on companies. Nasdaq's board diversity matrix disclosure rules were finalized in 2021, and even in spite of ongoing litigation challenging the SEC's approval of the Nasdaq rule,[27] both Nasdaq companies and a number of NYSE companies have been implementing (on a voluntary basis for NYSE companies) diversity matrix disclosure questions on D&O questionnaires and including the results in the company's public disclosures.

Additionally, BlackRock published its proxy voting guidelines in December 2021, which stated that BlackRock "may vote against members of the nominating/governance committee . . . [if] based on our assessment of corporate disclosures, a company has not adequately accounted for diversity in its board composition."[28] In discussing what it meant by diversity representation on boards, BlackRock clarified that it "believe[d] boards should aspire to 30% diversity of membership and encourage[d] companies to have at least two directors on their board who identify as female and at least one who identifies as a member of an underrepresented group."[29]

More companies have also experienced pressure to increase disclosure about the diversity of their broader workforce. As discussed above, EEO-1 Report shareholder proposals gained considerable momentum in 2021, and investors have increased pressure on companies through other campaign initiatives. For example, the New York City Retirement Systems reported in April last year that "62 S&P 100 firms now disclose or have committed to disclosing their EEO-1 data as a result of its letter-writing campaign begun last July [2020, up from just 14 prior to their campaign]."[30] State Street announced that, starting in 2022, it will begin voting against compensation committee chairs at S&P 500 companies that do not disclose EEO-1 reports.[31] In November 2021, a group of investors including Boston Trust Walden, Connecticut State Treasurer, Illinois State Treasurer, Washington State Investment Board and 59 other investor organizations sent a letter to Chairman Gensler urging "the SEC to incorporate the suggestion of Commissioner Allison Lee to require companies to publicly disclose their EEO-1 reports documenting the gender, race, and ethnicity of employees across job categories."[32]

Pressure to provide diversity disclosure, including both board/management diversity statistics and workforce EEO-1 reports has also come from the SEC itself: SEC Commissioners Lee and Crenshaw have both publicly emphasized the importance of diversity as a focus issue for investors and commented on the SEC's silence in

26 The Conference Board, "Corporate Board Practices, 2021 Edition", available here.

27 Alliance for Fair Board Recruitment v. SEC (5th Cir. 21-60626) (ongoing); *see* Alliance for Fair Board Recruitment, "Nasdaq Board Diversity Quotas Challenged in Federal Court by the Alliance for Fair Board Recruitment" (August 18, 2021) ("According to AFFBR, the Nasdaq rule will compel many of our nation's largest publicly traded corporations to illegally discriminate on the basis of gender, race, and sexual orientation in selecting directors"), available here.

28 BlackRock, "BlackRock Investment Stewardship—Proxy Voting Guidelines for U.S. Securities" (effective as of January 2022), available here.

29 *Id.*

30 Harvard Law School Forum on Corporate Governance, "2021 Proxy Season Review" (August 5, 2021), available here.

31 *Id.*

32 Investor Letter "Re: Investor support for mandating disclosure of EEO-1 workforce composition data" (November 18, 2021), available here.

addressing these topics in prior disclosure rulemaking.[33] Although the SEC's immediate focus seems to be to address climate and environmental disclosures, it would not be surprising if the SEC under the current administration also turns to addressing diversity and broader human capital management disclosure in the not-too-distant future.

When considering diversity disclosure and setting up infrastructure to collect the requisite data for such disclosure, companies should keep a few key considerations in mind. One main consideration, particularly for foreign private issuers and companies with international directors, is ongoing compliance with both domestic and foreign data privacy laws around the collection, treatment and retention of the personal information required for diversity disclosures. For example, while a company might typically want to maintain copies of D&O questionnaires for a longer period of time, there may be limitations under Europe's GDPR and European local privacy laws that restrict how long personal data of individuals may be kept. Additionally, since providing the personal information going into these diversity disclosures is still voluntary in most cases, companies should also think about how to craft their disclosure narrative if directors decide not to voluntarily disclose the information to the company and what reasons the company should give in response to Nasdaq requirements or otherwise.

Looking Ahead to 2022

Looking at the lessons learned during the 2021 proxy season, we expect that diversity issues will remain at the forefront of the 2022 proxy season's shortlist of top focus areas. Momentum in pushing for increased diversity representation and diversity disclosure has stayed strong and shows no sign of waning, and we expect that trend will continue in the coming year (and beyond), given how far the market has to go in making improvements in these areas. As with any fast-evolving space, we also expect there will be increased engagement and dialogue between companies and key stakeholders as new obstacles, concerns and considerations spring up along the path of progress. We do not expect that the momentum will falter in the face of these issues, but it certainly will provide opportunities for creating meaningful discussion about how stakeholders can better work together to make long-lasting and sustainable advancement in the diversity space.

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[33] *See*, Commissioner Allison Herren Lee, "Regulation S-K and ESG Disclosures: An Unsustainable Silence" (August 26, 2020), available here; Commissioner Caroline Crenshaw, "Statement on the 'Modernization' of Regulation S-K Items 101, 103, and 105" (August 26, 2020), available here.

Navigating a World Where Almost Everyone Is an Activist

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In many ways, 2021 was a high-water mark for corporate activism. The levels of traditional shareholder activism rebounded from the lows reached during the early days of the COVID-19 pandemic. M&A activism increased substantially as shareholder activists sought to capitalize on the M&A boom. Large-cap activism returned as activists targeted Fortune 500 CEOs with increasing frequency. The year also saw the emergence of a new brand of ESG-themed shareholder activism in the wake of the Engine No. 1 activist campaign supported by CalPERS at ExxonMobil and the copycat ESG tactics deployed by other shareholder activists.

At the same time, ESG shareholder proposals passed in record numbers as institutional investors sought to burnish their ESG credentials and attract an ever-growing pool of ESG capital. Under the Biden administration, the SEC joined the fray and facilitated activism by taking a step back from its role in policing which shareholder proposals make it onto the annual meeting agenda and moving to repeal Trump-era reforms designed to limit the influence of ISS and Glass Lewis. The ranks of climate change and DE&I activists expanded significantly, and their campaigns became more potent as efforts to accelerate change through corporate accountability gained traction amidst positive publicity and favorable political winds. Employee activism also proliferated as high-profile unionization drives accelerated and workforce-wide walkouts to register disapproval of corporate cultures continued to spread.

As we enter 2022, public companies face a world in which it seems that just about everyone is an activist. In navigating this new environment, boards and management teams would be well advised to take heed of some of the key lessons of 2021:

— Although ESG activism clearly is on the rise, investors typically are unwilling to sacrifice financial returns for ESG values— they expect companies to deliver both. Companies that incorporate sustainability into their strategic planning will be better positioned to achieve this objective than those that do not, but a sustainability focus alone will not be enough.

— M&A and activism often go hand in hand. Companies pursuing M&A must be prepared from the moment a transaction is announced to convince stakeholders of the strategic and financial merits of the transaction and how it will accelerate their broader corporate objectives. In 2022, a well-thought-out and effective M&A engagement strategy will be focused not just on top shareholders and analysts, but also on employees, business partners, government actors and other key stakeholders.

— Deconglomerization and optimizing portfolio mix will continue to be a focus of companies and activists alike—the late-2021 spin-offs announced by Johnson & Johnson and General Electric will likely trigger a re-assessment of other companies' sum-of-the-parts values and catalyze other corporate breakups.

— As retail shareholding evolves and generational shifts among asset owners and stewardship groups emerge, companies should re-assess their shareholder engagement strategies to ensure they are reaching and impacting the desired channels and constituencies and their broader messaging is aligned with strategic objectives.

— Someone does not have to be a shareholder to be an activist—activism is increasingly coming from independent ESG actors, employees, politicians, the plaintiffs' bar and others. Companies and their advisors must look proactively across the risk spectrum and beyond the traditional cast of activists, assess potential vulnerabilities holistically and calibrate their playbooks to the threats they are likely to face.

Someone does not have to be a shareholder to be an activist—activism is increasingly coming from independent ESG actors, employees, politicians, the plaintiffs' bar and others.

— As companies develop corporate strategy and respond to societal crises, they must be mindful of the perspectives of all potentially interested stakeholders. In an era when stakeholders look to companies for leadership, silence is often not an option. Companies must stay true to their purpose and communicate with clarity.

— Stakeholders are more willing to hold companies accountable for their public statements than ever before. A company's statements must be followed by meaningful action to achieve results.

— Preparedness will continue to be paramount. Companies, together with their advisors, should periodically revisit their preparedness plans at the C-suite and board levels to ensure they reflect a real-time assessment and are aligned with broader strategic planning.

M&A Outlook for 2022

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2021 was a historic year for mergers and acquisitions activity. While some reversion to the mean may be in store, we expect robust dealmaking to continue in 2022. As boards of directors and management teams seek opportunities in this competitive market, they will need to navigate a dynamic regulatory landscape and should expect investors and other stakeholders to focus on ESG metrics in the evaluation of M&A transactions to a greater extent than before.

Market Overview: Will the Boom Continue?

Attitudes among corporate executives, investment professionals and their advisors reveal a general optimism about the prospects for M&A in 2022. And who could blame them? 2021 was a historic year for M&A, with a record $5.8 trillion in global announced transactions.

There are headwinds brewing, some of which are not new but have yet to fully play out: projected interest rate increases, enhanced scrutiny of transactions from antitrust and foreign investment authorities, potential tax law changes, the recurrence of new COVID-19 variants and various macroeconomic uncertainties. In addition, some tailwinds (particularly government stimulus) are weakening.

As boards of directors and management teams seek opportunities in this competitive market, they will need to navigate a dynamic regulatory landscape and should expect investors and other stakeholders to focus on ESG metrics in the evaluation of M&A transactions to a greater extent than before.

Overall, however, the supply and demand for transactions remains strong. Strategic operators continue to seek repositioning and scale (through transformative acquisitions) and focus (through divestitures of non-core or other segments). Corporate cash remains at record levels. Private equity firms, whose 2021 acquisition spending accounted for a record 24% of global transaction value, have replenished their coffers through a torrid fundraising spree and continue to have record levels of dry powder to deploy. And more than 570 SPACs are on the hunt for a business combination partner.

Almost two years into the COVID-19 pandemic, companies and dealmakers alike also have greater comfort operating in an environment in which uncertainty abounds. And as the competition for assets has intensified, private equity buyers in particular have been willing to further limit closing conditionality and assume financing risk and have learned to move even faster and more efficiently in diligence and negotiation. In short, it's hard to bet against the view that 2022 will remain strong for dealmaking, albeit likely not to the same extent as 2021.

Antitrust and Regulatory Enforcement

The trend of increased scrutiny of transactions from competition and foreign investment regulators continued across the globe in 2021. We expect this to continue, and likely accelerate, in 2022.

In the U.S., Biden administration appointments to senior positions in the Federal Trade Commission (FTC) and the Antitrust Division of the U.S. Department Justice (DOJ), along with other executive and agency action (including a number of rule changes and policy statements at the FTC), have signaled a heightened focus on merger review. (*See* U.S. and EU Antitrust: Developments and Outlook in 2022 in this memo.) While an uptick in merger enforcement actions (relative to the final year of the Trump administration) has not yet followed, last year saw a number of such challenges, including suits by the FTC or DOJ to block Nvidia's acquisition of Arm, Penguin Random House's proposed acquisition of Simon & Schuster and Aon's proposed acquisition of Willis Towers Watson. The FTC in particular has been more likely to engage in prolonged merger investigations with a different scope and in different circumstances than traditionally seen, and the agencies' ongoing refusal to grant early termination of the initial HSR waiting period continues to delay consummation of many transactions with no competitive significance.

The trend of increased competition scrutiny will have important implications for transaction agreements. These will obviously apply most to transactions that raise competitive sensitivity as traditionally understood, particularly in key industries of focus such as health care, pharma and tech; as the scope of merger scrutiny expands.

In the United Kingdom, the Competition and Markets Authority has emerged post-Brexit as an active competition watchdog, independent of the European Commission. The latter continues to exert robust merger review, particularly in pharma and tech transactions.

The trend of increased competition scrutiny will have important implications for transaction agreements. These will obviously apply most to transactions that raise competitive sensitivity as traditionally understood, particularly in key industries of focus such as health care, pharma and tech; as the scope of merger scrutiny expands, however, a broader spectrum of buyers and sellers will need to think more carefully about regulatory approval covenants in their transaction agreements and how these interact with other considerations. And as more deals are scrutinized, cracks in the traditional architecture of antitrust provisions may begin to show. In particular:

— Sellers or target companies that believe they are well-protected by a buyer's strong regulatory commitments may need to re-think whether "hell-or-high-water" provides the absolute commitment they expect, as they may find it can be difficult to specifically enforce those covenants.

- It is not always easy to establish sufficiently early on that the buyer is not taking adequate steps to obtain approval or that it is unlikely approval will be obtained by the outside date, absent judicial intervention.

- As a practical matter, it may be challenging for a buyer and seller to present a unified front in their efforts to obtain regulatory clearance (particularly if that includes litigation with regulators) while waging a separate battle over whether the buyer has breached the transaction agreement.

- We expect target companies to continue to focus on seeking reverse termination fees from buyers as the principal remedy for failing to obtain the required antitrust approvals.

— Having a thoughtful strategy for obtaining antitrust approval that is calibrated to the current enforcement environment, and controlling the timetable for complying with second requests and the regulatory process more generally, will be more important than ever.

- Parties will need to think more carefully about pre-packaged remedies and divestiture commitments.

- Buyers in particular should consider crafting antitrust covenants in a manner that does not require them to accept restrictions on future M&A strategy, in light of recent changes to FTC policy (under which, in consent orders to settle contested transactions, the FTC will now routinely require merging parties to obtain prior approval of future transactions in relevant markets).

— Outside dates will get longer in order to accommodate extended review periods and preserve the ability to litigate with enforcement authorities. Parties will need to consider the impact of these longer outside dates on financing, employee retention, interim operating covenants, communications, synergies realization and other matters.

Historically, transactions with private equity buyers have received less scrutiny (outside of portfolio company transactions with significant overlaps). But recent FTC guidance and investigations have shown an increased attention on private equity. Private equity buyers and their counterparties should understand that antitrust agencies are more likely to issue second requests and conduct lengthier investigations of private equity acquisitions, particularly in sensitive industries like health care, pharma, data and tech, even when traditional competitive concerns may seem less prevalent.

We expect the increasing focus on ESG metrics in M&A transactions to be a significant trend in 2022 and beyond.

ESG in M&A

At this point, most public company boards of directors are well-attuned to the increasing focus of investors on ESG metrics. (*See* The Materiality Debate and ESG Disclosure: Investors May Have the Last Word and Navigating a World Where Almost Everyone Is an Activist in this memo.) While ESG themes featured significantly in many recent activist campaigns, including M&A-focused campaigns, the role of ESG in M&A more broadly has been less pronounced. That has begun to change, however, and we expect the increasing focus on ESG metrics in M&A transactions to be a significant trend in 2022 and beyond.

When ESG has figured prominently in M&A, often it has been with emphasis on the "E." Particularly as it relates to the impact of environmental and sustainability issues on terminal values and valuation multiples, ESG metrics are playing a greater role in the selection and valuation of acquisition targets or merger partners. (In this respect, ESG is just a different label for concerns that have always driven M&A activity.) Going forward, we expect this to continue and to be joined by an increasing focus on other ESG themes, especially social issues such as labor and human capital management, particularly as employees become more vocal in M&A communications.

As in other contexts, use of ESG buzzwords won't be enough to convince investors and other stakeholders that the purported ESG merits of a transaction are more than just window-dressing. Acquirors will need to incorporate more robust ESG due diligence into their transaction planning as they confirm the investment thesis and implications for existing ESG commitments. Proactively communicating the ESG benefits of a transaction (which is often a process that will begin before a transaction is announced) will also be critical as acquirors seek to convince investors and other stakeholders of the strategic benefits of the transaction.

The Delaware Courts' Evolving View of Director Independence

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In September 2021, the Delaware Supreme Court in *United Food and Commercial Workers Union v. Zuckerberg* revamped the test for pleading "demand futility" in shareholder derivative suits for the first time in decades. At the same time, the court's decision reinforces Delaware courts' increasing focus on the independence of directors, not only when the board is sued in a shareholder derivative action but also in other conflict situations in which independent directors are called on to exercise their business judgment on behalf of the company.

As explained below, the Delaware courts' view of what constitutes "independence" continues to evolve and has become a heavily fact-specific analysis, which requires careful consideration not only of the traditional "economic" conflicts but also of personal relationships and other non-traditional factors.

