CLEARY GOTTLIEB

Selected Issues for Boards of Directors in 2017

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By the end of 2016, the world was facing a considerably greater level of global uncertainty than it had experienced in recent years. From a legal perspective, many of the challenges faced by companies and their boards in the near-term will be significant in their magnitude, level of uncertainty, and complex global reach. For example, companies will face challenges as they grapple with an uncertain and changing tax regulatory landscape; the impact of overlapping and, at times, conflicting, privacy regimes that impact how they manage and store information in an increasingly global and digital age; the continued impact of cybersecurity concerns and hacking incidents; and continued, but evolving, trends in enforcement and anti-corruption investigations. These trends will increasingly bring these issues to board agendas of companies in the United States and across the globe, with a renewed focus on how boards assess, and assist in mitigating, these risks.

In some areas, however, the beginning of 2017 will provide for a period of reflection and refinement to themes from years past, as companies address issues of director tenure, skills mix and board refreshment—an area that has been garnering increasing attention from shareholders. The Delaware courts have also refined and limited the grounds for bringing a suit post-merger, but in ways that will require companies to carefully consider the disclosures made in the course of the transaction. This more measured approach to disclosure, however, is not entirely universal: the increased focus on environmental, sustainability and governance ("ESG") matters has put pressure on companies to respond and address the types of issues that companies may not have considered even a decade ago and, in the area of compensation, companies will need to grapple with new (and still fluid) disclosure rules, and related risk management considerations.

Finally, corporate developments across the globe will be influenced by the results of the presidential election in the United States and the outcome of the Brexit vote in the United Kingdom, with other elections and geo-political events still to come in Europe and elsewhere in 2017. As the world grapples with the outcome of these votes, the focus of directors and companies will need to shift and adapt, although it may yet be too soon to determine even the most significant of any impacts resulting from these events.

It is clear that new challenges will be brought into the boardroom in 2017. A strong understanding of the issues and challenges facing boards and companies over the next year and beyond will assist boards in addressing the issues and complexities that will undoubtedly arise in 2017. Active engagement and communication, with a defined strategy and execution plan, will be paramount as boards move forward this year.

This memorandum addresses the following issues for boards of directors:

Global Issues in Taxation

The tax landscape has been unsettled in many respects and this trend can be expected to increase in the next few years. It would be prudent for boards to provide clear guidance to management regarding the board's risk tolerance in this area, and to ensure that the proper level of oversight and foresight are being exercised and sufficient resources are being dedicated to these issuers. Key developments include:

U.S. tax reform.

If enacted, U.S. tax reform likely will have a profound impact on corporations and other taxpayers. Apart from rate reduction, fundamental adjustments could be made in the rules for capital recovery, interest and other deductions, the treatment of imports and exports, and the taxation of foreign operations. There will be winners and losers. Companies should evaluate the impact that the emerging legislative proposals would have on their businesses and consider steps to optimize their position, and may wish to participate in lobbying efforts to influence the outcome.

International tax uncertainties.

The Organisation for Economic Co-operation and Development's (OECD) base erosion and profits shifting (BEPS) project and other developments have energized foreign governments and the European Commission to more aggressively assert taxing authority over U.S.-based multinationals, through prospective changes in tax law as well as audits of prior years. Multinationals should realistically assess their exposures and consider ways to most effectively minimize tax risks from their international operations in this evolving environment.

The European Commission's State aid decisions.

Much attention has been given to the recent investigations by the European Commission into alleged illegal State aid granted through tax rulings with the imposition of massive recovery orders to several multinational companies, including Fiat, Starbucks and Apple (for an amount of more than €13 billion). The European Commission's expansive interpretation of State aid principles raises questions that will probably take several years to be adjudicated in appeals before the European courts. In the meantime, multinational companies with significant business in Europe should review any tax ruling they received in light of the recent European Commission decisions to confirm, for instance, that transfer pricing or internal profit allocation rulings are based on robust, documented transfer pricing studies and reflect economic reality. Tax rulings obtained through atypical ruling procedures, such as unpublished rulings, negotiated rulings, rulings granted following limited review by tax authorities or rulings granted for an extended period of time are more likely to attract the European Commission's attention and should be reviewed with particular care.

Increased tax information disclosure.

The mandatory reporting of country-by-country tax information and the sharing of information among tax authorities are a new reality, and multinationals should expect that tax authorities around the world will use that information to audit transfer pricing and other practices. Also, proposed changes to the U.S. GAAP rules would require U.S. multinationals to disclose information regarding their non-U.S. tax and cash positions that may lead to increased scrutiny of their tax planning strategies by both governmental and non-governmental actors.

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Risks from non-traditional sources.

Another troubling recent phenomenon has been the leaking of massive amounts of confidential information by non-governmental actors (*e.g.*, the Panama Papers, Luxembourg and Swiss leaks). Whistleblowers seeking bounties under various government programs have brought companies' allegedly questionable tax practices to the attention of regulators, prompting securities, tax and other investigations, including under state "false claims" laws (with potentially substantial penalties). Also, in Europe, tax authorities have resorted to highly publicized "midnight raids" and criminal proceedings. Management needs to be prepared to respond to these challenges and the public relations complications that they present.

