2018 Insights

Skadden

A collection of commentaries on the critical legal issues in the year ahead.

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Editorial Board

10 Themes for 2018

Tax reform, shifting international dynamics, Trump administration goals and a potentially strong market for transactions all seem likely to impact business activity in 2018. The following are 10 areas to explore in our **10th annual *Insights* publication**.

Tax Reform Takes Center Stage / p. 1

The most comprehensive tax reform in the United States since 1986 made its way into law just before the end of 2017, bringing with it a range of potential effects, from its influence on M&A and capital markets activity to sector-specific issues like the health insurance mandate and the expensing of capital purchases. However, changes to the treatment of multinational corporations could make it more difficult to achieve global consensus, as Europeans pursue ways to counter aggressive tax planning by these companies. Individuals and family offices also may increase their gift planning and use of trusts in order to take advantage of changes under the new law.

Optimistic Outlook for Transaction Activity / p. 9

Strategic activity continued to be a key driver of M&A deals globally and in the U.S. in 2017, helping corporations grow earnings and better position themselves to compete in the global marketplace. The factors that contributed to market confidence last year — stable equity markets, attractive financing, strong balance sheets — continue to point to a robust environment in 2018. Deal scrutiny likely will remain challenging, as Congress proposes changes to toughen CFIUS reviews, Europe continues to push novel theories of antitrust enforcement and jurisdictions around the globe focus on tightening foreign investment controls.

The reduction of corporate taxes combines with favorable market conditions to fuel optimistic expectations for the U.S. capital markets in 2018, and new regulatory tweaks at the SEC could further encourage IPOs. We also look at the slowing of restructurings and financial distress across most sectors in the U.S. and examine the flexibility asset-based loans offer borrowers with international businesses.

Governance and the #MeToo Era / p. 27

Social responsibility is becoming an increasingly important focal point for corporations. Amid this governance landscape, boards must focus on composition and diversity as well as communication and connection with investors. Compensation-related issues and key areas of Delaware corporation law were further clarified in the courts in 2017, and the #MeToo movement shined a light on workplace harassment, giving employers an opportunity to evaluate how strongly their culture supports professionalism and respect.

European Trends Worth Watching / p. 39

This year's focus on Europe features more than a dozen Skadden attorneys discussing their perspectives on a range of issues impacting businesses. From the current state of M&A and capital markets activity to Brexit to developments in the regulatory and enforcement environments, we share our insights on legal and business developments in the U.K., France, Germany and throughout the EU.

Enforcement Priorities Take Shape Around the World / p. 49

Although companies should expect continued vigorous enforcement from U.S. regulatory authorities, public statements from officials at these agencies indicate a desire to better target enforcement actions while continuing to rely on cooperation and self-reporting. We also offer a closer look at the SEC's priorities in year two of the Trump administration. Increased collaboration among agencies also seems to be on the radar, a development that would be welcomed by multinational companies, which can face enforcement actions in multiple jurisdictions, including in China (where the government issued guidance to state-owned entities advising them to control overseas enforcement risks) and throughout Europe (where tightly enforced anti-corruption laws, the use of deferred prosecution agreements and individual accountability are all on the rise).

China and Its Growing Global Presence / p. 57

Now that President Xi Jinping consolidated his hold on power at the Chinese Communist Party National Congress, his priorities will play a significant role in Chinese policy for years to come. This likely means an increasingly muscular China on the world stage, limited liberalization within the country and measured opportunities for foreign investors. Our attorneys examine what this means for M&A activity, infrastructure development, the capital markets and enforcement.

Litigation Risks Continue Unabated / p. 63

In its current term, the U.S. Supreme Court will address constitutional protections, class actions and other corporate liability issues. That the John Roberts Court tends to take more securities cases than its predecessors may be welcome news to public companies, which face record-high securities class action filings that show no signs of slowing. Trade secret litigation also is on the rise, thanks in part to how easy technology makes it for former employees to walk away with significant amounts of company data. Technology threats don't always come from former employees, however: Often insiders with privileged access to proprietary systems are a threat to cybersecurity. Our authors also highlight recent international arbitration trends, namely the increased use of arbitration to resolve financial institution disputes and the challenges of enforcing "home country" clauses in commercial contracts.

US Regulatory Action ... and Inaction / p. 79

By signing tax reform legislation into law just before the end of 2017, President Trump and Congressional Republicans claimed a significant regulatory achievement in the president's first year in office. Elsewhere on the regulatory front, legislation has been proposed to make national security reviews under CFIUS more thorough and lengthy, a development that could impact cross-border investment. President Trump also moved to roll back climate change initiatives enacted by his predecessor and imposed a temporary trade barrier that is expected to have significant implications on the solar industry.

Meanwhile, health care and infrastructure did not achieve the large-scale policy changes the Trump campaign promised. Instead, incremental adjustments to streamline permitting (infrastructure) and the removal of the health insurance mandate (through the tax law) carried the day. We look at the status of these initiatives, as well as areas where FERC could take steps to deregulate as President Trump has asked agencies to do.

The Evolving Financial Regulation Landscape / p. 95

The Financial Choice Act was another anticipated regulatory change that didn't transpire in 2017. Instead, various agencies addressed specific issues that will continue to be relevant to financial institutions: The CFTC is working to achieve clarity on international derivatives clearing, the CFPB is expected to bring welcome changes to rulemaking and enforcement after the contested appointment of a new director, the SEC chairman is seeking public comments on standards of conduct for investment advisers and broker-dealers, and New York state's cybersecurity regulations impacting financial institutions (including foreign banks) took effect, with additional requirements coming into play in 2018.

The growth of technology in this sector presents additional challenges for financial institutions. Conflicting cultural dynamics often shape deal negotiations in fintech M&A, making legal, regulatory and compliance issues particularly critical. And while bitcoins garner the bulk of the public's attention when it comes to virtual currency, the growing adoption of blockchain technology and the use of initial coin offerings to raise capital have brought additional legislative and regulatory scrutiny to this area.

Social Responsibility and the Rise of In-House *Pro Bono* / p. 111

As indicated in our governance discussion, social responsibility is becoming more important for businesses. In-house *pro bono* programs can provide corporations another way to give back to the communities in which they live and work. We share our insights on creating successful programs that are dedicated to bringing the culture of skills-based volunteering to in-house legal departments.

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Tax Reform Takes Center Stage

US Tax Reform Enacts the Most Comprehensive Changes in Three Decades

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The sweeping tax bill that President Donald Trump signed into law on December 22, 2017, represents the most comprehensive reform of U.S. tax law since 1986. The law makes substantial changes to the taxation of individuals and business entities, including by lowering tax rates, modifying rules relating to the use of losses and deductions, and altering the taxation of U.S. multinationals' foreign operations.

The act lowers the corporate income tax rate from 35 percent to 21 percent; reducing it was a central issue for Republicans in Congress and the Trump administration. The law also makes broad changes to the corporate tax base, including imposing new rules limiting the deductibility of interest expense and temporarily permitting accelerated cost recovery of certain capital expenditures.

Meanwhile, the new rules for taxing U.S. multinationals' foreign profits reflect a shift from a "worldwide" system of taxation to a more territorial one, with corporations generally permitted to repatriate future profits of their foreign subsidiaries tax-free. However, many features of the current anti-deferral rules that subject certain foreign earnings to current U.S. taxation are retained. Moreover, a new set of rules will subject any foreign earnings in excess of a certain threshold to current U.S. taxation at a reduced rate. The result is perhaps more appropriately viewed as quasi-territoriality with a minimum tax rather than a true territorial system. The act also contains certain base erosion rules and incentives to bring operations onshore to the U.S. that could prove controversial under the U.S.'s General Agreement on Tariffs and Trade and tax treaties.

In addition, as part of a transition to the new system, the accumulated earnings of "controlled foreign corporations" and other foreign corporations owned 10 percent or more by a U.S. corporation that have not previously been subject to tax are deemed repatriated, and 10 percent U.S. shareholders (including individuals) of such foreign corporations will generally be subject to a one-time tax on their allocable share of such earnings. This tax is imposed at an effective 15.5 percent rate on accumulated earnings invested in cash or cash equivalents and an effective 8 percent rate on accumulated earnings in excess of the cash position.

The reform also makes important changes to the taxation of individuals. Key changes include reducing the top individual tax rate from 39.6 percent to 37.0 percent; subject to certain limitations, allowing individuals a deduction equal to 20 percent of their qualified business income (and certain other types of income) that is earned directly or through pass-through entities (such as partnerships and S corporations), resulting in a top tax rate of 29.6 percent; and limiting individuals' deductions for state and local income and property taxes to $10,000 per year.

In many cases, there is significant uncertainty around the scope and application of the act's provisions. Members of Congress have already noted the need for a technical corrections bill, and significant regulatory guidance from the Treasury and the Internal Revenue Service also is expected.

For more on the tax reform, see our January 18, 2018, client alert "An In-Depth Look at the Impact of US Tax Reform on Mergers and Acquisitions."

International Taxation in the Digital Era: The Rapidly Evolving European Perspective

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Europe's politicians worry that international tax rules have not kept pace with the digital economy and too easily allow multinationals to organize their global operations to minimize net taxable profits in high-tax European countries.

Pressure has been mounting throughout the European Union to crack down on what some perceive to be aggressive tax planning. The European Commission, France, Italy and the U.K. have now taken initial steps in this area.

New Taxation Efforts

The European Commission first took steps — using competition law rather than tax law — by suing individual countries for employing attractive tax regimes that allegedly violate European state aid rules. (See our September 2017 *Insights* article "EU State Aid Enforcement: What Multinationals Need to Know.") It remains to be seen whether these novel challenges can survive review in the European Court of Justice.

These challenges also have been limited to relatively specific situations in which a particular taxpayer allegedly benefited from a deviation in the host country's normal tax treatment. The same argument cannot easily be made against groups selling goods or services, particularly electronic ones, in one country, while maintaining a base physically in another country, such as Ireland, where they enjoy standard low corporate rates.

International and Regional Reforms

The view expressed by the Organisation for Economic Co-operation and Development (OECD) in its base erosion and profit shifting (BEPS) project — *i.e.*, that profits are to be taxed where value is created and economic activity undertaken — is widely shared, but there is no general global agreement on what constitutes "value creation" in the context of digital business and how to apportion it. Accordingly, Action 1 of BEPS on the digital economy highlighted that because reaching any consensus was not going to be easy, it would not make formal recommendations — although that admittedly was two years ago. Nor did the OECD's multilateral treaty initiative, containing new permanent establishment definitions and anti-tax avoidance provisions to be introduced in approximately 3,000 tax treaties when it enters into force, revolutionize the way tech groups are taxed. In any event, the U.S. (a key jurisdiction for digital businesses) declined to sign the treaty, and now its newly enacted international tax reform seeks to subject to U.S. tax foreign source income derived from foreign low-tax intangibles assets as well as levy a new withholding tax on payments by U.S. groups to non-U.S. entities. Therefore, global consensus seems a long way off.

The European Commission is considering various short- and long-term responses to this lack of global consensus. It is reviving its common consolidated corporate tax base initiative, which aims to harmonize the corporate tax framework in Europe, in the hope that this will curb multinationals' tax planning within the EU single market. Building support for such a framework has proven technically very complex given the history of different tax systems within the 28 member states of the EU. Furthermore, any such legislation would require the unanimous support of member states, and it is hard to see why Ireland or Luxembourg, which have created thousands of jobs for their residents by attracting tech giants with favorable tax policies, would agree.

The European Commission also is considering as a short-term solution other forms of Europe-wide taxation, such as revenue-based models or deemed permanent establishments, where the focus is collection either at the source from customers within the EU or through direct assessment on the turnover generated by non-EU groups from such customers.

Country-Specific Initiatives

Individual jurisdictions have looked to tackle these issues, but international taxation treaties have hampered them. The recent *Google* case before the Administrative Court of Paris illustrates this difficulty, with the French authorities failing to tax an Irish corporate resident selling services over the internet to the French. Although authorities throughout Europe have intensified information exchanges and multijurisdictional audits, they face having to comply with the high procedural bar set by the European Court of Justice in *Berlioz* to protect taxpayers in these matters using the EU Charter of Fundamental Rights. (See Johannes Frey, Alex Jupp and Frank-Michael Schwarz's August 14, 2017, *Tax Notes International* article "The CJEU's *Berlioz* Judgment: A New Milestone on Procedural Rights in EU Audits.") So far, insufficient evidence appears to have been collected to launch many similar actions to *Google*.

The U.K. has adopted a 25 percent diverted profits tax that applies to "artificial" shifts of profits offshore by large multinational groups. France, followed by Germany, is threatening to adopt an "equalization tax" that would be imposed on the gross revenue generated in a particular state, rather than on net profits. The trend evidenced by these individual initiatives is concerning: Not only are they likely to be over-reaching as to the taxable base, but they could also result in double taxation in the absence of international coordination. Questions are almost certainly going to arise on their compatibility with new or existing treaties, European law and domestic constitutional principles.

Additionally, the U.K. has announced new withholding taxes for royalties linked to online sales in the U.K., where payments are earned by a low-tax jurisdiction, even where the payer of the royalties is not U.K.-based. Italy also has taken first steps toward an equalization tax that withholds on gross revenues. Again, treaties may impose limits here.

Conclusion

Certainly, one can see a dissonant world where the U.S. is increasing the tax on non-U.S. profit creation, the EU is forcing its member states to adopt one or several measures to tax revenues earned in its member states, and the U.K. is forging its own taxation and political path outside the EU. With no agreed-upon treaty resolution to resolve these tensions, avoiding double or even triple taxation on cross-border revenues is going to be a very difficult task in the short term. It may also spell the end for many zero-tax regimes in offshore jurisdictions. The next five years will for sure see a radical shake-up of cross-border tax planning for all multinationals with digital businesses. One can only hope that the rapidly assembled OECD Task Force on the Digital Economy can report some emerging consensus when it presents its interim conclusions to the G-20 in 2018.

Impact of New US Tax Law on High Net Worth Individuals, Trusts and Family Offices

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The newly enacted U.S. tax law makes significant changes to provisions of the Internal Revenue Code affecting high net worth individuals, their investment entities and family offices. These changes are likely to spur gift planning, increase the use of trusts to reduce exposure to state income taxes, give rise to new compensation arrangements and other changes within family offices, and provoke questions about conversion to corporate form.

Gift Planning

The act doubles the amounts that a U.S. person can transfer free of the federal estate and gift tax and the generation-skipping transfer (GST) tax. In 2017, each individual had an estate and gift tax exemption and a GST exemption of $5.49 million. Beginning on January 1, 2018, these exemptions were increased to approximately $11.2 million, indexed for inflation in future years.

The higher exemption amounts are scheduled to return to their lower pre-act levels after December 31, 2025. Accordingly, high net worth individuals should consider making gifts equal to their increased exemption amounts prior to this date. And because any appreciation in gifted assets should be protected from future wealth transfer taxes, a gift of property in 2018 may be a better use of an individual's exemption than a gift in 2025.

The act does not change the federal income tax treatment of assets owned by a decedent at the time of his or her death. This means that unrealized appreciation in an asset held by an individual during his or her lifetime will never be subject to income tax if the individual holds the asset at the time of death. Conversely, assets that are given away during a donor's lifetime generally will have a basis in the hands of the recipient equal to the basis of the donor. In structuring lifetime gifts to take advantage of the new increased exemption amounts, donors and their advisers should consider income tax consequences and potential planning opportunities in connection with a sale of assets by the gift recipient.

Individuals also should review their wills and revocable trust agreements in light of the changes in the new law. These documents frequently include dispositions that are based on estate and GST exemption amounts. In view of the changes to these exemption amounts, dispositions included in testamentary documents may not work as intended in some cases.

Income Tax Planning in View of Changed Deductions

The act makes significant changes to the income tax laws affecting individuals and trusts. These changes also are set to expire on December 31, 2025, after which time pre-act law will apply.

The act modifies the income tax rates applicable to individuals and trusts, with the top income tax rate now 37 percent instead of 39.6 percent. However, the act eliminates or restricts a number of important income tax deductions, including one for state and local income taxes. The restriction of this deduction should increase focus on utilizing trusts that are not subject to state or local income tax.

The act also eliminates the ability to deduct certain miscellaneous itemized deductions. These include deductions for expenses incurred in the production of income, such as investment management expenses and tax preparation fees. Family offices may consider approaches that potentially enable these items to remain deductible either by causing them to be trade or business expenses, or by structuring some of the payments as a profits interest rather than as a fee.

While the act eliminates a number of income tax deductions, it adds a significant 20 percent deduction for individuals, trusts and estates that receive income from a "qualified trade or business" held in pass-through form, such as a partnership or an S corporation. There are, however, limitations on the ability of individuals and trusts with income in excess of certain thresholds to benefit from this deduction.

The new 20 percent deduction may generate planning opportunities for family offices and investment entities. As one example, families with holdings that are likely to qualify for the new deduction might consider compensating family office executives with a profits interest in a family investment partnership rather than W-2 wage income. The profits interest arrangement may enable executives to enjoy the lower tax rate resulting from the deduction while further aligning the interests of the family office and the executive.

Conversion to Corporation?

The act significantly reduces the corporate tax rate to 21 percent, down from a top rate of 35 percent. Unlike the provisions applicable to individuals, trusts and estates, this rate reduction does not expire on December 31, 2025. Rather, it is drafted to be permanent. (See "US Tax Reform Enacts the Most Comprehensive Changes in Three Decades.") Moreover, corporations retain the ability to deduct state and local income taxes. These factors may prompt high net worth individuals to consider whether they should hold investment assets through corporations. In many cases, this may not make sense due to factors including (1) the additional shareholder-level taxes that may be imposed on a removal of assets from the corporation (either as a dividend or on a redemption of corporate stock), (2) a tax on appreciation in the assets held by the corporation, which would not have been imposed if the same assets had been held by the shareholder at the time of his or her death, and (3) the potential application of taxes such as the personal holding company tax and accumulated earnings tax, which may apply to the undistributed earnings of certain corporations that do not conduct active businesses.

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Optimistic Outlook for Transaction Activity

Strategic Imperatives, Market Confidence Drive US M&A

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2017 was another active year for mergers and acquisitions, both in the United States and globally, though the overall dollar volume of deals continued to lag behind 2015's record levels. Global M&A activity was relatively flat compared to 2016; U.S. dollar volumes were slightly down, though the number of deals increased meaningfully. U.S. transaction activity was restrained early in the year, as deal-makers treaded cautiously while assessing the implications of potential changes in policy direction following the 2016 presidential election — market commentators cited potential tax law changes and policy uncertainty as factors holding back deal activity. However, decision-makers seemed to move past these concerns, and transaction volume picked up over the course of the year (notwithstanding a continued lack of clarity throughout most of the year regarding the likelihood or terms of tax reform and questions regarding antitrust policy).

U.S. M&A continued to be driven primarily by strategic transactions as corporations, taking advantage of a relatively benign deal environment, continued to address the need to grow earnings and better position themselves to compete in the global marketplace. In the low-growth environment of recent years, M&A has provided many companies an opportunity to increase earnings at a rate beyond that possible through organic growth alone, and to take advantage of margin expansion opportunities through realization of the synergies and cost savings often available in the transaction context. M&A also has provided an avenue for corporations to augment technological, geographic and product-offering platforms. The combination of stable equity markets, the availability of transaction financing at attractive rates and strong balance sheets helped to provide corporate executives and boards with the confidence to pursue significant, even if not truly transformational, deals in 2017 despite extant uncertainties.

Cash Transactions. Cash acquisitions represented a substantial portion of deals in 2017, although later in the year more transactions included stock consideration, particularly at the higher end of transaction size. For the most part, investors rewarded corporate acquirers executing strategic transactions, particularly where substantial synergies were identified as being available in the near term. Low interest rates for debt financing, coupled with synergies, allowed many cash transactions to be immediately accretive, and while interest rates may rise over time, they continue to be relatively low on a historical basis. Acquisition financing remains available (subject to new limitations on interest deductibility that may be relevant to some purchasers), and the availability of repatriated earnings will likely provide additional cash "firepower" for corporate acquirers. While stock or partial-stock deals may be attractive to the extent acquirers face interest deduction limitations or target boards seek greater participation in transaction upsides for their stockholders, it is likely that cash transactions will continue to represent a significant portion of activity in the coming year.

Technology and Convergence. Rapid technological change is having a profound impact on a large portion of the economy, with entire industries being reshaped as a result of the disruptive power of new technologies and platforms. A manifestation of this impact has been in the trend toward convergence across a wide range of industries, from financial services to health care to retail, but perhaps most clearly playing out in the technology, media and telecommunications sector. Companies in the media and technology ecosystems are realigning their business models to compete with vertically integrating competitors and large technology platform companies. Facing rapid changes in global consumer preferences, increased utilization of digital distribution channels, the emergence of new hybrid businesses and the implications of the globally networked internet of things, companies in most industries are using M&A to effect expedited change in their business models and product mix.

Unsolicited Activity. Openly "hostile" transactions continued to represent a relatively small portion of total M&A activity in 2017, but these situations constitute only a fraction of unsolicited activity. While there are no reliable statistics to assess the prevalence of transactions involving unsolicited offers that do not become public, anecdotal evidence suggests that an increasing portion of deals are beginning on an unsolicited basis rather than as a result of target-initiated sales processes, often with significant nonpublic pressure. Put another way, in the current market, many targets are "bought, not sold." This is not surprising given the nature of the strategic imperatives driving M&A and mainstream acceptance of hostile M&A as a viable alternative in the right circumstances. As a result, companies will want to be prepared for the possibility of an unsolicited offer from an aggressive suitor.

Activism. A significant feature of the corporate landscape is the continued prevalence of shareholder activism in pursuit of economic platforms. Notwithstanding "passive" institutional investor commentary encouraging corporate managements and boards to pursue long-term decision-making, activist campaigns have continued to have a meaningful impact on corporations' strategic actions, including capital allocation decisions and M&A. A significant number of corporate transactions such as company or business-unit sales, spin-offs and other transactions have occurred following activist involvement in a stock, and activists have at times sought to involve themselves directly in transaction processes. This type of activity seems to have become a permanent part of the corporate landscape and one for which boards and management teams should be prepared, including in the context of reviewing potential strategic initiatives. It is possible that corporate access to additional liquidity arising from the repatriation of offshore cash and lower corporate tax rates may lead to more activist campaigns seeking bigger share repurchases or other capital return to shareholders.

Tax Reform. Uncertainty regarding U.S. tax reform was a major topic in 2017, though much of the uncertainty was eliminated with the adoption of the new Tax Cuts and Jobs Act. The new law is likely to have far-reaching implications for transaction structuring that are not yet fully understood, but overall the reduction of the U.S. corporate tax rate and incentives for U.S. companies to repatriate offshore earnings are likely to be positives for U.S.-targeted M&A. Passage of the tax law should allow parties greater confidence in planning transactions than existed in 2017, notwithstanding questions regarding the details of the law's implementation. (See "US Tax Reform Enacts the Most Comprehensive Changes in Three Decades." For a more detailed look at the new tax law, see our January 18, 2018, client alert "An In-Depth Look at the Impact of US Tax Reform on Mergers and Acquisitions.")

Regulatory Environment. While much of the regulatory agenda of the Trump administration has been generally favorable for business, M&A participants have remained cautious with respect to the development of policy in certain areas affecting M&A activity, including antitrust enforcement and national security review.

In the antitrust area, there seems to be a global trend toward more aggressive review and enforcement, with much of the focus in the U.S. on the government's approach to vertical integration issues and whether this represents a shift. (See "Novel Theories Emerge in Merger Enforcement.") The question of U.S. regulators' approach toward vertical integrations may become more pointed as the convergence trend discussed above plays out. National security reviews also are becoming more complicated on a global basis, with the adoption of new review regimes and expansion of the application of existing regimes to a broader array of transactions slowing or complicating some portion of cross-border deals. U.S. national security review has continued to impose a hurdle for acquisitions by Chinese buyers in many of the industries of interest to such buyers. (See "Reform Proposes Sweeping Changes to CFIUS Reviews.") However, at this time, a fundamental shift in the regulatory review environment in which we are operating does not appear to have occurred. Importantly, the percentage of transactions that are blocked or meaningfully restructured or delayed due to regulatory review and enforcement continues to be low.

Overall, the transactional landscape for 2018 appears very similar to that of 2017: strategic imperatives driving corporations to pursue M&A activity, a benign environment due to stable equity markets and attractive debt financing markets, and regulatory challenges in deal execution that for the most part should be manageable with careful focus on transaction planning and execution. There are headwinds that could restrain deal activity this year: A faster-growing economy may decrease the pressure to "buy" growth; the combination of high asset prices and increasing interest rates may make it more difficult to make the math for acquisitions work; and uncertainty as to the impact of trade policy, geopolitical disputes and other political risks could undercut the confidence necessary to pursue significant M&A.

Reform Proposes Sweeping Changes to CFIUS Reviews

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Over the past year, a bipartisan group of legislators in Congress has been drafting and soliciting support for a new statute that, if passed, would dramatically reform national security reviews performed by the Committee on Foreign Investment in the United States (CFIUS). The Foreign Investment Risk Review Modernization Act of 2017 (FIRRMA) was introduced on November 8, 2017, with ultimate goals of maintaining American leadership in certain critical technology industries and protecting against evolving threats to American national security and critical infrastructure.

FIRRMA's lead sponsors, U.S. Sen. John Cornyn, R-Texas, and U.S. Rep. Robert Pittenger, R-N.C., promoted the bill throughout December 2017. On December 14, 2017, the House Financial Services Subcommittee on Monetary Policy and Trade held a hearing on FIRRMA, the first in a series of congressional hearings on CFIUS reform and oversight. The subcommittee held a second hearing on FIRRMA on January 9, 2018. In addition, a number of key policymakers and industry representatives signaled their support for the bill, including Treasury Secretary Steven Mnuchin, Defense Secretary James Mattis, Attorney General Jeff Sessions and Oracle Corporation. Senate Banking Committee Chairman Mike Crapo, R-Idaho, has pushed back against the bill, but overall these developments demonstrate the sponsors' commitment to moving the bill forward in 2018.

The legislation attempts to address growing concerns that foreign entities may be using acquisitions of and partnerships with U.S. businesses to chip away at American technological leadership. Many policymakers are concerned that certain companies may be circumventing the CFIUS process by using creative structuring in their transactions to avoid CFIUS jurisdiction. Such transactions could present a harm to U.S. national security.

FIRRMA would address this concern through a wholesale revamp of the CFIUS process. Most notably, the legislation would bring additional types of transactions under the committee's purview and establish mandatory notification for certain transactions. The bill also would expand CFIUS authority to allow the committee to require risk mitigation measures and, if necessary, monitor and enforce them. And the bill would establish a filing fee to address concerns about resource constraints.

Although Chinese investments and partnerships in the U.S. received particular scrutiny during the House hearing, both the bill's sponsors and the witnesses testifying before the House were committed to the belief that any changes to CFIUS operations should reject economic protectionism. Entities from "countries of special concern" may face additional hurdles in the CFIUS review process if the new legislation passes, but the proposed bill is not intended to serve as the pretext for the creation of a foreign investment blacklist, according to its sponsors.

Key provisions of FIRRMA (see our November 10, 2017, client alert "Legislation Proposes Sweeping New Foreign Investment Review Authorities") include:

Expanding the Set of Covered Transactions. CFIUS jurisdiction would be expanded to include, among others, joint ventures and strategic partnerships, certain licensing agreements, noncontrolling investments in U.S. critical technology and infrastructure companies, and purchases or leases of real estate near sensitive U.S. government properties.

Establishing Short-Form and Mandatory Notification Procedures. FIRRMA would expand the CFIUS notice options by adding a "short-form" declaration that could be filed to ascertain whether CFIUS has sufficient interest in a given transaction to request a full notice and review. In certain circumstances, the bill would make the filing of these short declarations mandatory. The bill also would empower the committee to impose civil penalties on parties that do not comply with the mandatory notification requirements.

Emphasizing Countries of Special Concern. An additional component of the committee's analysis under the new bill would be the transaction's nexus with "countries of special concern" — *i.e.*, those that "pose[] a significant threat to the national security interests of the United States." CFIUS would not be required to maintain a list of these countries but would have the flexibility to analyze a particular transaction through a country-specific lens in conjunction with other risk factors.

Mitigating Transaction Risks Through CFIUS Action. FIRRMA would maintain CFIUS' broad authority to mitigate the risk posed by covered transactions and provide the committee with the authority to suspend a transaction while it is under review. The bill also contemplates the use of independent, third-party entities to monitor compliance — an increasingly common component of mitigation agreements under the current statutory framework.

Mitigating Transaction Risks Through Presidential Authorities. In addition to measures taken to suspend or prohibit a transaction, or to require divestiture, the president also may "take any additional action the President considers appropriate to address the risk to [...] national security."

Enforcing Mitigation. In the event of noncompliance with a mitigation agreement, the legislation would authorize CFIUS to (1) negotiate with the transaction parties to remediate the noncompliance, (2) require that the parties submit for review any covered transaction initiated after the date of noncompliance, or (3) seek injunctive relief.

Monitoring Non-Notified Transactions and Revisiting Previously Mitigated Transactions. The bill would require CFIUS to establish a monitoring mechanism to identify covered transactions that were not submitted for review and for which information is reasonably available. In addition, the bill would expand CFIUS' ability to revisit transactions in which the parties are in material breach and lower the bar for overcoming the "safe harbor" that restricts reviews of previously cleared transactions.

Establishing a Filing Fee and Extending CFIUS Review Timing. The bill would establish a fee for CFIUS submissions, set up to the lesser of 1 percent of the value of the transaction or $300,000, adjusted annually for inflation. In addition, the bill would lengthen the initial review phase from 30 days to 45 days and under some circumstances permit the secondary investigation phase to be extended for one 30-day period. Thus, the combined review and investigation process could total 120 days from acceptance of the CFIUS notice.

Key Takeaways

The proposed legislation would have far-reaching consequences for transactions between U.S. and foreign parties. Should FIRRMA pass, careful structuring and advance consideration of potential national security issues will be paramount. As a result, transaction parties would be well-advised to address CFIUS issues proactively when considering cross-border investments and commercial opportunities. International business partners also may need to consider CFIUS issues in their commercial negotiations. All cross-border investors should be prepared for thorough and potentially lengthy CFIUS investigations.

Changes to the review process also must be considered in light of the U.S. trade relationship with China, which is increasingly marked by accusations of unfair practices. The U.S. trade representative recently launched a Section 301 investigation into China's alleged theft of U.S. intellectual property, and U.S. companies complain that they face barriers and discriminatory treatment in seeking to invest in the Chinese market. In this context, the broadening of CFIUS jurisdiction and authority is a way to address ongoing trade disputes while protecting U.S. national security interests.

The expansion of CFIUS jurisdiction also could be viewed as an attempt to address limitations to the U.S. export control system. CFIUS already has the authority to mitigate national security risks that are not adequately addressed by export control regimes. However, by expanding the scope of CFIUS jurisdiction, FIRMMA would enable CFIUS to exert that authority over more transactions and effectively strengthen export control. Nevertheless, there is debate as to whether the CFIUS review process should be reformed to address gaps in the export control system or whether that system in the U.S. should be reformed separately. While some overlap in jurisdiction currently occurs, some policymakers have expressed fears that CFIUS would be unable to fulfill its legislative mandate if its jurisdiction were expanded too broadly. Changes to the CFIUS review process would unfold over the months following the legislation's passage as the committee increases its staffing and writes new regulations, but the ultimate effect will be profound.

Novel Theories Emerge in Merger Enforcement

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Antitrust merger enforcement historically has focused on horizontal mergers — consolidation of two firms that compete directly in the same space. This is especially true in the U.S., where antitrust authorities have challenged few vertical mergers — those of a firm with one of its customers or suppliers — and are even less prone to scrutinize conglomerate mergers that marry complementary assets, or transactions that may impact innovation competition that isn't tied to specific products or markets.