The *Zuckerberg* Decision

Zuckerberg arose from a decision by Facebook's board in 2016 to pursue a stock reclassification that would have enabled Mark Zuckerberg to donate a large portion of his Facebook shares to charity while retaining voting control of the company. Faced with class action litigation, Facebook abandoned the reclassification, and the class action was rendered moot. Another Facebook stockholder then brought the derivative lawsuit in *Zuckerberg*, claiming damages on behalf of the company for the nearly $90 million Facebook spent defending and settling the class action.

Delaware Court of Chancery Rule 23.1 requires a stockholder who wishes to assert derivative claims on behalf of a corporation to show that either (i) a pre-suit demand was made on the corporation's board of directors to bring the claims directly and such demand was wrongfully denied, or (ii) such demand is futile and excused because a majority of the corporation's directors are incapable of impartially considering the demand.

The *Zuckerberg* plaintiffs alleged that demand was excused as futile because a majority of the Facebook directors lacked independence from Zuckerberg and so could not impartially consider a litigation demand. In addressing this argument, the Delaware Supreme Court announced a new test to apply in such cases, which requires courts analyzing demand futility to evaluate three questions on a director-by-director basis:

1. Whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand.

2. Whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand.

3. Whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

Unless a majority of the board at the time the shareholder derivative suit lacks independence on any of these three prongs, the suit should be dismissed.

Applying this new test to the nine directors on the Facebook board at the time the lawsuit was filed, the Delaware Supreme Court's decision came down to a close analysis of whether three directors' relationships with Zuckerberg were sufficiently independent under the test's third prong. Although the court ultimately found that the *Zuckerberg* plaintiff failed to raise a reasonable doubt about these directors' independence, the court's analysis highlights the evolving evaluation of director independence under Delaware law, with courts carefully scrutinizing director relationships.

Evaluating Independence Under Delaware Law

Delaware jurisprudence traditionally focused on financial factors to assess a director's independence. A plaintiff asserting that a director lacked independence because of personal relationships was required to clear a high bar beyond mere allegations of friendship. In 2004, for example, the Delaware Supreme Court articulated the director independence test in *Beam ex rel Martha Stewart Living Omnimedia, Inc. v. Stewart* as requiring a derivative complaint to plead with particularity facts creating "a reasonable doubt that a director is…so 'beholden' to an interested director…that his or her 'discretion would be sterilized'" (citing *Rales v. Blasband* (1993)). The court elaborated that while a personal friendship or "outside business relationship" might influence a demand futility inquiry, a materiality standard must be satisfied by showing that the relationship is actually of a "bias-producing nature."

Delaware law "cannot ignore the social nature of humans or that they are motivated by things other than money, such as love, friendship, and collegiality."

Since then, however, the Delaware courts have been increasingly willing to find that non-traditional factors meet this test, as explained below. This trend was summed up by the Delaware Supreme Court's decision 15 years after *Beam* in *Marchand v. Barnhill* (2019), in which the court explained that Delaware law "cannot ignore the social nature of humans or that they are motivated by things other than money, such as love, friendship, and collegiality."

Shared Asset Ownership

Beam's progeny of cases remained generally unremarkable until *Sandys v. Pincus* in 2016, when the independence of a director was questioned based on the single fact that the director co-owned a private airplane with the company's controlling stockholder. In *Sandys*, the Delaware Supreme Court in a split decision reversed the Court of Chancery and found that certain directors of a company were not independent because of personal and professional connections to the company's controlling stockholder. The Delaware Supreme Court found the co-ownership of a plane to be so unusual in nature as to demonstrate actual bias since it "requires close cooperation in use, which is suggestive of detailed planning indicative of a continuing, close personal friendship."

The *Sandys* decision thus offered insight into the types of personal relationships that could be inferred to affect director independence under Delaware law. Subsequently applying *Sandys*, the Court of Chancery in *Cumming v. Edens* (2018) determined that one director was not independent primarily because the company's founder and co-chairman invited the director to join the ownership group for a professional basketball team, "a highly unique and personally rewarding asset."

Personal Admiration

In 2019, the Court of Chancery denied the defendants' motions to dismiss in *In re BCG Partners, Inc., Derivative Litigation* because a majority of the defendant-directors could have been considered lacking independence from a controlling stockholder.

For one director who had known the controlling stockholder approximately 20 years, the complaint alleged that the director and controlling stockholder had attended public events together, the director's wife honored the controlling stockholder's sister at a gala, and the controlling stockholder arranged a private museum tour for the director's wife and granddaughters when the transaction in question was under consideration. The court accordingly found plaintiffs had adequately pled a "constellation of facts" showing that the relationship was not a "thin social-circle friendship."

The case subsequently proceeded to trial in October 2021 after the Court of Chancery found that fact issues still existed following completion of discovery with respect to the directors' independence on summary judgment, even though the evidence was "not overwhelming." As for the director with the longstanding 20-year relationship with the controlling stockholder, although the court ultimately found "no apparent close social or familiar ties," it did find the director's deposition testimony highly praising the controlling stockholder as an "inspiration" and a "wonderful…good human being" sufficient to qualify as the kind of "exceptionally glowing" admiration that could cast doubt on the director's impartiality.

Director Compensation

In re BCG Partners, Inc. also made clear that traditional financial considerations such as the materiality of the compensation the director receives from the company still impact the independence analysis. The court found one director non-independent because his directorship compensation constituted a high percentage of his total income. Similarly, in *Klein v. HIG Capital* (2018), the Court of Chancery excused demand as futile when the plaintiff pled facts that the director's consulting fees from the company exceeded both his CEO compensation and the independence threshold established by the NASDAQ rules. As *Sandys* advised, a company's decision as to whether a certain director is independent under the relevant stock exchange rules may affect whether that director is considered independent for purposes of Delaware law.

Overlapping Business Networks

In re Oracle Corp. Derivative Litig. (2018) involved an allegation against Larry Ellison for breaching his fiduciary duties to Oracle by causing it to purchase the shares of another company in which he had a significant interest at an unfair price. A previous 2018 opinion found several directors were not independent for the purposes of demand futility on the basis of their multiple shared board memberships with Ellison – while the Court of Chancery explained in *Cumming v. Edens* that "service on another board alongside the interested director, alone, is insufficient to raise a reasonable doubt as to a director's independence," it noted in *Oracle* that multiple overlapping board memberships could lead to the creation of a "network" of ties raising such doubt.

Similarly in *In re Homefed Corp. Stockholder Litig.* (2020) and *Voigt v. Metcalf (*2020), plaintiffs adequately pled the directors lacked independence when the board members also served in executive and consulting roles with the controlling stockholder in addition to their director roles or had served on the boards of the controlling stockholder's portfolio companies.

In its 2021 opinion in *In re Oracle Corp. Derivative Litig.*, the Court of Chancery largely drew from the same facts that had supported its finding of the directors' lack of independence for the purposes of demand futility in finding that the directors lacked independence with respect to alleged breaches of fiduciary duties.

Charitable Contributions

In *In re Oracle Corp. Deriv. Litig.* (2003), the Court of Chancery also found it notable that multiple defendant directors and special committee members shared indirect ties through their mutual philanthropic contributions to the same university, although other cases have since limited the importance of such contributions when assessing director independence. For instance, a director's independence was upheld despite receiving donations from the company in question in *In re J.P. Morgan* (2005) and *In re Goldman Sachs* (2011) when the plaintiffs failed to allege facts showing that the contributions were important to the director, how they influenced the director, or how the contributions could or did affect the decision-making process. Similarly, the *Zuckerberg* court rejected the plaintiff's allegation that Reed Hastings, founder of Netflix, lacked independence from Zuckerberg because of a track record of donating to similar causes. The court maintained that "[t]here is no logical reason to think that a shared interest in philanthropy would undercut Hastings' independence."

Applying *Zuckerberg* in a December 2021 decision, the Court of Chancery in *In re Kraft Heinz* determined that generally pointing out linkages between a director's charitable activities and the interested parties was not sufficient to undermine independence. In that case, although at one point in time the director's private foundation held more than 12% of its portfolio in a fund controlled by the interested stockholder and the director chaired a nonprofit that received donations from entities controlled by that interested party, the court noted that without more information (such as whether the foundation was still invested in the fund when the derivative litigation was filed, whether the interested party had a role in the donations to the nonprofit and whether those donations were material), these allegations were insufficient to cast doubt on the director's independence.

A Shifting Status Quo

While personal relationships have become more important in the independence analysis, it nonetheless remains true that not just any allegation of friendly relations will suffice to call into question a director's independence. The *Zuckerberg* court, for example, in response to the plaintiff's allegations that Peter Thiel harbored a "sense of obligation" to Zuckerberg for not removing Thiel from the Facebook board in the face of public scandal, countered that plaintiffs failed to allege that remaining a Facebook director was "financially or personally material to Thiel." Moreover, the court made short shrift of the plaintiff's theory of "founder bias" that allegedly rendered Thiel and Hastings non-independent, noting that even if true, it would not necessarily disqualify the directors as long as they were acting in good faith.

In re Kraft Heinz similarly rejected non-independence arguments against directors on the basis of personal relationships. There, plaintiffs attempted to allege a transitive theory of independence by stating that two directors were beholden to Warren Buffet, who was in turn beholden to the interested stockholder and its partners. Although Buffet had walked one of the directors down the aisle at her wedding, the court rejected an argument that she could not act impartially with respect to the litigation demand. The court similarly rejected plaintiffs' arguments that Buffet lacked independence from the co-founder of the interested stockholder simply because Buffet had once attended that co-founder's birthday party and co-attended several professional workshops.

In *Franchi v. Firestone* (2021), the Court of Chancery dismissed a shareholder challenge to a transaction approved by an independent special committee. The plaintiffs argued that the directors lacked independence from controlling shareholder Carl Icahn and pointed out that one director had made a documentary about Icahn and another had served on multiple boards of Icahn-controlled companies. Notwithstanding these "unusual" facts, Chancellor McCormick found it a "closer call" warranting dismissal.

Independence of directors is critical under Delaware law in a number of situations, including when the board is sued in a shareholder derivative action or when the board is asked to consider a related-party transaction.

Key Takeaways for Boards in 2022

- The independence analysis under Delaware law is distinct from, and more nuanced, than under stock exchange rules. While the Delaware courts have noted that independence for purposes of stock exchange rules is one factor they consider, the Delaware law analysis is more holistic and fact-specific and considers, in addition to the traditional financial factors, such things as personal friendships or other relationships of a "bias-producing nature."
- Independence of directors is critical under Delaware law in a number of situations, including when the board is sued in a shareholder derivative action or when the board is asked to consider a related-party transaction. The Delaware courts have developed doctrines, including the demand futility test announced in *Zuckerberg* and the "*MFW* test" – which requires the approval of an independent special committee of directors for obtaining business judgment review of controlling stockholder squeeze-outs and other conflicted controlling stockholder transactions – that place a premium on the independence of directors in managing litigation risk.
- In evaluating director independence, Delaware courts have not hesitated to scrutinize closely personal relationships, taking into account facts such as co-ownership of unique assets, personal admiration, longstanding and overlapping business network ties, and shared philanthropic contributions. Boards should give serious consideration to these factors when selecting new directors or constituting special committees for the purposes of potentially conflicted transactions. It is advisable to stay aware of potential independence issues raised by interconnected personal relationships as Delaware courts continue to focus on this issue.

Priorities, Trends and Developments in Enforcement and Compliance

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2021 was a year of transition for white-collar criminal and regulatory enforcement. As courthouses reopened and trials resumed, newly-installed heads of law enforcement authorities looked to reset priorities and ramp up enforcement in the first year of the Biden administration. Policy priorities shifted toward enforcement against sophisticated financial institutions, corporates and their executives, in contrast to the previous administration's focus on retail investors and schemes with identifiable victims. While the shift at the SEC was more immediately visible with major new enforcement priorities, investigations and resolutions, the DOJ adopted policies and announced new initiatives that will likely only find expression in 2022.

The SEC

New leadership at the SEC made its mark quickly, with a palpable change in tone across the agency and a robust agenda that has seen rapid progression. In a transition year following a presidential election and with the turnover of leadership, enforcement has been a priority, with actions in fiscal year 2021 increasing 7% from the previous year (but still down from pre-pandemic enforcement levels in fiscal year 2019).[1] The SEC staff

[1] SEC, "SEC Announces Enforcement Results for FY 2021" (November 18, 2021), available here.

is under increased pressure to bring impactful cases quickly and engage more aggressively with defense counsel earlier in investigations, including by expediting deadlines for everything from document productions to oral presentations and written submissions. Aggressive approaches to investigations, together with the stated desire to impose more onerous settlement terms even if such terms result in damaging collateral consequences from a capital-raising standpoint,[2] suggest that the SEC is at least for now more willing to litigate cases even at the risk of trial losses or long-term programmatic damage that could result from pressing aggressive and controversial legal theories in federal court.

The SEC has already made use of sweeps across entire industries and areas of priority, including cybersecurity, digital assets, ESG, SPACs and most recently to explore the potentially improper use of personal devices for business communications.[3] Alongside this focus on emerging technologies and risks, the SEC's traditional enforcement actions involving accounting and auditing misconduct and alleged fraudulent conduct by financial professionals and investment advisers have continued apace.[4] The SEC has also emphasized vigorous enforcement of the insider trading laws, with a particular focus on corporate insiders and Rule 10b5-1 plans (plans designed to allow executives and companies to trade in their own securities via a safe-harbor), which we anticipate will only increase with the expected approval of proposed amendments aimed at closing perceived loopholes in the rules.[5] The Division of Enforcement has also returned to some of the more controversial tactics it applied in the past, including the insistence in certain cases on factual and legal admissions in settlements, the renewed use of Section 304 of the Sarbanes-Oxley Act to seek reimbursement of money from corporate executives for alleged misconduct on their watch, a refusal to negotiate waivers of certain collateral consequences for registrants and a renewed focus on bringing charges against individual actors where at all possible. Simply put, the SEC seems intent on aggressively using all of the weapons in its enforcement arsenal to further its policy goals.

Simply put, the SEC seems intent on aggressively using all of the weapons in its enforcement arsenal to further its policy goals.

Cybersecurity

Orders in three settled actions in 2021 underscored the SEC's focus on corporate disclosures and internal controls around cyber incidents. These resolutions suggest that companies may face regulatory scrutiny not only for alleged material misstatements and omissions about cyber incidents and related public statements, but also based on the SEC's view that the companies in question failed to institute reasonable controls to prevent them.[6] One such action reflected a growing trend where the SEC takes issue with a hypothetical statement that a risk "may" occur where

[2] *See*, *e.g.,* SEC, "Remarks at SEC Speaks 2021: Gurbir Grewal, Director, Division of Enforcement" (October 13, 2021), available here.

[3] The SEC and CFTC issued orders on December 17 against a global financial institution, with the bank admitting violations of the federal securities laws for failing to maintain required records and agreeing to pay a total $200 million penalty. SEC, "*In re J.P. Morgan Securities LLC*, Release No. 93807" (December 17, 2021), available here; CTFC, "*In re JPMorgan Chase Bank, N.A.*, CFTC Docket No. 22-07" (December 17, 2021), available here.

[4] SEC, "Addendum to Division of Enforcement Press Release Fiscal Year 2021" (November 18, 2021), available here.

[5] *See*, *e.g.*, SEC, "SEC Proposes Amendments Regarding Rule 10b5-1 Insider Trading Plans and Related Disclosures" (December 15, 2021), available here. For additional details on proposed rule changes to 10b5-1, *see* our December Alert Memo here.

[6] SEC, "*In re First American Fin. Corp.*, Release No. 92176" (June 14, 2021), available here; SEC, "*In re Pearson plc*, Release No 10963, 92676" (August 16, 2021) available here; SEC, "SEC Announces Three Actions Charging Deficient Cybersecurity Procedures" (August 30, 2021), available here ("It is not enough to write a policy requiring enhanced security measures if those requirements are not implemented or are only partially implemented, especially in the face of known attacks.").

the event in question has already taken place.[7] The SEC also conducted a major sweep on cyber incident responses and disclosures related to the SolarWinds cyberattack, with the issuance of subpoenas to hundreds of companies, including many in the technology, finance and energy sectors, thought to be potentially impacted.[8] Combined with the SEC's recent actions related to cybersecurity disclosures and controls,[9] this sweep suggests that the SEC is building up its resources on this topic and trying to set benchmarks.