Privacy and Global Investigations

In 2017, we expect that regulators and authorities investigating misconduct will demonstrate increased sophistication in navigating the complex and disparate privacy and confidentiality regimes around the world. The globalization of government enforcement actions and investigations, along with their increased frequency, means that regulators and authorities are now well-versed in the ground rules for obtaining the information they seek. Being so well-versed means that these regulators and authorities have studied the relevant legal regimes, have heard a wide spectrum of differing opinions on the implications of such regimes and, particularly in matters in which cooperation is key, including cartel cases, are pushing companies to adopt the least conservative view of these laws.

We believe the uptick in global investigations by regulators and authorities targeting conduct outside of their jurisdictions will continue. But, we think the trend towards increased cooperation between regulators and authorities from different jurisdictions may wane in the near term, potentially increasing the pressure on companies to provide foreign information to domestic authorities that may be increasingly less able to obtain it through international intergovernmental channels.

These issues highlight the critical need for companies to manage the process by which information is gathered, collected and communicated to respond to such investigations.

The Race to Charge

U.S. regulators and authorities—among others—remain focused on the foreign conduct of foreign-based companies, given the perception that targeting such companies creates a more even playing field for domestic companies. Regulators and authorities are also increasingly focused on quickly identifying specific individual employees and entities involved in alleged misconduct in an effort to be the first to fine or bring charges. How companies convey foreign information to domestic regulators and authorities will be critical to securing credit for cooperation but will present challenges to companies from confidentiality and privacy perspectives.

Multijurisdictional Cooperation, Multijurisdictional Discovery

Companies should strategize where to store and with whom to share data relevant to an investigation. Regulators and governmental authorities are increasingly taking the view that any data within the scope of their investigation is fair game for them to collect or demand, regardless of where that data is stored and they are increasingly putting the onus on the company seeking cooperation credit to navigate confidentiality and privacy laws without the need for what is seen as burdensome intergovernmental assistance. As a result, companies will face growing pressure to produce evidence concerning alleged misconduct on a voluntary basis. A company's ability to minimize its risks under data privacy laws can depend on how the data has been shared within the organization. Regulators and authorities will look with a high degree of skepticism upon arguments that data transferred between jurisdictions for the company's own purposes, for example to conduct an internal investigation, cannot be provided to the authorities and regulators in those same jurisdictions. Thus, companies that find themselves subject to a multijurisdictional investigation should prepare for the requirements of the jurisdictions in which facts are investigated, as well as what facts such investigators seek.

Penalties on the Rise for Breach of EU Personal Data Protection Rules

A new EU personal data protection regulation will come into force on May 25, 2018, which will impose heavier burdens on companies. Compared with the existing rules, the new regulation will continue to govern all processing of data relating to identifiable individuals but will, among other novelties, make it more difficult to obtain the consent from the relevant individuals as a valid ground to process their data, and add new obligations to proactively demonstrate compliance with the regulation. At the same time, regulators and authorities in various jurisdictions investigating misconduct have made it clear that the production of relevant information is a prerequisite to cooperation credit or leniency. Such production will virtually always entail the review of documents including personal data. In light of the new EU regime's higher fines of up to four percent of a group's annual, worldwide turnover and broadened geographic reach to cover non-EU companies that offer goods and services or monitor individuals in the region, companies will be incentivized to choose where they host and process personal data strategically, bearing in mind that their files and records may have to be produced as evidence in proceedings outside Europe.

Further, the recent repeal of the United States—EU Safe Harbor (which allowed the free transfer of personal data from the European Union to certain companies in the United States that agreed to submit themselves to high personal data processing standards) has left uncertainty regarding the available channels for transatlantic data transfers. While mechanisms still exist for transferring personal data from the European Union to the United States, each of these has been demonstrated to have limitations (including the "Privacy Shield" scheme, which succeeded the Safe Harbor). Thus, companies may need to re-assess the historical avenues through which data from Europe can be transmitted to U.S. regulators and authorities to comply with the new EU personal data regime.

Recent Developments in Cybersecurity

Cybersecurity and hacking incidents continued to dominate headlines in 2016—not only did they continue to impact corporations, but they also played a role in the U.S presidential election. At the same time, various states have introduced, considered or adopted cyber-related legislation, including legislation applicable to certain industries that are more sensitive to cybersecurity breaches (*e.g.*, New York proposed a cybersecurity regulation that applies to financial institutions licensed or regulated by the New York State Department of Financial Services). Federal agencies, including the U.S. Securities and Exchange Commission ("SEC"), the Federal Trade Commission and the U.S. Department of Justice ("DOJ"), are also playing key roles in regulating the area of cybersecurity.

At least since the SEC's CF Disclosure Guidance: Topic No. 2 – Cybersecurity in 2011, which clarified how companies should evaluate and disclose cybersecurity-related matters, and then-SEC Commissioner Luis A. Aguilar's 2014 speech, which emphasized the board's responsibility to "[ensure] the adequacy of a company's cybersecurity measures"—cybersecurity has become a recurring theme for companies and the board. As a result, companies and their boards should establish an

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incident response plan for potential cybersecurity incidents, which includes, for example, cross-organizational teams and contingency communications plans. We highlight below several recent developments in the cybersecurity area that are particularly relevant to boards.