The European Union's antitrust regulator, the European Commission, has been more apt to examine vertical issues, conglomerate effects and innovation competition, pushing the envelope of less traditional theories in their enforcement actions. Recent activity in Europe confirms this approach to nonhorizontal mergers, an enforcement trend that the U.S. may be unlikely or unwilling to adopt.

A fundamental difference between the two jurisdictions is that the European Commission's decisions are self-enforcing and subject to judicial review only after the Commission has issued its decision, whereas a U.S. enforcer's decision to block a merger must be sanctioned by a federal court before it can take effect. Because U.S. antitrust officials bear the burden of proof in merger litigation, and courts are bound by existing precedent, dramatic changes in U.S. merger enforcement are unlikely over the short term, even while the Commission continues its current trend of aggressively pursuing a broader range of theories of competitive harm.

Merger Decisions in the EU and US

As in the U.S., the European Commission's merger decisions are typically focused on horizontal mergers. In its nonhorizontal merger guidelines, the Commission states that conglomerate mergers — mergers involving complementary rather than overlapping products or services — generally do not raise competition concerns. However, several recent Commission decisions and pending investigations reveal an aggressive pursuit of vertical and conglomerate cases in spite of this view.

In 2016, the Commission approved a number of nonhorizontal mergers subject to the parties making commitments to address competition concerns, including in relation to dental equipment (*Dentsply/Sirona*), payment services (*Worldline/Equens/Paysquare*) and social networking services (*Microsoft/LinkedIn*). For example, the Commission cleared Microsoft/LinkedIn subject to a commitment that competitors would be assured continued interoperability with and access to Microsoft's products for a transitional period.

In 2017, the Commission opened in-depth investigations in relation to three transactions based at least in part on conglomerate theories of harm. It expressed concern that the merged entities might:

- in *Qualcomm/NXP Semiconductors* (June 2017), exclude rival suppliers through bundling or tying practices, including by potentially modifying current intellectual property licenses (for example by bundling one of NXP's technologies to Qualcomm's patent portfolio);

- in *Bayer/Monsanto* (August 2017), bundle or tie their sales of pesticide products and seeds and prevent competitors' access to distributors and farmers, which would be aggravated by the increased reliance on digital agriculture in which the merging parties have a particularly strong position; and
- in *Luxottica/Essilor* (September 2017), use Luxottica's prominent brands, including Ray-Ban, to convince opticians to buy Essilor lenses to the detriment of other lens suppliers.

The U.S. antitrust authorities' treatment of these cases was markedly different. U.S. regulators cleared *Dentsply/Sirona* and *Microsoft/LinkedIn* without remedies, and *Qualcomm/NXP Semiconductors* just months after the deal was announced, without an in-depth investigation.

Innovation Competition

A similar contrast can be drawn in relation to recent decisions involving innovation competition. The European Commission has long made clear that loss of innovation can be "at the heart of the anti-competitive effects of a merger," according to an April 2016 EU policy paper on EU merger control and innovation. But in past decisions, it focused its merger analysis on actual products in a merging firm's pipeline, *e.g.*, an analysis of whether a deal could lead to the elimination of products under development that otherwise would have been commercialized.

More recently, the Commission broadened its analysis to examine whether a transaction could reduce innovation more generally. In *Dow/DuPont*, the Commission pursued what many critics consider an entirely novel and speculative theory of harm, including the allegation that post-merger, the parties would have fewer incentives to maintain research and development (R&D) spending and develop new pesticide products, even in relation to products that had not yet been identified and that would be marketed at an undetermined future date. The Commission cleared the merger subject to DuPont's commitment to divest its global R&D organization. Following its decision, and likely in response to criticisms, the Commission rejected the notion that its innovation theory of harm was novel or speculative, referring to an economic study authored by its own economists that concludes that any merger "tends to reduce overall innovation."

In the U.S., *Dow/DuPont* was cleared subject to a narrow set of divestitures related to horizontal overlaps in herbicides, pesticides and performance polymer materials. And while the U.S. authorities have recognized the importance of innovation competition, the antitrust agencies have rarely initiated merger challenges on the basis of threats to innovation, with the Federal Trade Commission's 1997 review of the *Ciba-Geigy/Sandoz* merger noted as one possible exception. Even then, the concerns were focused on specific, albeit nascent, overlapping technologies.

Potential for Changes to US Enforcement

In November 2017, the Antitrust Division of the U.S. Department of Justice filed a challenge to service provider AT&T's vertical merger with Time Warner, a creator of content for distribution via cable and internet by firms like AT&T. The challenge raises the question of whether less traditional merger enforcement will become more prevalent in the U.S., and whether doctrines involving innovation market analysis, vertical integration and conglomerate effect theories will gain ground in the current political environment.

Such a shift in U.S. antitrust enforcement would be a significant departure from the policies traditionally embraced by Republican administrations, which have been less enforcement-oriented than their Democratic counterparts. Indeed, congressional Democrats recently espoused radically increased enforcement on the basis of vertical and conglomerate theories as a central principle of their "Better Deal" platform. The antitrust-specific bill calls for greater investigation of nonhorizontal mergers and proposes other dramatic deviations from well-established antitrust laws, including changing the standard for merger challenges altogether to account for a broader variety of effects on consumer welfare rather than focusing on a merger's impact on price and quality. Many political commentators view the proposed legislation as an effort by Democrats to attract voters leading up to the midterm elections, with little realistic chance of passing under the current Republican-controlled Congress and White House.

While both the "Better Deal" legislation and *AT&T/Time Warner* challenge are certainly worth noting, a radical shift in U.S. policy is highly improbable. The U.S. has not litigated a vertical case or any merger case based on conglomerate effects or innovation markets in decades, and there is little recent precedent to support these theories of competitive harm. Under these circumstances, with little precedent to the contrary and with the courts as gatekeepers, a shift in the U.S. toward the theories of harm that are gaining traction in the EU is unlikely. Parties contemplating transactions should be aware that less conventional theories of antitrust may nevertheless impede their ability to fully realize their goals if the transaction is subject to multijurisdictional review.

US Capital Markets Expected to Remain Robust in 2018

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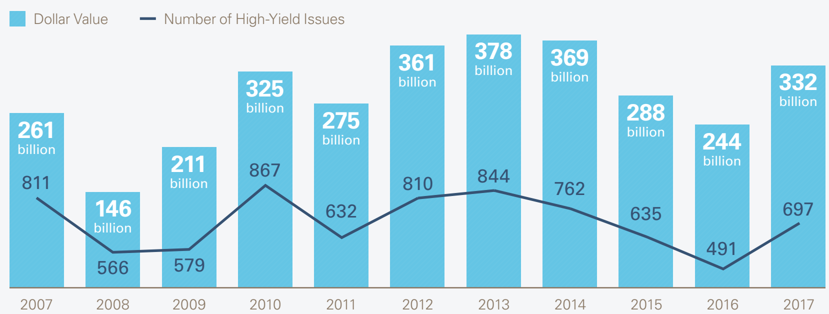
The U.S. high-yield and investment-grade debt markets saw significant increases in 2017 over 2016 in dollar volume and number of issuances.[1] The U.S. equity indices reached new highs throughout the year, with the Standard & Poor's 500 index ending the year up 19.4 percent.

The slow, steady expansion of the economy (one of the longest expansion cycles on record) and the current favorable market conditions, along with the recently enacted reduction in corporate taxes — which could drive earnings expansion — have fueled optimism for robust capital markets activity in 2018. Questions linger, however, about the sustainability of the bull run and whether volatility can remain at historically low levels.

Debt Markets. The U.S. high-yield debt market ended 2017 approximately 36 percent higher by volume and 42 percent higher by number of issuances than 2016, ending three consecutive years of decline but falling short of the record highs in 2012-14. U.S. high-yield bond issuances totaled $332 billion (697 issuances) in 2017 compared to $244 billion (491 issuances) in 2016.

US High-Yield Corporate Bonds

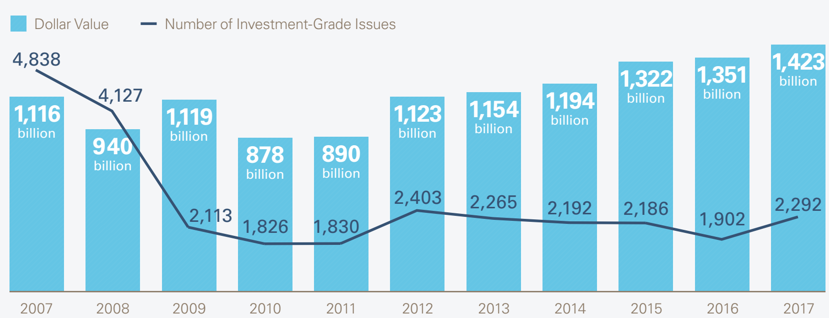
Source: Bloomberg



The U.S. investment-grade debt market had record volume of $1.42 trillion (2,292 issuances) in 2017, exceeding the previous record of $1.35 trillion (1,902 issuances) set in 2016 and marking the seventh consecutive year of dollar volume increase. AT&T was the largest issuer by volume, totaling $36 billion in 16 issuances, and in July 2017 also had the largest investment-grade transaction of the year at $22.5 billion in connection with its proposed acquisition of Time Warner. Refinancing activity continued to drive both high-yield and investment-grade volume, with M&A a distant second.

US Investment-Grade Corporate Bonds

Source: Bloomberg

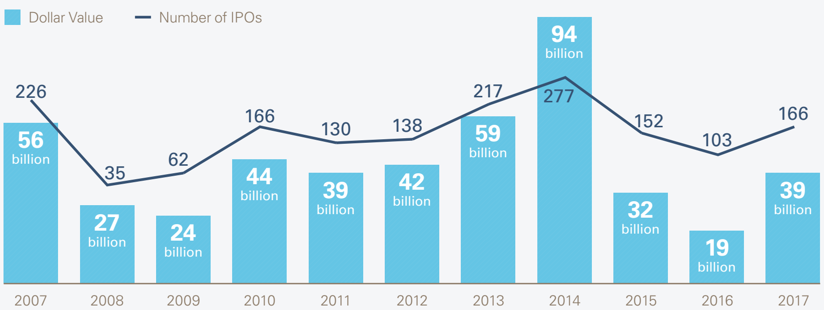


Equity Markets. The Dow Jones industrial average reached four 1,000-point milestones in 2017 — the most in any one year — topping out at over 24,000 in December 2017. The S&P 500 and Nasdaq composite also set all-time highs. The gains were driven largely by strong corporate earnings and a favorable macroeconomic backdrop of moderate but steady gross domestic product growth, low unemployment, a strong housing market, high consumer confidence, and the expected pro-business and anti-regulation agenda of the new administration, including the promise of tax reform.

Despite a favorable backdrop of rising equity markets and historically low volatility, the initial public offerings (IPO) market fell short of some expectations going into the year. Many companies chose to take advantage of the robust private markets that have developed in recent years to satisfy their capital-raising and secondary liquidity needs or to pursue an M&A exit (with secondary buyouts by private equity sponsors continuing to make up a large share of M&A activity). With 167 IPOs raising approximately $39 billion, it was a significant improvement over 2016 but still below post-financial crisis highs.

US IPOs

Source: Thomson Reuters

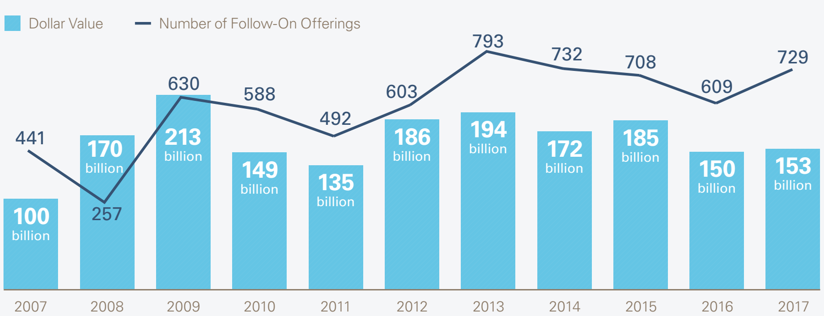


The leading sector for IPOs by volume and number of deals in 2017 was financial services, followed by health care and technology. The two largest IPOs of the year were Snapchat owner Snap Inc. and cable operator Altice USA Inc., which raised $3.91 billion and $2.15 billion, respectively. Despite a solid year, with 27 deals raising $9.1 billion, technology IPOs failed to materialize in the way that some had anticipated. Two of the largest tech IPOs — Snap and Blue Apron — fell short of investor expectations, although a number of subsequent deals — including Roku and Stitch Fix — performed well. Blank check, or special purpose acquisition company (SPAC), issuances increased sharply in 2017, with 29 SPAC IPOs raising a record $8.6 billion (up from 14 SPAC IPOs raising $1.7 billion in 2016).

Follow-on activity was relatively flat, with the number of deals up nearly 20 percent — from 609 in 2016 to 730 in 2017 — but the aggregate volume up only 3 percent — from $150.2 billion in 2016 to $154.3 billion in 2017 — reflecting a smaller average deal size. M&A activity continued to drive follow-on activity, as 18 percent of all follow-on volume raised in 2017 was used to fund M&A. Block trades declined as a proportion of overall follow-on activity, representing 30 percent of total follow-on offerings in 2017, more in line with recent years and down from a record high of 49 percent in 2016.

US Follow-On Activity

Source: Thomson Reuters



Looking Ahead

A number of factors will impact the strength and mix of capital markets activity in 2018.

Corporate Tax Reform. While it is too early to assess the ultimate impact of the corporate tax overhaul on the U.S. capital markets, a few themes have emerged. In general, the new tax law reduces the value of debt by both (1) lowering the corporate tax rate from 35 to 21 percent, which reduces the value of the tax shield provided by interest deductions, and (2) imposing a cap on interest deductibility to 30 percent of EBITDA. (See "US Tax Reform Enacts the Most Comprehensive Changes in Three Decades.") As a result, companies will need to re-evaluate the cost of their debt, and some issuers could gravitate toward equity or equity-linked securities, where the new interest deductibility rules and a rising interest rate environment could make pricing more attractive for companies' capital-raising strategies.

Companies also may find themselves with significant additional cash on hand due to the lower tax rate and the one-time mandatory deemed repatriation of money held overseas at discounted rates. Potential uses for this additional cash include M&A activity, share buybacks and dividend recapitalizations, all of which could bring about higher stock prices and promote additional equity market activity. On the other hand, tax reform could quell some secondary follow-on market activity, particularly block trades, if private equity sponsors choose to hold their positions longer to capture additional gains from potential stock appreciation as a result of potential increases in earnings.

Alternative Financing. The average age of all venture capital-backed companies going public has risen from 5.1 years in 2006 to 7.6 in 2016, demonstrating the continuation of a multiyear trend of companies choosing to stay private longer. This trend is the result not only of the JOBS Act increasing the number of shareholders private companies can have before they are required to go public, but also of the wealth of private capital and secondary financing strategies available. As a result, companies have been able to raise substantial primary capital and provide liquidity to existing shareholders and employees outside the public markets and at valuations often significantly exceeding what public investors are willing to pay. The seeding of the SoftBank Vision Fund in 2017, which to date has raised nearly $100 billion to invest in technology companies (including a notable investment in WeWork), may only prolong this trend.

A number of private companies also may be contemplating strategies to become public outside the traditional IPO process, including (1) by being acquired by publicly traded SPACs, effectively allowing a company to avoid the associated time and expense of Securities and Exchange Commission registration and minimizing market risk, and (2) through direct listings of shares without an accompanying capital raise, providing immediate liquidity for shareholders (who would otherwise be subject to IPO lockups) with no dilution. The success of Spotify's proposed direct listing could set a new precedent for companies with significant scale and a large investor base.

Increased financial leverage also has led some companies to look for alternative financing. Ave¬rage leverage ratios, as measured by net debt relative to EBITDA, are near their highest since before the financial crisis for nonfinancial firms in the S&P 500. Some highly leveraged companies have issued mezzanine-style preferred securities to raise capital without increasing their leverage. Typically, these hybrid instruments are carefully structured to be treated as equity by rating agencies to avoid increasing a company's leverage for ratings purposes.

Federal Reserve Activity. The monetary policy of the Federal Reserve may significantly impact the U.S. capital markets throughout 2018. The Fed has begun the process of reversing several years of quantitative easing and has continued to gradually increase interest rates, resulting in higher borrowing costs. Further rate hikes are anticipated in 2018, which will particularly benefit companies that are operated primarily in the United States (as a stronger U.S. dollar will increase the value of domestic products). On the debt side, many companies are issuing longer-term bonds to extend the maturities of their debt and lock in a lower interest rate as a hedge against higher borrowing costs in the future. Approximately 20 percent of the investment-grade debt issued in 2017 was 30-year notes.

[1] Sources for the data in this article are: Bloomberg, Dealogic, Deloitte, Moody's, PitchBook, PwC, Seeking Alpha and Thomson Reuters.

Equity Markets in 2018

Based on the views of equity capital markets and syndicate bankers across Wall Street, 2018 holds the promise of a strong year for equity issuances across many sectors. Technology will continue to be viewed as a key bellwether for the IPO market. While a number of the tech unicorns, including Airbnb, Dropbox and Lyft, are possible 2018 IPO candidates, others may continue to sit on the sidelines, rather than accept a potential "down round" relative to lofty valuations achieved in the private markets, not to mention hefty discounts investors demand to compensate for the risk of an IPO investment. Another indicator for the IPO market is the extent to which private equity sponsor-backed issuers will come to market. Sponsors have used strong cash positions to continue replenishing their pipeline, and sustained favorable market conditions combined with attractive public market valuations may entice them to begin monetizing these assets through the public markets in 2018.

Technology. Many experts anticipate smaller to medium-sized issuers to dominate the tech IPO calendar, although several deals by unicorns are also likely. Much of the activity is expected to come from high-growth software companies and internet and e-commerce businesses, with possible issuances by a number of technology services companies. Chinese and other offshore issuers continue to make up a significant portion of the potential IPO backlog, but some equity capital markets professionals question whether the mixed performance by the 2017 IPO class will impact such issuances. Follow-on activity is expected to be robust, as venture capitalists look to exit positions.

Health Care. Driven largely by life sciences, health care issuances were up over 55 percent in 2017 by proceeds raised, and all signs point to the sector once again being active in 2018. Life sciences issuers are expected to continue accessing equity capital to fund research and development and pipeline growth, while pharmaceuticals, services and facilities issuers are expected to benefit from the new tax law. The biotech IPO pipeline remains strong, with a number of issuances on the near-term deal calendar.

Industrials. The new tax law could have a particularly catalyzing impact in this sector, as many issuers carrying heavy tax burdens will see meaningful tax savings and benefit from the provision allowing immediate expensing of capital purchases. Areas to watch include companies sitting at the intersection of the technology and industrial sectors (particularly those that serve the automotive industry) and companies in the building products space, depending on the pace of interest rate rises and any impact of the new tax law on home construction and sales.

Continued on page 20

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Financial Institutions. Equity issuance in the sector was up in 2017, and with interest rates rising and regulations being relaxed, conditions appear favorable for the year ahead, with a number of insurance and business development company IPOs in the nearer-term pipeline. All eyes will be on Fed activity, with two to four rate hikes expected in 2018.

Consumer. Despite a few notable IPOs (Canada Goose and Laureate Education), 2017 was a fairly quiet year in the consumer space. Although Apollo-backed home security company ADT recently launched its highly anticipated $2 billion IPO, 2018 may continue to see relatively few issuances. Amazon's continued disruption of the way consumers shop makes it a challenging environment for traditional brick-and-mortar retailers, with possible bright spots for discount retailers and companies tied to the home improvement space.

Real Estate. The real estate equity capital markets are expected to see another active year in 2018 and subsectors with continued strong fundamental tailwinds (data centers, industrial real estate investment trusts (REITs), gaming, and single- and multi-family REITs) are likely to be strong. A number of sizable IPOs are expected in the early part of the year, while emerging small and midcap REITs may be appealing to institutional investors. At-the-market offerings, which reached record levels in 2017, are expected to continue to be a popular funding tool.

Energy. Industry observers expect much of the capital markets activity in the energy space to come in the form of financing M&A activity, as a crowded exploration and production (E&P) field appears ripe for consolidation. Despite a recent proposal from the Trump administration to open up offshore drilling around U.S. waters, market experts are skeptical that this will translate into renewed investor appetite for E&P IPOs, as offshore drilling ventures remain costly and largely dependent on crude oil prices. On the other hand, a substantial backlog in the oilfield services space could come to market, particularly if issuers are willing to accept valuation discounts. (As of the date of this publication, two oilfield services IPOs have priced in January 2018).

SPACs. SPAC issuance hit an all-time high in 2017, and a great deal of attention was paid to the Social Capital Hedosophia offering, a vehicle designed for the purpose of acquiring a technology unicorn. However, while SPAC issuance is expected to remain strong in 2018, many question whether the 2017 pace is sustainable, given the glut of recent issuance and a desire for issuers to demonstrate an ability to complete the back end of the process — that is, successfully acquire an operating company.

State of the Financial Restructuring Market

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Continuing low interest rates and generally improved economic conditions in the U.S. and worldwide during 2017 have reduced financial distress and the need for business bankruptcies in most sectors. However, out-of-court financial restructurings and Chapter 11 bankruptcies will continue in 2018 due to significant market changes in the energy, retail and health care industries that have developed over the past several years. While financial restructurings in the energy sector may decrease as oil prices rise, retail business enterprises will remain at risk because of the ongoing fundamental transformation of the retail sector, and uncertainty about the future of the Affordable Care Act (ACA) should contribute to continuing financial stress in the health care sector.

Meanwhile, according to Federal Reserve Economic Data and the Bank for International Settlements, total credit to nonfinancial corporations is at its highest level relative to U.S. gross domestic product since the 2008 financial crisis — now estimated to be more than 70 percent of the U.S. GDP. If the U.S. economy slows or recedes, interest rates rise markedly or credit markets tighten, the need for corporate debt restructurings may increase.

Political and regulatory changes in the U.S. in 2018 and beyond also may impact restructuring markets.

Energy. The rise and fall of energy prices drives financial outcomes in the energy sector. In early 2016, oil prices plummeted to roughly $30 per barrel, causing severe liquidity problems for many oil and gas companies, particularly those in the exploration and production (E&P) space. E&P companies rely on reserve-based loans to fund their operations, and the reserves that secure their borrowings are subject to periodic revaluations and redeterminations, usually twice a year. In the redetermination process, a lender assigns a value to a company's reserves and adjusts the company's borrowing base accordingly. The spring 2016 round of redeterminations and reserve revaluations reflected declining oil prices, thereby reducing borrowing base availability and liquidity for E&P companies. Accordingly, in 2016 and 2017, numerous E&P companies were forced to use Chapter 11 to shrink their cost structures and address their liquidity shortfalls. E&P-adjacent industries (such as oilfield services, pipeline construction, and offshore drilling and services) also experienced sharp increases in bankruptcy filings.

During the second half of 2016, oil prices rose to over $50 a barrel, and since September 2017 they have rebounded to over $60 a barrel. Accordingly, Chapter 11 filings in the E&P sector and related industries have slowed. In-court and out-of-court financial restructurings in the energy sector will continue, but the oilfield service industry is likely to benefit as reorganized E&P companies emerge from bankruptcy and undertake deferred maintenance and improvement projects. Pipeline construction may increase with improved E&P business activity and recent pro-pipeline policy changes in the United States. However, a global oversupply of oil continues to pose challenges for certain sectors, and the 2017 trend of bankruptcies by offshore drilling support vessels may continue.

Retail. Retail sector financial restructurings and bankruptcy reorganizations increased significantly in 2016 and 2017, with many high-profile retailer Chapter 11 filings, a trend that is expected to continue. The need for financial restructurings results from the ongoing fundamental transformation of the retail industry: increased online sales, including the Amazon effect (according to market research firm Slice Intelligence, Amazon accounted for an estimated 53 percent of all online U.S. retail sales in 2016), which is displacing brick-and-mortar store commerce; the success of discount chains; changing retail consumer demographics and preferences, especially among millennials; and a decrease in retail mall traffic, partially attributable to the continued success and expansion of online retailers.

Large, traditional national retail chain footprints entail cost structures that are difficult to rationalize as the retail industry continues its transformation. In 2017, retailers closed thousands of stores and laid off tens of thousands of workers to cut costs and compete with e-commerce. Announced store closures included 100 by Macy's and 150 by Sears — but the total store closure picture is much larger, with over 8,500 estimated in the U.S. in 2017.

Retail-related sectors such as commercial real estate will continue to be impacted as large retail chains use Chapter 11 to shrink their footprints and the Bankruptcy Code to reject their obligations to landlords under unwanted leases. Retail restructurings leave commercial property owners and managers with excess supply and dwindling demand for their properties.

Legislated state and local hourly wage law increases also pose significant challenges to retail stores, supermarkets, fast food restaurants and other businesses with operations and financial conditions that depend on unskilled, low-priced labor.

Health Care. Health care industry bankruptcies have increased as bankruptcy filings across the broader economy have plunged since 2010. Health care bankruptcy filings more than tripled in 2017, according to data compiled by Bloomberg. Additionally, health care mergers and acquisitions have noticeably increased in number. From 2013-14 to 2015-16, the number of U.S. distressed health care M&A transactions increased by over 85 percent, according to the May 2017 issue of *Journal of Corporate Renewal*. The need for financial restructurings in the health care sector is expected to continue in 2018 and beyond.

Changes in the ways health care is delivered have increased financial stress in the health care industry: the shift from volume-based to value-based reimbursement schemes; payer-led demand for less costly outpatient (rather than inpatient) procedures; the increased need for equipment and technology investments; and heightened competition among competitors, particularly in rural hospitals and senior assisted living facilities.

Continuing uncertainty about the future of the ACA (see "As Congress Struggles With ACA Repeal, Trump Administration Moves Forward With Regulatory Reform") also contributes to health care industry distress and is an important factor in health care workouts, restructurings and transactions. This uncertainty has caused some insurers to increase their premiums or exit ACA insurance exchanges. The number of uninsured patients may rise as premiums increase and patients have fewer insurance options, and a spike in uninsured patients may impose further financial pressure on health care providers. For instance, many private rural hospitals that now receive reduced payments under the ACA must nevertheless provide care to large numbers of poor and uninsured patients. The recent tax legislative elimination of the individual mandate that requires most Americans to have health insurance or pay a penalty may lead to a significant increase in the uninsured population that must be cared for by hospitals already in financial distress.

Political and Regulatory Impacts. Recent and potential U.S. political and regulatory changes may impact restructuring markets in certain industries. The Trump administration has adopted a pro-pipeline stance that may improve market conditions for oilfield service and pipeline industries. Also, the Trump administration has expressed its intention to repeal or alter some provisions of the Dodd-Frank Act. The act provides for the reorganization of failing banks and other financial institutions, and repeal or amendment of it may change the restructuring landscape for financial institutions. Federal Reserve policies and actions that increase interest rates will influence availability of credit.

Perhaps most significant are the recent reforms and changes to the U.S. tax code. (See "US Tax Reform Enacts the Most Comprehensive Changes in Three Decades.") The major reduction in the U.S. corporate tax rate may drive increased economic activity in numerous sectors and result in repatriation into the U.S. of significant capital. Such developments may result in significant general economic growth that leads to inflationary pressures and higher interest rates, which tend to increase the need for corporate restructuring activity in certain sectors.

Asset-Based Lending: A Powerful Tool With Increasing Flexibility

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Asset-based lending has historically provided to borrowers a number of benefits that are generally not available under cash flow loans, including lower pricing, a general lack of financial maintenance covenants (other than a springing fixed charge coverage ratio when availability is less than a percentage of the line) and greater operational flexibility. Asset-based loans have grown as a financing tool with greater acceptance by lenders of cross-border facilities as well as operating covenant packages that closely mirror the term loan B and high-yield markets, subject to exceptions relating to permitted investments, payment of dividends, and repurchases of stock and prepayments of junior indebtedness.

For borrowers with international operations, the optimal asset-based loan structure would provide a single, worldwide borrowing base, available to support credit needs in every jurisdiction (regardless of the location of the operations' financeable assets). In order to achieve such a structure, the borrowers and lenders must determine whether the laws of the applicable jurisdictions relating to creation, perfection and enforcement of security interests will allow the lenders to obtain expected recovery in a liquidation or restructuring (and whether those security interests are subject to priority claims). Lenders will also want to know if the applicable jurisdictions' insolvency laws generally are beneficial to them. As arrangers continue to push the envelope to provide creative structuring alternatives for their clients, the list of acceptable asset-based lending jurisdictions has expanded, with loans now including borrowing bases in the United States, Canada, United Kingdom, Ireland, Netherlands, France, Spain, Switzerland, Germany, Belgium, Australia and New Zealand, among others.

A true single, worldwide borrowing base may not be available because of jurisdiction-specific issues relating to the borrowers' cash management systems, limitations on guarantees, regulatory requirements affecting lenders and their ability to hold collateral, tax considerations, the ability of the lender group to lend in multiple currencies, and more. Arrangers can seek structuring alternatives to provide their clients maximum flexibility, including the ability to allocate excess borrowing base capacity in one jurisdiction to another jurisdiction, periodically reallocate commitments among jurisdictions, and borrow in one jurisdiction and use the proceeds to make intercompany loans to another.

Another important consideration for borrowers is the harmony of terms, including covenants, between their asset-based loan agreement and their other debt instruments, particularly high-yield bonds and term loans, as borrowers seek to have a substantially identical covenant package across their bonds, term loans and asset-based loan credit facilities. As competition for asset-based loans has grown among lenders and arrangers, especially in the sponsor-led acquisition context, borrowers have been able to negotiate covenant packages in asset-based loan agreements that by and large track their term loan or bond covenants, with a few key exceptions. First, asset-based lenders and arrangers typically do not agree to investment, acquisition or restricted payment baskets, or to prepayments of junior indebtedness based on "builder" or "available amount" baskets (which grow based on a percentage of consolidated net income, EBITDA or retained excess cash flows) or achieving a specified leverage ratio. Instead, these are replaced with an unlimited general basket so long as the borrower maintains a specified level of excess availability and a fixed charge coverage ratio of not less than 1 to 1. (Sometimes, if excess availability is sufficiently high, the fixed charge coverage test does not apply.) In addition, asset-based loan arrangers and lenders focus on preserving the core loan terms that are unique to an asset-based loan agreement and would not be found in cash-flow loan agreements, term loan agreements or bond indentures. These terms include borrowing base reporting, cash management, a springing financial covenant, field exams and appraisals, and the ability to establish reserves to react to unexpected future events.

The biggest deals — and rewards — go to the financial institutions that demonstrate the ability to deliver asset-based loans as part of an integrated capital structure, providing the most efficient solutions to the problems borrowers face. Asset-based lenders still enjoy low loss ratios and high recovery levels, even as liquidations have picked up in certain industries (particularly retail). The borrowing base automatically resizes availability with the expansion or contraction of the underlying business, which provides substantial control (and an early warning trigger) to the lender and minimizes potential losses. Asset-based loans also are self-liquidating, particularly in cash dominion — receipts automatically repay outstanding loans, and reborrowing requires the borrower to meet its draw conditions.

The attributes of asset-based loans suggest that corporate chief financial officers can anticipate an asset-based marketplace that will continue to adapt to provide flexible financing on favorable terms.

3

Governance and the #MeToo Era

The Board's Three 'C's' of Corporate Governance: Composition, Communication and Connection

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U.S. companies face a dizzying array of challenges, including from disruptive technologies and cybersecurity threats; economic and geopolitical uncertainties; climate change and evolving sustainability metrics; and questions about corporate culture, sexual harassment and ethics. Investors continue to look to boards of directors to oversee companies' navigation through these challenges while at the same time producing superior operating results, financial returns and stock price appreciation.

Activist investors remain active, quick to challenge a company's business strategy, management's ability to execute and the board's capabilities. In addition, many long-term institutional investors and large asset managers have become more likely to question whether board members possess the appropriate skills, knowledge and characteristics to oversee the company's business and management to avoid or mitigate risks and ensure long-term value creation.