Digital Assets

The SEC is devoting significant investigation and litigation resources – as well as public airtime – to emphasize its intent to continue to ramp up enforcement in the digital asset space. Prior SEC leadership principally focused on cryptocurrency frauds and entities that in the Commission's view were issuers of digital asset securities.[10] The agency has now broadened its investigative focus to market participants that are integral to the infrastructure of the digital asset space – such as digital asset trading platforms and market makers – and that would be subject to SEC regulation if the digital assets they list or trade were found to be securities.[11] Investigations of these market participants will continue into 2022, with litigated actions possible in 2022. With this increased scrutiny by the SEC and other state and federal regulators has come significant regulatory uncertainty and an internal debate within the Commission and indeed among the multiple criminal and regulatory agencies with a potential role to play in the space about the proper approach to the regulation of digital assets.[12]

ESG

Following significant grassroots investor focus, the SEC announced in March 2021 the creation of a 22-member Climate and ESG Task Force housed in the Division of Enforcement to develop initiatives to proactively identify ESG-related misconduct.[13] After the creation of the Task Force, there appeared to be a notable increase in SEC staff inquiries about ESG-related disclosures in ongoing investigations, including related to risk factors and greenwashing, even where the initial focus of the investigations did not appear to be ESG-related. Newly promised disclosure requirements combined with greater enforcement resources presage a likely uptick in ESG-related actions in 2022 as the Commission looks to put its stamp of approval on the alleged increased need for corporate disclosure in this space.

Retail Markets

With the rise in 2021 of "meme stocks" and commission-free brokerage firms, the SEC has also turned its attention to the gamification of the financial markets and the increasing participation of retail (often amateur) investors focused on potentially riskier investments such as cryptocurrencies and SPACs. There is a philosophical

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7 *See*, SEC "*In the Matter of Altaba Inc. f/d/b/a Yahoo! Inc.*, Securities Act Release No. 10485, Exchange Act Release No. 83096, Accounting and Audit Enforcement Release No. 3937" (April 24, 2018), available here (issuer's "risk factor disclosures in its annual and quarterly reports from 2014 through 2016 were materially misleading in that they claimed the company only faced the risk of potential future data breaches" that might expose issuer to loss and liability "without disclosing that a massive data breach had in fact already occurred"); SEC, "*In re Pearson plc*, Release No 10963, 92676" (August 16, 2021) available here; SEC "*In re Alphabet, Inc. Sec. Litig.*, 1 F.4th 687, 69394, 703 (9th Cir. 2021)"; SEC, "Mylan to Pay $30 Million for Disclosure and Accounting Failure Relating to EpiPen" (September 27, 2019), available here.

8 *See*, *e.g.*, Reuters, "U.S. SEC Probing SolarWinds Clients over Cyber Breach Disclosures," (June 21, 2021), available here.

9 For additional information on cybersecurity, *see* Cybersecurity: Data Breaches, Ransomware Attacks and Increased Regulatory Focus in this memo.

10 Notable examples of litigated enforcement actions in this first wave included *SEC v. Kik Interactive Inc.*, No. 19-cv-5244 (S.D.N.Y. 2019), and *SEC v. Telegram Grp. Inc.*, No. 19 Civ. 9439 (PKC) (S.D.N.Y. 2019). The SEC filed a lawsuit in December 2020 against Ripple Labs Inc. and two of its executives for allegedly conducting an eight-year long unregistered securities offering.

11 *See*, *e.g.*, SEC Chair Gary Gensler, "Remarks before the Aspen Security Forum" (August 3, 2021), available here ("While each token's legal status depends on its own facts and circumstances, the probability is quite remote that, with 50 or 100 tokens, any given platform has zero securities.").

12 *See*, *e.g.*, Commissioner Hester M. Peirce and Commissioner Elad L. Roisman, "Statement: In the Matter of Coinschedule" (July 14, 2021), available here ("There is a decided lack of clarity for market participants around the application of the securities laws to digital assets and their trading, as is evidenced by the requests each of us receives for clarity and the consistent outreach to the Commission staff for no-action and other relief."); Commissioner Hester M. Peirce and Commissioner Elad L. Roisman, "Falling Further Back - Statement on Chair Gensler's Regulatory Agenda" (December 13, 2021), here (critiquing Chair Gensler's regulatory agenda as "failing to provide more clarity on digital assets" and making "no mention of any regulation with respect to digital assets," even while the "sector has grown in size, complexity, diversity, and investor interest.").

13 SEC, "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues" (March 4, 2021), available here.

divide among regulators as to whether retail investors should have access to the full range of existing financial products or whether they require extra protection and should only have access to certain well-established financial products. Chair Gensler falls in the second camp, having indicated that he does not consider these investors to be adequately protected,[14] and also believes that some conflicts with retail investors cannot be "disclosed away." Chair Gensler has also been critical of payment for order flow, and has said publicly that a full ban of the practice is "on the table."[15] In particular, the SEC is likely to carefully scrutinize hedge funds and private equity firms that are involved in the retail market.

SPACs

As the market's appetite for SPACs cooled in the second half of 2021, the SEC's focus on SPAC enforcement started to heat up. Last spring, the Division of Corporation Finance issued guidance on financial reporting considerations for SPACs, signaling that the SEC would be more closely scrutinizing this reporting.[16] A short time later, the SEC announced charges against a SPAC, its sponsor and the SPAC's proposed merger target for allegedly misleading claims about the target's technology and national security risks related to the target's founder.[17] Most recently, the SEC announced a $125 million settlement with an electric vehicle company that went public through a SPAC acquisition in March 2020.[18] The SEC has persistently voiced concerns related to incentives and disclosures around SPACs, and more enforcement actions are likely to follow.

[14] NPR, "Why Wall Street's Top Cop Thinks It's Time To Get Tough," (December 19, 2021), available here.

[15] Barron's, "SEC Chairman Says Banning Payment for Order Flow Is 'On the Table'" (August 30, 2021), available here.

[16] SEC, "Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ('SPACs')" (April 12, 2021), available here.

[17] SEC, "SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination" (July 13, 2021), available here.

[18] SEC, "Nikola Corporation to Pay $125 Million to Resolve Fraud Charges" (December 21, 2021), available here.

There was a visible increase during the first year of the Biden administration on the DOJ's focus on white-collar crime, including cases against major corporations and their executives.

The DOJ

The DOJ ramped up resources and adopted policies in 2021 that are expected to take time to find expression in pleas and convictions. Many resolutions in 2021 were carryovers from the prior administration, and there was not a significant uptick in new actions. However, there was a visible increase during the first year of the Biden administration on the DOJ's focus on white-collar crime, including cases against major corporations and their executives. The Trump administration had taken less aggressive stances on corporate criminal enforcement, including loosening the standard for obtaining corporate cooperation credit, taking into account ability to pay in imposing fines and imposing monitorships less frequently. The result had been historic lows during the Trump administration in the number of white collar prosecutions brought by the DOJ.[19]

The DOJ under the Biden administration has signaled a return to the Obama administration, both in personnel and philosophy. Several senior DOJ officials returned from the Obama administration. They have signaled a strong commitment to white-collar criminal enforcement in relation to companies and individuals, including new initiatives on cyber-fraud, cryptocurrency

[19] *See*, *e.g.*, Bloomberg, "Trump Oversees All Time Low in White Collar Crime Enforcement" (August 10, 2020), available here.

and environmental justice.[20] DOJ officials have stressed the importance for companies to adopt and implement policies related to ephemeral messaging on apps such as Signal, SnapChat and WhatsApp, as collection of this content has become a regular part of enforcement agencies' investigatory playbooks.[21]

Corporate Enforcement Policies

Last fall, the DOJ announced three significant changes to its policies on corporate criminal enforcement.[22]

1. To be eligible for cooperation credit, companies must provide the DOJ with all non-privileged information about all individuals involved in or responsible for the misconduct at issue.

2. The DOJ will consider the full range of a company's prior misconduct – not just a narrower subset of similar misconduct – as part of its decision-making on the proper form of resolution.

3. For companies that cooperate with the government, there will be no default presumption against corporate monitors.[23]

The DOJ also called into question whether negotiated corporation resolutions that do not involve a guilty plea – non-prosecution agreements and deferred prosecution agreements – are appropriate for "recidivist" corporations that have a documented history of corporate wrongdoing by multiple sections and divisions across the DOJ.[24] The DOJ simultaneously announced the creation of a "Corporate Crime Advisory Group" within the DOJ tasked with reviewing the DOJ's approach to prosecuting criminal conduct by corporations and their executives, management and employees.[25]

FCPA

Last summer, the DOJ announced that it intends to take an "entirely new" approach to FCPA enforcement by spending more time and resources actively developing its own cases, including through data mining, the use of cooperating witnesses (including by leveraging existing whistleblower programs) and partnerships with foreign governments, in addition to its historical reliance on self-reporting to drive new actions.[26] In December 2021, the Biden administration issued the "United States Strategy on Countering Corruption," which seeks to enhance collaboration across governmental agencies and signals that the U.S. government will increase the scope of its anti-corruption laws, regulations and initiatives in the coming year.[27]

Cybersecurity and Cryptocurrency

The DOJ announced new initiatives in 2021 on cybersecurity and cryptocurrency that are likely to lead to increased corporate enforcement activity in 2022. The DOJ recently announced the launch of a Civil Cyber-Fraud Initiative, designed to combat new and emerging cyber threats to the security of sensitive information

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[20] *See*, *e.g.*, Law360, "Corruption, Cybercrime in Crosshairs for DOJ Crime Chief" (December 10, 2021), available here (Assistant Attorney General Kenneth Polite: "Corporate enforcement is a very high priority, not just for me, but for the overall DOJ leadership. Individual accountability is a very high-profile priority for me and the leadership as well."); Executive Office of the Presidency, "Tackling the Climate Crisis at Home and Abroad" 86 FR 7619 (Jan. 27, 2021); The United States Attorney's Office for the Eastern District of New York, "Acting United States Attorney Jacquelyn M. Kasulis Announces Formation of Environmental Justice Team in the Office's Civil Division" (June 24, 2021) available here.

[21] *See*, *e.g.,* The Wall Street Journal, "Justice Department Officials Dig in on Corporate Repeat Offenders" (December 1, 2021), available here.

[22] U.S. Department of Justice Press Release, "Deputy Attorney General Lisa O. Monaco Gives Keynote Address at ABA's 36th National Institute on White Collar Crime" (October 28, 2021), available here.

[23] Memorandum from Deputy Attorney General Lisa O. Monaco, "Corporate Crime Advisory Group and Initial Revisions to Corporate Criminal Enforcement Policies" (October 28, 2021), available here; for additional details, *see* our November Alert Memo available here.

[24] U.S. Department of Justice Press Release, "Deputy Attorney General Lisa O. Monaco Gives Keynote Address at ABA's 36th National Institute on White Collar Crime" (October 28, 2021), available here; *see* The Wall Street Journal, "Justice Department Officials Dig in on Corporate Repeat Offenders" (December 1, 2021), available here. Recent reports suggest that the DOJ has been taking a harder line on existing deferred prosecution agreements. *See*, *e.g.*, Bloomberg, "Deutsche Bank Haunted by Control Lapses as U.S. Warns of Breach" (December 8, 2021), available here.

[25] *Id.*

[26] Nicholas McQuaid, Acting Assistant Attorney General, American Conference Institute, Keynote Address at the Foreign Corrupt Practices Act Conference (June 2, 2021).

[27] The White House, "United States Strategy on Countering Corruption" (December 2021), available here.

and critical systems.[28] At the same time the DOJ announced the creation of a National Cryptocurrency Enforcement Team to organize and help spearhead investigations and criminal prosecutions related to cryptocurrency, including cases against cryptocurrency exchanges, infrastructure providers and other entities that misuse cryptocurrency and related products to commit or facilitate criminal activity.[29] The Team will also assist in tracing and recovery of assets lost to fraud and extortion, including cryptocurrency payments to ransomware groups.[30]

Boards of directors should be prepared for investigations and actions designed to drive policy goals and foster deterrence stemming from the ambitious agenda and numerous initiatives formed in the first year of the Biden administration.

Key Takeaways

Boards of directors should be prepared for investigations and actions designed to drive policy goals and foster deterrence stemming from the ambitious agenda and numerous initiatives formed in the first year of the Biden administration.

— Companies should update their policies and procedures to ensure that they adequately address enforcement agencies' priorities, and should devote resources to ensuring executives' compliance with these policies and procedures and appropriate related disclosures.

- All companies, including private companies and foreign private issuers, should maintain a continued focus on accounting policies and procedures and handling of MNPI as enforcement agencies have cast a broad net and shown a willingness to test the limits of their jurisdictional authority.
- Financial institutions should expect increased regulatory scrutiny, particularly related to digital assets and SPACS, as well as the continued focus on the use of personal devices for business communications.
- Companies in the oil and gas, mining, automotive, aerospace and industrial sectors should enhance their internal monitoring and compliance protocols for ESG targets and anti-corruption in light of the Biden administration's focus on these issues.

— Enforcement authorities are particularly focused on demonstrating capabilities and leadership in new areas, such as cybersecurity, digital assets and ESG, and companies need to be keenly focused on their conduct and disclosures in these areas.

- Public companies need to be particularly attuned to the accuracy of their cybersecurity disclosures and to ensure that in the wake of a cyber incident they will be able to demonstrate that they followed well-established protocols and that they appropriately escalated issues and timely disclosed material facts.
- Public companies should pay careful attention to their ESG disclosures in light of the lack of clear, concrete guidance combined with increased scrutiny from the SEC's Enforcement Division.
- Companies with any exposure to digital assets should carefully scrutinize their potential legal exposure given enforcement authorities' widespread focus on the entire industry and demonstrated willingness to bring actions even in areas of regulatory uncertainty.

[28] DOJ, "Deputy Attorney General Lisa O. Monaco Announces New Civil Cyber-Fraud Initiative" (October 6, 2021), available here.

[29] DOJ, "Deputy Attorney General Lisa O. Monaco Announces National Cryptocurrency Enforcement Team" (October 6, 2021), available here.

[30] *Id.*

— Companies facing active or potential criminal investigation, as well as those who have resolved enforcement actions in the last few years, should take particular heed of the new DOJ policies announced in 2021. Both the DOJ and the SEC will likely come down hard on perceived "recidivist" conduct. Advocacy related to which individuals may have been involved in misconduct, the relevance of prior misconduct and whether a monitor is warranted will be of critical importance. Companies should also consider these new policies in consideration of potential self-reporting decisions given the impact on cooperation credit.

Cybersecurity: Data Breaches, Ransomware Attacks and Increased Regulatory Focus

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A 2021 survey of chief legal officers demonstrated that cybersecurity has overtaken compliance as the most significant legal risk that businesses face today.[1] This should not come as a surprise as 2021 brought a series of high-profile cyberattacks on major companies and U.S. infrastructure targets. Regulators also brought a number of cybersecurity enforcement actions, and announced new rules, guidance and initiatives on ransomware and other cyber-related issues. In addition, after many years of debate, Congress has made some progress in crafting legislation that would require certain companies to report significant cyberattacks and ransomware payments to the U.S. federal government.

Boards should expect that the demands of cybersecurity oversight will only intensify in 2022, and they should continue to exercise active oversight of this significant area of potential risk.

Data Breaches and Ransomware Attacks

2021 witnessed a number of significant data breaches, with widely disruptive ransomware attacks often taking the headlines:

— Colonial Pipeline, one of the largest fuel pipelines in the United States, suffered a ransomware attack that disrupted fuel supplies across the United States. The company paid $4.4 million in ransom, part of which was recovered by U.S. law enforcement.

[1] Association of Corporate Counsel, "2021 ACC Chief Legal Officers Survey" (March 2021), available here.

— CNA Financial, a large commercial insurer, announced that it suffered a ransomware attack that caused the company to pay $40 million to regain access to its data.

— Cyber criminals demanded $50 million from computer manufacturer ACER after breaching the company's systems. The company refused to pay the ransom demand, which was subsequently raised to $100 million, and was targeted again in a cyberattack in October.

— One of the country's largest meat suppliers, JBS USA, disclosed a ransomware attack that temporarily halted operations and led to a $11 million ransom payment.

— An Iowa-based provider of agricultural services, NEW Cooperative, suffered a ransomware attack resulting in a $5.9 million ransom demand that would increase to $11.8 million if the ransom was not paid within a five-day period. The company refused payment.

— Microsoft announced that a Microsoft Exchange hack exposed vulnerabilities in the email software, affecting over 30,000 organizations across the United States.

— Airline technology provider SITA announced that it suffered a data breach affecting approximately 2 million airline passengers. The stolen information included program card numbers, status level information and, in some cases, customer names.

Regulatory Focus on Cybersecurity

In response to continuing significant data breaches and other cyber incidents, regulators – particularly the SEC – were increasingly active in bringing cybersecurity enforcement actions against companies that allegedly maintained inadequate cybersecurity protections or that failed to comply with related disclosure obligations:

— In March, New York's Department of Financial Services (DFS) brought an enforcement action against Residential Mortgage Services, Inc. (RMS) for allegedly violating DFS's cybersecurity regulations requiring timely reporting of data breaches and comprehensive cybersecurity risk assessments. RMS, a licensed mortgage banker, collected sensitive personal data of mortgage loan applicants as part of its business operations. After a July 2020 examination, evidence was uncovered showing that RMS had failed to report a cybersecurity breach involving unauthorized access to the email account of an RMS employee with access to a significant amount of that data. RMS agreed to pay a $1.5 million penalty.