Shareholder Litigation and Board Fiduciary Duties

In July and November of 2016, two separate shareholder derivative lawsuits related to cybersecurity incidents at Target and The Home Depot, respectively, were dismissed. These lawsuits alleged breaches of fiduciary duties, among other claims, by the directors. A similar lawsuit against the directors and officers of Wyndham was also dismissed in 2014. In all these cases, the courts showed deference to the directors' actions by applying the "business judgment rule," and found that the plaintiffs failed to show that the directors have "utterly" or "completely" failed to monitor or oversee the implementation or operation of systems and controls to protect against cybersecurity incidents in breach of their fiduciary duties. In addition to the procedural hurdles of a derivative lawsuit, these cases illustrate the significant hurdles that the plaintiffs must overcome in such lawsuits. They also help define the parameters of what boards should do to help insulate themselves against a successful shareholder derivative suit involving cybersecurity incidents:

1. The board or a committee designated by the board should be responsible for the oversight of the company's cybersecurity matters and the company's bylaws or committee charter should reflect these duties and responsibilities. The designated committee should meet regularly, receive periodic cybersecurity reports and give regular briefings to the full board.

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2. The board or the committee, as applicable, should oversee the implementation of appropriate systems and controls to protect against cybersecurity incidents and, once implemented, continue to be informed about their effectiveness and any need for changes. The board should approve plans to address any known security weaknesses in a timely and reasonable manner.

3. Upon any report of a cybersecurity incident or an alleged breach, the board or the relevant committee should meet frequently to discuss. The board and the company should also conduct a reasonable investigation in good faith (if needed, by engaging outside advisors/counsel and/or delegating to an independent committee) before making a decision on the proper course of action.

Despite the company-favorable results from these recent lawsuits, boards should proactively encourage measures to minimize liability from cybersecurity incidents. As more companies experience cybersecurity incidents, the courts' standard of what constitutes "utter" or "complete" failure may evolve to require more action or oversight by directors.

Confidential Information and Director Communications

In September 2016, former Secretary of State Colin Powell's personal email account was hacked, and thousands of his emails were published on the internet. The leaked emails included those that he received as a director of Salesforce.com, including one email that contained a confidential presentation identifying 14 possible acquisition targets. This incident demonstrates that electronic communications to and from directors can be especially sensitive because they often contain material non-public information about the company that, if hacked, could be used for insider trading, affect on-going deal negotiations or reveal company strategy. The risks are exacerbated when the directors use personal email addresses hosted on commercial email servers to send and receive company-related emails, as these services are outside of the company's control and may not have the robust security features that corporate email servers have. To minimize these risks, companies should consider the following:

1. Review their policies to require that directors use only official corporate email addresses, instead of personal email addresses, for company communications.

2. Provide encrypted laptops or mobile devices on which directors can access board presentations and other sensitive company documents.

3. Set up a web portal that the directors can securely access to receive messages and materials related to the company.

4. Incorporate email security training as an essential element of the directors' on-boarding process and ongoing director training.

M&A and Cybersecurity Diligence

In September and December of 2016, Yahoo! announced that it discovered cybersecurity incidents in 2014 and 2013 that affected a significant number of accounts. At the time of these announcements, which had not been disclosed during the negotiation of the deal, Yahoo! was the target in a proposed acquisition of its core internet business. The Yahoo! incident underscores the growing importance of cybersecurity diligence in corporate transactions and, at the same time, the limits of traditional due diligence investigations in discovering cybersecurity breaches. As a result, it is likely that cybersecurity issues will play a bigger role in corporate transactions:

1. There will be more focus on cybersecurity diligence, particularly in M&A transactions involving companies in the information technology industry or with large amounts of personally identifiable information.

2. Cybersecurity diligence may require engaging a third-party expert to perform a technical analysis to identify any undisclosed incidents and/or risks, depending on the industry or the nature of the company's operations.

3. Parties will negotiate more extensively over cybersecurity-related provisions in agreements, including representations and warranties and closing conditions.

Department of Justice Foreign Corrupt Practices Act Enforcement Initiatives

In the past year, the DOJ has continued to take an aggressive stance in the criminal enforcement of the U.S. foreign anti-bribery statute, the Foreign Corrupt Practices Act ("FCPA"). In fact, two of the largest fines ever imposed in an FCPA-related action occurred in 2016 with VimpelCom Ltd. and Och-Ziff Capital Management Group, each with combined penalties to the DOJ and the SEC of approximately $400 million.

