2019 Insights

Skadden

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

Editorial Board

Contents

Corporate

Capital Markets

Corporate Restructuring

M&A / Governance

US Capital Markets Face Uncertainty Entering 2019, With Volatility Likely to Continue

Contributing Partner

Michelle Gasaway / Los Angeles

Counsel

Benjamin K. Marsh / New York

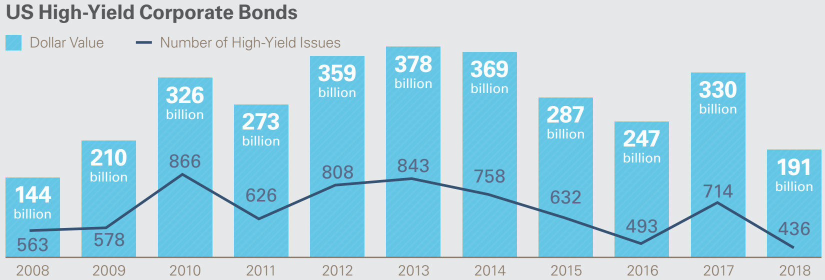
Associates

Agnes N. Aniol / Los Angeles
Lilit Kazangyan / Los Angeles
Jeremy A. Zucker / New York

Performance in the U.S. capital markets was mixed in 2018, with the equity new issuance market showing strength through most of the year and the debt issuance markets softening. The initial public offering (IPO) market had its strongest year since 2014, though it weakened in the fourth quarter due to significant market volatility. In 2019, the U.S. economy is forecasted to continue to grow, albeit at a slower pace, and most economic indicators remain sound, with an unemployment rate of 3.9 percent and 312,000 jobs added in December 2018. However, ongoing concerns over interest rates, domestic and geopolitical events, trade and the decelerated pace of global economic growth could cause further market volatility.

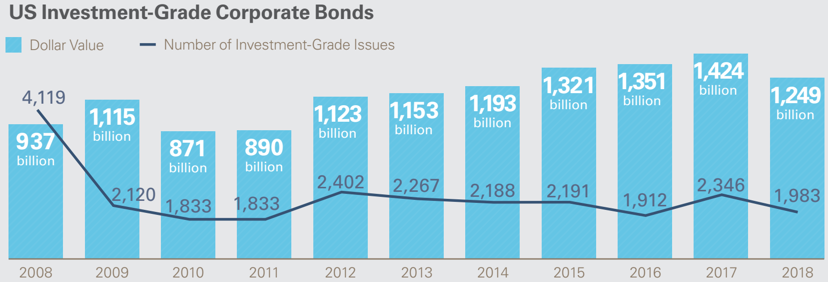
Debt Markets. The U.S. high-yield debt market ended 2018 42 percent lower by dollar volume and 39 percent lower by number of issuances than 2017. The $191 billion in total issuance was the lowest since 2008 ($144 billion), and the number of issuances fell to 436, the lowest in two decades. (High-yield activity in 2018 was frequently replaced with term loan B issuances, which are more attractive to investors when interest rates are rising and provide borrowers with covenant packages that are increasingly bond-like in flexibility.) Proceeds from U.S. high-yield bond offerings were largely used for refinancings (67 percent of issuances), with only 16 percent used for M&A activity. For the first time since 2008, in 2018 there were no issuances in December — a period of over 40 days without an issuance that continued until January 10, 2019.

US High-Yield Corporate Bonds



U.S. investment-grade debt market volume in 2018 was $1.25 trillion (1,983 issuances), ending seven consecutive years of increases after a record volume of $1.42 trillion (2,346 issuances) in 2017. Increasing interest rates and market volatility combined with the December 2017 tax reform, which encouraged repatriation of overseas cash and reduced the tax benefits of issuing debt, caused the decline. The largest issuer by volume was CVS Health Corp., with $40 billion raised in connection with its acquisition of Aetna, representing the third-largest U.S. corporate bond transaction in history. Overall, investment-grade issuances related to M&A increased in 2018 by dollar volume, totaling $226 billion by year-end.