— In June, the SEC announced a settlement with First American Financial Corporation for disclosure controls and procedures violations related to a cybersecurity vulnerability that exposed customer information. After a journalist informed First American of a flaw in its systems, the company issued a public statement noting that it had shut down external access to the document-sharing application that had exposed customer information and had no preliminary indication of large-scale unauthorized access. However, at the time of this disclosure, senior management was unaware that the company's information security personnel had identified the vulnerability several months earlier and had failed to remediate it. Thus, the SEC charged the company with maintaining deficient disclosure controls and procedures, even absent a third-party breach or intrusion of the company's systems. As part of its settlement with the SEC, the company agreed to pay a $487,616 penalty.

— The SEC has also been conducting a sweep of public companies involving disclosures relating to the cyberattack involving software made by SolarWinds Corp., which became public in December 2020.[2] The SEC has sought information on a voluntary basis from companies that may have used the

[2] SEC, "In the Matter of Certain Cybersecurity-Related Events (HO-14225) FAQs" (June 25, 2021), available here.

compromised versions of SolarWinds software, and it has advised companies that if they cooperate by providing the requested information and making any required disclosures, the SEC will not recommend an enforcement action against recipients of the request relating to disclosure controls and procedures. However, the SEC has also asked companies responding to the request to not only provide information about the impact of SolarWinds, but also to provide information about other cybersecurity incidents involving external attacks. The sweep demonstrates the aggressive approach that the SEC is taking to evaluating companies' responses to cyberattacks both from disclosure and disclosure controls perspectives.

The sweep demonstrates the aggressive approach that the SEC is taking to evaluating companies' responses to cyberattacks both from disclosure and disclosure controls perspectives.

Separate from the enforcement actions, regulators issued new rules, guidance and initiatives on cyber-related topics, including ransomware and cyber-incident notification:

— In September, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued an Updated Advisory on Potential Sanctions Risks for Facilitating Ransomware Payments, which highlights the sanctions risks associated with making ransomware payments.[3] The advisory stresses that the U.S. government "strongly discourages" making ransomware payments and instead "recommends focusing on strengthening defensive and resilience measures to prevent and protect against ransomware attacks." Later, in October, OFAC issued Sanctions Compliance Guidance for the Virtual Currency Industry, which provides details for companies in evaluating sanctions-related risks, building sanctions compliance programs, protecting their businesses from misuse of virtual currencies and understanding OFAC's recordkeeping, reporting, licensing and enforcement processes.

— Given the proliferation of ransomware actors demanding ransom payments in the form of cryptocurrency, in October, the U.S. Department of Justice announced the creation of a National Cryptocurrency Enforcement Team (NCET) to oversee complex investigations and prosecutions of criminal misuses of cryptocurrency. The NCET will draw upon DOJ's Cryptocurrency Enforcement Framework, released in October 2020.

— Also in October, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued an Advisory on Ransomware and the Use of the Financial System to Facilitate Ransom Payments, which updates and replaces its previous advisory from 2020. The FinCEN Advisory examines the role of financial intermediaries in facilitating ransomware payments, which are generally paid using virtual currencies like Bitcoin; identifies trends, typologies and financial red flags of ransomware and associated payments; and stresses the legal obligations of U.S. financial institutions in the ransomware context—for example, to report suspicious transactions that may involve ransom payments to criminal actors.[4]

— In November, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Board) announced a final rule requiring banking organizations to notify their primary regulator of certain significant computer-security incidents within 36 hours. The rule separately requires bank service providers to notify their bank customers if they experience a

[3] For additional details, *see* our September blog post here. *See also* Economic Sanctions: Developments and Considerations in this memo.

[4] For additional details, *see* our November blog post here.

cyber-incident that causes a material disruption of services that lasts for four or more hours.[5]

— There has also been progress on a federal data security legislation that has eluded lawmakers for years. Congress is considering draft legislation that would require critical infrastructure companies to report certain substantial cyberattacks to the U.S. federal government within 72 hours, and would require businesses with more than 50 employees to notify the government within 24 hours of making a ransomware payment.

Litigation Developments

There were also significant developments in cyber-related litigation in 2021:

— California data breach law continues to develop in response to the California Consumer Privacy Act (CCPA)'s creation of a private right of action, with more than 80 CCPA-related cases filed throughout 2021. Notably, in February, a California federal judge dismissed plaintiffs' CCPA claim in class action litigation against Alphabet, Inc. and Google, LLC, on the basis that plaintiffs merely alleged that the defendants monitored and collected users' sensitive personal data without consent. The court found that the plaintiffs failed to allege that any personal information was subject to unauthorized access as a result of a security breach, reasoning that a private right of action under the CCPA could only be pursued for violations related to personal information security breaches.

— In May, in class action litigation stemming from a 2019 Capital One data breach, a federal judge in Virginia granted Capital One's motion to certify to the Virginia Supreme Court the question of whether Virginia state law imposes a duty to use reasonable care to protect consumers' personal information from disclosure. In so doing, the court noted there were not yet any cases in Virginia considering whether a tort duty of care exists in these circumstances. The decision to certify highlights the changing landscape of state law resulting from cybersecurity-related incidents.

— In June, in class action litigation against TransUnion stemming from violations of the Fair Credit Reporting Act, the U.S. Supreme Court issued a decision limiting consumers' standing to sue if the alleged harm, such as from misleading credit reports, does not actually materialize. This has potential implications for a wide variety of cyber-related cases in which personal information may be exposed but not necessarily used for fraudulent activity.

— In September, another federal judge in Virginia dismissed a shareholder derivative action against K12 Inc., a small-cap technology-based education company now known as Stride Inc., in connection with a series of cyberattacks affecting one of the company's largest customers. While the investors alleged that K12 had embarked on a campaign of self-promotion with respect to its cybersecurity protocols to inflate its stock price, the court highlighted that the plaintiffs never alleged that the company failed to have such protocols, only that its systems were not sufficient to meet the company's needs.

— In October, the Delaware Court of Chancery dismissed a shareholder derivative action concerning Marriott's discovery of a data breach for failure to make a pre-suit demand and failure to plead sufficient facts to establish demand futility. The court found that the Marriott board members did not face a substantial likelihood of liability stemming from the breach, as they had not failed to undertake their oversight abilities, turned a blind eye to compliance violations or consciously failed to remediate cybersecurity failures. Thus, the board retained its ability to assess whether to pursue litigation on behalf of the company and the derivative action was improper.

[5] For additional details, *see* our December blog post here.

Board Oversight Best Practices for 2022

In light of regulatory and litigation developments, boards should review their oversight of cybersecurity matters, including:

— Delegate to a committee of the board responsibility for cybersecurity matters (or establish specific cybersecurity review guidelines if responsibility is retained at full board) including (i) oversight of the implementation of disclosure controls and procedures related to cybersecurity risks and (ii) monitoring of potential vulnerabilities from third-party vendors.

— Establish regular briefings by management to the board of cybersecurity risks including benchmarking company policies and procedures against industry peers and best practices; create a robust record of such reporting including directors' active engagement in such discussions.

— Ensure that the board is familiar with the company's cyber-incident response plan including the proposed reporting matrices to communicate incidents.

— Periodically engage in a cybersecurity response tabletop exercise to familiarize directors with their oversight role in the event of a cyber-related incident, and document the occurrence of such exercises to show that directors have met their risk oversight duties.

— Regularly review the company's cybersecurity budget and assess cyber-related insurance coverage.

Key Takeaways

— Cybersecurity continues to be an essential issue for boards due to increased dependence on technology, a pandemic-generated shift to remote work arrangements and the continued proliferation of data breaches, ransomware attacks and other cyber intrusions.

— Ransomware in particular represents an increasing concern for companies from across industries, due to the substantial costs, legal risks and reputational concerns.

Increased regulatory action related to cybersecurity issues reflects the continued shift away from regulators viewing hacked companies as only victims and toward potentially holding them responsible for perceived deficiencies in their cybersecurity programs and other internal policies and procedures.

— Federal regulators instituted a requirement for banking organizations to notify their primary regulator of certain significant computer-security incidents, and there has been recent progress on a federal data security legislation that would apply more broadly. Boards should receive regular reports from management on developments in the law to keep abreast of their companies' evolving obligations in this area.

— Increased regulatory action related to cybersecurity issues reflects the continued shift away from regulators viewing hacked companies as only victims and toward potentially holding them responsible for perceived deficiencies in their cybersecurity programs and other internal policies and procedures. Importantly, regulators like the SEC are focused on whether and how a company maintains disclosure controls and procedures to ensure that management is adequately and timely informed of cyber incidents that warrant public disclosures. We expect these trends to continue in 2022 as the Biden administration enters its second year.

— Private litigation arising out of data breaches continues to proliferate. In dismissing plaintiffs' claims in the Marriott case, the court nevertheless noted that "corporate governance must evolve to address" cybersecurity risks and that "the corporate harms presented by non-compliance with cybersecurity safeguards increasingly call upon directors to ensure that companies have appropriate oversight systems in place."

— Collectively, these trends underscore the need for boards to take an active role in overseeing management's preparation of adequate cyber defenses and responses to incidents. Among other things, boards should establish clear ownership of cyber risk oversight, have briefings on cybersecurity risks to the full board and document steps the board has taken in connection with its oversight.

Sustainability Policy Remains Center Stage in Europe

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EU Regulatory Developments

2021 was a pivotal year for European sustainability policy, caught in the implementation of an ambitious agenda. This is expected to continue throughout 2022, when new rules will be finalized and others will enter into force, requiring companies to increase sustainability-related disclosures and due diligence requirements to further the EU Green Deal's climate transition plans. Regulators in other countries (such as the United Kingdom) are following suit.

These criteria establish which industrial activities (and therefore which investments) may or may not qualify as contributing substantially to "climate change mitigation" and "climate change adaptation".

Defining "Sustainable" Activities

After the entry into force of the Taxonomy Regulation (2020/852) in 2020, the European Commission turned to drafting the related "technical screening criteria."[1] These criteria establish which industrial activities (and therefore which investments) may or may not qualify as contributing substantially to "climate change mitigation" and "climate change adaptation" (the first two of the Taxonomy's six environmental sustainability objectives).

[1] For additional details on the Taxonomy Regulation, *see* our November 2020 Alert Memo here.

The economic activities affected by the screening criteria include sectors such as manufacturing, mining, energy and forestry.

Activities not recognized as "green" will increasingly face higher costs of capital and greater difficulty in attracting investments.

The screening criteria were adopted following fierce debate in December 2021 (with a January 1, 2022, application date).[2] At the forefront of the debate was whether nuclear energy and natural gas should qualify as sustainable – a question that was ultimately shelved in an effort to finalize the Taxonomy and remains to be covered by future amendments to the criteria.

Activities not recognized as "green" will increasingly face higher costs of capital and greater difficulty in attracting investments.

Measuring the Proportion of a Firm's "Sustainable" Activities

In the spring of 2021, the European Commission finalized a separate set of delegated acts under Article 8 of the Taxonomy Regulation. These rules specify the way in which EU-based large companies and EU-listed companies will be expected to measure and disclose (starting in 2023) the *proportion* (percentage) of their activities that qualify as environmentally sustainable under the Taxonomy Regulation.[3]

The rules depend on the type of business activity:

— ***Non-financial sector firms*** will be required to indicate in their annual reports the percentage of their turnover (revenues), capex and opex that are associated with sustainable (versus non-sustainable) industrial activities.

— ***For asset managers***, the relevant measure to be disclosed will be the percentage of sustainable activities that are carried out by the firm's portfolio companies (in proportion to the total value of its investments).

— ***For credit institutions***, the disclosure will require the proportion of loan and investment exposures toward sustainable activities and borrowers (that is, the bank's "green asset ratio" or GAR) as a proportion of the bank's total covered assets.

These detailed Article 8 annual disclosure requirements (of which the above are only examples) will imply a continuous monitoring and measurement of a company's business activities – particularly for financial sector firms, for which the financial exposures are by nature subject to continuous change.

Once in place, it is expected that the system will facilitate disclosures by investors and issuers further up a firm's value chain.

Wider Sustainability Reporting Duties

Sustainability reporting by EU companies will be subject to a more general overhaul starting in 2024.

The European Commission unveiled its proposal for a new Corporate Sustainability Reporting Directive (which would repeal and replace the Non-Financial Reporting Directive in force since 2018) in the spring of 2021.[4] The proposal is currently under review by the EU

[2] *See* the draft technical screening criteria that were formally adopted by the Commission in June 2021, available here. A "Taxonomy Compass" was also made available by the Commission (available here) to allow readers to browse through the draft criteria by sector of activity.

[3] *See* the delegated acts published under Article 8 of the Taxonomy Regulation, available here.

[4] *See* the draft "Corporate Sustainability Reporting Directive," available here. For an analysis of the Directive, *see* our May Alert Memo, available here.

Parliament and Council and should be finalized in the first half of 2022.

For the first time, companies will also be required to assign and disclose the role of their administrative, management and supervisory bodies with respect to sustainability matters.

The new Directive will markedly expand the scope of EU domiciled companies that are subject to non-financial reporting duties (from approximately 2,000 to over 50,000), by extending beyond the financial sector to all sectors of activity and at the same time lowering the applicable company-size thresholds. Further, it will abandon the current "comply-or-explain" framework in favor of a mandatory regime. Lastly, it will require all in-scope entities to have a proper "sustainability strategy" in place, including plans to ensure that their model and strategy are compatible with the limiting of global warming to 1.5°C in line with the Paris Agreement, with targets and an annual measurement of the progresses made.

For the first time, companies will also be required to assign and disclose the role of their administrative, management and supervisory bodies with respect to sustainability matters.

Financial Sector Disclosures

EU fund and asset managers have been subject to detailed sustainability reporting obligations since March 2021. These are destined to increase, as the application of the Sustainable Finance Disclosure Regulation (2019/2088) continues to phase in throughout 2022 and 2023.[5]

In 2021, fund managers, including non-EU managers of alternative investment funds registered for marketing in Europe, were busy preparing their ESG policies and the pre-contractual disclosures on the sustainability of their portfolio companies, at the level of each fund they manage. Reinforced disclosure requirements apply to "impact" and "green" funds.

In 2022 and 2023, fund managers will also need to prepare for the first time their annual ESG reports, which must include detailed measurements of the principal negative impacts of their investments on sustainability factors over the previous year, and all actions taken or planned in order to remediate them.

Mandatory Supply Chain Due Diligence

In the spring of 2021, the European Parliament issued a detailed set of recommendations to the European Commission on a new Directive regulating corporate due diligence and accountability on ESG matters.[6] The text of the draft Directive was originally expected before the end of 2021, and has since been delayed to 2022.

Based on the recommendations of the EU Parliament, it is expected that the new regime will establish minimum due diligence requirements for large, listed and high-risk sector companies to identify, monitor, disclose and remediate the adverse impacts on sustainability factors down their entire "value chain," including second- and third-tier suppliers, customers, business partners and subsidiaries. The Directive is also expected to establish rules on the accountability of companies' Board members for the observance by companies of their due diligence obligations.

These rules also are likely to capture non-EU companies that sell goods or provide services within the EU, but probably not before 2024-2025.

5 For more information on the Sustainable Finance Disclosure Regulation, *see* our January 2021 Alert Memo, available here.

6 *See* the EU Parliament's recommendations and other working documents on the "Sustainable Corporate Governance" initiative, available here.

Sustainable Debt

In July 2021, the European Commission tabled yet another regulatory proposal on a new EU Green Bond Standard.[7]

Just like the industry-born Green Bond Standard maintained by the International Capital Markets Association (ICMA), the EU's standard was proposed as a voluntary standard, to which bond issuers would be free to adhere. In this case, however, the standard would attest the use of a bond's proceeds for financing green projects aligned with the EU Taxonomy, which sets a higher, measurable and "premium" sustainability standard.

In November, however, the European Central Bank commented that the EU Green Bond Standard should become mandatory for EU issuers and all other bonds traded as "green" on EU regulated markets, after a transitional period.[8]

ESG Pressures From Courtroom to Boardroom

Just as the regulatory landscape is changing dramatically across Europe and beyond, the disputes landscape is also undergoing a sea change, with corporations increasingly exposed to ESG liability as a result.