In light of these dynamics, boards of directors must focus on the three "C's": composition of the board; communication, both regarding items of importance to investors and to convey the board's competence with and command of issues that pose threats to long-term performance; and connection, or building relationships, with investors to establish credibility and confidence, which become essential when a company hits a rough patch.

Board Composition

Recent proxy fights at Procter & Gamble (P&G) by Trian Partners and at Automatic Data Processing by Pershing Square stand as stark reminders that shareholder activism remains a permanent part of the corporate landscape and that mega-cap companies are not immune to activist attack. The Trian campaign at P&G was unique in that the only Trian nominee was Nelson Peltz, and Trian indicated that it would be willing to add back to the P&G board the unseated incumbent director if Trian prevailed. Nevertheless, over the past few years, activist investors have become more sophisticated in forming slates of nominees in proxy contests, typically nominating candidates with relevant industry and other operational experience consistent with the activist's case for a board's shortcomings.

Citing evidence supporting the view that more diverse boards outperform boards lacking diversity, large asset managers such as BlackRock, State Street and Vanguard have been unambiguous in expressing their desire to see greater boardroom diversity — with an emphasis on gender diversity. In addition, in September 2017, the New York City comptroller and New York City pension funds followed up their successful campaign to increase the number of companies with proxy access bylaws with a new campaign dubbed "Boardroom Accountability Project 2.0" to "ratchet up the pressure on some of the biggest companies in the world to make their boards more diverse, independent, and climate-competent, so that they are in a position to deliver better long-term returns for investors."

Recent data on boards of directors of Standard & Poor's 500 index companies indicates that boards are, in fact, becoming more diverse — with Spencer Stuart reporting in its 2017 U.S. Board Index that more than half of incoming directors were women or minorities — although the pace of change may not be as swift as some would prefer. As described in Vanguard's August 31, 2017, open letter to public company directors, Vanguard "view[s] the board as one of a company's most critical strategic assets" and believes that "when a company has a great board of directors, good results are more likely to follow." It will remain incumbent on boards and board-nominating committees to be vigilant in analyzing and assessing the composition of the board and its members' skill sets in light of the company's business, strategy and challenges to ensure that investors continue to perceive the board as an important strategic asset.

Communication

One outcome of the adoption of mandatory say-on-pay votes has been the transformation of proxy statements, at least at many large-cap companies. Proxy statements have evolved from "compliance documents" that hew closely to required disclosures to "communications documents" that strive to convey a coherent and continuing story regarding company strategy and performance. In addition, proxy statements go to lengths to explain how the directors standing for election, as well as the executive compensation structure subject to the say-on-pay vote, support that strategy and incentivize that performance. Consistent with this transformation, BlackRock's 2016 annual letter to CEOs requested that they "lay out for shareholders each year a strategic framework for long-term value creation [and] explicitly affirm that their boards have reviewed those plans." BlackRock's 2017 annual letter commended companies for heeding this call, stating that these disclosures "provided shareholders with an opportunity to evaluate a company's long-term strategy and the progress made in executing on it." BlackRock's recently released 2018 annual letter reiterated this call for companies to publicly articulate their strategic framework for long-term value creation and to "demonstrate[] to investors that your board is engaged with the strategic direction of the company."

As companies have expanded and improved their communications regarding strategy, performance and executive compensation, shareholders have called for expanded and improved disclosure on other topics of concern. For example, the New York City comptroller's Boardroom Accountability Project 2.0 goes beyond calling for more diverse boards by seeking better disclosure — in particular a board skills matrix so that investors can more easily assess the skills and diversity represented in the boardroom. Although some companies in recent years have been including a directors skills matrix in their proxy statements, others view matrices as an oversimplification or crude device to convey the complexities of boardroom composition. In any event, the campaign makes it clear that some investors believe there is a lack of communication or transparency regarding board skills and composition. As a result, companies should consider, whether by using a matrix or other forms of disclosure, how to best convey the thought and care that goes into determining the needs of the board in terms of skill sets, and how those determinations are addressed in the board refreshment process.

Another topic on which investors seek greater information is sustainability. Sustainability encompasses a broad range of issues and is not limited to climate change and related environmental topics, although that remains an essential area where investors seek more transparency in how a company is addressing the risks presented and seek better ways to compare the financial impacts of climate change from one company to the next. Sustainability also may include items such as human capital management as well as business practices and corporate culture matters that have the potential to either foster or derail long-term value creation. As stated in BlackRock's 2017 letter to CEOs, "[e]nvironmental, social and governance (ESG) factors relevant to a company's business can provide essential insights into management effectiveness and thus a company's long-term prospects." As companies continue to consider how they communicate business strategy to investors, they also will need to determine how to convey the ways in which relevant sustainability matters are factored into their business strategy and how the boards oversee the associated risks as part of their oversight responsibilities.

Beyond sustainability, BlackRock's 2018 annual letter to CEOs calls on companies to "not only deliver financial performance, but also show how [the company] makes a positive contribution to society." While this call is best understood in light of BlackRock's focus on long-term financial performance, it nevertheless will require additional efforts by companies and boards of directors to consider what and how they communicate with stakeholders and the public regarding a host of issues beyond financial performance.

Connection

For a number of years, the message for boards of directors has been to enhance engagement with shareholders. As a result, companies and directors have expanded their shareholder engagement efforts, often meeting with investor governance teams and increasingly including director involvement in engagement efforts regarding topics such as executive compensation, board leadership and board refreshment practices. Investors may not always feel a need to engage with a particular company or its directors, but periodic check-ins and reminders that directors are available can garner the credibility and goodwill that may be critical when the board is facing an activist challenge or other crisis.

BlackRock made it a point following the 2017 annual meeting at ExxonMobil to explain that it had repeatedly requested meetings with the company's independent directors to better understand the board's oversight of long-term strategy amid major strategic challenges (including but not limited to climate change), and that those requests were denied pursuant to the company's policy of not permitting engagement between independent directors and shareholders. As a result, BlackRock voted against the company's lead independent director and the chair of the committee responsible for this policy. According to press reports, in December 2017, ExxonMobil announced that the board had changed the policy and would allow directors to engage directly with key shareholders to address areas of interest.

It also is important to remember that communication is a two-way process and that director engagement with shareholders can provide directors with valuable insights into investor perceptions. In some instances, directors may learn that they are already addressing issues of importance to investors, but company disclosures fail to effectively communicate that fact, creating a gap between investor perception and reality. In any event, listening to investor views with an open mind is an important element of director-shareholder engagement.

As boards of directors head into 2018, some of the challenges they face will be familiar and some not yet known. The recent sexual harassment scandals present issues that boards were not contemplating a year ago but are now playing a role in board CEO searches and succession planning. Directors will be better positioned to address these challenges if they pay attention to the three "C's" — they have focused on board composition so that the board has the diverse skills and perspectives to address the challenges that inevitably arise; they have communicated with investors to convey the board's diligent oversight of business strategy and risks, and how the board is a strategic asset for the company; and they have connected and built relationships with investors so that they have the credibility and goodwill with investors that provide the board time to manage through the challenges.

Impact of Compensation-Related Litigation on Public Companies

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Compensation-related litigation and threats of litigation continued to significantly impact public companies in 2017. These companies should be mindful of issues that were raised in recent litigation: proxy disclosure, director compensation issues and the short-swing profit rules of Section 16 of the Securities Exchange Act.

Proxy Disclosure Litigation

Background. Public companies must adequately disclose information required by the compensation-related disclosure rules contained in Item 402 of Regulation S-K, including the rules relating to perquisites.

Overview of Litigation. In January 2017, the Securities and Exchange Commission (SEC) issued an order instituting cease-and-desist proceedings against MDC Partners for failure to disclose over $11 million in perquisites paid from 2009 to 2014 to its then-CEO. The SEC's order also found that MDC separately violated non-GAAP (generally accepted accounting principles) financial measure disclosure rules. MDC took a number of remedial actions and paid a $1.5 million penalty to settle the charges.

In May 2017, the SEC issued a separate order against the CEO alleging that he knew, or was reckless in not knowing, that the proxy statements contained materially false and misleading executive compensation disclosures, and that they omitted numerous personal expenses for which he sought reimbursement as business expenses. The SEC's order noted that the CEO also submitted unsubstantiated expenses outside of MDC's expense reimbursement process and failed to disclose perquisites in his director and officer questionnaires. The CEO agreed to repay the perquisites and personal expense reimbursements, pay $5.5 million in disgorgement and penalties to the SEC, and be barred from serving as an officer or director of a public company for five years.

Takeaway. Public companies must carefully comply with perquisite disclosure rules — a relatively tricky area of disclosure. In practice, it can be difficult to determine whether a benefit is a perquisite. Although the SEC has provided general principles and interpretive guidance, companies must analyze the applicable facts and circumstances in order to determine whether a benefit is a perquisite, and significant grey areas remain. Once the determination has been made, the disclosure rules themselves are also rather complicated, and care must be taken to ensure compliance.

Intel's Equity Plan Lawsuit

Background. Preparing and amending equity plans is time-consuming, and care must be given to the disclosure of the equity plan proposal for stockholder approval. Proposals to approve new or amended equity incentive plans are highly scrutinized by proxy advisory firms, institutional investors and other stockholders. (See our January 26, 2017, client alert "Avoiding an ISS Negative Recommendation: Considerations for Companies Seeking Shareholder Approval of Equity Incentive Plan Proposals.")

Overview of Litigation. Intel sought stockholder approval in 2017 for an amendment to its equity incentive plan. The proposal indicated that eligible participants included Intel's nonemployee directors and all of Intel's full-time and part-time employees, where legally eligible to participate, and that approximately 84 percent of Intel's employees received an equity award in 2016.

In April 2017, a stockholder plaintiff alleged that, despite this level of detail, the proxy statement was deficient because it did not identify the actual number of employees who were eligible to participate in the plan, as required under Item 10(a)(1) of Schedule 14A of the Securities Exchange Act. The complaint noted that Intel's prior proxy statement seeking approval of its equity incentive plan included this information.

The stockholder plaintiff ultimately dismissed the case without prejudice. Other companies have encountered similar claims recently in connection with equity plan proposals.

Takeaway. When seeking stockholder approval for a new or amended equity incentive plan, companies must include all information required by Item 10 of Schedule 14A of the Securities Exchange Act.

Director Compensation

Background. In Delaware, claims involving director conduct generally are subject to review under a deferential standard known as the "business judgment rule." However, claims relating to director compensation are typically reviewed under a stricter "entire fairness" test, which requires directors to bear the burden of proving that a compensation decision was entirely fair to the corporation. A board of directors can avail itself of the business judgment rule in those circumstances if the challenged decision was ratified by a vote of fully informed stockholders. Previously, the Delaware Court of Chancery had held that stockholder approval of a discretionary equity plan could constitute "ratification" if the equity plan contained a "meaningful limit" on director compensation.

Overview of Litigation. In December 2017, the Delaware Supreme Court issued an opinion, *In re Investors Bancorp, Inc. Stockholder Litigation*, holding that, except under limited circumstances, the court will not apply the deferential business judgment rule in reviewing challenges to director awards granted pursuant to stockholder-approved equity plans. In this case, the board of directors submitted for stockholder approval an equity plan that imposed an aggregate limit on awards that could be granted to nonemployee directors. The company's stockholders approved the plan, and the board members awarded themselves as a group approximately $51.5 million in equity awards. The plaintiff alleged that the directors' compensation exceeded the compensation paid to directors of peer companies. The court held that the stockholder ratification defense was not available to the board of directors to dismiss the case because the equity plan granted discretion to the directors to approve specific awards. According to the Delaware Supreme Court, stockholder ratification is a permissible defense only in two scenarios: (1) when stockholders approve specific director awards, and (2) when the equity plan is a self-executing formula plan, such that the directors have no discretion in granting the awards to themselves. If directors retain discretion to make awards under the general parameters of a plan — even when the parameters are specific to directors — then ratification cannot be used to obtain the benefit of the business judgment rule standard of review for a breach of fiduciary duty claim.

Takeaway. Public companies should work with their compensation consultants to conduct a peer review of their director compensation programs in order to determine whether equity grants are reasonable. Companies should carefully document this process and consider the extent to which it may be beneficial to describe the process in their annual proxy disclosure, particularly in light of increased scrutiny of director compensation programs by institutional stockholders. (See our November 20, 2017, client alert "ISS Announces 2018 Updates to US Proxy Voting Guidelines.") In light of the Delaware Supreme Court's opinion, companies should consider whether to provide for grants of director equity awards in a stockholder-approved formula plan or seek shareholder approval of specific grants of awards to directors.

Section 16 Litigation

Background. Under Section 16(b) of the Securities Exchange Act, a public company's officers and directors ("insiders") are generally required to disgorge any profit from purchasing and selling company securities within six months. Typically exempt from this short-swing profit rule are grants of company equity awards and the withholding of shares to cover related taxes or the applicable exercise price (*i.e.*, net share settlement). To qualify for the exemption, the board of directors or compensation committee typically approves such transactions in advance, as contemplated by Rules 16b-3(d)(1) and 16b-3(e). This exemption generally requires that the committee's advance approval be specific to a transaction. Any grant of this decision-making power to "the company" may be viewed as too vague. Plaintiffs have recently challenged the effectiveness of approvals under Rule 16b-3(e) on grounds of both insufficient specificity and improper implementation.

Overview of Litigation. Plaintiffs have contested instances of net share settlement by alleging that the compensation committee did not approve the settlement with sufficient specificity, that the compensation committee's grant of discretion to the insider was insufficient or that a net share settlement as ultimately effected was outside the scope of the terms approved in advance. Plaintiffs assert that such net share settlements are not exempt from Section 16 and seek to match those alleged sales against insiders' purchases.

Takeaway. Preapproval by the compensation committee of the specific terms of each net share settlement would eliminate the risk of these claims. However, neither the SEC nor the courts require this level of specific preapproval. Companies should review their award agreements and resolutions relating to net share settlement or share tax withholding provisions to ensure compliance with the Section 16 rules.

Key Developments in Delaware Corporation Law in 2017

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Developments in appraisal law, the application of *Corwin v. KKR Financial Holdings LLC* in post-closing damages actions and the potential expansion of *Kahn v. M&F Worldwide Corporation* (*MFW*) — a case examining the standard of review in certain controlling stockholder transactions — were all significant in 2017, and likely will continue in the year ahead.

Notable Delaware Supreme Court Decisions on Appraisal Value

Appraisal law continued to be a major focus of the Delaware courts in 2017 and resulted in two significant Delaware Supreme Court decisions that indicate a transaction's merger price may be the best evidence of appraisal value.

First, in *DFC Global Corporation v. Muirfield Value Partners, L.P.*, the Delaware Supreme Court reversed and remanded the Court of Chancery's decision in appraisal proceedings in which it determined fair value by weighting one-third to the deal price, one-third to a discounted cash flow analysis and one-third to a comparable companies analysis. While the Supreme Court declined to create "a presumption that in certain cases involving arm's-length mergers, the price of the transaction giving rise to appraisal rights is the best estimate of fair value," it strongly suggested the deal price was the best indicator of fair value. Ultimately, the Supreme Court reversed because the Court of Chancery's one-third weight afforded to the merger price was not "explained" and thus the Supreme Court could not "discern the basis for this allocation." The court also did not follow the logic behind the Court of Chancery's conclusion that a "deal price resulting in a transaction won by a private equity buyer is not a reliable indicator of fair value."

In *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*, the Supreme Court issued an equally strong, if not stronger, decision emphasizing that, in appropriate circumstances, failing to give due weight to the deal price as the best evidence of appraisal value can result in reversal. The Supreme Court reversed and remanded the Court of Chancery's exclusive reliance on a discounted cash flow analysis that resulted in an appraisal value 28 percent above the merger price, finding its decision was based on assumptions — including that the deal price was unreliable because the market was inefficient and the transaction was a management-led buyout — not grounded in "relevant, accepted financial principles." Although the Supreme Court reiterated its long-standing view that assigning "some mathematical weight to the deal price" is not required, it found that the deal price "deserved heavy, if not dispositive, weight" in this case. The *Dell* court also emphasized that statutory fair value does not require extraction of the "highest possible bid" or that a company "prove that the sale process is the most reliable evidence of its going concern value in order for the resulting deal price to be granted any weight."

How the Court of Chancery applies the Supreme Court decisions in *DFC* and *Dell* in future appraisal proceedings will be watched closely in 2018.

Standards of Review in Post-Closing Damages Actions

The number of merger cases seeking preliminary injunctive relief in Delaware has declined significantly since the Supreme Court's groundbreaking 2015 decision in *Corwin*, which requires dismissal of post-closing challenges to mergers approved by a fully informed, uncoerced stockholder vote (absent a conflicted controller), and the Court of Chancery's 2016 decision in *In re Trulia, Inc. Stockholder Litigation*, which held that disclosure-based settlements would not be approved unless the supplemental disclosures at issue in the settlement addressed a "plainly material" misrepresentation or omission. Focus instead shifted to post-closing actions for money damages in a number of cases throughout 2017.

Corwin remains a viable option for defendants facing post-closing deal litigation, and the Delaware courts continue to dismiss challenges in circumstances where *Corwin* applies. For example, in *In re Merge Healthcare Inc. Stockholders Litigation*, the Court of Chancery rejected arguments that the chairman and 26 percent stockholder extracted personal benefits in the transaction and that the disclosures issued in connection with it were insufficient.

However, *Corwin* is not a "cure-all," and the Delaware courts also have declined to apply *Corwin* where a vote was not fully informed or was coerced. For example, in *In re Saba Software, Inc. Stockholder Litigation*, the Court of Chancery declined based on material omissions in the proxy issued in connection with the transaction. Moreover, the Court of Chancery in *In re Massey Energy Company Derivative and Class Action Litigation* placed some limits on *Corwin*'s reach: Although *Corwin* is intended to avoid "judicial second-guessing" when fully informed, disinterested stockholders have freely determined the economic benefits of a transaction themselves, this policy does not apply where the conduct being challenged occurred well before the merger.

We anticipate further developments involving *Corwin* in 2018. One particular issue is whether enhanced scrutiny in the context of a sale of control under *Revlon*, or with respect to defensive measures under *Unocal*, should apply post-closing, regardless of the ratifying effect of a stockholder vote. In *In re Solera Holdings, Inc. Stockholder Litigation*, Chancellor Andre G. Bouchard dismissed a post-closing claim for money damages, referencing (among other reasons) the Delaware Supreme Court's reasoning in *Corwin* that enhanced scrutiny was "primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing" and was not "designed with post-closing money damages claims in mind … ." On the other hand, in *In re Paramount Gold and Silver Corp. Stockholders Litigation*, the Court of Chancery, citing the Delaware Supreme Court's 1995 decision in *In re Santa Fe Pacific Corporation Shareholder Litigation*, considered whether the presence of *Unocal* claims might preclude application of *Corwin*, even in a post-closing action for money damages. It ultimately dismissed the case under *Corwin* because the complaint failed to adequately allege an unreasonable deal protection device. More recently, in *Van Der Fluit v. Yates*, the Court of Chancery applied enhanced scrutiny under *Revlon* in a post-closing damages action after finding that alleged disclosure violations prevented a *Corwin*-based dismissal. It ultimately dismissed breach of fiduciary duty and aiding-and-abetting claims because the plaintiff failed to state any nonexculpated claims against the defendants.

The effect of a *Corwin* defense on a books-and-records request pursuant to Section 220 of the Delaware General Corporation Law also presents an area ripe for further development. For example, in *Lavin v. West Corporation*, the Court of Chancery held that a *Corwin* defense could not impede an otherwise properly supported demand for books and records.

It remains to be seen whether in 2018, the Delaware courts will offer further clarity on whether enhanced scrutiny under *Revlon* or *Unocal* remains a viable post-closing theory in deal litigations seeking money damages, and on *Corwin*'s implications in books-and-records actions.

Application of *MFW* to Reclassification Transactions

Case law addressing the standard of review in certain controlling stockholder transactions has continued to develop. In *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, the Court of Chancery dismissed stockholder claims challenging Sequential Brands Group, Inc.'s acquisition of Martha Stewart Living Omnimedia, Inc., a company controlled by Martha Stewart. The Court of Chancery found that application of the business judgment rule applied even in the context of third-party sales with a conflicted controller because the defendants had complied with the procedural protections outlined in the Delaware Supreme Court's decision in *MFW* — namely, approval by an independent, disinterested and properly empowered special committee and a nonwaivable, fully informed and uncoerced vote of a majority of the minority stockholders.

In *IRA Trust FBO Bobbie Ahmed v. Crane*, the Court of Chancery applied the framework articulated in *MFW* to dismiss fiduciary duty claims brought in connection with a reclassification of shares of NRG Yield, Inc., a company controlled by NRG Energy, Inc. In that decision, which extended the application of *MFW* beyond a merger transaction, the Court of Chancery acknowledged that the reclassification was a conflicted transaction and thus presumptively subject to entire fairness review. It nevertheless applied the business judgment rule because, consistent with *MFW*, the transaction was approved by a disinterested special committee and a majority of the minority stockholders.

In so concluding, the court explained that there was no principled basis for determining that the *MFW* framework should apply to some transactions involving controlling stockholders but not others. The court added that the overall goal of the *MFW* framework is to provide a way for a controlled company to replicate an arm's-length bargaining process and that encouraging the use of this approach protects minority stockholders in transactions involving controlling stockholders, regardless of structure.

Further development of *MFW* along these lines is anticipated in 2018, including the extension of *MFW* into transactions other than mergers that involve controlling stockholders.

Addressing Workplace Sexual Harassment in the #MeToo Era

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Stories of high-profile individuals in politics, media, entertainment and hospitality alleged to have engaged in sexual harassment, or worse, have been breaking at an unprecedented rate. In the wake of these allegations, millions of women from diverse backgrounds and industries have recounted stories of workplace sexual harassment or abuse on social media, using the hashtag "#MeToo" to demonstrate the prevalence and scope of the problem. An October 2017 NBC News/*Wall Street Journal* poll reported that 48 percent of women working in the United States say they have personally experienced an unwelcome sexual advance or verbal or physical harassment at work. Yet, according to an Equal Employment Opportunity Commission study conducted in 2016, approximately 90 percent of individuals who said they experienced workplace harassment never formally complained about it. As more women speak out, employers can expect more legal action.

The impact on businesses, and their officers and directors, could be dramatic and costly. For example, in addition to settlements paid to victims, companies terminating executives who have engaged in sexual misconduct may still be bound to pay them significant severance. Furthermore, public exposure of a company's tolerance of workplace sexual harassment could result in difficulty retaining and attracting talent, customer defections, lost revenue and profit, decreased investor confidence, and lower stock prices. Indeed, the plaintiffs' bar is looking for opportunities to bring shareholder derivative actions alleging that failure to properly recognize and address sexual harassment resulted in financial and reputational harm to a corporation.

These recent events present an opportunity for employers to re-evaluate how to avoid harassment in their workplaces, starting with a strong corporate culture of professionalism and respect.

Sexual Harassment and the Law

The law recognizes two primary types of sexual harassment: quid pro quo and hostile work environment. Quid pro quo harassment occurs when some type of employment benefit is made contingent on an employee performing sexual favors, or conversely, when an employee is threatened with negative work consequences for refusing to confer sexual favors. Hostile work environment harassment occurs when unwelcome sexual conduct is sufficiently severe or pervasive to alter the conditions of the victim's employment and create an abusive working environment. The U.S. Courts of Appeals for the Third and Ninth Circuits have held that the severity and pervasiveness of alleged sexual harassment should be looked at from the perspective of a reasonable woman, with the Ninth Circuit in *Ellison v. Brady* reasoning that "a sex-blind reasonable person standard tends to be male-biased and tends to systematically ignore the experiences of women." It remains to be seen whether the reasonable woman standard will be adopted by the U.S. Supreme Court, which, to date, has only gone so far as to rule in the male-on-male harassment case *Oncale v. Sundowner Offshore Services, Inc.* that the severity of harassment should be judged from the perspective of a reasonable person in the plaintiff's position.

With respect to employer liability, the Supreme Court held in the landmark cases of *Burlington Industries, Inc. v. Ellerth* and *Faragher v. City of Boca Raton* that an employer is always liable for a supervisor's harassment that culminates in a tangible employment action (*e.g.*, hiring or firing, promotion or failure to promote, undesirable reassignment, or a significant change in employee benefits). If, on the other hand, no employment action is taken in connection with the harassment, the employer may raise an affirmative defense by establishing that (1) the employer exercised reasonable care to prevent and promptly correct any harassing behavior, and (2) the employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer, or to otherwise avoid harm.

The first of these elements generally requires an employer to establish, disseminate and enforce an anti-harassment policy and complaint procedure. An employer may satisfy the second element by pointing to the employee's failure to utilize its established harassment complaint procedure. However, if the employee had reason not to resort to the complaint mechanism, the burden lies with the employer to prove that such belief or perception was not reasonable. In addition, the U.S. Court of Appeals for the Second Circuit, in *Townsend v. Benjamin Enterprises, Inc.*, joined the Fifth, Seventh and Ninth circuits in ruling that the *Faragher-Ellerth* affirmative defense is not available when an alleged sexual harasser holds a sufficiently high position within an organization so as to be considered the organization's proxy or alter ego. Moreover, in *Zakrzewska v. The New School*, the Second Circuit held that New York City employers are subject to strict liability under the New York City Human Rights Law for sexual harassment committed by supervisory employees (regardless of whether there is a tangible employment action) and the *Faragher-Ellerth* defense does not apply at all to New York City Human Rights Law claims. Further, notwithstanding the general consensus among federal courts that supervisors may not be held individually liable for workplace sexual harassment under Title VII of the Civil Rights Act, individual liability may be imposed on supervisors under certain state and local laws.

Takeaways

Many employers have adopted anti-harassment policies and complaint procedures and are conducting various forms of training. It also is advisable to:

- **Set the Tone at the Top.** Top management must set the example. If other managers or employees believe, rightly or wrongly, that senior management tolerates harassment, they may be more likely to engage in or allow unprofessional or unlawful conduct in the workplace.
- **Encourage Employees to Speak Out.** Employers should establish a multichannel complaint process that allows employees to bring harassment complaints to various members of management and to human resources personnel, not just to one specific individual who may be the alleged harasser. Because many employees fear retaliation, particularly when the alleged perpetrator is a powerful person in the organization, it also is advisable to have a mechanism that allows employees to make anonymous complaints of sexual harassment. Moreover, a strong and well-known practice against retaliation can create an environment in which employees are willing to come forward with sexual harassment complaints.
- **Avoid and Report Bad Conduct.** All employees can be encouraged to speak up if they witness sexual harassment. In some instances, co-workers may be in a position to intervene or redirect an errant employee. In others, co-workers may prefer to report the situation, especially if the offender is a senior employee or high performer. Training employees how to avoid, respond to and report these situations can be invaluable.
- **Ensure Prompt, Thorough and Independent Review of Complaints.** All harassment complaints, no matter when or against whom they are raised, should be promptly investigated. Employers should ensure that those responsible for looking into these types of complaints have experience conducting such investigations and possess the necessary independence and authority to do so in an impartial and thorough manner. Where the complaint involves high-ranking or key individuals, it may be prudent to delegate the investigation to an external third party.
- **Take Immediate and Appropriate Remedial Action.** While a confidential settlement agreement with a claimant might resolve an instance of workplace sexual harassment, employers should not stop there. (Note that under the newly enacted federal tax law, settlement of a claim related to sexual harassment or sexual abuse is not deductible as a business expense if such settlement is subject to a nondisclosure agreement.) Importantly, employers should take appropriate remedial action to send a message that, regardless of the person's seniority in the organization, the conduct is not acceptable and will not be tolerated. For a first-time offender, the penalty may be a reduced bonus, mandatory training and/or a memo for the personnel file about the incident. If the individual's actions are severe or repetitive, however, suspension or termination of employment may be appropriate. Employers may be reluctant to cut ties with a key employee who has otherwise been of value to the company. However, recent scandals show that they are increasingly willing to do so.

- **Expand For-Cause Termination Provisions to Include Violation of Sexual Harassment Policies.** Employers are advised to consider whether sexual harassment is adequately addressed in the termination provisions of executive employment agreements and severance plans. Companies should not be encumbered with financial impediments (such as large severance packages) to terminating executives who engage in sexual harassment.

In this #MeToo era, employers and executives should anticipate an increased willingness to speak out about sexual harassment, which will undoubtedly lead to more litigation and public embarrassment. Employers would be well-served to consider the long- and short-term impact these situations can have on business performance and revenues, including recruiting and retaining employees, and maintaining shareholders and customers. As the spotlight continues to shine in this area, it is time to look past policies on paper and assure a professional tone starting at the top carries throughout the organization.

4 European Trends Worth Watching

Europe Insights

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Despite a year of continued global political uncertainty and increasing enforcement, shareholder activism and foreign investment control activity, the 2018 outlook for Europe is positive overall. Skadden partners in the U.K., France, Germany, Russia and Belgium discuss the environment for M&A, capital markets and other activity this year.

Complex Dynamics Shape Overall Positive Outlook for M&A

Richard Youle (London, private equity): The M&A environment is complex. While we have been seeing rapid transaction processes and high valuation multiples (arguably above 2007 levels), the macroeconomic factors are challenging — North Korea, terrorism, Brexit, the U.S. political environment, and privacy and cybersecurity concerns, to name a few.

Scott Hopkins (London, corporate): Political and macroeconomic uncertainties create opportunities, especially in the public markets — as reflected, for example, by the increase in the value of public bids in the U.K. in 2017. A cheaper pound attracted foreign bidders, and domestic activity was supported by defensive combinations, as U.K. companies realized their exposure as targets. Outbound deals by listed companies also increased, led by BAT/Reynolds and Reckitt Benckiser/Mead Johnson. Overall, U.K. M&A was up more than 17 percent over 2016, with 1,543 deals representing a total deal value of £157 billion. In 2018 we expect this trend to continue, and possibly accelerate, as money continues to be cheap and U.S. tax reform further drives investment into the U.S.

Pascal Bine (Paris, corporate): In 2017, French M&A reached an aggregate amount of $246 billion, representing an increase of 50 percent in deal value compared to 2016. This increase was mainly driven by the outbound and domestic segments. France accounted for 29 percent of European M&A last year. French corporate buyers were active in cross-border deals throughout the year, such as the acquisitions of Luxottica by Essilor, Opel by Peugeot and Westfield by Unibail-Rodamco. The Safran/Zodiac merger, Gecina's acquisition of real estate investment company Eurosic and Thales' successful bid for Gemalto were among the largest M&A transactions on the French domestic market.

The top contributing sectors of French M&A in 2017 were technology/media/communications, consumer goods, energy and utilities, industry/chemicals, aeronautics and real estate. In terms of deal rationale, European consolidation and trans-Atlantic buys remain the key drivers of French M&A. The French M&A market is expected to reflect the same trends in 2018.

Matthias Horbach (Frankfurt, corporate): In Germany, M&A activity in 2017 increased slightly over 2016, as general business confidence reached an all-time high. Recent studies from the German Private Equity and Venture Capital Association show that the amounts invested on a per-transaction basis also increased significantly compared with previous periods.

In 2017, Germany again saw significant deals in the industrial and machinery industry: One noteworthy transaction was the $2.3 billion acquisition by Peugeot S.A. of Adam Opel AG and the related financing company GM Financial from General Motors. The transaction still requires clearance from the competition authorities but is expected to close in the first quarter of 2018. The most prominent outbound transaction in 2017 was the proposed merger of Linde AG with Praxair Inc., at an estimated deal value of $74 billion. This transaction showed a rare willingness by a large German corporation to relocate its principal place of business to another jurisdiction as part of a public company merger. Germany likely will remain an attractive environment for M&A business in 2018, with low interest rates, a healthy economy and available financing.

Richard: From a private equity perspective, exit value in Europe was up 12 percent in 2017, despite a slight decrease in volume, and new investments rose 50 percent, to €90 billion, according to the European private equity news publication *Real Deals*. However, investors should be cautious. Debt is back to 2007 levels, covenants are light or loose, debt funds are plentiful — the dynamic for a disaster is around the corner.