US Investment-Grade Corporate Bonds

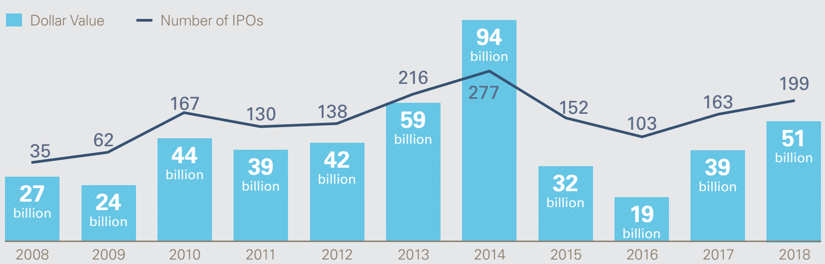


Source: Bloomberg

Equity Markets. After a volatile start to the year, the Dow Jones Industrial Average, S&P 500 and Nasdaq composite achieved record highs in the third quarter of 2018, driven by a strong economic backdrop and solid corporate earnings (fueled in part by the impact of tax reform, which led to a record $1 trillion of stock buybacks that boosted earnings per share). Fourth-quarter volatility, however, erased the year's gains, and the three indices ended the year down 5.6 percent, 6.2 percent and 3.9 percent, respectively, from 2017, their worst annual performance in 10 years. Volatility soared in the fourth quarter, driven by concerns over slowing global economic growth, rising interest rates, U.S.-China trade tensions and policy uncertainty arising from White House communications.

Strong markets in the first three quarters helped make 2018 the best year for U.S. IPOs since 2014, with 199 IPOs raising $51 billion. IPO volume was 31 percent higher than 2017 and 168 percent higher than 2016. While aftermarket performance was mixed, overall, IPOs significantly outperformed broader market indices.

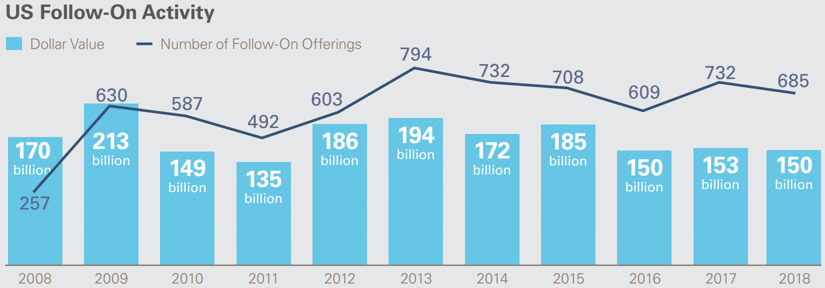
US IPOs



The leading sector for IPOs by volume in 2018 was technology, with a number of tech unicorns completing highly anticipated IPOs. Other top sectors were health care and consumer products and services. Special purpose acquisition companies continued to constitute a significant amount of IPO volume, with 43 deals, representing 19 percent of total IPO proceeds. In 2018, 33 China-based companies completed IPOs, raising $9.2 billion, a 140 percent increase over 2017. In addition, music-streaming service provider Spotify garnered significant attention when it went public in April 2018 by means of an unconventional direct listing, potentially leading the way for a select few others to follow suit. (For example, messaging platform service provider Slack has discussed a possible direct listing.) Companies also continued to take advantage of recent Securities and Exchange Commission (SEC) accommodations, such as the ability for all issuers to confidentially submit draft registration statements and omit certain financial statements previously required for interim drafts. (See "SEC Continues Steady Progress With Regulatory, Enforcement Goals." See also "New HKEx Rules Spur Bumper Year in Hong Kong Capital Markets, but Lasting Impact Remains Unclear.")

Follow-on activity was relatively flat, both by dollar volume and number of deals. Block trades represented 28 percent of total follow-on offerings, down slightly from 30 percent in 2017 and down significantly from a record 49 percent in 2016. The decline in block trades is attributed largely to weaker aftermarket performance resulting from tighter discounts to market price relative to marketed follow-ons.

US Follow-On Activity



Source: Thomson Reuters

Looking Ahead

The U.S. economy enters 2019 in its ninth year of expansion, with stock markets on pace to eclipse the bull run of 1991-2001 as the longest in history. But whether the capital markets are capable of continued strength depends on several factors.