For the first time, in May 2021, a court imposed a duty on a company to "do its share" to contribute to climate change mitigation. The District Court of The Hague ordered Royal Dutch Shell plc to reduce its worldwide CO_2 emissions by 45% by 2030 compared to 2019, in line with targets set out in the Paris Agreement.[9]

The lawsuit was filed as a class action by Milieudefensie (Friends of the Earth Netherlands) and six other Dutch non-governmental organizations, plus approximately 17,000 individual co-claimants. Although Shell has challenged the ruling, it is required to comply pending appeal.

This case may usher in further claims against energy companies – and those in other sectors – to reduce their contributions to climate change. It is still unclear at this stage, however, whether other courts may follow suit and translate emission targets set by governments into concrete obligations for corporations.[10]

Another evolving doctrine relevant for ESG liability is the concept of parental company liability. The UK Supreme Court for the first time decided in *Vedanta Resources plc and another v Lungowe and others* in 2019 that an English parent company may in principle be held liable for the activities of its overseas subsidiaries when it has been negligent in the subsidiaries' oversight.[11] Further decisions from the UK Supreme Court and from The Hague Court of Appeal in the Netherlands in early 2021 applied similar principles in the case of Royal Dutch Shell and the activities of the group's Nigerian subsidiary.[12] Decisions such as these may in the coming years open the door for potential claims against parent entities for issues that arise far up supply chains.

ESG pressures will also be felt outside the courtroom. In the boardroom, pressure from activist shareholders will continue, increasingly coupled with an environmental agenda.

7 *See* the EU Green Bond Standard proposal, available here.

8 *See* the European Central Bank's opinion on the "EU Green Bond Standard" proposal, of November 5, 2021, available here.

9 The Hague District Court, *Milieudefensie et al. v. Royal Dutch Shell plc*, NL:RBDHA:2021:5339 (May 26, 2021), available here. For further information, *see* our June Alert Memo, available here.

10 For further information, *see* our Climate Change Litigation publication, available here.

11 *Vedanta Resources PLC and another v Lungowe and others* [2019] UKSC 20, Judgment (April 10, 2019), available here. For further information on the decision and its implications for managing risk in multinationals, *see* the November 2020 article by Cleary Gottlieb attorneys, available here.

12 For further information regarding the 2021 decision of the UK Supreme Court in *Okpabi and others v Royal Dutch Shell plc and another*, and the 2021 decision of The Hague Court of Appeal in *Milieudefensie and others v Royal Dutch Shell Plc and Shell Petroleum Development Company of Nigeria Ltd*, *see* the May article by Cleary Gottlieb attorneys discussing the decisions and ESG liability risks, available here.

In May 2021, activist investor Engine No. 1 emerged from its proxy battle with ExxonMobil having nominated three directors to the energy major's board, hoping to develop a clean energy strategy.[13] Later, in the fall of 2021, activist hedge fund Third Point argued that the Royal Dutch Shell group should break up, into legacy oil and chemicals lines and a green arm.[14] Pressures from activists are expected to increase in the coming year.

As corporates look forward to the coming year, navigating the changing regulatory landscape while facing pressures in both the courtroom and the boardroom may feel like walking a tightrope. Adding to the mix investors and customers are increasingly focused on climate and ESG factors and companies that are responsive and proactive in disclosures and labelling may reap benefits in engagement and reputation. Board members will need to find a balance between the interests of shareholders interested in maximizing returns and those with an activist agenda or requiring consideration of social or other stakeholder interests.

[13] Financial Times, "Hedge fund that beat ExxonMobil says it will have to cut oil output" (May 27, 2021), available here.

[14] Financial Times, "Activist fund Third Point calls for break-up of Shell" (October 27, 2021), available here.

Taxes: Stepping up Enforcement and Ending the Global "Race to the Bottom"

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The path was paved in 2021 for unprecedented tax developments in the coming years for large businesses, especially for multinationals and investment businesses operating across borders. The year ended with what appeared to be significant progress in the OECD/G-20 "inclusive framework" project, with nearly 140 countries working to fundamentally change some of the ways in which they will tax multinational businesses. 2022 may also bring other new taxes and new tax regimes, amidst enhanced investigations and enforcement action in key jurisdictions like the United States and the European Union.

The push for global tax reform received a significant boost in 2021, with broad international consensus reached on the principles of a "two-pillar solution" intended to come into effect, for the most part, in 2023.

With the COVID-19 pandemic continuing to weigh on fiscal budgets globally, governments will at some point soon need to recoup lost revenue. The most likely path appears to be new taxes and increased enforcement targeting the world's largest and most successful enterprises.

Developments Toward Global Agreement on Corporate Taxation for Multinationals

The push for global tax reform received a significant boost in 2021, with broad international consensus reached on the principles of a "two-pillar solution" intended to come into effect, for the most part, in 2023.

Pillar One is aimed at large multinational businesses that have customers in jurisdictions where the business has no or minimal physical presence. Regulated financial services and extractive industry businesses are exempt, and other multinationals are subject to the rules only if they have "global turnover" (i.e., gross revenues) above €20 billion and profitability (i.e., profit before tax/revenue) above 10%. Where the rules apply, 25% of the group's residual profits (i.e., profits in excess of 10% of revenue) may be allocated to and taxed in market jurisdictions even if the group does not have sufficient presence there to create a taxable nexus under current rules.

For now, the financial thresholds for entry into the regime should mean that Pillar One will have little impact for most businesses, with only approximately 100 global groups likely to be affected. However, there are some knock-on consequences (like the abolition of unilateral digital services taxes as a quid pro quo for the new regime) that will be of wider interest. The next-largest tranche of multinationals should also be aware that the turnover threshold could be reduced to €10 billion once the regime has been operating for a few years.

Pillar Two has the potential for a more far reaching impact. Its purpose is to ensure that large multinationals pay a minimum 15% level of tax on their worldwide income wherever they are headquartered or have their business operations. The rules will apply to multinationals with €750 million or more in consolidated revenues, although sovereign, nonprofit and charitable entities, and pension, investment and real estate funds will be excluded.

The main tool to achieve Pillar Two's global minimum tax is a global anti-base erosion regime consisting of two components: an income inclusion rule (IIR) and an undertaxed payments rule (UTPR). The idea is that in-scope taxpayers calculate their effective tax rates in the jurisdictions where they operate and pay a top up tax for the difference between their effective tax rate per jurisdiction and the 15% minimum rate. The IIR will generally charge the top up tax in the jurisdiction of the ultimate parent company; the UTPR will act as a backstop if IIR rules do not pick up all of the group's low-taxed income and will require adjustments (such as a denial of a deduction) to increase tax levels in subsidiary jurisdictions.

There will be limitations, including a *de minimis* exclusion for jurisdictions where revenues and profits are low, and a substance carve out that excludes certain amounts of income based on the carrying value of tangible assets and payroll.

A further rule is also being developed that would allow developing countries to deny treaty benefits in respect of interest, royalties and certain other payments that are subject to corporate income tax at below 9% in the recipient country, in effect creating a right to tax the difference.

Much work remains to be done on finalizing the detail of the new rules and in providing guidance for taxpayers. It is also worth noting that individual jurisdictions or blocs might adopt local minimum top up taxes on similar but not identical principles. The EU, for example, has announced that it will apply income inclusion rules to purely domestic groups and to multinational groups.

Particular challenges present themselves in the United States. The Biden administration has been one of the most forceful champions of Pillar Two but ended 2021 with a failure to get Congress to enact the Build Back Better Act (discussed further below), which would have brought U.S. tax law into compliance with Pillar Two.

Thus, the United States begins 2022 with international tax rules (known as GILTI and BEAT) that conflict with Pillar Two's IIR and UTPR. The impact of this on the success of Pillar Two (and the timeline for its effectiveness) is unclear.

The United States' Build Back Better Act

In the United States, the focus in 2021 was on whether the Biden-endorsed Build Back Better Act (BBB), with its far-reaching tax law changes, would be enacted and, if so, with what modifications and when. As of this writing, it appears to be virtually certain that the BBB will not be enacted in its current form. Yet, boards of directors will want to understand how the BBB's tax provisions would affect their companies, because these provisions could be enacted in 2022 as part of a revised BBB or as part of another legislative package.

The tax provisions in the BBB are almost entirely revenue raisers (i.e., tax increases) intended to (i) fund the social spending provisions that are the heart of the BBB and (ii) achieve certain international and domestic policy objectives (including bringing the U.S. rules into compliance with Pillar Two, as mentioned above). The BBB's international provisions would make significant changes to the international tax rules enacted at the end of 2017 (by the Trump-era tax reform known as the TCJA). The TCJA basically re-wrote the international provisions of U.S. tax law. In the view of the Biden administration and other Democratic proponents of the BBB, the TCJA has encouraged U.S. businesses to move operations and revenue into foreign low-taxed jurisdictions, contributing to what is referred to as a global "race to the bottom" – that is, non-U.S. jurisdictions lowering their tax rates to attract businesses and jobs and multinationals responding by restructuring operations to take advantage of the tax savings. The BBB was designed to reverse this and therefore is full of provisions that would increase the U.S. taxes on income derived by U.S.-headed multinationals from their non-U.S. subsidiaries. The BBB would also increase the U.S. taxes paid by foreign-headed multinationals with U.S. operations by targeting, among other things, payments made by these U.S. operations to the foreign parent or foreign affiliates. These provisions include changes that would bring the U.S. rules into almost full alignment with the OECD's Pillar Two rules discussed above.

The BBB's tax provisions have been of concern to businesses in 2021, not only because of the tax increases but also because of the increase in complexity and uncertainty.

The BBB provisions in their current form include:

— A new alternative "minimum tax" equal to 15% of financial statement book income, applicable to corporations with profits over $1 billion;

— A new 1% excise tax on corporate stock repurchases;

— Modifications to the GILTI rules applicable to U.S. corporations with non-U.S. subsidiaries, including increasing the tax rate on the non-U.S. income to 15% computed on a country-by-country basis;

— Modifying the rules that apply a lower rate to U.S. corporations' Foreign-Derived Intangible Income (FDII) so that the rate is closer to the normal corporate tax rate;

— Modifications to the Base Erosion and Anti-Abuse Tax (BEAT) applicable to multinationals that make payments from the U.S. to their non-U.S. affiliates; and

— Modifications to the rules limiting interest deductions to apply a new additional limitation on multinationals that have significant leverage in their U.S. entities.

The BBB's tax provisions have been of concern to businesses in 2021, not only because of the tax increases but also because of the increase in complexity and uncertainty. Since the TCJA was enacted at the end of

2017, the Treasury Department, the IRS and businesses have devoted an enormous amount of time and resources to trying to understand, interpret, adapt to and apply these rules. The BBB would make changes to virtually all of the TCJA provisions and enact a handful of entirely new rules; all of the BBB changes are complex, and there are significant gaps and ambiguities. Accordingly, the multi-year process that followed enactment of the TCJA would start all over again, and businesses would face uncertainty about the meaning of the new rules while the process was playing out.

The tax departments of most multinationals have already spent the better part of 2021 assessing the potential impact that the BBB's tax provisions would have on them. If these provisions are enacted in 2022, the focus for business stakeholders will be on the regulatory rule-making process, whether to undertake structural and operational changes in response to the new laws, and trying to develop tax expense projections with sufficient certainty.

The United States – Digital Assets

The Infrastructure Investment and Jobs Act (the Infrastructure Bill) enacted on November 15, 2021, imposes new information reporting requirements on transactions in cryptocurrencies and other digital assets. One provision is aimed at centralized exchanges and requires information reporting, starting in 2023, of transfers of cryptocurrencies and other digital assets. Another provision, effective starting in 2024, will require persons that receive $10,000 or more in digital assets in connection with a trade or business to report the transaction under the existing rules for receipt of $10,000 or more in cash. The penalties for noncompliance are significant and include criminal sanctions.

These changes were motivated by lawmakers' conviction that digital assets were facilitating noncompliance and significant tax evasion, but have been widely criticized as applying too broadly and requiring many blockchain participants to report information they may not have. Although Congress declined to narrow the text, the Treasury Department and the IRS have signaled that they are willing to work with the industry to better define the scope of the new requirements.

Joint Tax Audits and Increased Cooperation in the European Union

Following initiatives at the level of the OECD and the European Commission, on the enforcement side we expect to see an increase in joint audits conducted by Member States of the European Union.

A legal framework for joint audits was introduced in 2021 with a new Directive on administrative cooperation in the field of taxation (known as DAC7). DAC7 allows the competent tax authorities of one EU Member State to request joint audits with the competent authorities of other EU Member States. Such joint audits would be conducted in a pre-agreed and coordinated manner and in accordance with the law and procedural requirements of the Member State or States where the activities of the joint audit take place.

The joint audit provisions of DAC7 need to be transposed into national law by December 31, 2023, so groups with operations in multiple EU Member States should ready themselves for investigations under DAC7 by 2024.

One other noteworthy aspect of DAC7 is the introduction of a new mandatory reporting obligation for operators of digital platforms, requiring those with a nexus in the EU to identify certain sellers and to report information about income realized by their sellers from certain relevant activities (e.g., the sale of goods, the rental of immovable property, the provision of personal services and the rental of any mode of transport). These provisions need to be transposed into national law by December 31, 2022.

Key Takeaways

— Groups with entities operating in low-tax jurisdictions should work through the details of the OECD minimum tax rules and implementing rules in the EU and other local jurisdictions. The world's largest multinational groups in scope for new taxation in market jurisdictions will already be up to speed, but those in the next tier should remain alert to the possibility of entry criteria broadening in due course.

— U.S.-headed multinationals with non-U.S. subsidiaries and foreign-headed multinationals with U.S. operations will want to understand how the tax law changes proposed in the BBB would affect their groups. Even though the legislation has failed to pass in 2021, it is possible that some or all of the provisions will be enacted in 2022.

— Groups operating on a cross-border basis in the EU should prepare for an increase in tax investigations, and the prospect of coordinated joint audits conducted by more than one Member State.

U.S. & EU Antitrust: Developments and Outlook in 2022

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In the 2021 edition of this memo, we wrote that antitrust in 2020 received more political and media attention than at any recent time. 2021 beat that standard in multiple ways, and 2022 looks to continue that trend. In addition to continuing the major tech cases brought under the Trump administration, 2021 saw unprecedented levels of legislative activity in antitrust (both federal and state), competition policy taking a leading position across federal agencies and startling new approaches at the Federal Trade Commission (FTC) in particular – new approaches that, while they haven't yet produced a wave of new enforcement actions, have required changes in thinking about and approaching antitrust issues. We expect these trends to accelerate in 2022.

The biggest antitrust story of 2021 was the sidelining of antitrust moderates, including long-time Biden advisors, as the progressives in antitrust took control of the administration's agenda.

Enforcement in the Biden Administration: The Progressives Take Control, and the Whole Government Joins the Party

Going into 2021, the consensus in the antitrust world was that President Biden's election, combined with the 50-50 split in the Senate, signaled continuity and moderation, with key appointments likely coming from the Democratic Party's antitrust mainstream. But that was not what happened; instead, the biggest antitrust story of 2021 was the sidelining of antitrust moderates, including long-time Biden advisors, as the progressives in antitrust took control of the administration's agenda.

The takeover was headlined by the appointment of Columbia professor Tim Wu, a leading progressive antitrust thinker, as Special Assistant to the President for Technology and Competition Policy on the National Economic Council. With Wu in place, the Biden administration launched an expansive antitrust agenda, issuing a sweeping executive order on competition in mid-2021 that instructed multiple agencies (including but not limited to the FTC and the Antitrust Division of the Department Of Justice (DOJ)) to launch reviews and initiatives aimed at including competition policy across the landscape of the federal government.

Further widening its antitrust policy focus, the White House also established a Competition Council, consisting of eight cabinet secretaries and the heads of eight independent agencies. The Council notably includes agencies like the FDA, which have not traditionally focused on competition policy. Soon after the Council's inaugural meeting, the FDA issued a first-of-its-kind proposed rule aimed at bringing increased competition to the market for the sale of hearing aids, a surprising move. In 2022, expect increased scrutiny and enforcement of competition practices by other federal agencies outside of the FTC and DOJ. Those are likely to include the Departments of Agriculture, Health, Labor and Transportation adopting antitrust-influenced frameworks, rules and regulations.

Radical Changes but Uncertain Impact at the Federal Trade Commission

The FTC in 2021 was characterized by staff and leadership turmoil, controversy and at least the appearance of a significant shift in agency priorities and practices. Initially, under Acting Chair Slaughter, the FTC largely continued its longstanding consensus-driven approach to antitrust, albeit with some aggressive statements on various issues from the Acting Chair and fellow Democratic Commissioner Rohit Chopra. That approach changed substantially with Lina Khan's ascension to the position of FTC Chair.