The past year has also seen enhanced transparency by the DOJ in connection with its April 2016 FCPA Pilot Program, articulating the circumstances in which the DOJ will accord credit to companies based on self-reporting violations, cooperation during the investigation and remediation. Under the one-year Pilot Program, a company that meets the stated criteria can—at the discretion of the DOJ—receive up to a 50 percent reduction in penalties or even a declination to prosecute, provided the company disgorges the ill-gotten profits. Both in public remarks by DOJ officials and in connection with its announcement of resolutions of FCPA violations, the DOJ has continued to tout individual accountability as a primary means of deterring corruption in its focus on individual actors at the outset of an investigation and on remedial disciplinary action taken by companies against culpable individuals, including in the executive ranks.

In light of these trends, we believe boards should consider the following observations in 2017:

1. The DOJ has expressed an expectation that boards will be knowledgeable about, and exercise reasonable oversight over, anti-corruption compliance programs. Directors can be liable for bribery violations and internal control deficiencies for failure to properly exercise oversight. While we have not seen precedent for this, boards should be wary of the DOJ's heightened focus on individual accountability, especially among senior executives and its increased reliance

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on the books and records provisions of the FCPA, which require an appropriate system of internal controls.

2. It is critical that boards take action when potential misconduct under the FCPA is uncovered, depending on the gravity of the potential misconduct and other specific facts and circumstances. When entering the realm of a possible DOJ investigation, boards should bear in mind that the DOJ has expressed that:

3. Voluntary self-reporting will determine mitigation credit and may weigh against the imposition of an independent compliance monitor.

4. Companies seeking credit for full cooperation should expect that the DOJ will want the company to provide facts concerning culpable individuals.

5. Remediation credit will be dependent on appropriate discipline of employees, in addition to implementation of an effective compliance and ethics program.

Of course, in light of the upcoming administration change, any number of these trends could change FCPA enforcement. While it is impossible to predict with any certainty, it seems probable that the new attorney general would adapt the approach or scope of FCPA enforcement—such as revising DOJ initiatives like the Pilot Program or pursuing only cases with a strong U.S. nexus—rather than abandoning the law entirely. In addition, the change in administration could impact the level of international cooperation that currently exists between the DOJ and foreign authorities. The bottom line is: an effective anti-corruption compliance program remains a critical feature of responsible corporate governance.

Board Refreshment Disclosure

Board, committee and even individual evaluations have been mainstream practices for boards and individual directors seeking to improve their performance and it has been increasingly common for boards to create matrices identifying the experiences of current directors, matching them to the skill sets most needed by the company on whose board they serve. Boards are now supplementing these practices with a focus on tenure and refreshment.

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This development comes as investors and proxy advisory firms scrutinize director tenure. For example, Glass Lewis states in its Global Policy Survey that lengthy director tenure may be a "potential obstacle to adding new skill sets and diversity to boards and…a potential risk to the independence of long-serving directors." While this can be a sensitive subject, there are some practical steps that boards can begin to take prior to the 2017 proxy season.

Start the conversation and know your numbers.

The nominating and governance committee should begin the conversation by understanding the underlying facts—average and individual tenure, the interval since the election of the last new director and upcoming director retirements.

Critically scrutinize board skills and mix.

The nominating and governance committee should critically review the board skill set compared to the current and projected company needs and reflect on diversity recruitment progress. This should be more than a routine update or "check the box" exercise, particularly given the rapidly changing business and competitive environment for many companies. For example, companies may need directors with social media, emerging markets or digital marketing backgrounds—skills that might not have been relevant a few years ago.

Decide whether change is needed.

The goal is not to remove long-tenured directors from the board. Instead, the nominating and governance committee, and the board, should be clear about each director's contributions and value, regardless of tenure. As Glass Lewis stated in its most recent guidelines, "a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face." As a result of this exercise, the board should be confident that it collectively has the right skills or should identify any significant gaps and consider how to address them.

Consider the path forward.

Some companies have made director tenure a "numbers" game by adopting mandatory tenure limits. This is not a majority practice and not universally endorsed by institutional shareholders or proxy advisory firms, although the new ISS Quality Score question gives "increasing credit for increased proportions of the board represented by directors with less than six years tenure, up to one third of the board." It avoids the delicate task of asking a director to step off the board before the mandatory retirement age and blunts independence concerns related to tenure. However, it operates indiscriminately and may result in qualified directors departing at an inopportune time. Other approaches to refreshment can include increasing board size—sometimes in anticipation of an upcoming retirement. For example, a 10 person board may add an 11th director anticipating a director retirement in the next few years. Regardless of the practice chosen, it is crucial for the board to have and consistently execute a plan to address any skill gaps.

Tell the shareholders what you are doing.

Board tenure and refreshment is becoming part of the regular, ongoing dialog with shareholders. The company should be comfortable addressing the topic and its approach in its proxy statement, corporate governance guidelines, and investor relations and shareholder engagement programs. In particular, companies and boards should focus on the section of the proxy statement that discloses individual director skills and articulate how the contributions of each director—particularly directors with longer tenure where shareholders might naturally question the relevance of an individual's skills and experiences—contributes to the overall effectiveness of the entire board.

Like most governance matters, the solutions to these issues are not "one-size-fits-all" exercises. A board should not feel pressured to adopt a process that will not enhance its ability to advance and protect shareholders' interests. However, as investor pressure increases and other companies address these issues more publicly, not tackling the topic will increasingly become a governance vulnerability.