Economic Growth. The U.S. economy expanded at an accelerated pace in 2018. U.S. gross domestic product grew 3.1 percent, marking the first year since 2005 that the economy expanded above 3 percent. The strength was driven by increases in government spending, healthy corporate profits and increases in consumer and business spending. The U.S. dollar rose in value 4.3 percent in 2018, according to the U.S. dollar index, demonstrating positive sentiment toward the U.S. economy.

Many economists expect the pace of U.S. economic growth to moderate in 2019. While a reduced economic growth rate does not necessarily mean a recession is imminent, it could negatively impact stock prices and corporate earnings, and reduce investor confidence. Nevertheless, many economists have indicated that a recession in 2019 is unlikely, and investment banks remain generally bullish on the near-term outlook for capital markets activity. However, the longer the government shutdown lasts, the more pressure there is on some of these forecasts.

Corporate Earnings. Moderating earnings growth could present challenges to capital markets activity, with a forecasted decline from 9 percent in 2018 to 7-8 percent in 2019. However, with S&P 500 multiples at five-year lows, arguably the market already has adjusted prices in anticipation of a slowdown. Stronger-than-anticipated earnings growth could improve investor confidence and slow recent market declines, facilitating activity as issuers seek to take advantage of rising valuations. On the other hand, weaker-than-expected earnings could contribute to market volatility and dampen capital markets activity.

Trade Uncertainty. The ongoing U.S.-China trade dispute could continue to disrupt activity. To date, the U.S. and China have imposed $250 billion and $110 billion worth of tariffs, respectively, on the other country's products. (See "Enhanced US Export Controls and Aggressive Enforcement Likely to Impact China.") Although a temporary "truce" was reached in December 2018 (including a 90-day pause on tariff hikes until March 1, 2019), an array of challenging trade issues remain unresolved. Until a final resolution is reached, the existing tariffs and continued uncertainty over U.S.-China trade relations may negatively impact business investment and consumer confidence. Moreover, other trade matters, such as the effects of the renegotiated North American Free Trade Agreement and tariffs on certain imported products (*e.g.*, aluminum and steel) could also weigh on the markets.

Federal Reserve Activity. The monetary policy of the Federal Reserve impacted the capital markets in 2018 and could continue to do so in 2019. Under the new leadership of Jerome Powell, the Federal Reserve increased the federal funds interest rate four times in 2018, most recently in December 2018, from 2.25 percent to 2.5 percent, and continued to pursue its plan to reduce the Fed's balance sheet (most recently at a pace of $50 billion per month). However, Powell more recently indicated that the Federal Reserve will be patient with monetary policy as it watches economic performance. From a capital markets perspective, higher interest rates can reduce existing bond prices and make new bond issuances more expensive for issuers. In addition, market volatility from Federal Reserve activity and policy statements may lead to tighter and more unpredictable windows of opportunity for capital raising.

U.S. and Geopolitical Events. Political uncertainty both in the U.S. and internationally has significantly impacted the capital markets in recent months. On the domestic front, according to *The Washington Post*, White House tweets have moved markets by as many as 3 percentage points in a single trading session, such as when faltering trade relations with China were revealed on December 5, 2018. Meanwhile, the longest government shutdown in history effectively closed the IPO window in January 2019. Additionally, even when the government reopens, IPO companies with a calendar year-end would need to price their offerings by February 14, 2019, if they want to go effective without providing 2018 audited financial statements. A prolonged government shutdown could have implications for the IPO market for the full year, as the SEC and issuers work through the pent-up backlog, and could potentially have broader economic effects if it impacts business investment and consumer confidence. Other elements of domestic politics may also continue to disrupt markets in 2019, with a survey by a bulge bracket financial institution finding that individual investors perceive the White House to be the greatest source of market risk in 2019. Political uncertainty outside the U.S. also may impact the markets, including Brexit and trade disputes, in addition to changes to foreign direct investment rules across Europe (see "Foreign Investment Control Reforms in Europe") and sanctions (see "Key Developments in US Sanctions").

[1] Sources for the data in this article are: Bloomberg, *Business Insider*, Dealogic, Deloitte, Moody's, Nasdaq, *The New York Times*, PitchBook, PwC, Russell Investments, Seeking Alpha, Thomson Reuters, UBS, Vanguard and *The Wall Street Journal*.