Prudent funds are probably wondering if now is the time to sell their businesses if they find sufficient interest. That said, given the fundamental requirement to invest their capital, they will continue being very active investors, and they will look at diverse sectors and geographies in order to deploy that capital efficiently. On the whole, we expect 2018 to be a year of net realizations across the industry.

Pascal: The number of transactions in the French private equity market increased in 2017, with 169 leveraged buyouts and 74 exits as of December 2017, for a total deal value of €17.7 billion. The top leveraged buyout transactions included ICG's €2.3 billion acquisition of DomusVi — a European private operator of nursing homes — from PAI, and CVC's €2 billion acquisition of the French medical diagnostic company Sebia from Montagu Private Equity and Astorg Partners. The French private equity market remains very competitive as U.S. and U.K. private equity players maintain an active presence.

Shareholder Activism Is Here to Stay

Scott: A factor that may be starting to impact U.K. M&A is the continued growth of activism. The U.K. attracts around half of European activity, driven by its supportive regulatory and political landscape, widely dispersed public markets, and efficient price discovery. In 2017, although the activists' sights were trained on midcap companies, press coverage focused on the campaign targeting the London Stock Exchange, which follows recent campaigns at other large-caps, such as BHP Billiton and Rolls-Royce.

Pascal: In France, 30 percent of activist campaigns in 2017 targeted large-cap companies. Overall, shareholder activism maintained its steady pace — there were 10 public campaigns in France, just one more than in each of the previous two years. Anglo-Saxon hedge funds, such as Elliott and TCI, continue to lead the trend in France, alongside French arbitrageur CIAM, which recently emerged as a prominent activist investor on the French market. French activist campaigns in 2017 focused on a variety of topics, including board governance, strategic direction, capital allocation, operational improvements and takeover terms.

Matthias: Activism remains relatively new in the German market but had a busy year in 2017. Several widely publicized situations set the stage for activists, including in the third quarter, when the private equity fund Cerberus emerged as a new significant shareholder of Deutsche Bank AG. This gave rise to published speculation about a potential merger of Deutsche Bank with Commerzbank AG, based on the fact that Cerberus also held a position in Commerzbank. Published reports have recently indicated that Cerberus does not intend to facilitate such a merger. Activism should continue to have a presence in Germany because the country provides strong legal protection for shareholders.

Scott: Activism's bedfellow, shareholder engagement, also was more prevalent in 2017, largely due to the work of the Investor Forum, which last year started to get involved in the M&A process. The dialogue between investors and public companies, both within and outside the M&A context, continues to evolve.

Pascal: With regard to shareholder engagement, France's transparency and anti-corruption law, Sapin II, established mandatory "say on pay" rules in France with respect to corporate officers of French-listed corporations. Sapin II has instituted two annual separate binding shareholder votes: a forward-looking vote on the corporation's executive compensation policy and a backward-looking vote after the fact on individual compensations granted to executive officers with respect to the prior year. Binding shareholder votes on executive officers' compensation policies took place for the first time at 2017 shareholder meetings — on average, shareholder proposals relating to executive compensation policies received approximately 85 percent of favorable votes among companies featured on the CAC 40 index. Binding shareholder votes on individual compensations granted to executive officers for the previous fiscal year will take place throughout 2018. These "say on pay" rules are more stringent than the rules set forth in the European Union's 2017 Shareholders' Rights Directive and might inspire further activist initiatives in France.

Activists and minority shareholders also might find encouragement in continued calls by France's stock exchange regulator, the AMF, to improve governance among French-listed companies, in particular by ensuring the effective presence of independent directors on their boards, as well as by the AMF's recent proposals to bolster participation and voting at shareholder meetings.

The State of Foreign Investment Control in the EU, UK and Russia

Frederic Depoortere (Brussels, EU/international competition): In the EU, foreign investment control continues to be governed by the laws of the individual member states. In September 2017, the European Commission drafted regulations to establish an EU framework for screening foreign investment. Rather than propose to transfer the power to review foreign investment from the member state-level to the EU, the regulations would create a framework for closer cooperation and coordination among the affected member state, the European Commission and other member states. For foreign investment that is likely to affect projects or programs of EU interest on grounds of security or public order, the Commission may issue an opinion addressed to the member state where the foreign investment is planned or has been completed. The member state involved "shall take utmost account of the Commission's opinion and provide an explanation to the Commission in case its opinion is not followed." However, the final decision would remain with the individual member state. How member states react to the Commission's proposal and whether they will accept this approach for future investments remains to be seen.

Pascal: French President Emmanuel Macron pushed for the implementation of a foreign investment control at the European level at the June 2017 European Council meeting. The aim of President Macron's proposal was to bolster the European integration political process to offset the negative impact of Brexit. Although the September 2017 EU proposal is less ambitious, France is a strong supporter of the European Commission's initiative.

The protection of French strategic industries is a key driver of the nation's foreign investment policy. The government remains closely involved in all sensitive or strategic situations — such as the corporate restructuring of the French nuclear company Areva. Foreign investments in strategic business sectors remain under high scrutiny from French authorities, and the government is seeking to amend French foreign investment rules in order to better protect its strategic assets and resources. French Minister of Economy Bruno Le Maire announced on January 15, 2018, that the reform will extend the scope of French foreign investment control to new business activities, including data storage and artificial intelligence, and reinforce applicable sanctions and remedies.

The French government's foreign investment policy also includes promoting France's economic attractiveness. Certain structural measures implemented following the May 2017 French presidential elections, such as the labor law reform and the alleviation of the corporate income tax, have improved foreign investors' perceptions of the French economy and are expected to have a positive impact.

Matthias: In Germany, the scope of the application of the German Foreign Trade Ordinance was materially extended in July 2017. Investments by certain foreign investors continue to be subject to review and prohibition by the German Federal Ministry for Economic Affairs and Energy. The new provisions also identify certain industries that might fall under increased scrutiny (critical infrastructure, certain related software, telecommunications, cloud computing and infrastructure for telematics) and expand the list of goods that will require mandatory clearance (certain weapons and IT security goods). In addition, the review period was extended by three to six months in the aggregate.

Scott: The U.K. Takeover Code has continued to evolve since it was first established in 1968. Historically, changes have been in response to techniques deployed on bids, but they now also reflect political and social imperatives. One such change is the continued development of the requirement that bidders disclose their intentions for the combined business and the impact the combination will have on various stakeholders, particularly employees. This is an area that the Takeover Panel has developed successively following Kraft's bid for Cadbury, Pfizer's bid for AstraZeneca, and most recently, SoftBank's acquisition of ARM. The Takeover Code will likely be updated to include an industrial policy capable of ensuring Britain has the necessary skills base to compete globally beyond Brexit. Accordingly, in the future, bidders will be required to disclose the impact of their plans on the (1) target's research and development functions, (2) balance of skills and functions of the target's employees and management, and (3) location of the combined company's headquarters and headquarter functions.

When it comes to foreign investment control in the U.K., it is important to remember that a significant majority of the U.K.'s gross domestic product is already generated by foreign-owned companies. The U.K. is anticipating a much more open trading policy once it leaves the EU. Although the debate on the desirability and efficacy of controls over foreign takeovers continues, the government appears to be aiming for a minimal approach post-Brexit, with as few new controls as possible and largely focused on security issues, in order not to deter much-needed foreign investment.

Alexey Kiyashko (Moscow, corporate): Russia is following the global trend of strengthening oversight over foreign investments. In July 2017, amendments to the Russian foreign investment law resulted in a signifi¬cant tightening of control over transactions involving Russian companies and foreign investors, including investments in Russian companies. The Russian government now has the authority to review any transaction entered into by a foreign investor regarding any Russian legal entity with the view of ensuring the defense of the country and security of the state.

A foreign investor can include a Russian citizen also holding citizenship in another country, as well as Russian entities controlled by non-Russian entities, and the scope of the review is not strictly limited to transactions involving shares or equity interests — it can potentially cover any type of transaction, subject matter or sector. This regime represents a significant new legal risk for the validity of Russian transactions involving foreign investors.

Dmitri Kovalenko (Moscow, corporate): In addition, there are new restrictions under the Russian Strategic Enterprises Law for investors incorporated in offshore jurisdictions or controlled through offshore companies, potentially including those that have offshore companies anywhere within their group structure. These new rules prohibit acquisition of control by offshore investors over Russian strategic enterprises (generally, more than 50 percent of the voting rights or 25 percent or more for an enterprise that is a subsoil user) and require prior governmental clearance to acquire more than 25 percent of a strategic enterprise (or more than 5 percent in the case of a subsoil user) but less than "control." Finally, offshore investors also are prohibited from participating in privatizations.

Merger Review, Anti-Corruption Laws and Other Enforcement Priorities

Ingrid Vandenborre (Brussels, EU/international competition): One of the key legislative developments in EU antitrust enforcement expected in 2018 is the European Commission's proposal for a directive to improve the effectiveness of national competition authorities' enforcement. The proposal, which is still pending in the legislative process, provides minimum guarantees and standards for a level playing field in relation to antitrust enforcement throughout the EU.

The European Commission is expected to continue its role as a leading enforcer. In the area of cartel enforcement, the Commission has imposed fines of €5.24 billion on 60 cartelists in the past three years during Commissioner Margrethe Vestager's term, including an aggregate fine of €3.8 billion in relation to the truck cartel in 2016 and 2017, the highest cartel fine imposed in the EU to date. The Commission also dealt with matters across a wide range of sectors, including banking, energy, e-commerce, transport, information technology, manufacturing, pharmaceutical, telecommunications and automotive. The

Brexit: Much Discussed, Little Understood

Katja Kaulamo (Frankfurt, capital markets): With structural and political change in Europe in 2017, the European capital markets industry was left in a state of uncertainty pending the final outcome of the Brexit negotiations. It remains to be seen how Brexit will ultimately affect the German economy in general and capital markets in particular. What is certain is that the U.K. financial service providers will lose their European passporting rights, hence banks and financial service providers will be required to shift their regulated activities to a European Union or European Economic Area member state in order to maintain access to the EU single market for financial services.

In the meantime, companies in the financial industry have started to draw their own conclusions from the negotiation progress (or lack thereof) and are preparing for upcoming changes. Even though Paris was chosen as the new location for the European Banking Authority, Frankfurt is likely to be one of the primary beneficiaries of Brexit-related changes. Leading players in the financial industry are leaning toward, or have already chosen to pursue, a significant increase in their presence in Frankfurt, strengthening the city's position as a leading European financial center.

At the same time, the impact of the ongoing Brexit negotiations on the German business climate has generally been limited.

Matthias Horbach (Frankfurt, corporate): That's correct. Despite the political and economic challenges of Brexit, there is no clear evidence of it having a negative impact on current or future German business dealings. M&A activity remains strong, and recent surveys suggest that Brexit will not seriously affect the business landscape. The acquisition of Medisoft Limited by Heidelberg Engineering and the investment of Deutsche Bahn into the British startup what3words serve as good examples of continuing activity. The U.K. referendum may have resulted in longer transaction processes, as the general legal and business environments are reassessed, and the possibility of delayed legislation to enact the terms of the U.K.'s exit from the EU has been raised as a potential obstacle ahead. However, transactions are still being signed and strategically important acquisitions are still subject to premium valuations.

Pascal Bine (Paris, corporate): The relocation of the European Banking Authority (EBA) that Katja mentioned is an emblematic victory for Paris. Paris is already the home of the European Securities and Markets Authority, meaning that the EBA will become the second European financial regulator in the French capital. Such a concentration will increase Paris' role as a financial center and attract higher focus from the European financial community on Paris, potentially with some business and job relocations to the city. Beyond that, Brexit is not expected to have much of an impact on France.

Richard Youle (London, private equity): Ultimately, I think Brexit is much discussed and little understood — even in the U.K. Some businesses are actively pursuing alternative location strategies to move to jurisdictions with the most favorable tax and regulatory regimes, thereby minimizing the impact of a hard Brexit. On the whole, companies with a geographically diverse portfolio of assets don't see Brexit as causing a wholesale downgrade of their businesses. I do think, going forward, that funds will look to businesses with pan-European operations that have predictable cash flows and minimal currency risk. In short, international investors will be unlikely to pursue the U.K. market on a stand-alone basis in the short term, preferring a more international strategy.

Commission's 2017 decisions included a €2.42 billion fine levied against Google for the alleged abuse of dominance relating to search engine results; other investigations against the company are pending.

Private damages actions in EU member states have assumed a significant role in antitrust enforcement in Europe. By December 2017, 25 of the 28 EU member states had implemented the EU's Directive on Antitrust Damages Actions — a framework of harmonized minimum standards for private damages in EU member states established in 2014 — in their legal systems. While private damages actions still tend to be brought in a small number of jurisdictions, in particular the U.K., Germany and the Netherlands, the existence of harmonized rules will likely increase the number of such actions in other EU member states.

Fred: Among other activity in 2017, the European Commission issued its seminal decision approving the Dow/DuPont merger. In this decision, the Commission proffered a novel theory on innovation competition and required that the combined firm divest a large part of DuPont's research and development organization. The Commission also prohibited two proposed mergers, Deutsche Boerse/London Stock Exchange and HeidelbergCement/Schwenk/Cemex Hungary-Croatia. Additionally, Knorr-Bremse/Haldex was aborted after the Commission opened an in-depth Phase II investigation. It is clear to most observers that merger control enforcement has become stricter in terms of substantive review, and that the Commission is willing to pursue novel theories and impose broad remedies. (See "Novel Theories Emerge in Merger Enforcement.") The procedural aspects of merger control also are under closer scrutiny than ever before: The Commission imposed a €110 million fine on Facebook for providing misleading information during the Commission's review of its acquisition of WhatsApp.

Pascal: Anti-corruption and compliance issues should be another area of heightened scrutiny in M&A deals. In France, this will impact acquirers and targets now that Sapin II — France's response to the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act — requires large French companies to implement measures to detect and prevent corruption, and provides authorities with stronger enforcement powers.

Valentin Autret (Paris, litigation): In November 2017, the "Parquet National Financier" (PNF), a specialized prosecutor's office in Paris tasked with prosecuting serious and complex financial crimes, announced it had entered into its first-ever deferred prosecution agreement (DPA), or "convention judiciaire d'intérêt public" (CJIP), with HSBC Private Bank Switzerland (HSBCPB). CJIPs were introduced in French law in December 2016 as part of Sapin II. CJIPs offer a mechanism for companies to negotiate a settlement with the public prosecutor in connection with corruption, influence peddling and laundering of tax fraud proceeds cases. The HSBCPB CJIP could signal a new phase of government enforcement in France. (For more on the agreement, see our December 8, 2017, client alert "France Announces Its First Deferred Prosecution Agreement.")

Elizabeth Robertson (London, government enforcement and white collar crime): DPAs continued to be prominent in the U.K.'s enforcement agenda, with the Serious Fraud Office (SFO) entering into two DPAs in 2017: with Rolls-Royce for more than £497 million and with Tesco for £129 million. More are in the pipeline for 2018, and the SFO has been very clear that companies will only be offered a DPA if they have been cooperative, including by utilizing early self-reporting and even divulging privileged materials.

Cooperation also is likely to extend to corporations that are ready to assist in the prosecution of individuals. This can be most readily seen in the trials of a number of former Tesco executives in relation to the company's accounting scandal. The interests of the corporation and the individual may be expected to diverge, and it will be essential to ensure that individuals have independent legal representation at the earliest opportunity.

Ryan Junck (London, government enforcement and white collar crime): Individual accountability continues to be a high priority for U.S. prosecutors, and it will remain so despite recent statements by the Department of Justice (DOJ) that it is considering potential changes to the 2015 Yates memorandum.

Overall, potential changes in U.S. enforcement priorities — and their likely impact on European businesses and individuals — may become more clear now that the Trump administration has made additional senior-level appointments at the DOJ, Securities and Exchange Commission (SEC), Commodity Futures Trading Commission and FBI, in addition to the appointment of a growing number of U.S. Attorneys. (See "Agencies Indicate Efficient, Targeted Enforcement Priorities That Rely on Self-Disclosure.")

In recent months, the SEC's Cyber Unit has focused on cybersecurity issues and enforcement, with an uptick in cybercrime investigations. The SEC also has issued guidance and warnings with respect to the offering and sale of digital assets sold by virtual organizations as part of initial coin offerings and the use of blockchain technology, and we are likely to see increased enforcement of securities laws in this area. (See "Rise of Blockchain and ICOs Brings Regulatory Scrutiny.")

It remains to be seen whether potential reductions in funding for some law enforcement agencies, including the DOJ and SEC, may affect their priorities with respect to white collar crime regulations.

Regulatory Developments Shape Markets, Tighten Enforcement

Katja Kaulamo (Frankfurt, capital markets): The EU's Market Abuse Regulation (MAR) was in force for the first full year in 2017. The discussion regarding certain details of the MAR and its application is ongoing, showing that it remains a challenge to market participants in Europe. The European Securities and Markets Authority and local financial regulators, including Germany's BaFin, issued further guidance on aspects of the application of the MAR, and BaFin has entered into an ongoing dialogue with market participants. Although this has been a meaningful step in the right direction, we expect further guidance will be needed in the coming year. This is specifically true for the large number of domestic and foreign issuers that have listed financial instruments on unregulated markets of German stock exchanges and are now also subject to the post-listing obligations under MAR.

BaFin is expected to vigorously pursue any violations of the new regime and apply its far-reaching sanctioning powers, including its ability to impose increased administrative fines. In 2017, we witnessed the first high-profile BaFin investigations involving insider trading and *ad hoc* disclosure violations under the new regime. However, these cases are still pending and cannot yet serve as precedents with respect to action that BaFin may take in the future.

Matthias: Also in Germany, the Prevention of Money Laundering Act became effective in June 2017. The act implements the Fourth EU Anti-Money Laundering Directive, which is intended to prevent money laundering and terrorist financing. The new requirements will lead to substantially higher transparency regarding beneficial holders in private companies. Investors with subsidiaries in Germany will have to adapt to this new legislation, and new investors will have to take the increased transparency into consideration.

Bernd Mayer (Frankfurt, corporate governance): Tougher enforcement around these regulatory changes is an important trend. In recent years, potential fines and forfeiture provisions have increased. In 2017, this trend is evident in the sentencing guidelines for infringements of the MAR and the Securities Trading Act that BaFin issued in February 2017, the administrative offenses in the new Prevention of Money Laundering Act, and the EU General Data Protection Regulation that will be implemented in May 2018. Failure to comply with any of these new administrative or regulatory laws could result in hefty fines.

Valentin: The French Anti-Corruption Agency (AFA) recently announced that it has started its first inspections of companies' compliance programs, including both off-site and on-site controls. Companies that fall under the scope of Sapin II should therefore be prepared for similar inspections in 2018 and ensure that they have taken appropriate measures to meet the law's extensive compliance requirements. The AFA can issue warnings or fines against companies and their management, and may refer any acts of corruption uncovered in the course of its inspections to prosecutors.

Starting on January 1, 2018, French companies with more than 50 employees had to implement policies and procedures to receive and address reported misconduct. Such policies must be distributed to all employees as well as to any external or occasional associates of the company (including clients, suppliers, intermediaries, etc.).

Elizabeth: The Criminal Finances Act 2017, which introduced failure to prevent the facilitation of tax evasion as a new corporate criminal offense, was the key legislative development of the year in the U.K. Companies are now expected to have "reasonable prevention procedures" in place to prevent those associated with them from facilitating tax evasion. Corporate clients should conduct a thorough risk assessment and put reasonable prevention procedures in place in order to avoid criminal liability.

A number of important developments also came from the English courts at the end of 2016 and into 2017. First, two High Court of Justice decisions reiterated the narrow confines of privilege in English law. The "client" is defined narrowly, reasonable contemplation of a criminal investigation may not be sufficient to attract litigation privilege and legal advice privilege requires the provision of advice — merely recording facts, such as in an interview memo, is not enough (*In re RBS Rights Issue Litigation*; *Director of the SFO v Eurasian National Resources Corporation Ltd*). The practical implications for clients are that it will likely be necessary to involve external counsel from an earlier stage of an investigation, and extreme care must be taken throughout an investigation to ensure that privilege attaches to communications.

Second, in a unanimous judgment, the Supreme Court held, *obiter* (*dicta*), that "dishonesty" in English criminal law should be judged objectively (*Ivey v Genting Casinos (UK) Ltd t/a Crockfords*). This significant decision contradicts the prevailing case law of the previous three decades, which also included a subjective element. Although this was only *obiter*, it will take a strong court to disregard the signals coming from the Supreme Court on this issue. In practical terms, this may lead prosecutors to be more robust in the prosecution of offenses resting on dishonesty.

Bernd: A number of landmark enforcement cases were adjudicated in Germany last year as well, including those involving cum/ex transactions and diesel emissions.

German prosecutors have been focusing on "cum/ex" transactions for a number of years now. These intertwined transactions in shares and derivatives are executed around dividend dates and can be prearranged to "generate" multiple tax certificates and yield multiple "refunds" of a tax amount that was only levied once. Public prosecutors consider this fraud and have directed investigations against all players involved: bank employees, customers and attorneys who allegedly advised on such transactions or even structured them. Administrative proceedings led to fines against banks and other companies involved.

Alleged fraud and illegal advertising with regard to diesel emissions also were front and center in 2017, as authorities from Germany and around the world continued their investigations into U.S., Italian, French and German car manufacturers and suppliers. Munich prosecutors have arrested two suspects and kept them in pretrial custody — one of them a former member of the management board of a German car manufacturer.

The prosecutors' tough approach is being challenged in some instances. Following the raiding of an international law firm's Munich offices to seize documents relating to its internal investigation of a client's diesel practices, the firm filed a complaint with the Federal Constitutional Court, and a ruling is expected in 2018. Many consider such searches and seizures contrary to the German concept of legal privilege.

Positive Outlook for European Capital Markets

Danny Tricot (London, capital markets): Capital markets in Europe were generally positive in 2017, recovering from a mixed year in 2016. The first half of the year was particularly strong for high-yield issuances in Europe, with the U.K. and Italy performing especially well, and the demand for corporate debt continuing to be high as U.S. issuers sought euro-denominated debt in order to take advantage of low interest rates. The second half of the year saw an increase in initial public offerings (IPO) activity in Europe and the U.K. in particular, with the financial and industrial sectors leading the way, a trend that is likely to continue in 2018.

The U.K.'s Financial Conduct Authority (FCA) plans to introduce a new concessionary route to listing for property companies, which may encourage continuation of the current trend of real estate IPOs in London. The FCA also plans to introduce provisions in July 2018 to improve the range, quality and timeliness of information available during the IPO process in order to create a more level playing field between connected and unconnected analysts. This will potentially lengthen the public phase of the IPO process; better and earlier access to information is likely to benefit investors overall.

Katja Kaulamo (Frankfurt, capital markets): Also on the regulatory front, the European Commission launched its midterm review of the Capital Markets Union (CMU) initiative in 2017. The initiative aims to support economic growth by enhancing access to capital, and one of its central goals is improving access to finance for small and medium-sized enterprises (SMEs). Such support of SMEs is much needed, in particular in the context of equity financing. Given the complexity of the IPO process and the costs of listing for smaller issuers, origination in this space has remained somewhat subdued in Europe since the 2007 financial crisis.

Despite the stability of the markets, low levels of market volatility, record-high DAX indices and positive economic outlook, the German IPO market — with only seven IPOs and an aggregate issue volume of €2.6 billion in 2017 — lagged behind the rest of the European Union and Switzerland, where IPO activity was up roughly 40 percent. In 2017, most exits by private equity investors from German assets were trade sales to other sponsors or strategic buyers, irrespective of whether the assets were initially offered in dual-track processes. The IPO drought in 2017 was a continuation of what we saw in 2016, when the German market had only five completed IPOs. Meanwhile, the rest of the German equity market was strong last year, with overall equity issue volume doubling that of 2016, driven mainly by large accelerated book-building offerings of liquid stocks.

In addition to the European Central Bank's (ECB) asset purchase program, low borrowing costs created an attractive environment for debt capital markets. In 2017, corporate bond issuances remained at record levels, and the market expects similar issue volumes in 2018. The German market for high-yield bonds, on the other hand, decreased in 2017, as noninvestment-grade issuers had easier access to less expensive bank financings.

Pascal Bine (Paris, corporate): In France, debt issuances and IPO proceeds were both up in 2017. Low interest rates and an improved economic climate following the presidential elections resulted in increased volume of debt issuances by French corporations, totaling close to €70 billion for the year. According to analysts, the volume of debt issuances will be even higher in 2018. With low interest rates enabling issuers to refinance their debts at favorable conditions, around 80 percent of debt issuances in 2017 involved refinancing by investment-grade issuers. By way of exception, there was a slight decrease in the French high-yield market: €5.6 billion for the first nine months of 2017 compared to €8.8 billion for the same period in 2016. This overall trend is likely to persist if the ECB maintains low interest rates in the eurozone.

Stable and favorable macroeconomic conditions also benefited the French equity capital markets. A significant number of equity offerings by French issuers in 2017 were completed in the context of corporate acquisitions. The €3.3 billion share capital increase of Air Liquide, one of the largest French public equity issuances during the year, was completed to partly refinance the 2016 acquisition of Airgas. The volume of equity raises on the French market is expected to increase during 2018.

Despite the fact that IPO proceeds nearly tripled from 2016 to 2017, the number of French IPOs did not increase significantly during that period. The €1.2 billion IPO of ADL Automotive, the French automobile fleet management and car leasing company, was the largest IPO in France in 2017. Amid an increase of confidence in capital markets and the favorable economic environment, the level of activity on the French IPO market in 2018 is expected to be boosted by certain sponsors' early exit strategies and the contemplated asset sales and privatization program of the French state.

Katja: Most market participants share a similarly positive outlook for the German IPO market in 2018, anticipating an increase in IPOs from corporate realignment activity and a few large spin-offs. The largest IPOs expected to come to market in 2018 are the spin-offs of the health care business of Siemens and of the asset management business of Deutsche Bank. Generally, investors remain selective and seem to prefer the larger, more liquid stocks.

Overall, the fluctuating value of the euro presents a source of uncertainty, as does the question of whether the ECB will decide to reduce its asset purchases in early 2018.

Danny: Additionally, political developments within Europe, including in relation to Brexit, will continue to create a certain amount of volatility in European capital markets in 2018; however, investors have weathered these challenges so far.

5 Enforcement Priorities Take Shape Around the World

Agencies Indicate Efficient, Targeted Enforcement Priorities That Rely on Self-Disclosure

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One year into the Trump administration, it remains difficult to forecast what lies ahead with respect to regulatory and white collar enforcement activity. Perhaps most instructive are recent public statements of officials at the Securities and Exchange Commission (SEC), Department of Justice (DOJ) and Commodity Futures Trading Commission (CFTC), which suggest that vigorous regulatory and enforcement activity will continue, albeit with a focus on targeted enforcement actions that use the government's resources as efficiently as possible.

A Move Away From 'Broken Windows' Strategy

With the SEC's new chairman and two new co-directors of enforcement now in office, Co-Director of Enforcement Steven Peikin has suggested that, in light of limited agency resources, it may take a "more selective" approach to regulatory enforcement rather than continue on the Division of Enforcement's pursuit of a "broken windows" strategy to policing the securities markets, under which it actively prosecuted even minor and technical violations. (See "Priorities Begin to Emerge for Trump's SEC.")

While Co-Director Peikin did not specify the types of cases on which the SEC might choose to focus, they are likely to include those intended to protect so-called Main Street investors. The division recently created the Retail Strategy Task Force, which leverages agencywide resources to analyze trends affecting retail investment, with a focus on Ponzi schemes, microcap or offering fraud, and investment professional malpractice.

How this potential new approach may impact enforcement actions remains to be seen. In 2017, the division brought 446 stand-alone actions (102 fewer than in 2016) and imposed monetary penalties totaling $832 million ($441 million less than in 2016). Given that enforcement actions generally span more than one year, the declines were presumably caused by factors other than the division's "more selective" approach. In explaining the decline, the SEC noted that its Municipalities Continuing Disclosure Cooperation Initiative, which in 2016 led to 84 actions related to material misstatements and omissions in municipal bond offering documents, expired in 2017. Changes in personnel and the demands of the transition also were likely at work.

'Piling On' and Deterrence

The DOJ also has signaled its desire to make white collar crime enforcement more efficient by limiting the number of agencies that investigate and punish companies for the same underlying misconduct — a practice referred to by Deputy Attorney General Rod Rosenstein as "piling on." The phenomenon occurs both internationally, with foreign regulators and prosecutors, and domestically, among federal agencies and state actors. In a November 2017 speech at The Clearing House's Annual Conference, Deputy Attorney General Rosenstein stated that duplicative investigations and penalties "undermine the spirit of fair play and the rule of law" and deprive targeted companies of "certainty and finality."

The DOJ continues to prioritize international coordination and has expressed a commitment to working with foreign authorities to reduce the risk that companies will face prosecutions and penalties in multiple jurisdictions for the same conduct.

This commitment is particularly significant with respect to the DOJ's Foreign Corrupt Practices Act (FCPA) cases, which appear to continue to be an enforcement priority. These cases require international cooperation and coordination but are vulnerable to overlapping enforcement. In recent cases, authorities from multiple jurisdictions worldwide appear to have been working collaboratively to divvy up investigations of misconduct that crosses jurisdictional lines, pursuing separate but coordinated prosecutions. The goal is to limit duplicative work and expedite the route to prosecution or settlement.

The Rolls-Royce corruption probe that concluded in January 2017 is one example where U.S., U.K. and Brazilian authorities engaged in parallel investigations, assisted by law enforcement agencies in Austria, Germany, the Netherlands, Singapore and Turkey. The company entered into deferred prosecution agreements with U.K. and U.S. authorities and a leniency agreement with the Brazilian Ministério Público Federal, and was required to pay penalties exceeding $800 million, apportioned among the three authorities.

International coordination must be carefully managed, lest it jeopardize the DOJ's cases. Standard and lawful investigative practices in foreign countries may raise substantial constitutional issues in the United States. In *United States v. Allen*, the U.S. Court of Appeals for the Second Circuit ruled in July 2017 that the use of evidence derived from testimony lawfully compelled by foreign authorities violated the Fifth Amendment. As a result, the court vacated the convictions of two London-based traders for conspiring to fix the London Interbank Offered Rate (Libor).

To achieve better coordination and minimize the risk to future convictions, the DOJ may expand its "division of labor" approach, whereby cooperating enforcement authorities divvy up prosecutions of individuals to best suit each country's prosecutorial needs and constraints. This tactic could allow governments to more effectively allocate their resources and tailor investigative approaches to the particular jurisdiction that anticipates prosecuting each individual. It also may limit the number of regulators with which a potential defendant might choose to cooperate.

The DOJ also has expressed a commitment to coordination domestically, though the form such coordination may take remains unclear and could be challenging in the current environment, in which some state attorneys general have pledged to step up enforcement actions to fill a perceived vacuum in federal enforcement activity.

With regard to corporate penalties, recent speeches suggest that the DOJ is questioning whether substantial penalties against corporations really accomplish the department's goal of deterring the individual wrongdoers through whom corporations act. In one such speech, Deputy Attorney General Rosenstein stated that "[e]ffective deterrence of corporate corruption requires prosecution of culpable individuals. We should not just announce large corporate fines and celebrate penalizing shareholders." Such statements indicate that while the DOJ is reconsidering the principles of the Yates memorandum — the DOJ's focus on individual accountability outlined in 2015 by then-Deputy Attorney General Sally Yates — it will continue to pursue enforcement actions against individuals, an unsurprising goal. Whether these statements suggest the DOJ may be backing down from corporate penalties, or simply that it will increase individual prosecutions alongside corporate ones, remains to be seen. The answer lies in how the DOJ decides it can best deter corporate fraud.