Claim Extinguishment in M&A Litigation

In 2016, Delaware courts considerably narrowed post-closing challenges to mergers by reasserting the deference for corporate decisions approved by fully informed, disinterested, and uncoerced stockholders. By extinguishing breach of fiduciary duty claims entirely, such approval now provides a useful cost-effective path to early dismissal of lawsuits. Claim extinguishment, however, is only available when forthright disclosures fully inform stockholders and there are no conflicts of interest that require heightened scrutiny under the entire fairness standard. Going forward, boards and their counsel must not only ensure well-run sale processes, but also identify and disclose any material issues so that stockholders can be apprised before approving a transaction.

Even after successful mergers, plaintiffs' lawyers frequently bring post-closing breach of fiduciary duty claims seeking damages. In the past, such claims against disinterested directors have required plaintiffs to demonstrate gross negligence by these directors. Recent Delaware decisions have clarified that fully-informed stockholder approval of a transaction will extinguish all claims except waste unless the transaction is subject to the entire fairness standard. And since Delaware courts believe rational stockholders would not approve a wasteful transaction, such post-closing damages claims will generally be dismissed. Indeed, the Delaware Supreme Court has now twice held that claim extinguishment requires dismissal of breach of fiduciary duty claims concerning transactions approved by fully-informed stockholders, and lower courts have done so repeatedly as well, including twice with respect to mergers approved by stockholders tendering shares in a two-step merger.

Because claim extinguishment requires fully informed approval, disclosures to stockholders are more important now than ever. Boards and counsel should focus not only on running an effective sale process but also on identifying all material issues and disclosing them to stockholders. When the facts that form the basis of breach of fiduciary duty allegations have already been described in the proxy or recommendation statement, courts can find that the stockholders were fully informed about the relevant issues but voted to proceed with the transaction nonetheless. If a majority of those stockholders approved the transactions, Delaware courts will not second guess that judgment.

Disclosure is particularly important regarding financial advisor conflicts of interest, which have been the basis of several breach of fiduciary duty claims. Underscoring the benefits of identifying conflicts early in the sale process, Delaware courts have applied claim extinguishment after reviewing disclosures and finding that stockholders were fully informed about such alleged conflicts before they approved the transaction. Since these decisions further held that stockholder approval also extinguishes claims against financial advisors, who may be alleged to have aided and abetted the board's breach of fiduciary duties, advisors should likewise focus on facilitating early, thorough disclosure.

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Given the protections afforded by claim extinguishment, we expect plaintiffs' lawyers will try even harder to invoke the entire fairness standard by alleging conflicts of interest that supposedly taint oversight of the sale process. While the Court of Chancery has rejected these efforts in certain recent cases, the Delaware Supreme Court has yet to weigh in. Wherever these efforts lead, an ounce of disclosure is worth a pound of post-closing litigation, and boards and their counsel should act accordingly.

Environmental, Sustainability and Governance Activities and Disclosure

The demands of investors and other stakeholders (*e.g.*, customers, employees, NGOs) for companies to engage and provide information regarding ESG matters has dramatically increased in recent years. It has also swiftly spread from so-called "socially responsible" investors to the largest fund complexes, asset managers, pension funds and other institutional investors. These investors now seek ESG information in the context of improving company and investment performance and there is a notable increase in shareholder proposals on ESG matters.

In addition, the decision to engage on ESG issues has been made by companies globally. Companies, especially larger companies, receive dozens or even hundreds of questionnaires or other requests for information regarding ESG matters, and they respond to many of them. One large company is reported to respond to over 600 questionnaires and requests for information annually.

Board oversight of risk management, SEC filings and other disclosure should extend to oversight of company decisions and responses in the ESG context, including strategic decisions regarding engagement with investors and other stakeholders around ESG matters, decisions as to disclosure and other responses to requests for information in the ESG area and decisions concerning controls supporting ESG-related decisions and disclosure. Board oversight should be adequate to ensure that such a strategic process is in place and is followed.

This oversight, as with other board oversight roles in the ESG area discussed below, can be delegated to a committee and, given the disclosure and reporting considerations discussed below, the audit committee or other committee responsible for those matters is one logical place to lodge the responsibility.

Most information sought by questionnaires and other information requests in the ESG area is not material to a company or its investors, although it may be of interest to other stakeholders. Often the questionnaires cover a broad spectrum of requested information and do not differentiate by industry, which results in questionnaires that seek information that may be immaterial, unimportant or even irrelevant. Whenever a company speaks, publicly or privately, there is strategic, legal and reputational risk. Companies should have a process that involves senior investor relations, finance and legal (including those responsible for SEC reporting and disclosure) functions for making the strategic decision as to whether and how to engage in ESG matters. In addition, this process should also determine what level and type of controls over such information is desirable for the company and a plan for the application and execution of such controls. Part of this discussion should also involve disclosure controls and procedures as well as internal control over financial reporting for ESG-related information, even in the absence of a legal requirement to provide disclosure in SEC filings or for other information the company voluntarily provides to third-parties.