Khan, a headliner antitrust progressive most famous for her criticism of Amazon and of the view that antitrust should focus on protecting consumers from higher prices or reduced output, was originally nominated by the President to be a Commissioner; no mention was made of her being Chair. Yet, to the surprise of observers and (as we understand it) much of the Senate, immediately after she was confirmed as a Commissioner the President designated her as Chair – an important distinction, because the FTC Chair controls the day-to-day administration of the FTC. Khan, with a three-Commissioner majority, moved swiftly to alter FTC practices in several areas:

- Streamlining the process of adopting trade regulation rules and initiating discussion of several possible rules, notably including unprecedented rules on competition (such as on exclusive contracts, discounts and other widespread contractual practices)
- Streamlining procedures for issuing compulsory process and eliminating the normal requirement of Commission votes for process in a wide range of cases
- Rescinding longstanding bipartisan FTC guidance on antitrust enforcement to reflect a more regulatory, aggressive philosophy
- Withdrawing from the recently adopted Vertical Merger Guidelines, leaving the FTC differently situated from the DOJ and with no clear guidance on vertical mergers.

Interestingly, though, these and other aggressive steps were not accompanied by an uptick in case filings (either initially under Acting Chair Slaughter or subsequently under Chair Khan); in fact, FTC case filings declined from the levels set under the Trump administration.

In any event, following this initial spate of activity, the progressive agenda has been slowed by the departure of Commissioner Chopra to serve as Director of the Consumer Financial Protection Bureau. While Commissioner Chopra cast a number of so-called "zombie votes" enabling the Commission to move forward on a limited number of issues after his departure, the Commission now has only four Commissioners, and so any controversial steps will have to wait until another Democratic Commissioner is confirmed, since the two Republicans can block new Commission actions they don't support.

As a result, Commission action in the near future will either involve consensus – such as the study of supply-chain disruptions launched in December 2021, or the recently-filed challenge to the merger of NVIDIA and Arm – or areas in which the Chair and Bureau Directors can act without a vote, such as in issuing Second Requests triggering in-depth reviews of mergers (but actual challenges to mergers or consent decrees will require Commission votes, and thus at least some Republican support).

The President has nominated Alvaro Bedoya, a Georgetown law professor and privacy expert, to the Commission; however, his nomination (though supported by all four current FTC commissioners) drew significant opposition in the Senate and failed to advance in 2021. The President has just renominated Bedoya, re-starting the confirmation process. While we think it is still more likely than not that he will be confirmed, it may take several months for the process to play out.

So what will we see from the FTC in 2022? Initially, enforcement action in the form of consent decrees and litigated cases will likely be limited to consensus cases, given the 2-2 Commission split. Chair Khan has used the tools at her disposal to delay the review of some mergers, to launch full Second Request investigations of mergers that on their face don't appear to raise competition issues and to issue threatening-sounding though legally insubstantial letters to merging firms reminding them that HSR clearance doesn't mean that the merged firm is immune from antitrust scrutiny. We expect those trends to continue, even if they don't result in enforcement action in the near term. While FTC staff has been subjected to a gag order and barred from public speaking since Chair Khan's arrival, limiting insight into the FTC's position and practices, we expect the limited public statements from the FTC to continue pushing for a progressive agenda. This will likely include criticizing large firms, touting the virtues of deconcentrating markets and expressing a general skepticism of mergers.

If Professor Bedoya is confirmed (or if his nomination fails to progress and another progressive Democrat is appointed and confirmed), we expect the FTC to move aggressively to advance Chair Khan's original agenda. This will likely include:

— working with the DOJ to propose new, anti-merger vertical merger guidelines;

— revising the horizontal merger guidelines to make them more hostile to mergers;

— continuing attempts at competition rulemaking;

— challenges to mergers that might previously have been viewed as competitively neutral or even beneficial, with the pharmaceutical, technology, energy and retail industries particularly likely targets;

— dusting off the Robinson-Patman Act, a federal law that prohibits "price discrimination" and is so widely viewed as poorly designed and counterproductive that the federal agencies have essentially ignored it for decades. Chair Kahn, however, has specifically called for reinvigorating Robinson-Patman in order to, for example, prevent large firms from obtaining better discounts than smaller firms (which may have more symbolic than practical effect, as most businesses covered by the Act attempt to comply with it anyway due to the risk of private enforcement).

It's worth noting that 2022 could also be a challenging year for the FTC. The FTC has already lost some enforcement tools as a result of court decisions addressing nuances of the FTC Act, and Chair Khan's actions have jeopardized prior congressional consensus to restore the FTC's authority. Moreover, current judicial skepticism of administrative agencies – including at the U.S. Supreme Court – could result in changes to or limits on the FTC's independence, authority and procedures, as several cases raising these issues (with the FTC specifically or with other agencies) are winding their way through the courts.

U.S. Department of Justice

In 2021, DOJ antitrust enforcement largely took a back seat in the media to headline-generating FTC announcements. The antitrust bar viewed the DOJ as, at the very least, more predictable than the FTC – though it is worth noting that under Acting Assistant Attorney General Richard Powers, the DOJ quietly walked back some of the pro-intellectual property positions taken by former AAG Makan Delrahim and brought several significant cases, including a challenge to the AA/JetBlue domestic alliance (despite its clearance by DOT), and a lawsuit to block the merger of Penguin Random House and Simon & Schuster (particularly notable because it focuses on a "monopsony," or buyer-power theory involving harm to bestselling authors).

The relatively low-key situation at DOJ will likely change in 2022 as recently confirmed antitrust chief Jonathan Kanter takes the helm. While (unlike FTC Chair Khan) Kanter is an experienced antitrust lawyer with a history of representing large companies such as Microsoft and Yelp, he was supported by progressives as an anti-Big Tech advocate, notably because of his substantial private practice work representing Google adversaries. Kanter, while only on the job for a few weeks, has already signed off on a major merger challenge in the sugar industry, and has also expressed support for the DOJ's groundbreaking criminal cases involving so-called "no-poach" agreements, where businesses agree not to compete for each other's employees. The exact direction of the DOJ under AAG Kanter is difficult to predict, and the first few months of 2022 will shed light on two important questions: (1) Will the DOJ under AAG Kanter follow FTC Chair Khan's more radical positions, or serve as a moderating force reflecting Kanter's experience and views?; and (2) Who will be appointed to the critical Deputy positions under AAG Kanter? – which, in a surprising and unprecedented development, remain vacant even though they do not require Senate confirmation and are normally filled early in an administration.

Legislation

2021 was an extremely eventful year for introducing antitrust legislation – but not for passing it. At the federal level, a spate of bills proposing changes to general antitrust enforcement as well as specific bills aimed primarily at hobbling U.S. technology companies were introduced in both the House and Senate, but none advanced. The general antitrust bills run the gamut from relatively narrow changes to HSR filing fees and agency funding, to restoring FTC enforcement authority, to sweeping changes to merger law that would give the government (which already wins the majority of merger cases it brings) even more advantages in merger challenges. These bills have generated unusual legislative coalitions both in support and opposition, and they will be interesting to watch.

State legislatures are also worth watching. Notably, New York came fairly close to passing legislation that would have effectively turned the state of New York into a global merger enforcer with a pre-closing filing requirement that would apply to transactions around the world (even transactions with no apparent connection to New York), as well as prohibiting (and potentially criminalizing) routine business practices even when those practices would be procompetitive. The bill's sponsors have pledged to reintroduce it; we will follow this with interest.

All in all, there is more antitrust legislation pending or promised today than at any time in nearly the last century. Close attention to this space is warranted.

Europe

On the other side of the Atlantic, antitrust in 2022 is likely to be even more eventful. We identify five points for attention.

First, the EU's Digital Markets Act (DMA) will be adopted, likely before mid-2022. In response to a perception that traditional competition law doesn't work when it comes to the digital economy, the DMA is designed to regulate digital platforms that are considered to be “gatekeepers.” On announcing the DMA, Commissioner Vestager explained: “We’ve come to a point where we have to take action. A point where the power of digital businesses – especially the biggest gatekeepers – threatens our freedoms, our opportunities, even our democracy . . . So for the world’s biggest gatekeepers, things are going to have to change.”

The DMA marks a dramatic shift from relying on *ex post* competition law to *ex ante* regulation. It’s the most notable of the new wave of global regulation – across the US, Europe and Asia – because of its broad geographic scope, the near-certainty that it will pass, the inflexibility of its rules, and the severe consequences of non-compliance. The DMA provides for a set of strict behavioral rules that apply directly to platforms (“do’s and don’ts”). Some of the DMA’s obligations are relatively non-controversial, such as the rule against wide most-favored nation clauses, or the rule against platforms using businesses’ non-public data to compete against them. Other provisions, in contrast, are far-reaching and novel. For example, the draft DMA includes a rule requiring gatekeeper search services to share Europeans’ search data with potentially unlimited rival search services. It also includes an unbounded and open-ended access and interoperability obligation.

The DMA’s rules are rigid and categorical. They don’t take account of competitive effects or harm; they do not explicitly allow for efficiency justifications; and they only provide for extremely narrow exemptions. The DMA’s penalties, in turn, are severe: fines of up to 10% of a gatekeeper’s annual global turnover and behavioral remedies, including breakup in the case of multiple infringements. Under amendments proposed by the EU Parliament, there would be a minimum fine of 4% of a gatekeeper’s worldwide revenue and a maximum cap of 20%; in other words, there would never be discretion to set a fine lower than 4% of global revenue.

Second, Germany has already introduced new rules to tackle perceived problems in the digital space. The 10th amendment of the German Act Against Restraints of Competition has given the German Federal Cartel Office (FCO) the power to prohibit certain conduct by digital companies with so-called “paramount cross-market significance” (PCMS). Under the new rules, the FCO can issue an *ex ante* prohibition order against certain conduct by PCMS companies, based on an open-ended list of practices (*e.g.*, impeding interoperability, gaining unfair advantages, leveraging, or self-preferencing). There’s no need for the FCO to prove competitive harm, and the company bears the burden of proof to justify its practices. The FCO has already opened investigations against Amazon, Facebook, Apple and Google under the new rules. 2022 may see the FCO reach decisions in many of these cases and open new investigations.

Amid all these new rules, traditional antitrust will continue – and it will continue to focus on Big Tech.

Third, the traditional European system of merger control established over the past 30 years is undergoing significant reform and 2022 will be characterized by more merger control in Europe. In response to a critique that its jurisdictional scope has been too narrow and that anticompetitive transactions – in particular, in the digital sector – are escaping review, antitrust agencies across Western Europe have expanded (or are considering expanding) the jurisdictional reach of their merger laws. Germany and Austria have introduced transaction value-based thresholds. The UK has applied its “share of supply” test to assert jurisdiction over transactions involving companies with no or minimal UK revenues and proposed a mandatory notification regime for large digital platforms. The EU Commission (EC) has issued guidance encouraging Member State agencies to refer to it potentially anticompetitive transactions that would otherwise escape review because they do not meet national thresholds, while the European Parliament proposes to amend the DMA to allow the EC ban gatekeepers from engaging in any acquisitions at all. In addition, France and the Netherlands are considering new rules that would either include transaction value thresholds or require mandatory notification of all acquisitions by leading digital platforms.

Fourth, amid all these new rules, traditional antitrust will continue – and it will continue to focus on Big Tech. Amazon is reportedly seeking to settle two EC investigations regarding preferential treatment of its own retail offers and those of marketplace sellers that use its logistics and delivery services. The EC has opened an investigation into whether Facebook uses advertising data from its advertisers to compete with them in markets where Facebook is also active. And the EC issued a statement of objections (a formal charge sheet) against Apple, concerning its App Store policy – the EC objects to Apple requiring app developers to use Apple's in-app payment for buying digital goods, and to Apple banning developers from communicating to customers that alternative subscription routes and payment options are available, *e.g.*, subscribing through the developer's website. The EC may also be emboldened by the EU General Court, in November 2021, partially upholding its *Google Shopping* decision and the €2.3 billion fine.

Fifth, the UK has now fully left the European Union and will "take back control" by adding red tape and compliance costs for companies in the competition space. In mergers, the Competition and Markets Authority (CMA) now has jurisdiction to investigate transactions that were previously subject to the EC's exclusive jurisdiction. The CMA therefore expects to investigate many more transactions, including complex mergers that are subject to parallel investigation by other agencies around the world. While the UK's voluntary regime means that not all these mergers will be notified or require investigation in the UK, the CMA has projected a 40-50% increase in its merger caseload. The CMA's recent interventionist approach towards mergers suggests that securing UK merger approval for international transactions may be at least as arduous, protracted, and challenging as the EU process (if not more).

As to antitrust enforcement, the CMA has gained jurisdiction over international cartel and abuse of dominance cases that are today investigated by the EC, but not national authorities. In respect of cartels, companies applying for leniency at the EU level will need to consider whether to submit parallel applications to the CMA, while dominant companies may face parallel investigations of their unilateral conduct.

The CMA's leadership has been quick to realize that Brexit provided an historic opportunity to strengthen the authority's claim to being one of the world's leading competition agencies.

The CMA's leadership has been quick to realize that Brexit provided an historic opportunity to strengthen the authority's claim to being one of the world's leading competition agencies. Over the last few years, the CMA has therefore grown in stature, authority, and confidence. Dr. Andrea Coscelli, the CMA's Chief Executive, is determined to see the CMA "play an important role in helping the UK to continue, up to and beyond its Exit from the EU, to be a dynamic competitive economy for consumers and businesses." The CMA has already flexed its muscles by taking increasingly-activist positions, such as ordering Facebook to divest Giphy, even though Giphy has no sales, assets, customers or employees in the UK. The CMA is also forging ahead with establishing a new regulatory framework for digital markets. While the precise scope and content of the new rules are presently uncertain, they could have far-reaching implications for digital platforms and the consumers and businesses that use them. In short: watch this space.

Navigating the Complex Regulation of Privacy and Data Protection

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Privacy Compliance Remains Top of Mind in 2022

For those following data privacy and consumer data protection trends, it should come as no surprise that enacting comprehensive legislation to regulate companies' use of personal data has continued to be a focal point both internationally and in the U.S., at the federal, state and local levels.

In the last three years, over 10 federal proposals and over 40 state proposals for comprehensive privacy legislation were introduced across the U.S., and we expect this trend to continue well into 2022, given the growing bipartisan support for legislation to protect consumer interests and mitigate against the risks associated with the digital economy. The ever-changing landscape and patchwork of compliance obligations globally will only continue to grow more complex and costly, and may lead to increased regulatory scrutiny and potential enforcement actions despite best compliance efforts. In the U.S., without comprehensive federal data privacy legislation, businesses remain subject to numerous state laws with ambiguous and sometimes conflicting legal obligations. Trans-Atlantic and other international data flows will only continue to become increasingly difficult and costly to navigate in light of recent developments, including in China, the UK and the European Union.

In 2022 companies will continue to require attention to and understanding of distinct, and at times conflicting, data privacy regimes both within the U.S. and in other jurisdictions.

Therefore, in 2022 companies will continue to require attention to and understanding of distinct, and at times conflicting, data privacy regimes both within the U.S. and in other jurisdictions, and thus it is of critical importance that boards and management ensure compliance with existing legislation and continue to monitor impending new developments both domestically and internationally.

Increasing State Legislation: Virginia and Colorado

Building upon the framework established by the California Consumer Privacy Act (CCPA) and the California Privacy Rights Act (CPRA), Virginia and Colorado became the second and third states respectively to adopt comprehensive consumer data protection laws, imposing new obligations on businesses and providing residents with new rights regarding the collection and processing of their personal data. While the Virginia Consumer Data Protection Act (VCDPA) and the Colorado Privacy Act (ColoPA, each an Act and collectively the Acts) largely track the requirements under the CCPA and CPRA, each Act imposes some significant new requirements on businesses, such as mandatory data security assessments for certain processing activities, and provides consumers with new and enhanced rights and protections, such as correction rights, that companies will need to take note of and begin to work into their existing data protection policies.

Scope

The VCDPA, effective January 1, 2023, and the ColoPA, effective July 1, 2023, each apply to entities or persons that (1) conduct business in each respective state or produce products or services targeted to its residents and (2) either control or process (a) the personal data of 100,000 state residents or more during a calendar year or (b) the personal data of at least 25,000 state residents and derive gross revenue from the sale of personal data. Unlike the CCPA, the thresholds for applicability in the VDCPA and ColoPA are more narrowly and geographically targeted, meaning an entity must collect data from a large number of local residents to be covered by the Acts, whereas an entity can be covered by the CCPA if it has a global annual revenue of $25 million and does business in California regardless of the number of California residents affected (as long as it collects personal data of one or more California residents).

General Consumer Rights

The VDCPA and ColoPA provide residents with the right to access, correct and delete their data and to obtain a copy of their data in a portable and readily usable format.