Self-Reporting

Finally, in recent public statements the DOJ, CFTC and SEC have emphasized the benefits of corporations self-reporting wrongdoing and cooperating with the government. This suggests that these law enforcement entities remain committed to pressuring companies with the threat of prosecution to maintain the leverage necessary to compel companies to come forward voluntarily. At the same time, the statements may signal the agencies' increasing reliance on self-disclosure as a way to efficiently settle enforcement actions.

The DOJ recently announced a revised FCPA Corporate Enforcement Policy that updates and codifies the FCPA pilot program that was in place for the past 18 months. The revised policy, while similar in many respects to the pilot program, appears to further encourage voluntary disclosure of FCPA-related misconduct. Under the program, a company can presume enforcement will be declined if it voluntarily self-discloses the alleged misconduct, fully cooperates with the DOJ, and timely and appropriately remediates the situation. Even if there is enforcement action, the DOJ would recommend a 50 percent reduction off the low end of the U.S. sentencing guidelines fine range and not require, in certain circumstances, appointment of a compliance monitor.

Similarly, the CFTC published an advisory in 2017 highlighting the benefits of self-reporting for all potential enforcement actions. Director of Enforcement James McDonald estimated that deserving parties could receive a 50 to 75 percent reduction in civil monetary penalties. The CFTC may even decline to prosecute in "extraordinary circumstances," for example "where misconduct is pervasive across an industry and the company or individual is the first to self-report," Director of Enforcement McDonald said in a September 2017 speech at the NYU Program on Corporate Compliance and Enforcement. While not going as far as the CFTC, the SEC also has reaffirmed that companies or individuals could avoid enforcement if they cooperate fully.

Federal regulatory and law enforcement authorities have long encouraged voluntary self-disclosure, but by clearly restating to companies and individuals the benefits of self-disclosure — and the magnitude of the benefits offered — authorities may be indicating a new focus on efficient regulation and law enforcement.

Conclusion

Though the DOJ, SEC and CFTC leadership all appear committed to continued enforcement activity, we expect they will employ new approaches to prosecutions, work collaboratively internationally and locally where possible, and rely on self-reporting and cooperation to meet their goals in the most efficient way.

Priorities Begin to Emerge for Trump's SEC

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The actions that Securities and Exchange Commission (SEC) Chairman Jay Clayton has taken since the start of his tenure in May 2017 provide an indication of SEC priorities, including encouraging initial public offerings (IPOs) and combating abuses in cybersecurity matters. These and other priorities will have a significant impact on the SEC's regulation and enforcement agendas in 2018.

Initial Steps

A key focus for Chairman Clayton has been filling the top leadership positions at the SEC. He has selected new directors for each of the SEC's major divisions — Corporation Finance, Investment Management, and Trading and Markets — and in the case of the Division of Enforcement, a new co-director. When naming these individuals, Chairman Clayton cited their shared characteristics, including that they are senior professionals with long-standing industry experience, as reasons why this group has the skills to deliver on his goal of re-evaluating the SEC's rules and practice. Additionally, with the December 2017 Senate confirmation of President Trump's commissioner nominees — former congressional aide Hester Peirce (Republican) and New York University School of Law professor Robert Jackson Jr. (Democrat) — the SEC is operating with all five commissioners for the first time since late 2015.

We have already seen the influence of these new leaders on the SEC's priorities. In the Division of Enforcement, for instance, the co-directors have indicated a change to the "broken windows" strategy of bringing enforcement actions based on facts that would generally indicate only minor violations. "It may be the case that we have to be selective and bring a few cases to send a broader message rather than sweep the entire field," newly appointed Co-Director Steven Peikin commented at a securities conference in October 2017 regarding the change. (See "Agencies Indicate Efficient, Targeted Enforcement Priorities That Rely on Self-Disclosure.") There also is speculation that the agency may no longer seek admissions of wrongdoing as a condition for settlement, as has been recent agency practice in select cases. Under the prior leadership, the SEC had insisted on admissions to settle a discrete number of matters where the SEC believed that the significance of the case warranted an admission, or where a parallel criminal proceeding included an acknowledgment of wrongdoing.

In the Division of Corporation Finance, the staff has issued new guidance that significantly streamlined the confidential submission process for companies conducting IPOs and effectively eliminated requirements for these companies to provide certain interim period financial statements in initial draft registration statements. This guidance was well received by the market and reflected a clear goal of Chairman Clayton — encouraging IPOs and easing regulatory burdens on capital formation, regardless of whether the company qualified as an emerging growth company. The Corporation Finance staff also provided welcomed guidance on the new pay ratio disclosure requirements and on the review of no-action requests to exclude shareholder proposals, which has the potential to significantly impact the historical abuse of the process.

Expected Regulatory Changes

In addition to SEC staff actions, Chairman Clayton has streamlined the SEC's rulemaking agenda to provide transparency on what he believes the SEC can reasonably accomplish in the near term. What remains unclear is what matters will advance the new agenda. Most observers expected the SEC to take immediate steps under new leadership to repeal many of the rules adopted pursuant to the Dodd-Frank Act. To date, that has not happened. Indeed, after much speculation that the SEC would either repeal or delay the requirement for companies to disclose the CEO-to-median-employee pay ratio beginning in 2018, the SEC has allowed the rule to go into effect. The SEC also approved the Public Company Accounting Oversight Board's new model for auditor reports that accompany audited financial statements in SEC filings. The new model requires a number of highly controversial new disclosures, including the auditor's tenure with the company and critical matters that he or she focused on during the audit.

The only material rulemaking matter that the SEC has considered under its new leadership, other than some technical rule amendments, is a proposal to modernize and simplify certain disclosure items in its rules and forms. The items proposed to be amended include the number of years required to be covered in the management's discussion and analysis of the company's financial statements and which material contracts must be filed as exhibits to filings made with the SEC. These rule changes would be welcomed if the SEC was to eventually adopt them, but they would not have a significant impact on company disclosure requirements. It is possible that the SEC's near-term regulatory agenda will be dominated by such amendments. Chairman Clayton noted at the Economic Club of New York in July 2017 that "[i]ncremental regulatory changes may not seem individually significant, but, in the aggregate, they can dramatically affect the markets."

In the meantime, the hope that many market participants had at the beginning of 2017 that Congress would repeal much of the Dodd-Frank Act has faded. Although the House of Representatives passed the Financial Choice Act in July 2017 — which would significantly alter the regulatory framework that has been in place since the financial crisis, including a number of SEC reporting and disclosure requirements — the Senate has not taken up the measure in any concerted way. It remains unlikely that the House bill will be adopted in its entirety, but certain provisions and other requests for changes to the SEC rules could become law and would significantly impact SEC rules and practices.

Enforcement Priorities

Many observers also expected to see an immediate and significant decline in the number of SEC enforcement actions as a result of the change in leadership. But the drop in enforcement actions was more modest than expected. According to the SEC Division of Enforcement's annual report, in fiscal year 2017 (which included the last three months of the Obama administration and the first nine months of the Trump administration), the SEC brought 754 enforcement actions, returned approximately $1 billion to investors and obtained orders for approximately $3.8 billion in disgorgement and penalties. Excluding actions brought as part of the SEC's Municipalities Continuing Disclosure Cooperation Initiative, a voluntary self-reporting program that concluded in 2016, the number of enforcement actions brought in fiscal year 2017 declined only 3.8 percent.

In his recent remarks before the Economic Club of New York, Chairman Clayton noted that he "fully intend[s] to continue deploying significant resources to root out fraud and shady practices in the markets, particularly in areas where Main Street investors are most exposed." With regard to more sophisticated market participants, he promised that "the Commission will continue to use its enforcement and examination authority to support market integrity," notwithstanding the agency's move away from a "broken windows" enforcement strategy. In addition, Chairman Clayton and members of the SEC staff have made public statements about their intent to remain focused on the recent increase in bitcoin-related offerings.

The SEC enforcement directors recently identified five core principles that they said will guide the agency's enforcement priorities. They focus on:

- Main Street investors;
- individual accountability;
- keeping pace with technological change;
- imposing sanctions that most effectively further enforcement goals; and
- constantly assessing the allocation of SEC resources.

It is not clear at this point how these principles will impact the number and type of matters that will gain the attention of the SEC's enforcement staff in 2018. One area of certainty is the SEC enforcement lawyers' intent to focus on cybersecurity matters and threats to retail investors, such as inadequately disclosed fees, investment professionals who steer customers to mutual fund share classes with higher fees, and abusive practices such as churning and excessive trading. The staff has already announced the creation of two task forces to combat abuses in these areas. The SEC feels that cyber-related issues are increasing in frequency and significance and that retail investors are among the market's most vulnerable participants.

Although uncertainty persists, in 2018 the SEC is expected to take steps to streamline its rulemaking agenda, even if a repeal of the Dodd-Frank Act or the passage of the Financial Choice Act are each viewed as increasingly unlikely. A slight reduction in the volume of enforcement actions also can be expected, as the enforcement staff focuses its efforts on the agency's recently articulated five core principles.

6

China and Its Growing Global Presence

As President Xi's Power Grows, So Does China's Presence on World Stage

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In October 2017 at the Chinese Communist Party National Congress, President Xi Jinping consolidated his hold on power and cemented himself as what many commentators are calling the most powerful Chinese leader since Mao Zedong.

President Xi came to power when he replaced Hu Jintao as general secretary of the Chinese Communist Party at the 18th Party Congress in 2012 and, in accordance with tradition, assumed the role of president at the subsequent meeting of China's parliament. By convention, Chinese leaders serve two five-year terms, and so at the 19th Party Congress last year, President Xi was expected to appoint a likely successor to a senior leadership role. However, this did not happen, triggering speculation that he was preparing to serve beyond the customary two terms.

President Xi's position was further bolstered when the Congress unanimously elected to write his signature ideological theory — "Xi Jinping Thought on Socialism With Chinese Characteristics for a New Era" — into the party Constitution, the first time since Mao that a Chinese leader has received such recognition. All the signs indicate that, whether in a formal leadership role or from behind the scenes, President Xi will continue to wield influence in China for a long time to come.

As a result, his priorities will continue to play a significant role in Chinese policy. President Xi wants a greater leadership role for China internationally, and the Congress endorsed this enthusiastically. It also endorsed continued policies of "socialist modernization" and building China into a "moderately prosperous society," all while maintaining strict party control.

Under President Xi, we expect to see an increasingly muscular China on the world stage as well as limited liberalization within the country. (For example, the internet will continue to be tightly controlled.) We may see limited further opening of opportunities for foreign investors — China recently announced some relaxation of the rules restricting foreign investment in financial institutions — but these opportunities likely would be measured and only sufficient to justify China's position as an ostensible promoter of an open global trading order.

Government Role in Outbound, Inbound Activity

In late 2016, China imposed new restrictions on outbound foreign investments, including a cap on renminbi-denominated loans issued outside China and a requirement that the loans be registered in China. In November 2016, China also imposed new limits on the amount of renminbi that Chinese companies can remit overseas. These restrictions, together with a desire to curb what some commentators have considered overly exuberant bidding for foreign assets, significantly impacted M&A volumes in greater China throughout 2017. China outbound M&A decreased from $217.2 billion to $126.1 billion. As domestic financing for outbound acquisitions also became more difficult to obtain, a number of China-based conglomerates that had been particularly active in overseas markets in prior years saw their M&A activities impacted as Chinese banking regulators requested that lenders review loans made to them. Outbound investment in 2017 dropped 30 percent from 2016 as a result of these restrictions.

The biggest development regarding inbound M&A was the first significant liberalization of China's financial sector in 10 years. In November 2017, China's deputy finance minister announced that over the next five years foreign ownership restrictions will be relaxed to allow foreign firms to hold majority stakes in joint ventures with mainland Chinese securities companies and life insurance joint ventures and remove caps on foreign banks' stakes in Chinese banks and asset managers. Foreign players in the insurance and investment banking businesses currently must operate through joint ventures with domestic companies, while foreign banks (other than those based in Hong Kong) are forbidden from holding controlling interests in Chinese domestic banks. Foreign financial institutions and insurance companies likely will review their medium- to long-term strategies in China and potentially work toward securing control once regulations allow.

Technology, Infrastructure Drive Activity in 2017

Meanwhile, the value of domestic (including inbound) M&A dropped by a smaller amount, from $382.7 billion to $318.8 billion. The still-robust level of activity was driven by several emerging themes, including a growing number of projects linked to the "One Belt, One Road" policy and a significant focus on investment in emerging technology sectors.

One Belt, One Road

After four years of seemingly being little more than a slogan, China's One Belt, One Road initiative began to take shape in 2017. At the Belt and Road Forum held in Beijing in May 2017, heads of state from 29 countries as well as ministerial-level representatives from dozens more gathered to hear China promote the One Belt, One Road initiative and discuss international investment cooperation projects under it.

One of President Xi's signature initiatives, One Belt, One Road comprises two zones:

- the 21st Century Maritime Silk Road — covering the sea lanes and related land-based infrastructure from China across the South China Sea, throughout the Pacific and Indian oceans, and all the way to the Mediterranean; and
- the Silk Road Economic Belt — covering the land corridor from China through the central Asian landmass to Europe, roughly following the route of the old Silk Road.

The plan is for China to invest extensively in infrastructure projects along the two zones. Funding will come from Chinese financial institutions, the Silk Road Fund (a new Chinese $40 billion sovereign wealth fund) and two new multilateral international development banks — the Asian Infrastructure Investment Bank and the New Development Bank (formerly BRICS bank) — each aiming to raise $100 billion in funds. While specific plans remain hazy, the expectation is that the initiative will involve big money, potentially into the trillions of dollars over the next decade.

For China, the initiative serves economic as well as geostrategic purposes. Investment projects forming part of the initiative will support Chinese companies in their attempts to globalize, soak up excess Chinese industrial capacity (particularly in steel) and provide a major labor export market. Financing the projects also is expected to provide an alternative channel for China to diversify its vast foreign exchange reserves and promote the renminbi's role as an international trading and reserve currency. But the strategic goals are equally important: securing China's trade routes and supplies of key resources as well as increasing China's global influence, thereby enhancing its claims to global leadership.

For companies operating in the infrastructure and related industries, One Belt, One Road offers significant opportunities. China is looking to spend, and any project that can be reasonably seen as falling within the scope of the initiative stands to receive generous financing packages from Chinese lenders. Governments from developing nations throughout the two zones also are signing on enthusiastically, hoping to fund their own countries' infrastructure needs with Chinese money. Expectations are that the projects will be facilitated, the legal path will be smoothed and approvals will be fast-tracked in countries across the region.

Technology Sector Developments

On the technology front, many of the world's largest "unicorns" are now Chinese companies, with several raising significant capital in new investment rounds in 2017, most notably the $5.5 billion raised by Didi Chuxing. China's incumbent technology giants (Baidu, Alibaba and Tencent, often referred to collectively as "BAT") engaged in a number of major transactions during 2017, including two material acquisitions by Alibaba involving Hong Kong-listed companies operating retail businesses in China, which would appear to represent further steps in Alibaba's plan to merge its online operations with offline businesses.

Strong growth in the technology and new economy sectors also drove the greater Chinese equity markets, which remained buoyant throughout most of 2017, with Hong Kong's main Hang Seng Index exceeding 30,000 in November 2017 — a 10-year peak. Several deals — including initial public offerings (IPOs) by ZhongAn Online Insurance, China Literature and Yixin Group — achieved such significant levels of oversubscription from Hong Kong retail investors that they each locked up more than 10 percent of Hong Kong's entire monetary base during the course of their offerings. The success of the ZhongAn IPO — the first fintech IPO in Hong Kong — is likely to drive further deal activity in the fintech space in 2018.

Changes to Chinese Exchanges Could Spur Additional Capital Markets Activity

On December 15, 2017, the Hong Kong Stock Exchange announced that it was proposing amendments to Hong Kong's Listing Rules that would permit companies with dual-class share structures to list in Hong Kong. A historical aversion to such structures is perceived to have led to Alibaba's decision to list in New York. While this proposal remains subject to a consultation process expected to be undertaken in the first half of 2018, if implemented, Hong Kong could become an attractive listing venue for new economy companies with founders who retain control through shares with super-voting rights despite having had their economic interest significantly diluted through various rounds of funding.

Meanwhile, the late 2016 abolition of trading quotas under the Shanghai-Hong Kong Stock Connect scheme, which provides mainland Chinese investors with a mechanism to invest in Hong Kong-listed securities, also has given strong impetus to the Hong Kong market, resulting in net capital inflows of $81.7 billion as of the end of October 2017. Additionally, China's domestic A-share market hovered between 3,000 and 3,500 points for most of the year, significantly below the peaks of above 5,000 points in 2015 but with a stability unseen in recent years. Debt markets remained active, with around 4,600 fixed-income offerings in greater China compared to approximately 2,500 in 2016 — albeit with an overall value of approximately $1.5 trillion compared to $2.5 trillion in 2016. Deal volumes were driven in part by issuers looking to take advantage of current low rates before anticipated increases in future years. The successful $1.35 billion issue of senior notes in two tranches due 2024 and 2027, respectively, by Wynn Macau was one of the more notable transactions in the Hong Kong debt capital markets during the year that sought to take advantage of the low-rate environment.

Globalized Nature of Enforcement Requires Coordinated Response

Two factors have contributed to the increasingly globalized nature of law enforcement. First, a number of jurisdictions, with the United States in the lead, are taking increasingly aggressive positions on jurisdiction. For example, a foreign corporation or executive may become subject to the U.S. Foreign Corrupt Practices Act based on any of the following, so long as the authorities can show that it furthers the alleged bribery: a single meeting in the U.S., a money transfer that goes through a U.S. bank account or an email that passes through a server located in the U.S. Other criminal and regulatory statutes can be similarly expansive. Corporations that do not ordinarily think of themselves as having a U.S. presence sometimes are unpleasantly surprised that their fleeting U.S. contacts were sufficient to allow the U.S. authorities to assert jurisdiction over them.

For its part, China's corruption watchdog, the Central Commission for Discipline Inspection (CCDI), published guidance in December 2017 directing Chinese state-owned enterprises (SOEs) to implement safeguards to combat corruption in their foreign operations. According to a statement on the CCDI's website, SOEs need to "deeply understand the important urgency of controlling overseas risks" to "ensure the safety of China's assets, make our state enterprises strong and excellent, and cultivate world-class enterprises that are globally competitive." Until recently, China's anti-corruption campaign had focused on SOEs' domestic operations. This new directive may signal that, similar to their U.S. counterparts, the Chinese authorities are paying increasing attention to and cracking down on corrupt conduct overseas.

Second, like never before, law enforcement authorities are paying very close attention to enforcement activities in jurisdictions outside their own, and enforcement activity in one jurisdiction often generates spillover effects in another. The nature of the spillover varies. Sometimes, countries coordinate — as evidenced most recently by the Telia Company's $965 million global settlement in September 2017 with the U.S. and Dutch authorities for bribery-related offenses. Sometimes a jurisdiction piggybacks on another's already-completed investigation — as PTC learned in 2016 when, shortly after its settlement with the U.S. Department of Justice and U.S. Securities and Exchange Commission, the Chinese authorities requested information about PTC's operations in China.

And sometimes one jurisdiction's information demand runs afoul of another's laws and policies. This dilemma arises with increasing frequency for international auditing firms encountering competing demands by the U.S. accounting watchdog — the Public Company Accounting Oversight Board (PCAOB) — and the Chinese regulatory authorities. The PCAOB may request the production of audit work papers relating to certain Chinese auditing clients, and the Chinese authorities may forbid compliance with the demand on grounds of Chinese state secrecy laws. A memorandum of understanding (MOU) designed to resolve such impasses was entered into in 2013 between the PCAOB and the Chinese authorities. Nevertheless, in the past two years, two Hong Kong-based auditing firms, Crowe Horwath and PKF International, were sanctioned by the PCAOB for their alleged failure to comply, with the PCAOB rejecting these firms' argument that the MOU was the appropriate channel to initiate and resolve these document production requests and notwithstanding express objections by the Chinese authorities.

Practically speaking, what this means for multinational companies is that a regulatory inquiry from one jurisdiction is often no longer a self-contained event. Passively responding to an authority's information requests without thinking ahead and considering the implications in other jurisdictions can be a perilous strategy. Instead, companies are well-advised to, at the very outset of a government inquiry, consider the potential legal ramifications of its responses and sketch out a coordinated strategy.

Litigation Risks Continue Unabated

2017-18 Supreme Court Update

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In the 2017-18 term, the U.S. Supreme Court will decide a number of potentially significant disputes relevant to businesses, including those involving constitutional protections, class actions and other corporate liability issues.

Constitutional Issues

The Legality of Sports Gambling

A precept of constitutional law is that the federal government cannot "commandeer," or coerce, the states to take regulatory action that the 10th Amendment would otherwise reserve to them. In a pair of consolidated gambling cases — *New Jersey Thoroughbred Horsemen's Association, Inc. v. National Collegiate Athletic Association* and *Christie v. National Collegiate Athletic Association* — the Supreme Court will consider New Jersey's argument that the Professional and Amateur Sports Protection Act (PASPA) violates the anti-commandeering doctrine. PASPA prohibited states from authorizing betting on amateur or professional sports — effectively creating a nationwide ban on sports gambling — but exempted four states (New Jersey not among them) that already permitted such activity. It also exempted New Jersey's casinos, provided the state establish a regulatory scheme for sports gambling within one year of PASPA's enactment.

New Jersey sat idle for nearly 20 years, until voters approved a ballot measure in 2011 to legalize sports gambling. The National Collegiate Athletic Association and the four major professional sports leagues sued, citing the state's failure to take advantage of the one-year grace period and PASPA's prohibition on any sports gambling outside the four previously exempted states. New Jersey argued that PASPA impermissibly commandeered the states by prohibiting them from legalizing sports gambling. The U.S. Court of Appeals for the Third Circuit, sitting *en banc*, sided with the leagues, as had the district court below. A victory for New Jersey at the Supreme Court would pave the way for sports gambling in the Garden State and in others that follow its lead. It could also call into question other federal limitations on state activities on "commandeering" grounds. The case was argued on December 4, 2017.

Warrantless Search and Seizure

In Fourth Amendment cases decided in the 1970s, the Supreme Court held that, when one voluntarily shares information with a third party, law enforcement can obtain that information from the third party without obtaining a warrant — even if "the information is revealed on the assumption that it will be used only for a limited purpose and the confidence placed in the third party will not be betrayed" (*United States v. Miller*, 1976). But the ease and ubiquity of data sharing and collection in the era of computers and smartphones have raised questions about the practicability of this so-called "third-party doctrine." Justice Sonia Sotomayor, for example, argued in a 2012 concurring opinion in *United States v. Jones* that the third-party doctrine is "ill suited to the digital age, in which people reveal a great deal of information about themselves to third parties in the course of carrying out mundane tasks."

The Court will have an opportunity to reconsider the doctrine in *Carpenter v. United States*, which involves a decidedly digital-age investigative tool: cellphone records. The question presented in *Carpenter* is whether the Fourth Amendment permits the warrantless search and seizure of cellphone records revealing a user's location and movements over the course of 127 days. The case was argued on November 29, 2017, and the outcome will be closely watched by law enforcement, defense lawyers and privacy advocates.

The Future of *Inter Partes* Review

The rise of "patent trolls" — who file and receive patents for claims that are obvious, found in nature or "prior art," only to use those patents as an offensive weapon against alleged "infringers" in the hope of securing multiple, quick settlements — prompted Congress to create a more efficient adjudicatory process outside traditional patent litigation. The America Invents Act, signed into law by President Barack Obama in 2011, established *inter partes* review (IPR) as a way to efficiently challenge and invalidate patents, including those owned by patent trolls. IPR proceedings are conducted by the Patent Trial and Appeal Board, an administrative arm of the U.S. Patent and Trademark Office, rather than by a court or judicial body. In *Oil States Energy Services, LLC v. Greene's Energy Group, LLC*, the Supreme Court will consider whether IPR proceedings satisfy constitutional requirements, including the right to a jury trial. The case was argued on November 27, 2017, after business interests weighed in as *amici* on both sides of the case.

ALJs and the Appointments Clause

The Supreme Court will consider, in *Lucia v. SEC*, whether the appointments clause of the Constitution requires administrative law judges (ALJs) within the Securities and Exchange Commission (SEC) to be appointed by the entire commission, which had not been the practice until just weeks ago. In 2012, the SEC charged Raymond Lucia with violating the Investment Advisers Act and certain SEC rules. After a formal administrative hearing before one of the agency's ALJs, Lucia was barred from working as an investment adviser for life and received other severe penalties. The question in *Lucia* is whether the SEC's ALJs are mere employees (as the federal government has maintained through years of litigation) or "officers of the United States" within the meaning of the appointments clause (as the federal government conceded in a dramatic about-face in November 2017). If the ALJ in Lucia's case was an officer, then the ALJ was likely appointed in an unconstitutional manner. A decision in Lucia's favor could have ramifications well beyond the SEC, as ALJ proceedings take place in a range of federal agencies.

Partisan Gerrymandering

In a case with the potential to reshape American politics, the Supreme Court will consider, in *Gill v. Whitford*, challenges to partisan gerrymandering. When the issue came before the Court in 2004, Justice Anthony Kennedy — then, as now, the pivotal vote on the issue — called for workable standards "for measuring the burden a gerrymander imposes on representational rights." The appellees in *Gill* — who in the three-judge district court below successfully challenged the 2011 redistricting plan drawn by the Republican-controlled legislature in Wisconsin — contend that they have now developed the necessary standards. At oral argument on October 3, 2017, the Court seemed likely to once more divide along ideological lines, with Justice Kennedy again holding the decisive vote. Adding another twist to this issue, the Court recently agreed to hear one more partisan gerrymandering case, *Benisek v. Lamone*. Whereas *Gill* presents a statewide challenge to a Republican-drawn map, *Benisek* concerns a single congressional district drawn by the Democrat-controlled Maryland Legislature. Finally, the Supreme Court will also decide a pair of consolidated redistricting cases from Texas alleging racial, rather than partisan, gerrymandering.

Free Speech and Public Union Dues

For the second time in three terms, the Supreme Court will consider whether the First Amendment restricts the collection of mandatory union dues from nonmembers. Nearly 40 years ago, in *Abood v. Detroit Board of Education*, the Court rejected a First Amendment challenge to "agency shop" arrangements, which allow public sector unions to collect mandatory fees from nonmembers. Those "fair share" fees are meant to offset the costs of contract negotiation or administration that, in principle, benefit both union members and other employees. (Nonmembers cannot be forced to pay "non-chargeable fees" that support other union activities, like lobbying.) The question before the Court in *Janus v. American Federation of State, County, and Municipal Employees, Council 31* is whether to overrule *Abood* and hold that requiring nonmembers to pay any mandatory fees violates the First Amendment.

Notably, the Court was poised to answer this very question in the 2015-16 term, but Justice Antonin Scalia's death after the Court heard oral argument in *Friedrichs v. California Teachers Association* left the Court equally divided. Two years later, Justice Neil Gorsuch has taken Justice Scalia's seat and could deliver the fifth vote needed to overrule *Abood* and ban fair share fees.

Class Actions

The Securities Act and State Court Jurisdiction

Cyan, Inc. v. Beaver County Employees Retirement Fund presents a thorny issue of statutory interpretation left unsettled in the wake of two statutes designed to limit securities class actions. In 1995, the Private Securities Litigation Reform Act heightened the federal pleading requirements for securities fraud and made it more difficult for those actions to survive motions to dismiss. In response, litigation migrated to state courts, and Congress responded by passing the Securities Litigation Uniform Standards Act (SLUSA) in 1998. Among other provisions, SLUSA prohibited state courts from exercising jurisdiction over certain "covered" class actions — the precise scope of which is at issue in *Cyan*. The Court heard oral argument on November 28, 2017, with several justices noting the difficulty of parsing SLUSA's language.

Statutes of Limitation for Successive Class Actions

The Court recently agreed to hear another securities lawsuit, *China Agritech, Inc. v. Resh*, this time with implications for class actions generally. (See "Securities Class Action Filings Reach Record High.") The dispute concerns the tolling of statutes of limitations for successive class actions. In its 1974 decision in *American Pipe & Construction Co. v. Utah*, the Court held that the filing of a class action tolls the statute of limitations for members of the putative class. But appellate courts disagree whether the tolling benefits subsequent class actions or only subsequent individual claims. In an *amicus* brief urging the Supreme Court to hear the case, the U.S. Chamber of Commerce argued that the former approach would prompt perpetual litigation in the form of "stacked" class actions — and suggested that *American Pipe* itself may be ripe for reconsideration.

Corporate Liability

Corporate Liability Under the Alien Tort Statute

Whether corporations can be liable under the Alien Tort Statute (ATS), also known as the Alien Tort Claims Act, is the subject of *Jesner v. Arab Bank, PLC*. The ATS, enacted as part of the Judiciary Act, confers jurisdiction on federal district courts to hear a civil action by "an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." The Supreme Court has gradually limited the scope of the ATS — most recently in 2013 by closing the door on so-called "foreign-cubed" cases involving foreign acts, plaintiffs and defendants. *Jesner* asks whether, irrespective of extraterritoriality issues, a corporation (rather than a natural person) can ever be liable under the ATS. In *Jesner*, individuals and families of individuals killed in terrorist attacks overseas brought suit in the U.S. District Court for the Eastern District of New York against Arab Bank, a multinational financial institution headquartered in Amman, Jordan. The plaintiffs allege that the bank — which has a branch in New York — is liable under the ATS for those terrorist acts because it "provided a range of financial services to terrorists and terrorist front groups posing as charities." Although a majority of the justices appeared skeptical of ATS corporate liability at oral argument on October 11, 2017, the Court could issue a narrow opinion focusing on Arab Bank's limited U.S. connection.

Protections for Non-SEC Whistleblowers

In *Digital Realty Trust, Inc. v. Somers*, the Court will consider corporate liability under a far more modern statute — the Dodd-Frank Act, enacted in the wake of the 2008 financial crisis. The Dodd-Frank Act prohibits retaliation by employers against a whistleblower (defined as someone who reports misconduct to the SEC) in a number of contexts, including when the whistleblower makes "disclosures that are required or protected under" several other laws. Some of these laws, however, protect disclosures beyond those to the SEC. How does the definition of whistleblower apply under those circumstances? If the Court — which heard argument on November 28, 2017 — finds the statute ambiguous, it might defer to the SEC's interpretation, which does not require disclosure to the SEC for whistleblower protection.

Employment Agreement Arbitration Clauses

A trio of consolidated cases could have significant implications for arbitration clauses in employment agreements. *Epic Systems Corp. v. Lewis*, *National Labor Relations Board v. Murphy Oil USA, Inc.* and *Ernst & Young LLP v. Morris* address a tension between two landmark statutes: the Federal Arbitration Act (FAA) and the National Labor Relations Act (NLRA). The Supreme Court has previously held that arbitration agreements are presumptively enforceable under the FAA. The NLRA, meanwhile, protects the right of employees to engage in "concerted" action — such as class action litigation. The Court will consider whether employee arbitration agreements mandating that disputes with employers be resolved individually and through arbitration, effectively waiving employees' right to join a class action lawsuit, are valid notwithstanding the NLRA's protections. Oral argument took place on October 2, 2017.

Securities Class Action Filings Reach Record High

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As expected, securities class action filings reached a high-water mark in 2017. In fact, last year's total of 400-plus filings was the second-highest on record, topped only by 2001, when the number was skewed by more than 300 cases brought in connection with the allocation of shares in high-tech initial public offerings (IPOs). In the last 18 months, more securities suits have been filed in federal court than in any comparable period since the Private Securities Litigation Reform Act was enacted in 1995. About 8 percent of U.S. exchange-listed companies were hit with a securities suit in 2017, up for the third consecutive year.