Among the disclosure issues that need to be addressed are:

1. Whether the company is making required disclosures in its SEC filings. ESG matters are only rarely if at all addressed in a company's specific line item disclosure requirements, but they can be covered by existing general disclosure requirements. These include in particular:

   - Requirements for additional disclosure of material information the omission of which would make the disclosure that is provided misleading;

   - Disclosure in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") of forward-looking information regarding known trends and uncertainties that are reasonably likely to have a material impact; and

   - Risk factor disclosure, to the extent any of the ESG considerations could materially affect the company's business, results of operations, liquidity or financial condition.

2. Whether the company's disclosures are accurate, balanced and consistent across its various means of communications. A company should ensure that its responses to ESG and related questionnaires are scrutinized for accuracy and balance and are not characterized by unjustified overstatement. In addition, communications outside of SEC filings should be consistent with information included in those filings and should not raise questions as to whether additional information should also be included. Use of words like "material", "significant" or "important" in ESG-related communications, which are in fact encouraged in some questionnaires and other requests for information, can give rise to questions if the matters so characterized are not addressed in SEC disclosure documents.

3. Whether the company is in compliance with Regulation FD and its disclosure policies in its non-public discussions with investors regarding ESG matters (*e.g.*, in response to a shareholder proposal).

Finally, in light of the oversight functions suggested above for the board or relevant committee, the board calendar should include periodic reports to the board on the company's ESG-related activities. It is management's responsibility to determine the level and nature of the company's engagement in the ESG space, however, the board should provide oversight, including in connection with its oversight of reporting and risk management, to ensure that management has put in place and implemented adequate decision-making processes and controls.

Compensation Considerations

Clawbacks

The potential clawback of executive compensation, an area of focus for compensation committees, attracted headlines in connection with Wells Fargo this fall, particularly in the widely televised interrogation by Senator Elizabeth Warren of former Wells Fargo CEO John Stumpf. The responsibility for enforcement of executive compensation clawbacks lies in the hands of boards and compensation committees. They should be prepared to exercise that authority, in seemingly routine situations as well as crisis settings, by ensuring that equity plans and award agreements contain the proper clawback language and by developing a consensus about how such provisions should be applied generally. Many boards would likely benefit from an advance discussion of the most probable considerations when making clawback decisions, such as the implications for a related company lawsuit, employee morale and retention impacts, shareholder and media responses, and efforts that can minimize management distraction.

In the event that the Dodd-Frank Act clawback regulations become final, which we expect eventually, there will be additional regulatory overlay. If finalized as currently proposed, all companies (including foreign private issuers) listed on a national securities exchange would be required to claw back executive compensation upon

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a financial statement restatement. Whether proposed compensation regulations applicable to large financial institutions, which have their own clawback requirements, will be finalized in substantially their current form is less clear. Of course, compensation committees at financial institutions with operations in Europe will already be well versed in the clawback requirements of the CRD IV Directive which, in certain circumstances, apply for 10 years from the date of the award and can lead to the clawback of 100 percent of variable pay.

Compensation Program Risk Management

The very public Wells Fargo matter also highlighted a second area for board and compensation committee focus: compensation program risk management. The sales incentive program at issue in that matter was relatively common and not inherently risky. However, aspects of the program's implementation resulted in findings of fraud, bad press, damaged reputation and lost business opportunities. Importantly, while neither the amount of sales incentives nor the direct impact of any improper conduct were material from a financial perspective to Wells Fargo, the collateral consequences, including the resignation of the CEO, certainly were. It remains to be seen whether any of the U.S. regulators will follow the European Banking Authority's recent efforts (in guidelines that come into force in January 2018) to specifically target compensation policies and practices that relate to the sale of retail banking products. The types of policies and practices identified by the European Banking Authority as problematic include those where pay is solely linked to a quantitative target of banking products sold, that promote the sale of a particular product over others to the detriment of the consumer or where incentive increases with sales volumes over a particular time period.

Since 2009, in their annual proxy statements, U.S. public companies have been required to "discuss the registrant's policies and practices of compensating its employees, including non-executive officers, as they relate to risk management practices and risk-taking incentives" to the extent the "risks arising from the registrant's compensation policies and practices for its employees are reasonably likely to have a material adverse effect on the registrant." This disclosure requirement led to seemingly boilerplate language to the effect that the company "believes that the risks arising from its compensation policies and practices are not reasonably likely to have a material adverse effect on the company." While companies and compensation programs vary widely, boards and compensation committees would be well advised to consider the fundamental questions raised by the yearly proxy statement disclosure requirement based on the principles underlying each company's enterprise risk management functions.

Pay Ratio Disclosure

As evidenced by the wave of "say when on pay" votes occurring in 2017, it has been over six years since the Dodd-Frank Act added to the ever-increasing amount of executive compensation disclosure. Unless rescinded by the new administration, U.S. public companies (with fiscal years beginning on or after January 1, 2017) will be disclosing the ratio of 2017 CEO to median employee pay in their 2018 annual meeting proxy statements. Many companies have started assessing the logistics for identifying the median employee. Compensation committees should request an update on progress and possible disclosure throughout the year, including a comparison of the likely ratio to estimated peer group ratios. In the current environment, both the ratio itself and the geographic location of the median employee (required to be disclosed if cost-of-living adjustments are utilized) may be a focus. Peers in the United Kingdom will be watching with interest, as the British government has recently launched a consultation on introducing a similar disclosure requirement. While one may doubt the materiality of pay ratio disclosure, it could result in unwanted attention from shareholders, employees, politicians and the media for which companies, including boards, should be prepared.