Opt-Out and Opt-In Rights

The VDCPA and ColoPA provide residents with the right to opt-out of uses of their data for certain purposes (*e.g.*, for targeted advertising purposes, sales[1] of personal data or profiling in furtherance of decisions that produce legal or similarly significant effects concerning the consumer). Most notably, both Acts and the CPRA extend a consumer's ability to opt-out of not only "sales" of their personal data, but also other instances of sharing of their personal data, an expansion that will likely require significant investment and changes to current operations of many businesses. Additionally, like the CPRA, the Acts give consumers additional rights over "sensitive personal data" (including data revealing racial or ethnic origin, religious beliefs, mental or physical health, sexual or biometric data); however, unlike the CRPA,[2] both the ColoPA and VDCPA require affirmative, GDPR-style consent (i.e. opt-in consent) before consumers' sensitive personal data can be processed.

Additional Compliance Obligations

In addition to the aforementioned rights, the ColoPA and VCDPA place additional compliance obligations on covered entities, including the duty of data minimization and transparency, as well as obligations to post a privacy notice detailing the sources of and purposes for which their data is collected and processed

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1 Under the VDCPA, the definition of "sale" is limited to cover only "the exchange of personal data for *monetary consideration* by the controller to a third party," as opposed to the language of the CCPA/CPRA and ColoPA which cover both "monetary or *other valuable consideration*".

2 The CPRA provides a limited opt-out approach which permits the processing of sensitive personal data as long as notice is provided and consumers are permitted to limit the use of their sensitive personal data where such data is used to infer characteristics about the consumer (i.e. a limited opt-out approach).

and how it is shared. Furthermore, covered entities are required to:

1. establish and maintain reasonable administrative, technical and physical security measures to protect data;

2. conduct data security assessments for certain data processing activities that present a "heightened" risk of harm, such as profiling, selling personal data, processing sensitive personal data and engaging in targeted advertising; and

3. enter into specific data processing agreements with service providers that set forth instructions and obligations with respect to processing performed by such service providers on behalf of such covered entities.

It is likely we will continue to see a trend away from the inclusion of a private right of action, as legislation in many states where a privacy law initially had strong support, failed in part due to disagreements amongst lawmakers on issues of enforcement.

Enforcement

Unlike the CCPA and CPRA, neither the VDCPA nor ColoPA provide consumers with a private right of action; instead, enforcement is maintained exclusively by each state's attorney general or district attorneys, which can impose civil penalties of up to $7,500 for violations of the VDCPA or up to $20,000 per violation of the ColoPA.[3] It is likely we will continue to see a trend away from the inclusion of a private right of action, as legislation in many states where a privacy law initially had strong support, failed in part due to disagreements amongst lawmakers on issues of enforcement (*e.g.*, Florida and Washington).

Other U.S. Privacy Developments

Other U.S. State Laws on the Horizon

Currently, several states including Massachusetts, Minnesota, North Carolina and Ohio have active bills working through their respective state legislatures, and we expect that many other states will introduce proposed legislation. While many of these bills will likely contain common key provisions, such as rights afforded to consumers and required contractual and security standards, it is also likely that many will contain nuanced distinctions and further contribute to an increasingly complex compliance landscape. Accordingly, as states continue to contribute to the melting pot of privacy law compliance, the need for boards and management to continue to stay abreast of changes in the legal landscape and adapt their budget for compliance costs will expand significantly.

Growing Support for Greater FTC Oversight and Enforcement

With the lack of progress made toward federal data privacy legislation, many have focused their attention on the Federal Trade Commission (FTC) and its potential to make an impact on consumer data protection regulation, with Lina Khan assuming her role as the Chair of the FTC, growing support for enhanced enforcement authority and an increase in funding for consumer protection agencies. The Build Back Better Act, which passed the U.S. House of Representatives at the end of 2021 and moved to consideration by the U.S. Senate, provides the FTC with $1 billion over 10 years to fund a privacy enforcement bureau to address matters related to unfair or deceptive acts or practices relating to privacy, data security, identity theft, data abuses and related matters. Further, if passed, the FTC would have authority to file lawsuits in federal district court seeking monetary penalties of up to around $43,000 per violation of the FTC Act. While the Build Back Better Act makes its way through the legislative

3 Because a violation of the ColoPA is considered a deceptive trade practice, the penalties are governed by the Colorado Consumer Protection Act; thus, a noncompliant entity may be fined up to $20,000 per violation.

process, the FTC has signaled its intent to take matters into its own hands, filing an Advanced Notice of Proposed Rulemaking on December 10, 2021, to initiate a rulemaking process to curb lax security practices, limit privacy abuses and ensure that algorithmic decision-making does not result in unlawful discrimination.

FTC Updates the Gramm-Leach-Bliley Act "Safeguards Rule"

In October 2021 the FTC adopted a new Gramm-Leach-Bliley Act Safeguards Rule (the New Rule) that became effective January 10, 2022 and imposes more stringent data security requirements on regulated financial institutions. Most notably, the definition of "financial institution" has been expanded to include entities engaged in activities that the Federal Reserve Board determines to be incidental to financial activities. Thus, "finders," or companies that bring together buyers and sellers of a product or service for transactions that the parties themselves negotiate and consummate, are within the scope of the New Rule. The New Rule expands upon existing requirements to implement an information security program with compliance obligations that are appropriate to an institution's size and complexity, the nature and scope of its activities and the sensitivity of any customer information it possesses.[4] Additionally, the New Rule requires the designation of a "qualified individual" responsible for implementing and overseeing the financial institution's information security program and requires security awareness training. Finally, the FTC has initiated a supplemental notice of proposed rulemaking to further amend the New Rule to require financial institutions to report to the FTC any security event in which the financial institutions have determined misuse of customer information has occurred or is reasonably likely and at least 1,000 consumers have been affected or reasonably may be affected.

Increased Focus on Protection of Children's Personal Data.

As reliance on the internet and digital connectivity continued to grow in the wake of the COVID-19 pandemic, 2021 sharply increased digital activity by children and gave rise to growing concern over the lack of comprehensive children's privacy protections online. In response, legislators have proposed updates to the Children's Online Privacy Protection Act (COPPA) to fill in the gaps, including with proposals such as (i) the PROTECT Kids Act (H.R. 1781), which proposes to amend COPPA by expanding its scope to cover children up to the age of 16 (currently only 13) and services provided through mobile applications and (ii) the Protecting the Information of our Vulnerable Children and Youth Act (H.R. 4801), which would cover minors under the age of 18, prohibit targeted advertising to children, require privacy impact assessments for all covered entities and allow a private right of action for parents to bring claims on their children's behalf. While no legislation or amendments to COPPA have gained traction, legislators have called upon companies operating in industries that tend to attract children to consider complying with the U.K. Information Commissioner's Office's Age Appropriate Design Code, which came into effect in September and restricts the collection and use of personal data by online or connected products or services that are likely to be accessed by anyone under the age of 18 in the U.K. In the interim, we expect to see increased regulatory scrutiny in the U.S. by the FTC for companies that collect or process children's personal data in violation of COPPA.[5]

[4] The New Rule enumerates certain elements that must be included, such as requirements to implement access controls, inventories to manage data, personnel, devices, systems and facilities, encryption for customer information in transit and at rest, secure development practices, multifactor authentication, information disposal procedures, change management, testing and incident response and to test and continuously monitor information systems with periodic penetration testing and vulnerability assessments.

[5] *See*, for example, a recent $2 million settlement between the FTC and OpenX Technologies Inc. (OpenX), an online advertising platform, that was alleged to unlawfully collected personal data from children under 13 without their parents' permission. As part of the settlement, OpenX will also be required to delete all data it collected to serve targeted ads, implement a comprehensive privacy program to ensure that it complies with COPPA, and cease the collection and retention of personal data of children under 13.

EU and UK Privacy Developments

New Standard Contractual Clauses for Cross-Border Data Transfers Under the GDPR

On June 4, 2021, the European Commission (the Commission) published its new standard contractual clauses (the New SCCs) for transferring personal data from the EU and European Economic Area (the EEA) countries to third countries, under the GDPR. The previous set of standard contractual clauses (the Old SCCs) were subsequently repealed on September 27, 2021. The immediate effect of this on the contracts governing transfers of personal data out of the EEA depends on the timing of the entry into the contract:

— Contracts entered into prior to September 27, 2021, which implement the Old SCCs, must be revised in order to implement the New SCCs by December 27, 2022;

— Contracts entered into, or new processing operations undertaken, on or after September 27, 2021 must implement the New SCCs.

The key differences between the Old SCCs and the New SCCs are:

- Instead of separate sets of SCCs for different transfer scenarios, the new SCCs consist of one set with certain common clauses and a specific 'module' for each of the following four identified transfer scenarios: (1) transfer from controller to controller (C2C); (2) transfer from controller to processer (C2P); (3) transfer from processor to processor (P2P); and (4) transfer from processor to controller (P2C). The provisions relating to P2P and P2C transfers were previously not available under the Old SCCs, and the introduction of these modules has resulted in greater clarity and legal certainty for organizations that transfer data internationally.

- In addition, companies using the New SCCs for C2P or P2P transfers no longer have to enter into separate data processing agreements given that all the requirements of Article 28(3) of the GDPR (provisions to be included in data processing agreements) are covered by the New SCCs.

- Under the New SCCs, the parties must carry out a "*transfer impact assessment*," which must be made available to the competent supervisory authority, upon request. This involves the parties considering the specific circumstances of the transfer in order to assess the risk associated with the transfer. Such considerations include, but are not limited to: the nature of the personal data, the type of recipient, the laws and practices in the third country and the purposes of the processing

- Finally, the Old SCCs were bipartite agreements between two parties; there was no option for additional parties to join – this was a particular challenge for global organizations with large-scale intra-group or extra-group data transfers. The New SCCs address this issue through the "docking clause," which allows additional data exporters or importers to accede to the agreement throughout its term by completing a new data transfer appendix.

Transfers of Personal Data from the UK After Brexit

The New SCCs do not apply in the UK following Brexit, which means that, for now, the Old SCCs continue to govern all transfers of personal data out of the UK. In August 2021, the UK Information Commissioner's Office (UK ICO) launched a consultation on its own set of SCCs, which included a draft international data transfer agreement (IDTA) and a draft transfer risk assessment (TRA) tool. The UK ICO also released a template draft addendum (the Addendum), which amends the New SCCs so that they can be used for UK data transfers and EEA data transfers. The consultation closed on October 7, 2021 and the finalized forms of the IDTA and TRA are expected in early 2022, as well as a decision on whether the Addendum can be used to amend the New SCCs. In the meantime, companies should continue to monitor developments for further guidance issued by the UK ICO.

The DCMS strives to reduce barriers to the use of data by UK businesses, in particular with respect to furthering innovation and research purposes.

UK Government's Consultation to Reform the UK GDPR

Less than a year after the UK GDPR – which is substantially based on the EU GDPR – came into effect on January 1, 2021, the UK Government's Department for Digital, Culture, Media and Sport (DCMS) launched a consultation in September 2021 detailing its proposals to reform the UK's data protection regime. With an aim to create "*a more pro-growth and pro-innovation data regime whilst maintaining the UK's world-leading data protection standards*," the DCMS seeks to remove what it considers to be unnecessarily complex or vague obligations under the UK GDPR and loosen restrictions on the use of data in order to spur growth and innovation. The DCMS strives to reduce barriers to the use of data by UK businesses, in particular with respect to furthering innovation and research purposes.

The consultation focuses, for example, on the use of data for AI projects. To that end the DCMS proposed making it easier for entities to process personal data for the purposes of monitoring, detecting or correcting bias in relation to developing AI systems by explicitly listing it as a legitimate interest (one of the grounds for lawful processing), and by allowing entities to process sensitive personal data for this purpose. The consultation invited views on removing Article 22 of the UK GDPR – which specifically affords data subjects the right not to be subject to a decision resulting from "solely automated" processing – and permitting the use of solely automated AI systems on the basis of legitimate interests or public interests. The consultation also envisaged removing certain existing obligations under the UK GDPR, such as the requirements to appoint a data protection officer and to conduct data protection impact assessments. Instead, the DCMS proposed to impose a requirement to implement a "privacy management programme" that would be "*tailored to [the entity's] processing activities and ensure data privacy management is embraced holistically*" and allows different entities to "*adopt different approaches to identify and minimize data protections risks that better reflect their specific circumstances*." The consultation also suggests that the UK government is seeking to allow for easier cross-border transfers of personal data out of the UK.

While the abovementioned proposals may lessen certain obligations under the UK GDPR, a departure of the UK GDPR from the EU GDPR may impact businesses with a foot in the EU as well.

China's Personal Information Protection Law Takes Effect

On November 1, 2021, China's new data protection law, the Personal Information Protection Law (PIPL) took effect. Similar to the GDPR, the PIPL has extra-territorial reach and will apply to both (i) the processing of personal information carried out within China and (ii) the processing of personal information of Chinese individuals by a foreign entity outside of China in which the purpose of such processing is to provide a product or service to individuals in China, to analyze or assess the activities or behavior of individuals in China or pursuant to other circumstances provided in laws and administrative regulations.

There are certain similarities between the PIPL and the GDPR. For instance, the minimum required content in privacy notices pursuant to the PIPL is very similar to that required under the GDPR, and the substance of the data processing agreement that is required under the PIPL if a third party is engaged to process personal information on behalf of the "Personal Information Handler" (which is similar to the concept of "data controller" under the GDPR – being the entity that independently determines the purposes and means of processing the personal data) is similar to that required under the GDPR. As such, companies may be able to fairly easily adapt existing GDPR compliance programs and policies for compliance with certain aspects of the PIPL.

However, in other respects the PIPL introduces more stringent requirements than under the GDPR. For example, "sensitive personal information" under the PIPL, for which there is a need to obtain "separate consent" for processing, is defined much more broadly than "special categories of data" under the GDPR, being "personal information that once leaked or illegally used would easily result in harm to the dignity of natural persons or to their personal safety or the safety of their property", including "financial account information" (which is not a special category data under the GDPR). Further, the PIPL appears to favor data localization, and attaches additional conditions to the transfer of personal information out of China. Any entity contemplating cross-border transfers of personal information will need to obtain separate consent from the individual, enter into data processing addendum with the data importer/receiver (similar to standard contractual clauses under the GDPR), and, in certain circumstances, satisfy additional requirements such as undergoing a security assessment carried out by the Cyberspace Administration of China (CAC). The exact requirements differ between operators of critical information infrastructure (CII) and non-CII operators, and depends on the type and volume of personal information processed. Such security assessment and approval of the cross-border data transfer will only be valid for two years. Most notably, the CAC would also have broad discretion to deny cross-border data transfers and require data localization by default.

While the exact requirements for compliance with the PIPL are unclear while certain ancillary rules are still to be clarified and draft measures supplementing the PIPL are awaiting passage into law, it is nonetheless critical to comply with the stringent requirements of PIPL.

The introduction of the PIPL places additional obligations on businesses when processing personal information in China or in relation to Chinese residents (when providing them with products or services or analyzing their behavior), and may limit the ability of companies to transfer personal information outside of China. Non-compliance with the PIPL can attract maximum fines of up to CNY 50 million (approximately US$ 7.85 million) or 5% of the previous year's annual turnover, and orders to suspend the related business operations and/or to revoke the business permit or license of the entity. The PIPL also provides for fines on any person in charge or other directly liable individual. In early December 2021, it was reported that over 100 smartphone apps had been removed from China's app stores due to violations of the PIPL and Data Security Law. Therefore, while the exact requirements for compliance with the PIPL are unclear while certain ancillary rules are still to be clarified and draft measures supplementing the PIPL are awaiting passage into law, it is nonetheless critical to comply with the stringent requirements of PIPL.

Key Takeaways

— Though the CPRA, ColoPA and VCDPA do not come into effect until 2023, companies must begin to prepare to comply, as certain of these laws have lookback periods commencing as early as January 1, 2022. Further, companies should expect additional states to introduce and codify further data protection legislation and thus should keep abreast of legislative activity at both the state and federal levels.

— Companies must monitor ongoing developments to remain compliant with new and amended privacy laws and regulations in areas relevant to their businesses; this includes, for example, companies that collect children's data, financial institutions and entities carrying out activities that are incidental to financial institutions' operations and businesses that transfer data across borders.

— The New SCCs will require organizations engaged in cross-border data transfer out of the EEA to replace their Old SCCs, assess which of the New SCCs to use and carry out a transfer impact assessment.

— Although there remains uncertainty around the exact requirements under the PIPL, in particular concerning cross-border transfers, companies must already comply with the PIPL as Chinese regulators have begun to clamp down on businesses found in violation.

— More generally, as more and more countries around the world enact comprehensive privacy legislation, management and boards of companies that operate in multiple jurisdictions should pay particular attention to their compliance obligations, with an eye toward how these laws and regulations interact and diverge.