Rise in Securities Class Actions

Various factors likely account for the continued trend of increased filings. A high number of merger objection lawsuits continues to be filed in federal court, as opposed to state court, following the Delaware Court of Chancery's *Trulia* decision (and its progeny, including in states other than Delaware) limiting the use of disclosure-only settlements. But securities filings are at a record high even without such lawsuits, in large part because plaintiffs' firms have recalibrated their business strategies to pursue cases with more remote payoffs, often filing actions on any significant stock price decline. In addition, a greater number of securities class action lawsuits are being filed against non-U.S. companies (61 in 2017, compared to 47 in all of 2016). The health care sector has been hit with a high number of class action lawsuits (100 in 2017, compared to 84 in 2016), perhaps due to some of the uncertainty surrounding health care regulations. And event-driven securities fraud suits following the disclosure of any corporate crisis — including data breaches and environmental, antitrust, Foreign Corrupt Practices Act or other regulatory issues — continue to rise. Finally, life sciences, technology and other companies that may have highly volatile results depending on the success of certain products remain particularly susceptible to securities actions and continued to be targeted frequently in 2017. We anticipate all of these trends will persist in 2018.

Significant Decisions

A number of important decisions in securities litigation are expected this year. The delineation of statutes of repose and tolling will continue to percolate through the courts, including the U.S. Supreme Court. In 2017, the Court held in *CalPERS v. ANZ* that statutes of repose, unlike statutes of limitations, are not subject to equitable tolling. Thus, *American Pipe* tolling — the tolling of the statute of limitations for unnamed class members pending class certification in a putative securities class action — does not apply to the three-year statute of repose applicable to claims brought under Sections 11 and 12 of the Securities Act. While Justice Anthony Kennedy authored the majority opinion, it perhaps more significantly marked Justice Neil Gorsuch's first securities opinion, in which he joined the majority in the 5-4 outcome.

In the upcoming term, the Court will have another opportunity to opine on the contours of the tolling of statutes of limitations and possibly repose in the securities context, having granted *certiorari* in *China Agritech, Inc. v. Resh*. (See "2017-18 Supreme Court Update.") The Court will decide a split in the circuit courts as to whether *American Pipe* tolling can apply to successive class actions as opposed to individual actions. The case also marks the continuation of the Court's trend under Chief Justice John Roberts of taking up an average of two securities cases per term, more than previous courts. Further interpretation of the bounds of statutes of limitations and repose — including whether the statute of repose can bar class certification after the three-year period expires — is expected in 2018.

Given the reality of globally connected financial systems, the extraterritorial application of U.S. securities laws to nonexchange-traded securities will continue to be a closely watched development in 2018. Last year, for example, the U.S. Court of Appeals for the Second Circuit found in *In re Petrobras Securities* that the need to determine if a transaction was "domestic" raised individual issues that had to be addressed before a class was certified. (See our July 10, 2017, client alert "Second Circuit Clarifies Class Certification Requirements in Significant Securities Class Action Decision.") This area of securities litigation will continue to develop in 2018. Similarly, we will continue to see issues surrounding market efficiency as a battleground on the class certification front.

While 2017 resulted in several defense-oriented decisions, there is no reason to expect the pace of filings to abate. Indeed, as the stock market indices rise, similar percentages of declines in stock prices could result in larger so-called investor losses that attract the plaintiffs' bar. Further, plaintiffs may have the opportunity to bring more actions under the Securities Act if there is an increase in the number of IPOs. (See "US Capital Markets Expected to Remain Robust in 2018.") In addition, the trend of event-driven or corporate crisis follow-on securities litigation is expected to continue. As a result, 2018 should be robust in both filings and developments in the law.

The Rise of Trade Secret Litigation in the Digital Age

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U.S. courts have recognized trade secret protection for more than 200 years, and companies have long relied on trade secrets to guard iconic intellectual property, such as the ingredients for Coca-Cola and the Big Mac's special sauce. Yet it was not until 2016 that Congress authorized a federal civil cause of action for trade secret misappropriation, in the form of the Defend Trade Secrets Act (DTSA). A combination of increased technological and employee mobility, compounded by reduced patent protection, prompted the need for federal trade secrets legislation after centuries of enforcement under common law and state statutes.

The availability of federal jurisdiction under the DTSA and powerful DTSA procedural tools, like *ex parte* seizure of allegedly purloined trade secrets, mean that conditions are ripe for trade secret litigation to increase.

Technological Innovation and Legal Changes Promote Trade Secret Litigation

Information and Employee Mobility Enable Technological Theft

A combination of two important trends around the turn of the 21st century spurred an increase in technology theft. First was an increase in employee mobility. Regular job changes have become de rigueur, particularly in high-tech industries. Moreover, employees often move to competitors of their prior employer. With each employee who walks out the door, valuable company information may follow — sometimes in the mind of the departing employee, but often in the form of documents and files.

Second, electronic document storage dramatically improved. The ability to fit an airplane hangar's worth of paper documents onto a single USB drive or remove reams of information from a company's premises using email and online file transfer services increases the risks associated with employee mobility. Well-intentioned email and file destruction policies may even erase, or at least obscure, evidence of an improper information transfer. More than 85 percent of misappropriation cases are estimated to involve a trade secret owner's employee or business partner, according to a 2016 study by economic and financial consulting firm Cornerstone Research. This is happening every day, and associated litigation is on the rise.

Reduced Patent Protection Incentivizes Reliance on Trade Secrets

In 2014, the U.S. Supreme Court decided *Alice Corp. Pty. Ltd. v. CLS Bank International*, which drastically curtailed patent protection for software and business methods. As a result, many companies have lost confidence in the ability to protect their technology with patents and are instead turning to trade secrets. The comparative lack of acquisition costs for trade secrets as opposed to patents only enhances their appeal.

Likewise, patent litigation has become procedurally less attractive for some plaintiffs. In 2017, the Supreme Court decided *TC Heartland LLC v. Kraft Foods Group Brands LLC*, which narrowed the available venues for patent litigation. Whereas before, patent litigants could file a patent lawsuit anywhere infringement had occurred, now defendants may only be sued where they are incorporated or have a physical place of business.

(See our September 2017 *Insights* article "Interpretations of *TC Heartland* Add Uncertainty to Patent Litigation.") This limits a patent owner's ability to select a home court or a plaintiff-friendly venue, and may add expense by requiring enforcement in a distant jurisdiction.

Together, the reduced ability to protect technology with patents and the increased cost and unpredictability of patent litigation have made the trade secret alternative more appealing. While only available when there has been an affirmative act of misappropriation — as opposed to the strict liability nature of patent infringement — compelling arguments to opt for trade secret enforcement over patent enforcement can be made when the option exists.

The Increasing Popularity of Trade Secret Litigation

According to federal judicial caseload statistics, the rates for both federal and state trade secret litigation have skyrocketed. In fact, the number of federal trade secret cases increased by 14 percent for each year from 2001 to 2012, according to a spring 2016 analysis by Willamette Management Associates. Moreover, trade secret litigation tends to concern precisely the type of newly available and easily transportable technology discussed above. Some studies indicate that from 2001 to 2015, as much as 50 percent or more of federal and state trade secret litigation concerned technical know-how and software.

Additionally, trade secret plaintiffs have been highly successful. In the year following the 2016 enactment of the DTSA, 280 unique federal trade secret cases were identified in a *Cybersecurity Lawyer* study. Of the cases that have made it to trial, the trade secret holder won 69 percent of the time and recovered money damages in the majority of instances, according to the November 14, 2017, *Law360* article "Why Trade Secret Litigation Is on the Rise." By comparison, in civil lawsuits in general, plaintiffs historically prevail less than half the time.

Only 61 out of the 280 cases identified in the study — about 22 percent — were dismissed. This is lower than the historical average dismissal rate for complex civil litigation in federal courts (27 percent, according to litigation research company Lex Machina); however, given the early stage of most of these cases, it is too soon to tell whether DTSA case dismissal rates will vary from historical ones. Data on preliminary injunctions is ripe, however, and rather surprising. Upon enactment of the DTSA, it was generally expected that courts would be more inclined to grant preliminary relief, at least in part because the urgency of action in these cases was underscored by the availability of *ex parte* injunctions — whereby U.S. marshals are empowered to seize allegedly misappropriated goods with little or no notice to the accused. Yet only five preliminary injunctions — about 2 percent — were granted in the 280 cases, according to the *Cybersecurity Lawyer* study. This is much lower than the 10 percent general rate at which preliminary injunctions were granted for trade secret owners from 1950 until 2008, according to a 2010 paper by O'Melveny & Myers LLP. A larger sample size of cases will reveal more reliable statistics, but it is noteworthy that the general expectation of an increase in preliminary injunctive relief under the DTSA is not reflected in the data to date.

Conclusion

Patents will continue to be the dominant form of intellectual property protection in certain industries. But the realities of today's legal and technological world suggest that trade secrets will continue to gain importance in coming years.

Companies must be cognizant of the risks associated with the movement of confidential information. The success rate and damages awarded in recent trade secret litigation indicate that defendants should take trade secret matters seriously. The data also should give heart to aggrieved parties seeking recompense for stolen and misused information, as should the unprecedented *ex parte* seizure provisions that are part of the DTSA.

Key Considerations to Protect Against Insider Threats in Cybersecurity

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Most companies have strengthened their cybersecurity defenses against outside hackers, but many often neglect the equal threat posed by those within their network walls — employees who already have privileged access to proprietary systems and whose activity often goes undetected by security systems designed to identify outside attackers. According to a March 2017 study by IBM Security, in 2016 more than half of the cyberattacks against the financial services and health care industries were carried out by employees who maliciously stole or unwittingly distributed sensitive data. Companies in these and other industries find themselves increasingly vulnerable from the inside as the value and volume of their data grows.

The strategy for addressing the growing problem of insider threats must be multidisciplinary, drawing on a combination of employee policies and training, human resources techniques, and technical measures. Companies should consider the following four steps:

1. Set Clear Guidelines in Confidentiality Agreements. Organizations should consider requiring new employees to sign confidentiality or nondisclosure agreements that identify and specify the circumstances under which an employee may access valuable information, such as customer data or trade secrets. These agreements must be carefully crafted, for they often become the linchpin in a lawsuit against an insider who makes off with company secrets. Common provisions that may be critical in litigation include definitions of the technology and proprietary information as well as descriptions of their proper uses, procedures for documenting the authorized use of the information, and destroy or return provisions.

2. Set Data Access Restrictions and Monitor Employees for Suspicious Activity. Data access restrictions play a critical role in thwarting insider threats. Employees should be authorized to use only the resources needed to do their jobs, a notion that is often referred to as the principle of "least privilege." That principle may be enforced using network segregation or software to log access to confidential documents or databases.

Equally important for an organization is a security information and event management solution, which aggregates data from a variety of sources — including databases, applications, networks and servers — to continuously monitor employee network activity. To take full advantage of these tools, the data must be reviewed to establish a "baseline" for regular, sanctioned activity. Doing so will allow monitors to identify irregular use, such as connections to unusual IP addresses at unusual times, abnormally large data transfers or unauthorized uses of encryption. Monitors ought to pay special attention to remote access, terminated employees and highly privileged users.

3. Enforce Clear Written Policies and Procedures With Signed Acknowledgment. Employers should design and enforce all organizational policies and procedures in a clear and consistent manner. Many insider incidents result from misunderstood or poorly communicated policies. In several documented cases, insiders have taken to a new employer proprietary information that they had a hand in creating, unaware that their previous employer owned it. (See "The Rise of Trade Secret Litigation in the Digital Age.") Organizations ought to provide documentation of and reasoning for all policies, and ensure they are consistently enforced. These policies may be reinforced through training that incorporates awareness of both malicious and unintentional insider threats.

4. Prepare for Employee Departures With Separation Agreements and Asset Collection Policies. Exit interviews serve as an invaluable, and often overlooked, method of limiting the security threat of outbound employees, regardless of the circumstances surrounding their departures. The interview allows the employer to reinforce confidentiality provisions and procedures and collect all company assets. The company also may ask for a final signed assurance that no confidential information or trade secrets are being removed from company control. At the same time, the company's information technology team should ensure that departing employees have all privileges and access revoked.

* * *

The frequency and cost of attacks from insiders will likely grow in 2018, particularly because an increasing number of companies are encountering an operational need to give employees, partners, suppliers and contractors remote access to their networks. The safeguards discussed above should help put companies in the best position to prevent or mitigate this growing problem.

Growing Acceptance of Arbitration in International Commercial Financial Transactions

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Financial institutions have historically been skeptical about arbitration in the commercial context. As a result, the documentation used in commercial financial transactions has generally required that disputes be submitted to the courts of a particular jurisdiction. In recent years, however, these institutions have shown an increased interest in considering the relative merits of arbitration for certain complex international financial transactions, and a number of initiatives have developed in response.

Historically, financial institutions have been reluctant to use arbitration due to concerns relating to the risk of unpredictable outcomes and to a perceived lack of financial expertise among arbitrators. In contrast, financial institutions place a high degree of confidence in New York and England courts and believe that, due to the application of precedent, the courts provide consistency and uniform development of the law. Courts also have been preferred for the availability of summary or default procedures for many types of disputes and the ability to appeal trial court decisions.

Various studies have shown, however, that such assumptions are being reconsidered and that an interest in arbitration has increased in the financial services sector. In 2017, the International Chamber of Commerce's Commission on Arbitration and ADR published a report titled "Financial Institutions and International Arbitration," which examined "financial institutions' perceptions and experience of international arbitration" and suggested that financial institutions "increasingly" have "view[ed] international arbitration as an important alternative to litigation."

This shift is a result of several factors. First, when the courts were flooded with disputes over complex financial products following the 2008 financial crisis, assumptions about the advantages of having disputes heard by the courts proved inaccurate. Far from being predictable, there was a sense that the courts at times rendered inconsistent judgments and had limited expertise with complex financial products and not enough time to devote to such disputes due to overburdened dockets. The appellate courts were perceived to have similar issues. Summary adjudication procedures often proved ineffective, leading to extensive and expensive discovery. Moreover, unlike in arbitration proceedings, courts are reluctant to allow parties to keep information from the public eye, meaning that confidentiality was not readily available.

Additionally, the increase in business in emerging markets has given rise to new considerations concerning the ease of judgment enforcement across borders; courts in emerging markets may not readily recognize and enforce U.S. or English judgments. At the same time, courts in these markets may themselves lack expertise with commercial matters and the independence that financial institutions expect in New York and England. In some instances, parties in emerging markets may now have more leverage and bargaining power with counterparties, such that counterparties may no longer be able to impose a preference for litigation in New York or London.

In light of these developments, some industry organizations have taken the initiative to include provisions for arbitration in their standard documentation.

For example, in 2013, the International Swaps and Derivatives Association (ISDA) released its ISDA Arbitration Guide, which was the result of consultation with ISDA members beginning in 2011. It provides guidance on the use of arbitration clauses with the ISDA 2002 Master Agreement or ISDA 1992 Master Agreement and includes 11 model clauses. More recently, in 2017, the Loan Syndications and Trading Association issued new trading documents for loans governed by New York law and made to borrowers in Chile, Colombia or Peru, which provide for arbitration under the rules of the International Centre for Dispute Resolution. In both instances, these associations appear to be tapping into the features of arbitration — such as the relative ease of worldwide enforcement — that make it attractive in cross-border transactions.

Another significant initiative aimed at addressing the perceived lack of arbitrators with expertise in complex financial products has been the establishment of P.R.I.M.E. Finance (Panel of Recognised International Market Experts in Finance), a nonprofit Dutch foundation launched in January 2012. Among the services it provides is dispute resolution, including a panel of arbitrators with expertise in resolving complex financial cases and arbitration rules customized for these disputes. As of December 2015, arbitrations under P.R.I.M.E. Finance Arbitration Rules have been administered by the Permanent Court of Arbitration located in the Peace Palace in The Hague.

Finally, various arbitral institutions also have recently promulgated rules that may make arbitration more attractive to financial institutions. Examples include new rules addressing multicontract arbitration, providing for summary disposition of certain claims and offering expedited procedures.

These developments may address some of the reluctance by financial institutions to use arbitration. While certain transactions will not lend themselves so readily to arbitration, for other types of disputes, it may be an option that should be explored when drafting dispute resolution provisions.

‘Home Country’ Arbitration Clause More Trouble Than It’s Worth?

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Courts in many countries, including the U.S., generally enforce contracts with clauses specifying international arbitration as the preferred avenue for resolving disputes. Accordingly, when drafting such provisions, due consideration must be placed on ensuring that such clauses are drafted to fully reflect the parties’ desires.

In addition to making clear what kinds of disputes are to be arbitrated and which institutional rules (if any) will govern the proceedings, any agreement between two parties also should identify where the arbitration proceedings are to take place. Many clauses simply state that all disputes will be arbitrated in a single location (commonly New York, London or Hong Kong). Some, however, adopt more elaborate procedures. One mechanism, known as the “home country” provision, provides that the party initiating arbitration must sue the other party in its home country. Proponents of such clauses say they provide a disincentive to elevate disputes because a party will be reluctant to go to the other side’s home country. Though they are not widely used in large transactions (and are not recommended in arbitral literature or by arbitral institutions), they are occasionally present.

Complications can arise from such clauses, as evidenced by a 2017 case in the U.S. Court of Appeals for the Eleventh Circuit that may end up before the U.S. Supreme Court. The clause at issue in *Bamberger Rosenheim, Ltd. v. OA Development, Inc.* was included in a solicitation agreement between Profimex, an Israeli company engaging in fundraising for real estate developments, and OAD, a U.S. real estate developer based in Atlanta. The clause stated:

> Any disputes with respect to this Agreement or the performance of the parties hereunder shall be submitted to binding arbitration proceedings conducted in accordance with the rules of the International Chamber of Commerce. Any such proceedings shall take place in Tel Aviv, Israel, in the event the dispute is submitted by OAD, and in Atlanta, Georgia, in the event the dispute is submitted by Profimex.

When disputes arose between the parties, Profimex instituted an International Chamber of Commerce (ICC) arbitration against OAD in Atlanta alleging breach of contract. OAD responded with a counterclaim for defamation.

The ICC appointed a single arbitrator in Atlanta. Profimex then moved to dismiss OAD’s counterclaim, arguing that the arbitration clause required that the dispute be brought in Israel. The arbitrator, however, determined that “venue for the defamation counterclaim was proper in Atlanta, in part, because the ‘dispute’ was submitted by Profimex.” He ultimately dismissed Profimex’s claim but upheld the counterclaim and awarded $950,000 in damages to OAD.

Profimex sought to vacate the award in the U.S. District Court for the Northern District of Georgia, on the ground that the arbitrator had exceeded his authority. The award was upheld in both the district court and the Eleventh Circuit. The Eleventh Circuit regarded the question of “venue” as being a “procedural” question that was presumptively a matter for the arbitrators, not the courts, to determine. Accordingly, it deferred to the arbitrator’s determination about the admissibility of the counterclaim and upheld the award rendered in Atlanta.

On appeal, Profimex relied heavily on a 2010 decision by the U.S. Court of Appeals for the Ninth Circuit, *Polimaster Ltd. v. RAE Systems, Inc*., in which the contract provided that arbitration was to be conducted "at the defendant's site" — that is, the location of the defendant's principal place of business. When Polimaster, which was based in Belarus, brought arbitration claims against California-based RAE in that state, RAE filed counterclaims. The Ninth Circuit ultimately held that the arbitrator should not have allowed RAE's counterclaims to proceed because the arbitration agreement required that all requests for affirmative relief, whether claims or counterclaims, be arbitrated at the defendant's site (which would have been Belarus in the case of RAE's counterclaims against Polimaster).

The Eleventh Circuit noted that *Polimaster* was "somewhat similar to the provision in the present case," but in *Bamberger*, it rejected Profimex's attempts to rely on the case. In its view, *Polimaster* was either distinguishable (on the basis of the particular wording of the clause in that case) or wrongly decided — especially since the Ninth Circuit failed to analyze whether the question of venue in *Polimaster* should have been decided by the arbitrator.

Although Profimex later filed a petition with the U.S. Supreme Court seeking *certiorari* (claiming that there was a circuit "split" between the *Bamberger* and *Polimaster* decisions), the Court denied that petition, meaning that the Eleventh Circuit's decision is now final.

Bamberger and *Polimaster* demonstrate that "home country" arbitration clauses may prove cumbersome to administer in practice and may result in unintended consequences for the parties. Indeed, although varying approaches of the circuit courts in the two cases might be explained by the fact that the clauses were differently worded, the outcomes nevertheless show that the courts' interpretation of "home country" clauses can be difficult to predict. Accordingly, parties may continue to opt for the relative simplicity of specifying that all disputes be adjudicated in a single neutral venue.

8 US Regulatory Action ... and Inaction

Trump Administration Rolls Back Climate Change Initiatives

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As expected, the Trump administration has been actively engaged in efforts to reverse the federal government's regulatory direction with respect to climate change. In 2017, President Donald Trump announced plans to withdraw from the Paris climate accord and proposed reducing the Environmental Protection Agency's (EPA) budget. Under Administrator Scott Pruitt's leadership, certain EPA regulations are being reconsidered or proposed for repeal. A shift away from the previous administration's efforts on climate change is expected to continue in 2018.

The Endangerment Finding

In 2009, the EPA determined that the emission of six greenhouse gases, in combination, endangers the health and welfare of future generations (the Endangerment Finding). The finding has since become the basis for the regulation of emissions from a range of sources, both mobile (such as vehicles) and stationary (most notably power plants). The finding's significance is that, depending on the section of the Clean Air Act being invoked, it serves as a basis for the EPA to exercise discretionary authority to regulate greenhouse gas emissions and may (as in the case of regulating greenhouse gas emissions from mobile sources) obligate the EPA to regulate such emissions. The Endangerment Finding provides a basis for more climate activist administrations to use the Clean Air Act to attempt to reduce greenhouse gas emissions and for environmental activists to use the courts to attempt to force action by more reluctant administrations.

Whether the Trump administration will attempt to reverse the Endangerment Finding is uncertain. Conservative organizations have filed a number of petitions calling for it to be revoked. At a December 7, 2017, hearing before the House Energy and Commerce Committee, Administrator Pruitt criticized the EPA's reliance on the reports of the United Nations Intergovernmental Panel on Climate Change (IPCC) to make the Endangerment Finding, notwithstanding that the U.S. Court of Appeals for the District of Columbia Circuit previously rejected a challenge to the Endangerment Finding based on this premise in 2012. Administrator Pruitt also stated that he intends to conduct a "red team/blue team" exercise in 2018, during which climate skeptics and climate scientists will debate the validity of mainstream climate science.

Nonetheless, the extensive administrative record developed by the EPA in 2009 in support of the Endangerment Finding will likely be a formidable obstacle to attempts to reverse it. More recent climate evaluations, including the 2014 IPCC report and the first volume of the Fourth National Climate Assessment — produced by the interagency U.S. Global Change Research Program and released in November 2017 — are consistent with the conclusions of the Endangerment Finding. Its durability will be an important issue to monitor in the coming battles over federal climate change regulatory policy.

The Paris Climate Accord

On the international front, President Trump has announced his intention to withdraw from the Paris climate accord, and U.N. Ambassador Nikki Haley formally notified the United Nations in

August 2017 that the U.S. intends to do so "unless the United States identifies suitable terms for reengagement." However, there is little reason to believe that the parties would be able or willing to renegotiate the agreement for the benefit of the United States. The earliest the U.S. can submit its withdrawal notice is November 4, 2019, with the effective date no earlier than one year from the date the notice is submitted.

Climate Change and the Budget

The Trump administration has proposed reducing the EPA's 2018 budget by over 30 percent, including a proposed staffing cut of 25 percent. The administration has specifically targeted for elimination the EPA's Global Climate Change Research Program and various climate-related partnerships with outside groups, such as the EPA's state and local climate and energy programs. The justification for these proposed cuts is that climate change and sustainability are not among the EPA's core statutory obligations to protect air, water and land. The administration also has proposed substantial cuts to the Department of Energy's Office of Energy Efficiency and Renewable Energy; cuts to NASA earth science missions, including missions to track the distribution of carbon dioxide emissions and to better understand climate change; a reduction in support for climate science at the Department of the Interior; a reduction in funding for the U.S. Geological Survey's carbon sequestration research; and cuts to climate change programs at the U.S. Agency for International Development and the State Department.

EPA Regulatory Developments

Regulation of Carbon Dioxide Emissions From Power Plants

On the regulatory front, the Trump administration is taking aim at some of President Barack Obama's most significant actions in the regulation of carbon dioxide emissions from power plants. At the administration's request, the D.C. Circuit issued an order in April 2017 freezing the litigation challenging the Clean Power Plan, the EPA's emissions guidelines governing the regulation of carbon dioxide emissions from existing fossil fuel-fired power plants. On October 16, 2017, the EPA proposed repealing the Clean Power Plan on the basis that the regulation — which would require electric power generators and the electric generator sector to shift to low- or zero-emitting electricity generation sources, such as wind and solar — exceeded the agency's statutory authority.

On December 18, 2017, Administrator Pruitt signed an advance notice of proposed rulemaking soliciting information about a possible future rule providing emission guidelines to regulate greenhouse gas emissions from existing power plants. The notice seeks comment on potential technologies and strategies that feasibly could be applied at individual sources, with a primary focus on heat rate or efficiency improvements. The proposal also seeks comment on the respective roles of the states and the federal government in establishing performance standards for existing power plants.

The D.C. Circuit also agreed in April 2017 to the Trump administration's request to freeze the litigation challenging the 2015 regulation establishing carbon dioxide limits for new, modified and reconstructed coal-fired and natural gas-fired electrical generating units (Carbon New Source Performance Standard). In an October 23, 2017, court filing, the EPA stated that it was still conducting its review of this regulation. One difference between the Clean Power Plan and the Carbon New Source Performance Standard is that the Supreme Court issued a stay of the Clean Power Plan in February 2016, while the Carbon New Source Performance Standard remains in effect. The practical import of this distinction is limited, given that coal-fired power plants are being retired rather than constructed, but it is important to note that under the Clean Air Act, the EPA cannot issue a regulation governing carbon dioxide emissions from existing power plants without first having promulgated a regulation for new, modified or reconstructed power plants.

Regulation of Methane Emissions From Oil and Gas Drilling

As a result of industry petitions for reconsideration, the EPA also issued an administrative stay of the Obama-era regulation that established limits on fugitive greenhouse gas methane emissions from new oil and gas drilling operations. However, in July 2017, the D.C. Circuit vacated this stay and held that the rule will remain in effect until the EPA completes a new rulemaking to revise the regulation. In June 2017, the EPA issued a proposed rule to stay the regulation pending its reconsideration, and in November 2017, it issued a notice of data availability soliciting further comment on the proposed stay and other aspects of the regulation.

NEPA and the Social Cost of Carbon

On March 28, 2017, President Trump issued his executive order "Promoting Energy Independence and Economic Growth." Among other moves, the order disbanded the Interagency Working Group on Social Cost of Carbon and withdrew the group's technical documents, which were being used to evaluate the impacts of carbon pollution in connection with federal actions. The most recent technical document had established the social cost of carbon at $36 per ton. On April 5, 2017, the Council on Environmental Quality (CEQ) withdrew the document it had issued in August 2016 providing guidance to federal agencies on evaluating greenhouse gas emissions and climate change impact of projects when conducting reviews under the National Environmental Policy Act (NEPA).

The withdrawals of the NEPA guidance and social cost of carbon technical documents do not mean that federal agencies will be able to avoid consideration of climate change when conducting NEPA reviews. However, the absence of guidance may mean less consistency in such evaluations. Given the administration's skepticism toward global warming, it also is possible that the evaluation of the impact of federal actions with respect to climate change could be given short shrift in NEPA environmental reviews, which could make such assessments (and the underlying projects that require them) more vulnerable to legal challenge.

Trade Barrier on Solar Cells and Modules to Significantly Impact US Solar Industry

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On January 22, 2018, U.S. Trade Representative (USTR) Robert E. Lighthizer announced that President Donald Trump had decided to impose safeguard remedies, or temporary trade barriers, with respect to imports of crystalline silicon photovoltaic cells and modules — key components for solar panels. The president's decision follows a petition for remedies brought by the U.S. manufacturers Suniva, Inc. and SolarWorld Americas, Inc. in April 2017 and subsequent recommendations by the International Trade Commission and the Office of the USTR.

Given the significant impact that these safeguard remedies will have on the market conditions for solar cells and modules in the U.S., stakeholders in the solar industry should be prepared to analyze and adjust to the remedies that will be imposed.

Background

Section 201 of the Trade Act of 1974 authorizes the imposition of temporary trade barriers to protect U.S. industries that are injured — or threatened with serious injury — by increased imports. These safeguards are intended to protect the domestic industry by reducing the flow of global imports, thereby relieving pressure on U.S. producers and giving them time to "make a positive adjustment to import competition." Unlike other trade remedies, safeguards do not require a finding that foreign producers and exporters have engaged in unfair trade practices. However, the level of injury experienced by the U.S. industry must be more significant. Potential safeguard remedies that could be imposed include, but are not limited to, increased tariffs, quotas, tariff-rate quotas (TRQs), import licenses and international negotiations. While the president is required to consider recommendations for safeguards from the commission and USTR, he is not held to them and can choose other forms of remedies or decide not to impose any relief. Remedies are put in place for four years, with the possibility of an extension.

The Solar Safeguards Case

According to data gathered by the commission, annual U.S. consumption of solar cells and modules in new solar power installations increased from 2.7 GW in 2012 to 13.5 GW in 2016 — a nearly 400 percent increase. Over the same period, the average price of solar cells and modules in the United States fell by roughly a third due to both declining costs and competition from imports. In 2012, solar power represented 9 percent of all newly installed electricity-generating capacity in the United States. By 2016, that figure had grown to almost 40 percent, with more solar power capacity installed in 2016 than any other electricity generator, including natural gas, wind and coal. Significantly, however, the vast majority of the increase in U.S. consumption of solar cells and modules has been supplied by lower-priced imports. In 2016, imports comprised over 95 percent of all solar cells and modules consumed in the United States.

In April 2017, based on these trends, Suniva and SolarWorld filed a petition with the International Trade Commission for safeguards regarding imports of solar cells and modules. The commission later determined that U.S. producers of solar cells and modules had been injured as a result of increased imports of such products into the United States. Three commissioners recommended in a report to President Trump on November 13, 2017, that a TRQ with tariffs of up to 30 percent be applied to imports of solar cells and that a flat-rate tariff of up to 35 percent be applied to imports of solar modules. A fourth commissioner recommended that imports be subject to a maximum quota of 8.9 GW and to a licensing system whereby each import license is auctioned at a minimum of $0.01/W.

The USTR then solicited comments from interested parties and held a public hearing on the appropriate remedy that should be imposed in order to make its own recommendation to the president. In addition, the USTR asked the commission for additional information regarding "any unforeseen developments that led to the articles at issue being imported into the United States in such increased quantities as to be a substantial cause of serious injury," which has resulted in successful challenges of prior U.S. safeguards at the World Trade Organization. The commission issued a supplemental report on December 27, 2017, in which it stated that the "unforeseen developments" included the fact that "the government of China implemented a series of industrial policies, five-year plans, and other government support programs favoring renewable energy product manufacturing, including [solar cells and modules]."

On January 22, 2018, President Trump approved applying safeguard tariffs for the next four years with the following terms: The remedies will include a tariff of 30 percent in the first year, 25 percent in the second year, 20 percent in the third year and 15 percent in the fourth year. Additionally, the first 2.5 GW of imported solar cells will be exempt from the safeguard tariff in each of those four years.

Implications

President Trump's decision to impose safeguard tariffs will have a significant impact on the solar industry over the next several years. Some industry analysts have predicted that safeguard tariffs will result in a decrease in the consumption of solar cells and modules and the cancellation or delay of planned solar projects during this time period. As a result, companies and investors should begin taking steps to reduce the impact on their businesses and potentially even take advantage of the changed market conditions. Key players in the solar industry should consider the following as a result of the remedies:

- Because the first 2.5 GW of imported solar cells will be exempt from the safeguard tariffs, importers of solar cells may want to consider acting quickly to obtain products before the tariffs begin to apply.
- Consumers are expected to face higher prices and potential supply shortages for solar cells and modules. This may lead them to re-evaluate the viability of their planned solar installation projects and perhaps cancel or delay projects. The Solar Energy Industries Association recommends that consumers establish relationships with a diverse set of suppliers to ensure an adequate supply of panels, including manufacturers in the U.S. and in any countries that are excluded from the safeguards.
- Investors and other sector participants may be presented with new opportunities following increased prices and tightening supply conditions that will likely be created in the U.S. market. The imposition of safeguard remedies may cause a spike in demand for U.S.-manufactured solar products and imports from excluded countries or for substitute products not subject to the safeguards, such as thin-film solar panels that do not use solar cells and modules and are thus outside the scope of the Section 201 investigation.