The Change in Administration in the United States and Brexit and Political Uncertainty in the United Kingdom and Europe

The Change in Administration in the United States

Companies and boards are wrestling with how to prepare for the Trump administration, because the consequences of the political transition in the United States this year are unusually uncertain. They will need to tread carefully between the risk of being unprepared and the risk of overreacting in advance. The specifics vary widely across sectors and companies, but here are a few basic steps to consider.

1. **Identify the areas of potential exposure to regulatory change or government actions.** It is tempting to start by listing the topics on which political rhetoric has focused, but the list is long (tax reform, trade policy, health insurance, financial regulation, environmental regulation...)—and in most areas it is too soon to predict what specific measures a new administration might take. It might be wise to start instead with the company's own profile of regulatory and governmental challenges and ask internal specialists to identify the sensitivities, think outside the box about what could happen, and call out areas where change could be sudden.

2. **Identify the early signs that will show the direction of policy.** In many important areas of government policy, it is too early to know where regulators and the new administration are headed. In some areas–tax policy, for example–everything important will turn on details that will be in play for a while yet. But it is already time to think through the early indicators. How key jobs are filled, how long-time staffers react, what the near-term deadlines are, what agenda emerges: these kinds of signposts could usefully be listed in advance. For example, a board on the lookout for strategic acquisitions still cannot tell how the DOJ may change its approach, but there are some key appointments coming up that will be an early sign.

3. **Look for opportunities, too.** Uncertain times demand caution, but not paralysis; and changes in the regulatory landscape or government policy usually create opportunities as well as risks. To a rare degree, policy orientation may be up for grabs and regulators may be open to a new idea, especially in a deregulatory vein.

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4. **Review disclosures.** In the next Exchange Act report, the question will be whether to add to the risk factors. Companies should avoid bad risk factors: generic warnings about vague threats that could apply to any company. Instead, well-crafted risk factors—identifying specific issues and consequences for the company—are an important inoculation against risk, and if there is a specific trend or development already in view, that may need to be addressed in MD&A.

5. **Review readiness for communicating with media and investors.** There are good reasons for the board to be on its toes, and to expect management to be as well—and as numerous recent incidents show, social media are a powerful and unpredictable accelerant for media brush fires. It is worth reviewing the company's readiness to react quickly to news and public statements, especially about politics and government policy. It is also worth identifying business practices that could attract criticism based on new, emerging arguments and concerns at every point on the political compass.

With those steps taken, it could make sense to take a deep breath. A few changes can happen quickly, but most require time, and not everything can change at once. There is a risk of overreacting to the mere possibility of changes, and a risk of oversimplifying their real impact. An uncertain environment for doing business is, unfortunately, nothing new.

Brexit and political uncertainty in the United Kingdom and Europe

The UK's Brexit vote was one of 2016's major political events. While many boards have already started to assess the longer-term implications of Brexit, we expect this to be an area of increasing focus during 2017. The UK government announced it intends to make its "Article 50" notification in March 2017, which will trigger the start of a two-year timetable for formal Brexit negotiations between the United Kingdom and European Union, with the United Kingdom automatically leaving the European Union at the end. The United Kingdom's ability to maintain the timetable will depend on the outcome of the United Kingdom Supreme Court's deliberations regarding the need for parliamentary approval by passage of primary legislation in order to make the notification and the subsequent timely passage of such legislation through both houses of Parliament.

A key challenge for boards in carrying out effective Brexit planning relates to the uncertainty around the terms of the UK's post-Brexit relationship with the European Union. It is unlikely that the full terms of that relationship will become clear during the two-year period of "divorce negotiations," but it is hoped that the broad parameters and direction will begin to emerge during 2017, particularly once the UK government has set out its Brexit strategy (which it has committed to do prior to triggering Article 50) and the European Council has set out its position shortly thereafter. Our recommendation is for boards to start assessing the risks and opportunities raised by Brexit based on a range of potential scenarios (which may include, for example, a best case of the United Kingdom remaining in the European Single Market and a worst case of the United Kingdom having no trade agreement with the European Union and trading pursuant to default World Trade Organization (WTO) rules) and to refine this assessment over time. Boards should stay engaged with political and regulatory processes to ensure they have access to the

"Our recommendation is for boards to start assessing the risks and opportunities raised by Brexit based on a range of potential scenarios... and to refine this assessment over time."

best available intelligence for Brexit planning and should consider engaging with governments (directly or through trade associations) on areas where their business could be significantly affected.