Economic Sanctions: Developments and Considerations

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Boards of directors should be aware of continued regulatory focus on virtual currencies and ransomware, potential divergences and conflicts across new global sanctions regimes and potential sanctions developments relating to Russia, Iran and China.

U.S. sanctions policy in the first year of the Biden administration saw both change and continuity. As expected, the administration sought to cooperate with allies to impose multilateral (rather than unilateral) sanctions, focused on human rights abuses and opened the door for a new nuclear deal with Iran. At the same time, the administration continued to focus on virtual currencies and on combating illicit cyber activities relating to ransomware, and clarified (and in some respects expanded) sanctions issued under the Trump administration targeting Chinese companies deemed to be part of the Chinese military-industrial complex.[1]

In 2022, boards of directors should be aware of continued regulatory focus on virtual currencies and ransomware, potential divergences and conflicts across new global sanctions regimes and potential sanctions developments relating to Russia, Iran and China.

Virtual Currencies

In October 2021, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued its most comprehensive virtual currency-specific advisory to date, providing guidance on interpretive questions, sanctions compliance programs and "best practices" and hints about OFAC's enforcement priorities going forward.[2] Boards of companies with activities relating

[1] For additional details on the Chinese military-industrial complex sanctions, *see* our June Alert Memo here.

[2] For additional details on OFAC's guidance, *see* our October Alert Memo here.

to virtual currencies should thus be aware of and consider the expectations outlined in the guidance order to ensure that compliance programs meet OFAC's expectations and mitigate enforcement risks given the strict liability nature of U.S. sanctions. Best practices highlighted in the guidance include procedures relating to geolocation screening, transaction monitoring, know-your-customer diligence, red-flags awareness and reporting and investigations of potential violations.

Along with OFAC's second-ever enforcement settlement with a virtual currency company in February 2021 (relating to transactions with persons located in sanctioned jurisdictions), the guidance confirms that, despite the novel nature of the underlying technologies, OFAC is focused on compliance with applicable U.S. sanctions by virtual currency market participants – which OFAC considers to include a wide range of actors that spans technology companies, exchangers, administrators, miners, wallet providers and users.

The guidance also highlights OFAC's expectation that parties have formal, written compliance programs that include management's commitment to sanctions compliance, risk assessments, internal controls, periodic testing and auditing and sanctions-related training.

Ransomware

Given the continued rise in ransomware attacks against companies in 2021, boards, and committees with oversight over risk, crisis response and cybersecurity in particular, should continue to monitor the sanctions risks associated with making or facilitating cyber ransom payments.

In September and November 2021, OFAC sanctioned for the first time virtual currency exchanges and certain infrastructure support providers for their role in facilitating illicit transactions related to ransomware payments.[3] OFAC also released an updated advisory on the potential sanctions risks of facilitating ransomware payments, highlighting the strength of a company's cybersecurity protections and prompt outreach to the U.S. government as two "significant mitigating factors" in determining whether to pursue an enforcement action and the amount of any penalty for sanctions violations associated with ransomware payments.[4] Boards should thus carefully consider with sanctions counsel the advantages and implications of engaging with government authorities both before and after making a payment if a sanctioned party received the payment.

New Sanctions Regimes; Conflicts of Law

More than ever, potential deviations and conflicts in sanctions laws may arise given the implementation of new sanctions regimes around the world, creating a regulatory quagmire for multinational companies. For example, the UK now administers an autonomous sanctions regime. While UK restrictions to date remain largely similar to those of the EU, small discrepancies in the scope of persons sanctioned recently have begun to emerge and greater divergence is possible in the future.

China has also over the past year begun to implement and formalize its own sanctions regime. In June 2021, China adopted the Anti-Foreign Sanctions Law, a comprehensive framework for imposing Chinese sanctions and blocking foreign sanctions.[5] While it remains uncertain how broadly the new law will be applied, the imposition of Chinese sanctions to date has been largely limited to U.S. and EU officials, legislators and human rights-related institutions.

These new and existing sanctions regimes will continue to raise potential conflicts of laws issues in 2022, potentially requiring boards to decide which sanctions regime to comply with. Indeed, EU, UK and Canadian blocking regulations continue to provide covered persons with a private right of action to recover damages and legal costs in relation to the application of certain

3 For additional details, *see* our September and November Alert Memos here and here, respectively.

4 For additional details, *see* our September Alert memo here.

5 For additional details on China's Anti-Foreign Sanctions Law, *see* our June Alert memo here.

U.S. sanctions. Similarly, the Chinese Anti-Foreign Sanctions Law authorizes a private right of action for Chinese persons harmed by foreign sanctions laws, though there remains some uncertainty as to its scope of application.

Sanctions Outlook for 2022

While it is typical for sanctions to evolve with foreign policy priorities, boards should take particular care in the new year to prepare for the possibility of potentially significant changes in three key areas:

1. U.S. officials have warned of swift and "devastating" economic sanctions in coordination with European allies in response to a Russian conflict with Ukraine. Potential actions include expanded restrictions on Russian sovereign debt; the Russian financial, energy and defense sectors; and access to payment systems (including SWIFT), as well as travel restrictions and additional sanctions designations.

2. As the prospects for a new nuclear deal with Iran remain uncertain, boards should prepare for possibilities ranging from the lifting of U.S. secondary sanctions to increased enforcement of primary sanctions and imposition of secondary sanctions.

3. Should U.S.-China relations deteriorate, boards may also expect to see increased use of targeted sanctions by the United States, along with China's new sanctions authorities in retaliation to U.S. or other foreign sanctions against China (including potential private litigation under the Chinese blocking regulation).

Global FDI Review Landscape Continues to Evolve

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In 2022, boards of directors will continue to face a complex and expanding global foreign direct investment (FDI) landscape that increasingly requires transactions to undergo intensive multijurisdictional FDI reviews and filing and approval processes, alongside merger control reviews and clearances. This includes longstanding FDI review regimes with which boards of directors may be familiar, such as the Committee on Foreign Investment in the United States (CFIUS), as well as new and recently modified and expanded regimes, particularly in Europe. Governments appear increasingly willing to scrutinize, and in some cases ultimately prevent, transactions they deem objectionable – in late 2020, the French government blocked the acquisition of a French photo-sensor imaging technologies company by a U.S. company, and in April 2021, the Italian government blocked a Chinese takeover of a semiconductor company.

Most of these FDI review regimes focus on national security- or national interest-related concerns, such as (1) access to defense-related or otherwise sensitive export controlled or other information (*e.g.*, personal data) and (2) potential disruption to essential public services, supply chains or critical or sensitive infrastructure. However, the jurisdictional thresholds, review timelines and substantive tests vary by country, sometimes significantly. Moreover, FDI review analyses are often subjective and driven by factors of interest to each particular country, including factors that may not be known to the transacting parties. To further complicate matters, FDI review authorities have broad discretion to assert jurisdiction over transactions and to determine what does or does not qualify as a relevant concern. All of these factors combine to provide unique challenges to management teams and boards alike as they grapple with the lack of certainty associated with any FDI review.

Governments appear increasingly willing to scrutinize, and in some cases ultimately prevent, transactions they deem objectionable.

Certain recent FDI-related developments, such as Italy temporarily expanding aspects of its regime to reach non-European investors, India requiring government approval for investments from China and other neighboring countries and an increased general focus on investments in the healthcare sector and essential supply chains, can be attributed to the COVID-19 pandemic. Other developments, particularly the recent developments in the United Kingdom and Europe, occurred independent of the pandemic and are better explained by a desire to increase scrutiny over transactions that raise potential national security or national interest concerns.

We highlight below the FDI review regimes in major jurisdictions that we expect will be particularly active in 2022:

United States

CFIUS has jurisdiction over any transaction that could result in a foreign person acquiring "control" (which is defined broadly in the CFIUS regulations to be more akin to substantial influence) of a U.S. business. In the case of businesses involved with critical technologies, critical infrastructure or sensitive personal data (so-called "TID U.S. Businesses"), CFIUS also has jurisdiction over investments that result in a foreign person acquiring certain non-controlling rights. Transactions involving TID U.S. Businesses can also trigger a mandatory CFIUS notification requirement. Publicly available information regarding recent high-profile CFIUS reviews demonstrates that CFIUS will aggressively assert jurisdiction over transactions that it believes raise national security concerns. For example, CFIUS recently asserted jurisdiction over a transaction involving a joint venture in China that involved a U.S. company even though the joint venture only had operations outside the United States and not a single tangible asset within the United States was transferred as a result of the transaction.[1] Similarly, CFIUS asserted jurisdiction over a transaction involving a non-U.S. semiconductor company that CFIUS determined qualified as a "U.S. business" despite its very limited nexus to the United States.[2] Both of those transactions ultimately fell apart due to CFIUS concerns. In addition, CFIUS released an annual report in July 2021 providing information about transactions that closed without being notified to CFIUS. According to the report, CFIUS identified 117 non-notified transactions in 2020 and requested a filing in connection with 17 of these transactions.[3] We expect CFIUS to remain aggressive in its review of notified transactions and in identifying and "calling in" non-notified transactions.

FDI review analyses are often subjective and driven by factors of interest to each particular country, including factors that may not be known to the transacting parties.

United Kingdom

The National Security and Investment Act 2021, the United Kingdom's new CFIUS-like FDI regime, came into force on January 4, 2022.[4] Acquisitions that provide an investor (foreign or UK-based) with "control" over an entity with UK customers or activities, even if the entity itself is not organized under UK law, must be notified to the newly-created Investment Security Unit (ISU) if the target entity operates in one of 17 broadly defined sectors. The relevant sectors include defense, critical suppliers to the government, artificial intelligence, cryptography, synthetic biology, energy, transport and data infrastructure. If a foreign investor would acquire the ability to pass or block board resolutions, that is considered to be "control" and the investment must be notified. Similarly, an investor must notify ISU of any acquisition that would increase its ownership percentage beyond the 25%, 50% and 75% thresholds for share ownership or voting rights. Finally, regardless of the investment sector, the Secretary of State retains the authority to "call in" transactions that fall outside the mandatory notification regime if the ISU suspects a

[1] For additional details, *see* our June blog post here.

[2] For additional details on the transaction, *see* our September blog post, which was updated in December, here.

[3] CFIUS, "Annual Report to Congress" (Report Period CY 2020), available here.

[4] For additional details on the UK National Security Regime, *see* our July Alert Memo here.

risk to national security and the deal closed on or after November 12, 2020. Transactions can be called in below the thresholds identified above if there is an acquisition of "material influence." Only acquisitions of control over entities must be notified, but asset transactions can fall within this construct as well and could be called in.

Europe

The European Union's FDI regulation went into effect on October 11, 2020.[5] The regulation does not provide the European Commission with the power to veto investments, but instead lays out a common framework for FDI reviews by individual EU member states and increases cooperation among member states. Perhaps most importantly, the regulation calls on each EU member state to notify every other member state and the European Commission of any FDI review it conducts. This so-called "consultation" process allows the consulted member states and the European Commission to voice any concerns they may have to the reviewing FDI authority. The EU consultation process also increases the probability of additional FDI reviews, because a consulted member state could determine that it has independent jurisdiction to review the investment and reach out to the transacting parties. Ultimately, the EU consultation process appears to be leading to more intense FDI monitoring across Europe and greater consistency among EU member states. Moreover, in May 2021, the European Union proposed a new EU regulation that would empower the EU to substantively review certain investments made by non-EU investors funded by non-EU governments. The proposal is under review by the European Council and Parliament.

France

French law requires mandatory pre-closing FDI reviews by the Ministry for Economy and Finance for certain foreign investments in French companies that operate in certain "strategic" sectors, including defense, IT security, treatment or hosting of certain sensitive data, critical infrastructure, healthcare, press, food security and key technologies. Notification is mandatory for investments in these sectors if (1) non-French investors acquire a controlling interest in the relevant French company or acquire all or part of a relevant French business line or (2) investors from outside the European Economic Area (EEA) acquire at least 25% (10% if the company is listed) of the voting rights in a French company.

Germany

Germany's Federal Ministry for Economic Affairs (BMWi) operates a mandatory pre-closing FDI regime with a review timeline of 2-10 months. Non-German investors must notify BMWi before acquiring at least 10% of a German entity that is active in the defense or cryptography sectors. Additionally, investors from outside the European Union and the European Free Trade Association (EFTA) must notify BMWi before acquiring at least 10% or 20% (depending on the relevant business sector) of a German entity that is active in certain additional sensitive sectors, including critical infrastructure, certain IT services and IT security products, healthcare and key technologies such as semiconductors, additive manufacturing and autonomous driving.

Italy

The Italian government operates a pre-closing FDI review regime in which the parties' filing obligations depend on the sector of the relevant investment. Investors must notify the government of any transaction in the defense and national security sector, regardless of the nationality of the investor and the size of the stake (provided it is at least equal to 3%). For investments in certain additional sensitive sectors (a list that was materially expanded effective as of January 2021), non-EEA investors must notify the government of acquisitions of control. However, due to temporary powers granted as a result of the COVID-19 pandemic, investors must notify the Italian government of additional investments in these non-defense sectors, including certain acquisitions of control by EEA

[5] For additional details, *see* our October 2020 Alert Memo here.

investors and acquisitions of non-controlling stakes by non-EEA investors.

Netherlands

The Netherlands' current FDI framework is limited to sector-specific regimes in the gas, electricity and telecom sectors. The government is considering an expanded general FDI framework that would require pre-closing review by the Ministry of Economic Affairs of investments in companies active in the Netherlands providing certain "vital services" and/or "sensitive technology." Notification will be mandatory for both foreign and domestic investments, leading to (1) a change of control or (2) an acquisition or increase of significant influence in companies providing sensitive technology. The new regime is expected to enter into force as early as the first quarter of 2022 and grant the Dutch government retroactive authority to review transactions completed since September 8, 2020, if there are significant concerns to national security.

Spain

Spain operates a mandatory pre-closing FDI regime for non-EU/EFTA investments that involve the acquisition of at least 10% of the share capital or control of Spanish companies operating in certain sensitive sectors, including defense, critical infrastructure, critical technologies, the media, the supply of key supply chain inputs and sectors with access to sensitive information. Additionally, any investors that are owned or controlled by foreign governments generally must notify the Spanish government of their investments regardless of the relevant business sector, as must any investor having already made an FDI filing in another EU member state in the past. If the value of an investment in Spain is below €1 million, the transaction is exempt from filing. Until December 2022, EU/EFTA investors are exempt from filing when they invest in Spanish listed companies or in unlisted companies if the value of their investment exceeds €500 million.

Australia

Australia requires pre-closing FDI reviews by the Foreign Investment Review Board (FIRB) for certain acquisitions by foreign persons when certain monetary thresholds are met. The thresholds are complex and vary depending on the nationality of the foreign investor and the sector of the relevant target business. That said, any investment in a "national security business" must be notified to FIRB if the investor is acquiring at least 10% of the business or would otherwise be in a position to influence or control the business, such as by nominating a director. National security businesses include those that have access to classified information, supply critical products or services to defense agencies and/or operate critical infrastructure assets.

China

In December 2020, China reformed its FDI-related national security review regime. As written, the new regime may capture investments in non-Chinese companies that have Chinese subsidiaries. Review is now mandatory for foreign acquisitions of control over companies that operate in certain national security-related sectors. The Chinese government also publishes "Negative Lists" that identify sectors in which foreign investment is prohibited or restricted across China and in the free-trade zones. For example, outside the Hainan free-trade zone, the mining of certain rare earth minerals is prohibited, and foreign ownership is capped at 50% in the fossil-fueled passenger car industry.

India

The Indian government operates a complex FDI regime that bans foreign investments in certain "prohibited" sectors and applies sector-specific rules for several "regulated" sectors. For each delineated "regulated" sector, the Indian regime sets out a maximum foreign ownership percentage that can be acquired with and without government approval, as applicable. In the insurance sector, for example, foreign investments of up to 49% ownership are permitted through the "automatic" route, meaning no FDI reviews are required but foreign ownership beyond 49% is prohibited altogether. In the satellite industry, on the other hand, investments of up to 100% ownership are permitted through the "government" route, meaning FDI filings are always mandatory but there is no foreign ownership cap. In a recent development, India's FDI review regime also subjects FDI – from India's neighboring countries (which is understood to target China) to a specific mandatory government approval requirement.

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The global FDI review landscape will likely be active and continue to evolve during 2022. To avoid delays and disruptions to contemplated transactions, boards of directors should ensure that transactions are undergoing multijurisdictional FDI review due diligence and analysis well before closing, particularly if a transaction involves multiple jurisdictions and countries with active FDI review regimes and sensitive industries or sectors.

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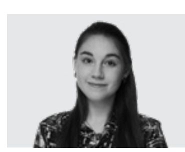

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