As Congress Struggles With ACA Repeal, Trump Administration Moves Forward With Regulatory Reform

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The Trump administration and Republican-led Congress spent substantial time and political capital in 2017 on efforts to repeal and replace the Affordable Care Act (ACA) and enact sweeping Medicaid reform. By the end of the year, their efforts yielded a more modest but symbolically important repeal of the ACA's individual mandate to purchase health insurance. While comprehensive reform — with a slim Republican majority in Congress during an election year — appears unlikely, health care is certain to be an ongoing policy and political battleground in 2018, with numerous pending proposals awaiting action. In the meantime, the administration has moved aggressively on its health care reform and deregulation agenda.

Congress Makes High-Profile but Limited Progress on ACA Repeal

The House of Representatives passed a sweeping bill that not only called for repealing and replacing the ACA but also for making fundamental changes to Medicaid by converting it from an entitlement program to a largely state-run block grant. The legislation foundered in the Senate without the 50 votes needed to pass it through the budget reconciliation process. Republicans were successful, however, in including a repeal of the individual mandate in the Tax Cuts and Jobs Act, which President Donald Trump signed into law on December 22, 2017.

Significant unfinished business for 2018 includes bipartisan proposals sponsored by Sens. Lamar Alexander, R-Tenn., and Patty Murray, D-Wash., to stabilize health insurance markets through a replacement of the cost-sharing reduction payments that the administration ended in 2017 (a proposal made all the more important by repeal of the individual mandate, which will reduce the number of younger, relatively healthy individuals participating in the ACA markets) and a long-term extension of the Children's Health Insurance Program (CHIP), which provides supplemental coverage for children in need who don't qualify for Medicaid. CHIP enjoys bipartisan support and is expected to be funded.

Administration Moves Aggressively on Health Care Regulatory Reform

While Congress struggled to enact sweeping health care reform, the Trump administration has begun to flex its regulatory muscles to reform several segments of the health care industry. On October 12, 2017, the president signed an executive order directing a trio of federal agencies to (1) craft rules to allow more employers to band together and purchase association health plans across state lines that are less regulated than those on the ACA marketplaces, (2) allow employees to use health reimbursement arrangement funds to pay for health care premiums, and (3) increase the availability of coverage under short-term, limited-duration health insurance.

The administration also pushed forward with payment model reforms begun under President Barack Obama. The Centers for Medicare and Medicaid Services (CMS) scaled back mandatory payment models for orthopedic and cardiac care procedures in favor of alternative, volunteer models and has plans for other market-driven reforms. More Medicare payment model changes are likely in 2018. CMS Administrator Seema Verma has stated her intention to provide states with greater flexibility under Medicaid, encouraging the type of innovations she implemented in Indiana's Medicaid program.

FDA Acts to Expand Access to Drugs and Expedite Medical Device Approvals

One area of significant regulatory action has been at the Food and Drug Administration (FDA) under its new commissioner, Scott Gottlieb. He has consistently stated that the FDA's public health mission includes evaluating how high drug prices impact patient access to care. Commissioner Gottlieb has committed the agency to lowering regulatory barriers and speeding up the approval of generic drugs to foster more price competition — and ultimately lower prices — for high-cost specialty drugs. This includes speeding the pathway for biosimilars and generic drugs that can compete with off-patent orphan drugs, the latter having seen significant price hikes and drawn criticism from the administration, Congress, and patient and provider groups alike. It remains to be seen whether Congress will authorize CMS to negotiate drug prices directly, which President Trump called for during the 2016 presidential race.

The FDA also announced changes to expedite the pathway to market certain medical devices, including by allowing some devices to go to market with only initial approvals (with further performance assessments coming later) and by implementing a voluntary program under which companies will be able to secure device approval by meeting the FDA's "objective safety and performance criteria." Industry observers predict this will reduce the cost and time to bring devices to market.

President Declares Opioids a National Health Crisis as DOJ and States Pursue Enforcement

The nationwide opioid crisis was another top policy priority in 2017, and President Trump declared it to be a nationwide public health emergency. Earlier in the year, the Department of Health and Human Services laid out a comprehensive five-point strategy to combat opioid abuse, and the Department of Justice (DOJ) announced increased federal prosecution efforts, initiated scheduling of certain fentanyl-related substances under the Controlled Substances Act and expanded grants to states to increase enforcement efforts. The FDA also has been active in addressing the opioid crisis, which Commissioner Gottlieb has named a top priority. The FDA's actions have included seeking the withdrawal of an approved opioid medication whose benefits the agency believes no longer outweigh its risks, requiring manufacturers of certain opioids to increase their physician education efforts via an FDA-required risk evaluation and mitigation strategy, and utilizing its regulatory authority to commission a number of studies designed to better understand the causes of the crisis. The FDA continues to believe that abuse-deterrent formulations are an important tool to make opioids safer for patients and physicians alike.

These efforts, however, fell short of what Democrats and some Republicans have said is needed to combat the crisis, and Congress is likely to face demands to expand drug education and treatment efforts in 2018.

Industry Awaits Direction of Enforcement Under New Administration

In fiscal year 2017, the DOJ recovered $2.4 billion in civil actions under the False Claims Act (FCA) involving health care companies, accounting for 66 percent of the overall FCA recoveries in this period. Four settlements exceeded $100 million (two involving drug manufacturers, one against a health care provider and another with a health information technology vendor). This is the eighth consecutive year that the department's civil health care fraud settlements and judgments have exceeded $2 billion.

The Trump administration's deregulatory agenda may have some impact on enforcement activity going forward. A senior DOJ official recently said that the DOJ intends to move away from prosecutorial enforcement of what are often technical regulatory violations or matters that do not pose a substantial risk of harm under the Food, Drug and Cosmetic Act. The recent U.S. Supreme Court ruling in *Universal Health Services, Inc. v. United States ex rel. Escobar* has already led to dismissal of many FCA cases that previously might have survived a challenge. Nevertheless, recent trends indicate that relators are willing to pursue cases even where the DOJ declines to intervene.

While the political environment in Washington, D.C. and beyond is likely to remain unsettled, health care companies are all but certain to face continued whistleblower suits under the FCA and tough scrutiny by criminal and civil enforcement personnel.

Looking Ahead

Congress will start 2018 with a full health care to-do list. While CHIP reauthorization is likely, and some form of insurance market stabilization possible, other more far-reaching legislation seems doubtful. House Speaker Paul Ryan stated that House Republicans will turn their attention back to health care and other entitlement reform in early 2018, but Senate Majority Leader Mitch McConnell quickly nixed hopes for such legislation due to the slim majority Republicans hold in Congress and the lack of consensus within his own caucus. According to press reports, Sen. McConnell seems unwilling to force his caucus to take tough votes on proposals unlikely to become law as he confronts the electoral map in the 2018 midterm elections.

The leaders of CMS and the FDA have already pushed out major regulatory reform actions, and more are likely in 2018 in the areas of alternative payment models, use of technology to improve care and hold down costs, speedier drug and medical device approvals, and market-driven payment model reforms to increase competition and keep prices down. Virtually every major area within the health care sector — physicians and providers, hospitals and health systems, insurers, and manufacturers and supplies — will be the subject of legislative and regulatory action. Increased efforts to combat the opioid crisis are likely to pass, as are reforms that can be achieved through regulatory action.

Infrastructure Policy Developments in Year One of the Trump Administration

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Despite campaign promises of a $1 trillion infrastructure investment plan during the first 100 days of the Trump administration, no infrastructure bill materialized in 2017. While President Donald Trump continues to state that infrastructure is a 2018 priority, there is uncertainty as to when a bill will be proposed and what it will propose.

Rather than large-scale policy changes, the White House and Department of Transportation (USDOT) took incremental steps to promote infrastructure development, issuing executive orders to streamline permitting processes and implementing statutes enacted during the Obama administration.

2018 Budget Infrastructure Initiative

On May 23, 2017, the Trump administration released a fact sheet outlining infrastructure-related goals in its fiscal year 2018 budget proposal, which include: streamlining environmental permitting; reducing federal regulatory requirements; expanding funding for the popular Transportation Infrastructure Finance and Innovation Act (TIFIA) federal credit program to $1 billion annually for 10 years (up from the current average annual amount of $287 million authorized through fiscal year 2020); funding the Water Infrastructure Finance and Innovation Act (WIFIA) federal credit program; removing the $15 billion cap on private activity bonds (PABs); relaxing current restrictions on tolling on interstate highways; and encouraging the use of public-private partnerships (P3s).

Of the priorities articulated by the Trump administration, only permitting and regulatory reform received meaningful attention from the White House in 2017. Congress, for its part, did not advance infrastructure funding. To the contrary, it placed investment levels in potential jeopardy through tax reform measures that cut federal tax revenues that help fund grants to municipal transit programs, such as New York City's subway and bus system, and reduced deductions for state and local taxes, which could increase the economic burden felt by taxpayers in jurisdictions that apply state and local taxes to transportation investments.

Executive Orders

The White House issued two infrastructure-related executive orders in 2017, each directing action to streamline federal environmental permitting for infrastructure projects.

Executive Order 13766 (Expediting Environmental Reviews and Approvals for High Priority Infrastructure Projects). The White House issued the order on January 24, 2017, just days after the inauguration. The order declares the executive branch's objective to expedite environmental reviews and approvals for infrastructure projects, especially high-priority projects such as improvements to the U.S. electric grid, telecommunications systems, critical port facilities, airports, pipelines, bridges and highways.

The order directs the chairman of the White House Council on Environmental Quality (CEQ) to coordinate with permitting officers at the lead permitting agency for each high-priority infrastructure project to establish specific expedited procedures and deadlines for the project. The order requires lead federal agencies to report permitting delays to the CEQ chairman and submit action plans to address such delays.

Executive Order 13807 (Establishing Discipline and Accountability in the Environmental Review and Permitting Process for Infrastructure). Issued on August 15, 2017, the order expands on the directives of Executive Order 13766 and uses existing frameworks under two Obama-era statutes — the GPRA Modernization Act of 2010 and the Fixing America's Surface Transportation (FAST) Act — to advance efforts to streamline environmental permitting. The order calls on the director of the Office of Management and Budget (in consultation with the Federal Permitting Improvement Steering Council, an interagency panel established pursuant to the FAST Act) to establish goals and milestones, called "CAP goals," to modernize infrastructure permitting. The goals must be established by February 15, 2018, and are intended to provide measurable steps to shorten the time frame for federal environmental reviews and authorization decisions for new major infrastructure projects to approximately two years from the current four to seven.

The order also requires the CEQ to develop a list of actions it will take to enhance and modernize the federal environmental permitting process. On September 14, 2017, the CEQ released the list, which highlights revisions to National Environmental Policy Act procedures that the CEQ expects to undertake in coordination with lead permitting officers at federal agencies.

USDOT Actions

In 2017, the Federal Transit Administration (FTA) and the Federal Highway Administration (FHWA) issued two significant regulatory actions.

Private Investment Project Procedures

On July 31, 2017, the FTA issued a notice of proposed rulemaking regarding the establishment of private investment project procedures (PIPP), a program to promote greater private investment and innovation in the rail transit sector. Under the PIPP, public- or private-sector sponsors of capital projects that would receive federal financial assistance could request modifications or waivers to specified FTA regulations, procedures or guidance that would impede the sponsor's ability to structure a P3. Federal statutory requirements themselves cannot be waived, nor can the regulations of any agency other than the FTA. Waivers and modifications will be at the discretion of the FTA administrator, and the application and requested modification must each satisfy specified requirements. The PIPP closely resembles an FHWA program, SEP-15, that commenced in 2004 to promote P3s for road, bridge and tunnel projects.

While the PIPP is meant to facilitate P3s, certain requirements described in the notice may have unintended consequences that make the framework more challenging to utilize. For example, one prerequisite to applying under the PIPP is evidence of committed financing for the project; however, sponsors and bidders would likely want to incorporate the FTA's feedback on the PIPP application before financial bids are finalized.

The PIPP is an outgrowth of another Obama-era statute, the Moving Ahead for Progress in the 21st Century Act, which directed the FTA to identify provisions, and their implementing regulations and practices, that impeded the use of P3s and private investment in rail transit projects. The FTA has received approximately 20 (mostly supportive) comments in response to the notice of proposed rulemaking for the PIPP. There is no public timeline for the FTA to respond or issue the final rulemaking.

Interstate System Reconstruction and Rehabilitation Pilot Program

On October 20, 2017, the FHWA solicited applications for candidate projects for the Interstate System Reconstruction and Rehabilitation Pilot Program (ISRRPP). Under the program, the FHWA may permit up to three states to collect tolls on a facility in the interstate highway system in order to fund reconstruction or rehabilitation of interstate highway corridors. Applications are due February 20, 2018, and the selected states will have three years to satisfy the necessary conditions to commence tolling.

The ISRRPP was first introduced in 1998, and while several states have been awarded provisional approval, none have succeeded in satisfying the criteria to initiate tolling. The primary obstacle has been obtaining state legislative approval, as tolling is a hot political issue in most jurisdictions. To address this issue, the FAST Act in 2015 added state authorization of tolling as a condition to provisional approval. The 2017 solicitation for applications is the first open call for pilot projects since 1998, and it reflects the FHWA's attempt to make the program work under the amended rules.

P3 developers and investors should note that ISRRPP slots can be structured as P3s, although the ISRRPP's selection criteria require applicant states to give preference to public toll agencies that have the ability to build, operate and maintain a toll expressway system that meets the criteria for the interstate system.

Conclusion

The Trump administration's early efforts to promote U.S. infrastructure are focused on regulatory reform and have yet to address infrastructure funding or financing. Administration officials have suggested that an infrastructure plan may be released before or shortly after President Trump's January 30, 2018, State of the Union Address. It remains to be seen whether the infrastructure plan or bill, when released, will carry forward ideas reflected in the administration's fiscal year 2018 budget proposal to expand investments in infrastructure or will be limited to advancing the goal of streamlining environmental permitting and other deregulatory efforts.

A Regulatory Reform Agenda for FERC

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Deregulation was a major theme during the first year of the Trump administration, with President Donald Trump calling on agencies to strike two regulations for each one they added. Many have taken up this call for regulatory reform, and the Federal Energy Regulatory Commission (FERC) could soon join their ranks. FERC is an independent agency that regulates the electric utility and natural gas pipeline industries; its core mission of ensuring that rates are just and reasonable remains vital. But there are areas in which FERC's regulations arguably impose significant burdens without advancing its mission in a meaningful way. Some of these regulations were sensible when implemented but may have become outmoded, while others were considered ill-advised from the beginning. Several could be targeted for reform if the administration pursues its agenda as we expect.

Create New Limits on Section 203 Reviews

Under Section 203 of the Federal Power Act (FPA), FERC approval is required if "a public utility seeks to sell, lease, or otherwise dispose of jurisdictional facilities." FERC has interpreted this authority broadly, requiring Section 203 approval for a wide variety of transactions.

The main idea behind Section 203 is that FERC should review changes in the control of facilities subject to its jurisdiction and their potential effects on the markets it regulates. However, the current regulatory framework requires Section 203 approval for a number of transactions that do not involve changes in the day-to-day management or operation of such facilities and would not affect markets subject to FERC's jurisdiction. For instance, large financial services companies and investment management firms that acquire and hold interests in public utilities generally act as passive investors with no intent or ability to control the public utility. But many transactions involving these companies may nonetheless trigger Section 203 approval requirements, imposing unnecessary costs and delays, acting as a barrier to investment in energy infrastructure, and taking up FERC resources.

FERC may look for ways to minimize Section 203 requirements for transactions that do not involve meaningful changes in control over day-to-day management and operations. FERC recently took a step in this direction by clarifying that such approval is not required to issue or transfer control of passive tax equity interests in public utilities. In addition, the agency has issued a notice of inquiry about potential modifications to its analysis of market power under FPA Sections 203 and 205, opening the door to broader reforms in this area.

FERC has already established "blanket authorizations" exempting certain categories of transactions from review. It could ease the burdens associated with Section 203 by expanding such authorizations, which currently include holding companies acquiring less than 10 percent of the outstanding voting securities of a public utility. FERC has previously considered increasing the threshold for this blanket authorization to 20 percent so long as the company acquiring securities affirms that it does not intend to change or influence the control of the public utility. FERC could implement this increase or go even further by adopting a blanket authorization allowing investment management firms to acquire larger percentages of the voting shares of public utilities so long as they agree not to exercise control.

Additionally, FERC could create new blanket authorizations for relatively minor transactions that do not merit Section 203 scrutiny. Congress is considering a bill that would exempt all transactions involving facilities valued at less than $10 million from Section 203 review. If that bill is not enacted, FERC could create a blanket authorization for such transactions. It also could create one for transfers of new interconnection transmission assets from the companies that construct them to the intended owners.

Finally, for transactions that still require Section 203 approval, FERC could streamline the review process. For instance, when conducting Section 203 reviews of transactions that result in de minimis changes in market power, FERC has determined that detailed competitive analysis screens are unnecessary. FERC could similarly waive this requirement for other types of transactions that do not raise market power concerns, such as transfers of new generation facilities after testing but before commercial operation and transactions that deconcentrate facility ownership.

Cut Back on Filing Requirements

Compliance with FERC regulations typically requires submitting numerous and often voluminous filings. While some amount of paperwork is unavoidable, FERC could look for ways to reduce filing burdens, such as by eliminating requirements that provide few substantive benefits. For instance, FERC could consider expanding the "broker or dealer" exclusion in the Public Utility Holding Company Act of 2005 to cover holdings connected to investment management and advisory functions. This change would eliminate the need for many firms to file notifications regarding their holding company status.

Ensure That Enforcement Is Conducted Fairly

Enforcement provides other prime opportunities for reform. FERC could make both procedural and substantive changes to ensure that it is protecting competitive markets while treating the subjects of its investigations fairly.

FERC has adopted a number of controversial positions on procedural rules for enforcement cases. For instance, those targeted for penalties under the FPA have the option to seek immediate *de novo* review in a federal district court. FERC has argued that such review should be limited to the administrative record. This interpretation has prompted pushback, with critics arguing that it does not give the responding party adequate opportunity to develop and present its case. Several federal courts have rejected FERC's narrow interpretation of *de novo* review. FERC Commissioner Neil Chatterjee, who served as chairman from August 2017 until December 2017, when Kevin McIntyre became the new chairman, recently said he thinks FERC needs to re-examine this issue. In addition to rethinking its position on the nature of *de novo* review, FERC may also reconsider its position that such review is not available under the Natural Gas Act.

Several other procedural practices could be reviewed. For example, in 2009 FERC authorized the director of the Office of Enforcement to issue a public notice of alleged violations once enforcement staff has completed an investigation and given the subject an opportunity to respond to preliminary findings. While FERC has argued that these notices promote transparency, they impose significant costs on those who are publicly identified and accused of wrongdoing. For individuals, even if later vindicated, the taint can follow them and impact their future employment prospects.

FERC also could adjust its approach to penalties in enforcement cases. It could do away with its civil penalty guidelines, which often call for harsh fines exceeding what is necessary to incentivize compliance. It also could follow the lead of the Commodity Futures Trading Commission by dramatically increasing the incentives for self-reporting violations and cooperating with investigations. Additionally, FERC could assess lighter penalties on companies — since those are ultimately borne by shareholders — and instead impose penalties directly on employees who act in unsanctioned ways.

Finally, FERC could make substantive changes to its enforcement strategy regarding market manipulation. FERC has taken an expansive view of market manipulation in recent years, punishing conduct that takes advantage of market design flaws or violates the spirit of market rules. In addition to raising fairness concerns, this approach may discourage participation in FERC-jurisdictional markets, undermining the competitiveness and liquidity of these markets. FERC could reconsider its aggressive stance and concentrate its enforcement resources on conduct that violates clearly established market rules.

Eliminate the 'Shipper-Must-Have-Title' Rule

Under FERC's "shipper-must-have-title" rule, companies transporting natural gas on interstate pipelines must have title to the gas they are shipping when it is delivered to the pipeline and while it is in transit. The rule originated in the late 1980s as a tool to prevent unauthorized capacity brokering and ensure transparency as the industry transitioned to an open-access regime. However, in light of intervening changes — such as the creation of capacity release regulations — some in the industry think that the rule has become an unnecessary encumbrance to economically efficient transfers of pipeline capacity. In the years after FERC's authority to assess civil penalties was expanded in the Energy Policy Act of 2005, many of the agency's enforcement cases focused on violations of the shipper-must-have-title rule and related restrictions. While enforcement has shifted away from these types of cases in recent years, the rule continues to act as a restraint on competition. FERC could consider eliminating the rule and allowing pipeline capacity to be used by those who value it most highly.

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The Evolving Financial Regulation Landscape

CFTC Updates on Virtual Currency Regulation, Alternatives to Libor and Fallout From Brexit

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In 2017, Commodity Futures Trading Commission (CFTC) Chairman J. Christopher Giancarlo made clear he will strive to improve, not abolish, many reforms the CFTC adopted to implement the Dodd-Frank Act's mandate for new derivatives regulation, with a particular emphasis on swaps market structure issues. (Giancarlo was confirmed as chairman in August 2017 and previously served as the acting chairman.) In 2018, we may see (1) a rulemaking proposal to amend the rules governing swap execution facilities, with a focus on the rules specifying required swap execution methods; (2) final rules on the long-standing proposal to impose some form of CFTC speculative position limits on physical commodities (agriculture, metals and energy); (3) a new rulemaking proposal for algorithmic trading; and (4) a major judicial decision on the CFTC's price manipulation authority. We also may see the Trump administration fill the two remaining vacancies (one Democratic and one Republican) on the commission, which has not had the full complement of five commissioners since 2014. A full commission may make the agency more comfortable working through major initiatives.

Additionally, there are three significant regulatory developments to watch closely in 2018 as they relate to virtual currency, interest rate benchmarks and Brexit.

Virtual Currency: Regulating Bitcoin

Whether styled as virtual currency, cryptocurrency, bitcoin or ether, this new asset class makes headlines almost every day. (See "Rise of Blockchain and ICOs Brings Regulatory Scrutiny.") Derivatives recently have played a major role in this story, and several U.S. exchanges either are currently offering or plan to offer CFTC-regulated futures or options products based on virtual currency. Under Chairman Giancarlo's leadership, in May 2017, the CFTC created LabCFTC within its general counsel's office to act as the agency expert and information clearinghouse for all things virtual currency. The CFTC's Division of Enforcement has been active in this space since 2015, pursuing cases involving retail fraud and failure to register.

In 2018, we are likely to see even more CFTC engagement. While no federal regulator exercises direct oversight and supervision for the trading markets in virtual currency itself, the CFTC regulates futures and options markets directly and comprehensively. A bitcoin futures contract, for example, would be regulated generally, like all other futures products. But the CFTC would not regulate the actual market in bitcoin any more than it would regulate the actual market in wheat, gold or crude oil where market participants contract for the actual delivery of the commodity. Whether that will change remains to be seen. Fundamental questions surrounding the explosion of interest and transactions in virtual currency that market participants need to consider and which federal regulators — and, in some instances, Congress — may need to address include: Is new statutory authority needed or advisable? What role will self-regulatory bodies like futures exchanges and the National Futures Association play? And where does the regulatory authority of the Securities and Exchange Commission start and stop in relation to that of the CFTC?

Libor

The London Interbank Offered Rate (Libor) is perhaps the most ubiquitous interest rate benchmark in the world's financial markets. Traders and commercial enterprises rely on Libor to price a wide range of instruments, from swaps to adjustable-rate mortgages. Libor is referenced by an estimated $350 trillion of outstanding contracts. But two issues have clouded Libor's continued viability. First, following the financial crisis of 2007-08, allegations arose that some traders at certain banks made false Libor submissions, triggering major government investigations and fines. Second, market practice has made Libor less reliant on actual transactions and more reliant on submitting banks' judgment, which concerns many in light of the government investigations.

Federal banking officials and CFTC Chairman Giancarlo have actively supported a Libor phase-out. Regulators in the U.S. and in other countries have created advisory committees, given speeches, evaluated and developed alternative rates for the currencies in which Libor is published, and solicited public comments. Regulators and working groups are developing transition plans to ensure that a move from Libor to alternative rates would be smooth and leave undisturbed the expectations of traders as well as of parties to commercial transactions.

At this point, it is unknown whether Libor will continue to be used as it is today, be replaced entirely by alternative rates or co-exist with them. Bank regulators and Chairman Giancarlo appear to be convinced that Libor must be replaced, and a consensus appears to be forming among the regulators that an overnight financing rate would be a credible and preferable alternative because it would be based on real transactions. Last year, the Alternative Reference Rates Committee (ARRC), a Federal Reserve-sponsored group studying alternative benchmarks, recommended a broad Treasurys repurchase (repo) financing rate — tied to the cost of overnight borrowing collateralized by U.S. Treasury securities — as its preferred U.S. dollar Libor alternative.

The Federal Reserve Board also has announced plans to publish three new reference rates based on overnight repo transactions, including the rate selected by the ARRC (called the Secured Overnight Financing Rate), in the second quarter of 2018. Yet Libor administrators insist that the benchmark's past problems have been rectified. In addition, commercial market participants, including parties to commercial loans and mortgages, recently have expressed concern that transitioning to a new rate may have unintended financial consequences for parties that negotiated their agreements based on Libor. Similarly, the fate of the benchmark will be a significant issue for the financial trading sector in 2018, especially as parties review their derivatives documentation to ensure that a transition from Libor to alternative rates would not result in a windfall for one party. Given the number of derivatives contracts priced by reference to Libor, the CFTC is expected to be in the thick of it.

Brexit and Derivatives Clearing

In the aftermath of the financial crisis, a worldwide consensus emerged that clearing of derivatives — which removes counterparty credit risk — would reduce risk in the financial system. As a result, many derivatives are now submitted to clearing.

As the European Union and the United Kingdom negotiate the terms of Brexit, one of the most contentious issues has become what to do about central counterparties (CCPs) clearing derivatives. The issue is a complicating factor for Brexit because major sources of clearing in the EU reside in London. The EU could insist that those entities relocate and be subject to regulation by the remaining 27 member states (EU27). It could permit the clearing entities to stay in London but insist that they be subject to EU27 supervision and regulation — a model called third-country regulation. Or it could allow clearing to remain in London and defer to the regulators in the U.K.

In 2017, the answers began to take shape in a form that presents ominous challenges for CCPs in the United States. The EU proposed legislation last year that would set out an elaborate regime for how non-EU CCPs that accept clearing business from EU counterparties would be regulated. Under this proposal, non-EU CCPs — including those in the United States and the U.K. after Brexit — would be subject to EU dictates on everything from corporate structure to vital risk management policies. While for decades U.S. CCPs have been subject to exclusive regulation by the CFTC, those days would be over, and not because the CFTC's regulation has been inadequate. It is widely considered the international gold standard.

Chairman Giancarlo has been vocal about what he views as the EU's attempt to trespass on the agency's turf. The CFTC does not require EU CCPs that clear futures and options for U.S. customers to be subject to CFTC oversight, deferring to the EU to regulate its CCPs. In the past, such rough edges in cross-border regulation have eventually been smoothed over. In 2018, market observers will see whether international comity carries the day or a hotly contested oceanic tug of war sparked by Brexit threatens to destabilize a critical area of financial market systemic risk mitigation.

Consumer Financial Protection Bureau Update

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A degree of uncertainty hangs over the Consumer Financial Protection Bureau (CFPB) following the November 2017 resignation of its first director, Richard Cordray. On his last day in office, Cordray appointed his chief of staff, Leandra English, to the position of deputy director, intending that she become acting director upon his resignation. Immediately thereafter, President Donald Trump appointed Office of Management and Budget Director Mick Mulvaney as acting director, prompting a legal challenge by English. On January 12, 2018, Judge Timothy J. Kelly of the U.S. District Court for the District of Columbia denied English's motion for an injunction prohibiting Mulvaney from acting on behalf of the Bureau. Two days later, English filed a notice of appeal with the U.S. Court of Appeals for the District of Columbia Circuit as well as a notice indicating that she would seek expedited treatment of her appeal.

Meanwhile, Mulvaney has signaled that the agency will be moving in a radically different direction than during Cordray's tenure. In particular, he has stated that he will seek to slow down (and in some cases reverse) Bureau rulemaking, and that the Bureau will adopt a significantly different approach to enforcement. And while Mulvaney's tenure at the CFPB is temporary, the priorities of any confirmed director are expected to more closely resemble Mulvaney's than Cordray's.

The changes that Mulvaney has proposed would undoubtedly be welcomed by the financial services industry, which has faced a challenging enforcement and compliance environment under the CFPB. In the Bureau's first six years, it brought more than 200 actions, obtained nearly $5 billion in consumer restitution and assessed more than $700 million in civil money penalties. During the same period, the Bureau published more than 60 final rules, along with numerous informal guidance directives.

Although the cadence and nature of Bureau enforcement and rulemaking are likely to change, a look at past activities is nonetheless instructive, as the underlying laws that the Bureau enforces — including the Consumer Financial Protection Act and Equal Credit Opportunity Act — remain the same.

Enforcement Actions Spur Litigation

As in most years, the majority of the CFPB's public enforcement actions in 2017 were settled without litigation by agreed-upon consent orders. The Bureau announced numerous such settlements last year across the consumer financial services industry, including: an action against Experian alleging that the credit bureau deceived consumers and violated the Fair Credit Reporting Act based on the company's description of its credit scores; an action against Fay Servicing alleging that the mortgage servicer illegally began foreclosure proceedings against certain homeowners; and an action against certain American Express subsidiaries alleging discrimination against consumers on the basis of national origin by offering terms and conditions on its Spanish-language card products and products offered in Puerto Rico, the U.S. Virgin Islands and other U.S. territories that were less favorable than on their English-language card products and products offered in the 50 states.

While all of these actions were resolved without litigation, the number of companies that elected to contest CFPB enforcement proceedings rather than settle increased in 2017. Whether these decisions were related to the merits of the cases or to Cordray's imminent departure is a matter of some debate. What is clear, however, is that a number of courts have shown a willingness to reject CFPB liability and damages theories, a development that could spur even more challenges to Bureau enforcement proceedings. In the litigation arena, notable decisions include:

- ***Intercept Corp.* (March 17, 2017).** In a case alleging that a third-party payment processor and its executives had "systematically enabled" certain debt collectors and lenders to collect debts that they were not legally owed, the court held that the CFPB's complaint did not contain sufficient factual allegations to back up its claims.

- ***Borders & Borders, PLC* (July 13, 2017).** In a case alleging violation of the Real Estate Settlement Procedures Act's (RESPA) anti-kickback provisions in the mortgage title insurance industry, the court granted summary judgment against the Bureau, ruling that the defendants satisfied the requirements for RESPA's "affiliated business arrangements" safe harbor.

- ***Nationwide Biweekly Administration, Inc.* (September 8, 2017).** In a case in which the CFPB sought $74 million in restitution from a company alleged to have misled consumers in connection with a mortgage "interest-minimizer" program, the court agreed that the defendants' conduct had been deceptive but declined to order them to pay any restitution, holding that the CFPB did not meet its burden of establishing a basis for consumer restitution.

- ***Universal Debt Solutions, LLC* (August 25, 2017).** In a case alleging that a number of payment processors participated in an unlawful debt collection scheme, the court dismissed all counts against the processors as a sanction against the CFPB for its "bad faith" conduct in discovery and "blatant disregard" for the court's instructions.