This uncertainty has also meant that many businesses have not begun making concrete changes to businesses or operating infrastructure in anticipation of Brexit. While this "wait and see" approach may continue to be appropriate for some businesses during 2017, those likely to be heavily impacted by Brexit (including businesses in the financial and manufacturing sectors that sell services and goods between the United Kingdom and rest of the European Union) should be cognizant of the often significant lead times for making changes—such as setting up new legal entities, obtaining new regulatory licences, leasing premises and moving staff—and may need to start planning and implementing changes during 2017.

Beyond Brexit, broad political uncertainty in Europe experienced during 2016 (culminating in the resignation of Italian Prime Minister, Matteo Renzi, in December 2016 following his defeat in Italy's constitutional reform referendum) is expected to continue in 2017 with French presidential and German federal elections being held in May and the second half of 2017, respectively. Businesses operating in Europe will need to consider the impact of these potentially significant political changes, in addition to Brexit, into their strategic planning.

Against the backdrop of the Brexit vote, which, in the view of UK Prime Minister Theresa May, signalled popular discontent with perceived excess and irresponsible behavior in the corporate arena, the UK government launched a potentially significant consultation on corporate governance reform for UK companies. Issues addressed include options for:

1. Strengthening shareholder engagement and control over, and increasing disclosure of, executive compensation;

2. Strengthening the engagement of employees, customers and other non-shareholder stakeholders in the management of UK companies (although Ms. May has now backtracked from her previously announced intention of mandating employee representation on the boards of UK companies); and

3. Improving corporate governance at large private companies, including whether they should be subject to the rules applicable to publicly listed companies (*i.e.*, the UK Corporate Governance Code).

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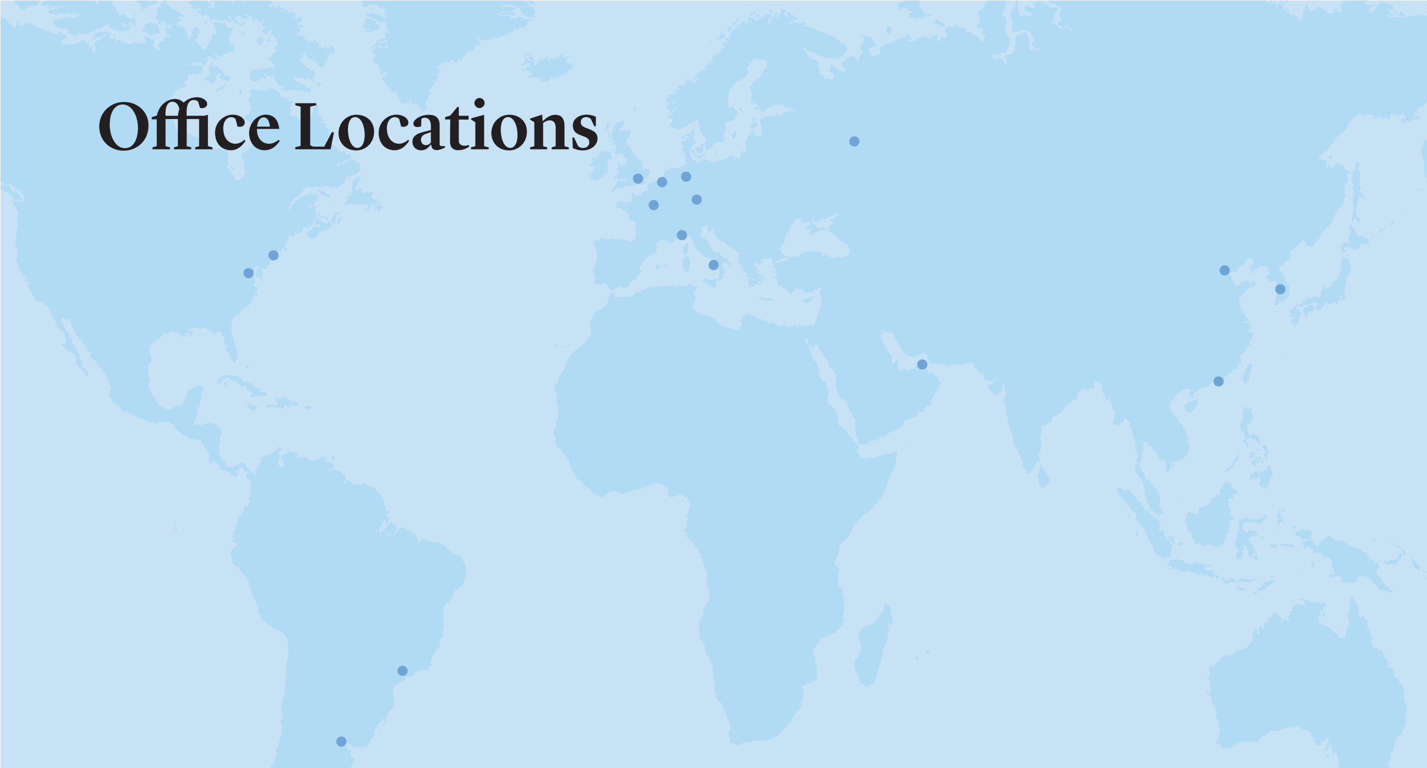

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