To be sure, the CFPB obtained a number of its own court victories in 2017 (including a ruling from a Pennsylvania court allowing its case against student loan servicer Navient to proceed). But the spate of court rulings against the CFPB in 2017 likely means that more targets will decline to settle CFPB charges and take their chances in court.

Mixed Results on Rulemaking

In 2017, the CFPB issued two rules that generated significant public interest — one regulating the use of arbitration agreements, and another requiring an ability-to-pay analysis for certain consumer credit products, such as payday loans, before the loans are originated.

The arbitration rule, which would have prohibited certain financial service providers from using predispute arbitration agreements to block consumer class actions in court, was issued in July 2017 and was to take effect two months later. However, in what was widely viewed as a rebuke to Cordray, Congress exercised its rarely used prerogative under the Congressional Review Act to issue a joint resolution disapproving of the arbitration rule. In November 2017, President Trump signed the joint resolution, thereby rendering the rule "of no force or effect."

Separately, the Bureau finalized the Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule (the Payday Rule) in November 2017, with an effective date of January 16, 2018. The rule requires that before originating short-term loans, lenders determine if a borrower can afford the loan payments while meeting basic living expenses. The rule also caps the number of loans made in succession to a borrower to three and creates additional loan payoff options for consumers.

Significantly, the final rule was narrower than the Bureau's original proposal, which would have extended ability-to-pay and other requirements to certain longer-term installment loans with interest rates greater than 36 percent. Nonetheless, industry opposition to the Payday Rule has been stiff, with many commenters asserting that the restrictions would leave millions of Americans with no access to credit. On January 16, 2018, the CFPB announced that it intends to commence rulemaking to reconsider the Payday Rule.

Finally, yet another of Cordray's noted achievements was undone in December 2017, when an opinion from the Government Accountability Office (GAO) effectively invalidated the Bureau's 2013 compliance bulletin on the applicability of fair lending laws to indirect auto lending, stating that the bulletin constituted a "rule" and therefore was required to have been presented for review under the Congressional Review Act. The GAO opinion not only negates any precedential weight of that bulletin, which the Bureau had relied on in obtaining several hundred million dollars in settlements, but also raises questions about whether other CFPB bulletins also may be subject to effective invalidation under the Congressional Review Act.

Standards of Conduct for Investment Advisers, Broker-Dealers Under SEC Review

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In the six months since Securities and Exchange Commission (SEC) Chairman Jay Clayton requested public comments on standards of conduct for investment advisers and broker-dealers, industry participants, investors and other commenters have filed more than 230 responses. The request comes long after the Dodd-Frank Act authorized the SEC to issue new rules to address the standards of care for broker-dealers and investment advisers, including potentially requiring broker-dealers to adhere to the same fiduciary standard as investment advisers under the Investment Advisers Act.

The request also follows the Department of Labor's (DOL) issuance of its fiduciary rule, which governs the standard of conduct for advisers and broker-dealers in relation to employee benefit plans, individual retirement accounts (IRAs), and other accounts and arrangements subject to the Employee Retirement Income Security Act (ERISA) and Section 4975 of the Internal Revenue Code (Code Section 4975). (See our *2017 Insights* article "Change in Administration Presents Opportunity to Revisit DOL Fiduciary Rule.") As we begin the new year, the issue is ripe for SEC rulemaking.

Meanwhile, the effective date of certain DOL fiduciary rule provisions has been delayed. (See our December 5, 2017, client alert "Department of Labor Extends Transition Period for Exemptions Under the Fiduciary Rule.") Secretary of Labor Alexander Acosta and Chairman Clayton have agreed that there is a need for coordination between the DOL and SEC, and the delay by the DOL has provided an opportunity for the agencies to develop their respective rules in a coordinated manner. Industry participants speculate that such coordination has the potential to weaken the existing standards applicable under the DOL fiduciary rule and the Investment Advisers Act.

Chairman Clayton requested public comments on the costs and benefits of the different standards of conduct that apply under current law to broker-dealers for accounts that are under the jurisdiction of the SEC but not the DOL (such as securities accounts not involving employee benefit plans, IRAs, ERISA or Code Section 4965). Chairman Clayton also requested comments on the costs and benefits of having different standards of care for broker-dealers and investment advisers — a difference that predates the DOL fiduciary rule. In particular, the request seeks input regarding confusion that retail investors have expressed regarding the type of professional or firm providing investment advice to them and the attendant standards of conduct.

In addition, the request solicits comments regarding the experience of investors and other market participants with the efforts of broker-dealers to comply with the DOL fiduciary rule. It includes specific queries regarding the trend toward the fee-based model (and away from the commission-based model) for retail investment advice, which appears to be motivated at least in part by the need to comply with the DOL fiduciary rule.

Chairman Clayton's request was not connected to a specific rule proposal and did not impose a deadline for comments. Most of the comments to date support the imposition of a fiduciary standard for broker-dealers and the SEC's assumption of a leading role in the regulation of retail investment advice. However, questions remain as to how any new rules will address key issues, including:

- Will the SEC and DOL continue to exercise overlapping regulatory authority over the same investment accounts? Will different rules continue to apply to accounts regulated by the SEC only — as opposed to accounts regulated by both the SEC and the DOL, or by the DOL only? Will different rules continue to apply to broker-dealers and investment advisers?
- Will the new rules affect the trend toward the fee-based model? Will the DOL fiduciary rule provisions that contributed to that trend — including the requirement that commission-based arrangements be accompanied by "best interest" contracts requiring broker-dealers to act "without regard" to their own interests and prohibiting limitations on broker liability and class actions — survive the new rulemaking?
- To what extent will the new rules rely on new requirements for broker-dealers to provide disclosure to investors regarding the nature of the advisory relationship, rather than regulate the standard of conduct to which broker-dealers must adhere?

The answers to these questions will shape the environment for retail investment advice in 2018 and beyond.

New York Cybersecurity Regulations Could Affect Foreign Banks

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Financial institutions covered by the New York State Department of Financial Services' (NYDFS) new Cybersecurity Requirements for Financial Services Companies must file their first annual certification by February 15, 2018. The regulations also require covered institutions to complete additional tasks throughout the remainder of 2018.

What Are the Regulations?

The regulations, the majority of which became effective in August 2017, require certain banks, insurance companies and other financial services institutions — including foreign banks operating New York branches and agencies — to establish and maintain a cybersecurity program. The regulations set forth general minimum standards for firms' cybersecurity programs and codify certain best practices into law. These regulations signify the first significant prescriptive rules on a state level in the cybersecurity space. State regulators have otherwise preferred to reference guidelines such as the National Institute of Standards and Technology Cybersecurity Framework and various industry-specific procedural and governance best practice standards. With the institution of these cybersecurity regulations, covered entities may face penalties for noncompliance.

Who Do the Regulations Cover?

Entities covered by the regulations include those operating under or required to operate under a license, registration, charter, certificate, permit, accreditation or similar authorization according to New York state banking, insurance or financial services laws. (See our September 15, 2016, client alert "New York State Proposes Cybersecurity Regulation for Financial Institutions.") While the regulations do not apply to national banks and federal branches of foreign banks, they do apply to the information systems that support the New York-licensed branch. As a practical matter, significant segments of a bank's global information system may be covered by the regulations if they cannot be logically separated from those that support the New York-licensed branch. Foreign banks face an additional compliance burden, considering they are subject to multiple foreign and domestic regulators' expectations. Prescriptive rules such as the NYDFS regulations will necessarily impact cross-border systems and operations as other jurisdictions adopt this type of cybersecurity regulation.

Foreign banks also should be aware that the cybersecurity regulations' definition of "nonpublic information" is more expansive than many other regulatory definitions of personally identifiable information and includes certain nonpublic business information. Accordingly, the set of NYDFS-covered systems containing such information may be meaningfully broader than those included in other regulatory frameworks. As a result, during a cyber event, covered entities must consider whether nonpublic business information was accessed in addition to traditionally targeted personally identifiable information.

Importantly, a foreign bank's New York branch can adopt an affiliate's cybersecurity program, rather than create one specifically to comply with the rules, if it meets the requirements.

What Is Required in the February 15, 2018, Certification?

In February 2018, covered entities must submit their first annual certification attesting to their compliance with the regulations to the NYDFS superintendent. The certification, a format for which is available from the NYDFS, requires the chairperson of the board of directors or a senior officer of the institution to certify that the board has reviewed the institution's policies required under the regulations and, to the best of their knowledge, that the program complies with the regulations' requirements.

Importantly, a certification of compliance indicates that the board member and/or senior official has determined to the best of their knowledge that the institution is prepared to notify the department of a covered "cyber event" within 72 hours of its discovery. Specifically, covered entities must report any act or attempt, successful or unsuccessful, to gain unauthorized access to, or disrupt or misuse, a covered system or the information stored on it. In practice, many covered entities likely already prepare for a cyber event, but reporting the event to the NYDFS within the specified time frame will be an added compliance burden.

If, during the process of implementing the plans and procedures required by the regulations, the covered entity identifies areas, systems or processes that require "material improvement, updating or redesign," then the entity is required to document the "identification and the remedial efforts planned and underway to address such areas, systems or processes" and maintain such documentation.

Finally, covered entities must maintain for examination by NYDFS all records, schedules and data supporting the certification for a period of five years.

What Additional Requirements Become Operative in 2018?

By March 2018, all covered entities, including covered foreign banks, must complete the following tasks:

- submit to the board (or a senior officer) the chief information security officer's report on the covered company's cybersecurity program;
- conduct an annual penetration test and vulnerability assessment;
- conduct an annual written risk assessment;
- implement multifactor authentication; and
- provide regular cybersecurity awareness training to personnel.

By late 2018, the covered entity must further expand its cybersecurity program to include:

- an audit trail;
- written procedures, guidelines and standards for the security of in-house or externally developed applications;
- data retention policies and controls to protect nonpublic information;
- policies and procedures to monitor the activity of authorized users; and
- controls, including encryption, to protect nonpublic information.

Should We Expect Robust Enforcement by NYDFS?

To date, NYDFS has been active in the use of its regulatory authority in the cybersecurity space, including conducting a series of surveys of covered entities that contributed to the development of the current regulations. Therefore, while it remains unclear how NYDFS will enforce its new regulations and remedy noncompliance, given the novel nature of their implementation, it is likely that it will move to aggressively audit compliance as contemplated under the regulations. Critically, given the importance that regulators, including NYDFS, have placed on cyber issues, it is likely that any negative action by NYDFS will be coupled with negative media attention and the potential for legal action by third parties, including customers and other regulators.

Key Takeaways

With 2018 underway, effective dates for additional portions of the cybersecurity regulations are approaching, and boards and senior officers of covered entities should begin to actively and meaningfully inquire into their institutions' progress in complying with the new rules. That inquiry should include an evaluation of their systems' security posture and existing risks and vulnerabilities. One important example is the institution's ability to meet the short 72-hour deadline for reporting cyber events. Given the scope of the reporting requirement and the continuous attacks to which they are subject, banks may bear a large reporting burden. Ultimately, while instituting new compliance measures may be time-consuming, banks should weigh the costs against not only the financial implications of a breach and government response but also the expense of negative publicity from a public NYDFS enforcement action.

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Fintech Deal Landscape to Remain Active in 2018

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A wide range of players participated in hundreds of financial technology (fintech) transactions in 2017, and the high level of global M&A and investment activity in fintech is expected to continue this year. Deals included multibillion-dollar, cross-border transactions between public companies (*e.g.*, Vantiv/Worldpay), private equity-backed take-privates (*e.g.*, Hellman & Friedman/Nets A/S), and acquisitions and strategic investments in fintech startups by banking organizations of all sizes (*e.g.*, JPMorgan Chase/WePay). In addition, according to KPMG, venture capital firms were on pace to invest approximately $12 billion in fintech firms across the world in 2017, following approximately $32 billion invested during the preceding two years combined. The fintech ecosystem is flush with capital and continuing prospects for growth.

Transactional activity in the fintech space often plays out at the intersection of Silicon Valley and Wall Street, which can lead to unique challenges. The disparate cultures and approaches have important effects on deal dynamics that are often observed in legal, regulatory and compliance aspects of fintech transactions. For example, large banking organizations typically have very different compliance expectations and risk appetites than do young, fast-growing and entrepreneurial fintech firms. We expect these issues will continue to be an important element in these deals in 2018.

Trends in Fintech M&A

Some areas of fintech were especially active in 2017. The payments industry experienced more than 165 M&A transactions with aggregate deal value of almost $30 billion. Consolidation among the largest payment processors headlined that activity; Vantiv's $11.6 billion acquisition of U.K.-based Worldpay Group was the largest fintech transaction of the year. Many of the payments M&A transactions were cross-border deals, driven in large part by the growth of e-commerce, which facilitates cross-border commerce. Higher user numbers and volumes of digital payments, and the need for merchants to process those payments, have driven revenues and valuation of payment processors. We expect cross-border M&A to continue to play a central role in payment processors' growth strategies.

Another important component of fintech M&A activity has been the interest of traditional banking and financial institutions in acquiring or making strategic investments in innovative fintech firms. In October 2017, JPMorgan Chase agreed to acquire WePay Inc., an online payments provider for technology platforms, for a reported $220 million. Many other large financial institutions, including those that have mostly sat on the sidelines since the financial crisis, are gearing up for or actively exploring fintech acquisitions or investments, which we expect to come to fruition throughout 2018.

Finally, consortiums continue to be an important deal vehicle in the fintech space. In particular, companies developing blockchain technologies (see "Rise of Blockchain and ICOs Brings Regulatory Scrutiny") have embraced consortium structures to combine fundraising with customer acquisition and product-testing partners. For example, R3CEV, a consortium of approximately 80 members devoted to developing distributed ledger technologies, raised more than $100 million from more than 40 banks in 2017. The Enterprise Ethereum Alliance, which launched in 2017, is an open-source blockchain alliance that has over 200 members, including prominent financial institutions, the University of New South Wales and the Indian government.

Other participants in the fintech market have used consortiums in creative ways to provide industry solutions. For example, in November 2017, four large financial institutions announced that they had formed TruSight, an industry utility that will provide vendor management services to the financial services industry. Consortiums likely will continue to be an effective investment vehicle in developing financial technology products and services. They allow financial institutions to enter new ventures more cheaply, as costs and risks are shared across similarly situated investors. They also enable firms to leverage existing expertise across multiple investors, bringing broader expertise and skill profiles. The enterprise's chances of success also increase because it has a committed customer base from the start.

Considerations in Fintech Deals

Transactions in the fintech space present important legal, regulatory and compliance considerations, such as the following:

- Is the target's business subject to licensing or regulation?
- Does the target's business present legacy or ongoing consumer-related litigation or reputation risk?
- What regulatory approvals are needed for the transaction?
- Are the parties in a position to obtain those approvals on a timely basis?
- What commitments or conditions might the regulators impose?
- Will the transaction cause the target's business to become subject to any new type of regulatory restrictions?
- Are any changes required for the target's business to fit within the buyer's compliance framework and risk management environment?
- What are the parties' rights with respect to the underlying technology and intellectual property?
- Who controls the timing and terms of an exit transaction?

Buyers and targets often will have very different answers to these questions. Fintech companies that provide services to regulated financial institutions generally have some familiarity with the regulatory framework applicable to their clients. Indeed, many technology service providers to regulated banking institutions are themselves subject to some form of supervision and examination by federal banking regulators. Nevertheless, many fintech companies seeking investment from, or partnership with, a traditional financial institution are surprised by the level of scrutiny their regulated counterparties give compliance and risk management matters. For such financial institutions, uncertainty or concern about regulatory or compliance matters can be a showstopper.

Fintech companies contemplating a transaction (such as investment, strategic partnership or M&A) with a traditional regulated financial institution should consider conducting a gap analysis or other type of readiness review of their own compliance and internal controls. This will prepare the fintech company for the questions and diligence to come and position it to leave a stronger impression, avoid delays and head off concerns.

Additionally, when innovative fintech firms are acquired by more traditional or larger financial institutions, a tension often exists between the target's desire for independence and continuing flexibility for innovation, and the buyer's risk appetite and enterprisewide internal controls. In addition, transactions in the fintech space often involve important negotiations related to the employment and efforts of key persons or innovators at the target. The success of many fintech transactions depends on the buyer and the target (and their respective management teams) finding a balance when it comes to these key considerations.

As activity in the fintech deal landscape remains active in 2018, cultural dynamics will continue to shape deal negotiations, and participants will have to navigate the resulting legal, regulatory and compliance issues for successful outcomes.

Rise of Blockchain and ICOs Brings Regulatory Scrutiny

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In 2017, the increased adoption of blockchain technology in various industries was partially obscured by the dramatic fluctuations in the price of bitcoins and the prevalence of so-called initial coin offerings (ICOs) to raise capital to build out blockchain applications and platforms. Adoption of blockchain technology is expected to continue to rise in 2018, and the growing popularity of both the technology and ICOs is likely to bring with it continued legislative and regulatory scrutiny, especially with respect to U.S. securities and anti-money laundering laws.

Blockchain Trends

There is no single "blockchain" in the way we might refer to "the internet." Rather, blockchain is a technological approach being built out across multiple public blockchains, which are accessible to all, and private blockchains, which are accessible only to approved users, such as a group of banks. (For background on how the technology operates, see our *2017 Insights* article "Blockchains Offer Revolutionary Potential in Fintech and Beyond.")

In 2017, a number of organizations began to incorporate nascent blockchain technology in proof-of-concept projects such as tracking swaps contracts post-execution and managing supply chains. To date, most of these projects have run parallel to traditional transaction methods rather than replaced them. We anticipate this trend will continue in the near term; thereafter, companies may begin to fully adopt blockchain technology as a replacement for their current modes of conducting business. Two key factors will drive the pace and extent of increased adoption: the regulatory environment and the legal treatment of so-called smart contracts.

In any industry with established oversight, regulators will need to determine how they can adapt their current role to new blockchain-based environments. This will require them to dedicate resources to understand the technology and develop approaches that foster, not hamper, innovation. For example, in the U.S., a new Delaware law went into effect in 2017 that allows Delaware corporations to maintain shareholder lists, along with other corporate records, using blockchain technology. In the U.K., the Financial Conduct Authority's "sandbox," which allows approved companies to test new financial products and services in a live market environment, serves as a prime example of cooperation between regulators and innovators. Although many regulatory solutions are being debated, one promising approach would be for regulators to act as a "node" on a private blockchain network in order to seamlessly execute their oversight role, thereby lowering compliance costs and increasing transparency.

Federal regulators also are grappling with the application of blockchain technology in securities financing/offerings, as described below, and derivatives, as described in "CFTC Updates on Virtual Currency Regulation, Alternatives to Libor and Fallout From Brexit." We expect that in 2018, regulators may make increased pronouncements and rulemaking in multiple arenas as they get up to speed on innovation in this area and industry players seek guidance on what is permissible.

Smart contracts to execute transactions on a blockchain are some of the most powerful tools used to enable this technology. Smart contracts are simply blocks of computer code that automatically execute agreed-upon transactions.

For example, a piece of smart contract code might trigger an insurance payment to a farmer if the objectively verifiable temperature falls below freezing for a number of days. While smart contracts will not themselves replace most paper contracts, they are a necessary component of any blockchain-based transaction. An unresolved issue is how courts will treat this code in the event of a dispute, such as a case where the code and paper contract do not align. In 2017, Arizona partially addressed this issue when it enacted a law stating that a contract "may not be denied legal effect, validity or enforceability solely because that contract contains a smart contract term." We expect similar amendments to other state laws in 2018, although some uncertainty will remain until courts begin to adjudicate the treatment of smart contracts.

ICOs

ICOs have become a significant source of funding for companies raising capital to build out blockchain applications and platforms. According to some sources, these offerings generated more than $3.7 billion of funding in 2017, more than 10 times the amount in 2016. As ICOs gained more prominence over the course of the year, many commentators and legal counsel began to highlight issues with the way these offerings were structured, including with respect to U.S. securities and anti-money laundering laws.

Securities Laws

Although other jurisdictions have taken drastic steps to curb the pace of ICOs — including China's flat ban on the sale of blockchain tokens — the U.S. Securities and Exchange Commission (SEC) has yet to develop an ICO-specific regulatory framework. Instead, in September 2017, the SEC announced the creation of the Cyber Unit within the Enforcement Division, which focuses on targeting cyber-related misconduct, including violations involving distributed ledger technology and ICOs. In the months since its formation, the Cyber Unit has filed complaints in court and brought administrative proceedings against a number of issuers, alleging that their ICOs are either fraudulent or otherwise do not comply with U.S. federal securities laws. In one such action, the Cyber Unit issued a cease-and-desist order to halt Munchee Inc.'s sale of MUN tokens. Munchee marketed MUN tokens as "utility tokens," which it said removed the offer and sale of the tokens from the purview of U.S. federal securities laws. The Cyber Unit, in its cease-and-desist order, disagreed with Munchee's position, finding that the company was offering securities in a manner that did not comply with applicable laws.

On December 11, 2017, SEC Chairman Jay Clayton issued a "Statement on Cryptocurrencies and Initial Coin Offerings," in which he drew a distinction between true cryptocurrencies that have inherent value (similar to cash or gold) and those blockchain tokens that resemble securities. Chairman Clayton emphasized that simply calling a token a "utility" token or structuring it to provide some consumptive value does not prevent it from being a security. He noted that "[b]y and large, the structures of initial coin offerings that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws."

It remains to be seen whether the SEC will develop a new regulatory framework for ICOs or continue applying traditional principles to determine whether a cryptocurrency or blockchain token is a security under federal securities laws. In the absence of additional guidance and in the face of the SEC's recent actions and a rising tide of private class action lawsuits, issuers and counsel are struggling to find consensus regarding an approach to ICOs that complies with securities laws while retaining the unique opportunities that ICOs offer to both token sellers and purchasers.

Anti-Money Laundering Laws

In the anti-money laundering (AML) arena, a key area of focus has been on whether the structure of an ICO, the nature and intended use of the token or coin being issued, or the company's operations after the ICO may qualify a company as a "money transmitter" and, consequently, as a money service business (MSB) under U.S. federal AML regulations. MSBs are required to register with the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) and implement an AML compliance program that includes policies, procedures and internal controls to ensure compliance with applicable laws.

While FinCEN has issued certain interpretive guidance at the federal level to clarify the applicability of the regulations implementing the Bank Secrecy Act (BSA) to persons creating, exchanging and transmitting virtual currencies, it has not yet issued ICO-specific regulatory guidance. Congress has begun to seek greater clarity regarding FinCEN's approach to ICOs. For example, in December 2017, Sen. Ron Wyden, D-Ore., sent FinCEN a request for answers to a series of questions on ICOs, including how FinCEN will apply the BSA framework to participants in the ICO market, like token developers, and when FinCEN will issue guidance regarding its enforcement intentions regarding digital token exchanges and ICOs.

Although FinCEN has yet to take an enforcement action in connection with the issuance of tokens in the ICO context, it has made clear that it will not hesitate to take action against companies dealing in the virtual currency realm. (See our article in the November 2017 issue of *Cross-Border Investigations Update*, "ICOs and Cryptocurrencies: How Regulation and Enforcement Activity Are Reshaping These Markets.")

Nearly all U.S. states enforce their own state laws related to money transmission, which may be relevant to certain ICOs or to a company's subsequent operations. State money transmitter laws are varied and do not take a uniform approach to virtual currency-related businesses.

New York has added to the complexity of the regulatory landscape by adopting a "BitLicense" regulation in addition to its own state money transmitter regulatory laws. Companies engaged in a "Virtual Currency Business Activity" involving the state or a New York resident must receive a BitLicense from the New York State Department of Financial Services (NYDFS). Regulated virtual currency business activities include controlling, administering or issuing virtual currency — which the regulation defines broadly — and receiving virtual currency for transmission or transmitting virtual currency for a financial purpose. Licensees must meet AML program standards similar to those imposed by FinCEN as well as certain capitalization, consumer protection and cybersecurity standards, and must comply with applicable U.S. sanctions laws. To date, there have been no ICO-related NYDFS AML enforcement actions. However, NYDFS is a regulator known for its aggressive enforcement posture, and its approach to ICOs will be closely watched.

Certain other states, including California, also are considering regulatory frameworks specific to virtual currency business activities. To help harmonize the patchwork of state laws regarding virtual currencies, in 2017, the National Conference of Commissioners on Uniform State Laws issued the model Uniform Regulation of Virtual Currency Businesses Act (VCBA), which would create a licensing and registration framework for engaging in virtual currency business activities. The VCBA has yet to be adopted by any state, but its existence may drive states toward a more synchronized approach to the world of virtual currency-related businesses.

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Social Responsibility and the Rise of In-House *Pro Bono*

Cultivating a Successful In-House *Pro Bono* Program

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Corporations have a long tradition of community engagement through corporate responsibility programs that have customarily involved attention to diversity and inclusion, environmental sustainability, and charitable giving or responsible investing. Such programs also have encouraged community service focused on issues relevant to the corporation's industry or the interests of individuals at the company. An opportunity to deepen the impact of the service offered by talented people at corporations through professional skills-based volunteering is now being led by a significant number of in-house legal departments, with visionary general counsels and chief legal officers at the helm.

Pro bono programs, which have long been synonymous with corporate responsibility efforts at law firms, have proven more challenging for corporations to adopt. Historically, the majority of in-house lawyers who have chosen to contribute to the legal profession's tradition of public service have done so by connecting with *pro bono* clients in an individual capacity. While this work was endorsed by their corporate employers, structures supporting and coordinating it within the corporation tended to be the exception to the rule.

However, the rise of in-house *pro bono* over the last decade has provided corporations a new way to give back to the communities in which they live and work. Expansion of traditional corporate responsibility into the realm of professional skills-based volunteering reaps benefits that include critical service to the communities where corporations operate, increased skill development and positive brand recognition. According to the Washington, D.C.-based Pro Bono Institute, which established the Corporate Pro Bono Challenge in 2006, the number of in-house legal departments that have committed to performing a substantial amount of *pro bono* has grown from fewer than 50 companies in 2006 to 170 companies representing 36 industry sectors in 27 countries in 2016.

When developing in-house legal department programs, for maximum impact, companies should prioritize directing efforts toward areas of meaningful need, creating policies that encourage *pro bono* work in a safe and responsible manner, and establishing partnerships with legal services organizations and outside counsel.

Goal-Setting

Successful in-house *pro bono* efforts intentionally define the structure, areas of substantive work and metrics for their programs.

Structural decisions include whether to promote a cafeteria-style plan by encouraging lawyers to select matters that appeal to their individual interests or to establish an umbrella-style one in which the corporation selects a focus (*e.g.*, families and children, veterans, immigration), and matters fit within that area. With either approach, some selection of general issue areas, even if broad, makes a program more impactful because it allows efficient training of lawyers, more substantial relationships with legal services attorneys, better understanding of client population and issues, improved results, and less reliance on resources of legal services organizations.

Substantive areas of law might be chosen because of the strengths of the company or industry sector, needs of the local community, current vital needs in the legal landscape or vision of in-house legal department leadership.

Establishing metrics that will be used from the outset of a program allows in-house legal departments to both assess and celebrate success. These include counting hours, examining the percentage of people participating, and conducting qualitative inquiries regarding participant engagement and client satisfaction. In addition, reviews of partnerships — and depending on the type of work, a look at larger-scale changes in public policy or community development — can reveal both meaningful outcomes and new challenges to tackle. For example, corporations can assess whether they are working with the right legal services organization and law firm(s) or whether interests, issues and resources would be better served through different partnerships.

Policy and Program Development

Written policies provide clarity to legal departments related to guidelines for involvement. They include:

- aspirational goals in terms of number of hours or instances of participation;
- whether time spent should be recorded;
- information about involvement by lawyers and nonlegal staff within the legal and compliance departments;
- inclusion of *pro bono* work in employee evaluations;
- required intake procedures for approval of matters, conflict checks, staffing considerations and any other reporting needs;
- types of matters, representations and clients that are permitted; and
- operating definitions of what counts as *pro bono*.

Attention to compliance and risks also is required as a program develops. These concerns can be company- and jurisdiction-specific but may include:

- understanding whether the company has sufficient malpractice insurance or if partnering with a legal services organization will provide coverage;
- examining attorney registration rules in the United States that require lawyers licensed in foreign jurisdictions to register where they will provide *pro bono* service;
- attending to corresponding limits on the service that can be provided under registration rules; and
- studying international lawyer regulations that may significantly restrict types of service, including bars on practice before certain types of tribunals or on behalf of certain clients.

Beyond policies, effective program development depends on building a supportive structure for the program in the form of a *pro bono* committee and director, administrative assistance or some combination of those roles. Messaging from the highest levels of the legal department or the company that involvement in *pro bono* work will be valued is a critical piece of the initiation, maintenance and success of a program.

Partnerships

Accomplished in-house programs rely on a three-legged stool model, involving partnerships with legal services organizations and outside counsel, to ensure an understanding of where real need exists; connection with clients; and support for program development, training and staffing.

The expertise of legal services organizations provides consequential insight that allows legal department leaders to make thoughtful choices about the focus of their programs. Legal services organizations also make it possible for in-house lawyers to better connect with the people and communities they hope to serve and provide training to lawyers who will likely need mentorship as they learn new areas of practice.

The Pro Bono Institute reports that over 90 percent of in-house legal departments partner with outside law firms when undertaking *pro bono* work. The Association of Pro Bono Counsel reports that over 200 *pro bono* counsel or partner roles are supported within over 100 large law firms internationally. Collaboration with outside law firms, many of which have dedicated *pro bono* professionals, allows legal departments to leverage the developed *pro bono* administrative structure within law firms and to engage in shared value projects staffed by lawyers from both the corporation and the law firm. *Pro bono* professionals within law firms regularly provide program development consulting and project partnering opportunities to corporate leaders invested in creating robust programs.

Creating Opportunities

Pro bono opportunities can generally be categorized into three types: limited-scope, full representation and signature projects.

Limited-scope opportunities most often take place in a clinic setting where lawyers work with a client for a period of hours to accomplish a discrete task or provide limited guidance on a legal issue. These could include assisting with certain types of immigration issues, advising small businesses or entrepreneurs, drafting simple legal documents like wills or guardianship papers, or guiding *pro se* litigants in family or housing court. In this setting, there is generally no expectation that participating lawyers will assist clients beyond the boundaries of the clinic. The locations of clinics vary from court-based settings to community sites, and they are frequently hosted by a law firm that organizes the clinics with a legal services partner.

Full representation or longer-term work involves assisting a variety of client types with legal needs from start to finish. Teams made up of in-house and outside law firm lawyers divide the responsibilities and bring different skills to the representations. The scope of work that falls under this category is broad and includes:

- assistance to indigent clients on matters such as landlord-tenant cases, family law issues, or immigration and asylum engagements;
- governance, entity creation, real estate or labor work on behalf of nonprofits;
- legal research in support of litigation or the goals of legal services and other nonprofits; and
- public policy advocacy work through white paper drafting and participation in *amicus* efforts.

Signature projects highlight a company or legal department's commitment to making a beneficial change for a certain population or issue. These projects often bring together lawyers with different skill sets who work on issues from multiple angles. For example, a legal department that decides to focus on veterans issues might engage its litigators in monthly clinics to help veterans with limited-scope legal needs, its transactional lawyers to provide governance assistance to nonprofits that support veterans and its government affairs lawyers to advocate for improved policies.

Creating opportunities that are mindful of the existing skills of the company's lawyers while also providing comfortable openings for lawyers to learn new ones maximizes participation. Notably, with each type of opportunity, involvement by nonlegal staff is readily available through efforts including research, translation and interpretation, and general project and program management. The process of developing projects is expanded through consultation with established law firm programs that can make connections with legal services organizations, provide a menu of possibilities, offer sample policies, manage administrative logistics, and facilitate partnering on work that is important to lawyers from both the company and the law firm.

The historical commitment of the legal profession to *pro bono* work is growing exponentially within legal departments across the globe. The path to creating successful programs is now paved with resources and experience at the ready for corporations that are dedicated to bringing the culture of skills-based volunteering to in-house legal departments.