Equity Markets in 2019

Though fourth-quarter volatility disrupted strong equity markets in 2018, many equity capital markets and syndicate bankers across Wall Street believe 2019 could be another robust year for IPOs, as issuers look to take advantage of a U.S. economy that remains strong ahead of the anticipated next economic cycle. However, Wall Street is continuing to digest ongoing volatility and parse the uncertain political and economic landscape. As a result, first-quarter issuance is expected to be muted (exacerbated by the longest government shutdown in U.S. history, which has delayed the lineup of IPOs slated for January 2019 launches) before a potential recovery for the remainder of the year. Several tech unicorns, including Airbnb, Lyft and Uber, have announced plans to go public in 2019, and the pipeline in a number of industry verticals remains strong. However, if volatility persists longer than anticipated, it could push some issuers toward quicker and more certain exits through mergers and acquisitions. Equity professionals will watch market sentiment closely, particularly the appetite of hedge funds to buy new issuances, as many funds suffered negative returns in 2018.

Technology. After a very good year for technology offerings in 2018, with 48 IPOs compared to 26 in 2017, many anticipate the momentum to continue, as companies feel increasing pressure to hit available market windows. Significant activity is expected from high-growth software and internet and e-commerce companies that have high revenue visibility and large addressable markets. Additionally, a number of deals by technology services companies (which help businesses utilize and adapt to new technologies) are possible; however, activity by systems and semiconductor companies is likely to remain subdued. Chinese and other offshore issuers continue to make up a significant portion of the IPO backlog, but recent mixed aftermarket performances could soften demand.

Continued on page 5

Continued from page 4

Health Care. Continued IPO deal flow by biotech and life sciences companies, as well as a number of public debuts by medical technology (medtech) and device companies, meant 2018 was another strong year for the health care sector. Heading into 2019, the deal pipeline remains robust, although for biotech companies it appears smaller than in past years. On the other hand, significant follow-on activity is expected by recently public biotech issuers, and a number of private biotech companies appear to be exploring "crossover" financing rounds to bridge to an IPO, thereby potentially replenishing the pipeline. Meanwhile, a number of medtech, health services and specialty pharmaceutical issuers are reportedly exploring IPOs, although for the latter, heightened political scrutiny around drug pricing could derail issuance activity. (See "Trump Policy Actions Could Reshape Health Care and Life Sciences Landscape.") The trend toward increasing levels of "insider participation" in IPOs (whereby existing investors disclose nonbinding indications of interest to buy shares in the offering) is expected to continue.

Industrials. Offering activity in the industrials sector slowed in 2018, and the trend is expected to continue in 2019, driven largely by skepticism toward issuers tied to the construction, manufacturing or housing industries, which can be more sensitive to economic downturns, and by continued trade uncertainty. These companies instead may shift focus to capital management strategies, which could lead to an uptick in stock buyback activity and recapitalization transactions. However, as with 2018, M&A activity may drive sporadic equity issuances across the sector. One potential bright spot remains in the automotive technology sector, with a number of companies — both domestic and foreign — that offer solutions for electronic or autonomous vehicles securing late-stage private funding and appearing poised to pursue IPOs.

Financial Institutions. Issuances by financial institutions in 2018 were solid, driven by rising interest rates, the impact of corporate tax cuts and deregulation. Sentiment for 2019, however, is mixed, with cautious optimism if recent volatility subsides, while recognizing that the economy may be in a late cycle and offering windows could close. The financial technology sector continues to be attractive — particularly the payments processing space, where valuations remain elevated. The market also looks attractive for midcap property and casualty insurers, as the subsector has outperformed broader market indices. The outlook for regional banks, which suffered significant valuation degradation in 2018, and consumer finance companies, particularly those exposed to subprime borrowers, is less optimistic. All eyes will be on Federal Reserve activity and whether rate hikes will continue and, if so, at what pace.

Consumer. Despite a better-than-expected year for consumer equity offerings in 2018 and a strong macroeconomic outlook for U.S. consumers, expectations for 2019 are modest, particularly given the sell-off in retail names in the fourth quarter of 2018. However, despite a reset in valuations, cautious optimism exists for new issuances in the general retail and consumer discretionary sectors, with several sponsor-backed companies potentially eyeing public market exits. Conversely, significant issuance activity in the restaurant and specialty retail areas is less likely. As in past years, technology-oriented consumer companies (companies selling consumer goods through online or subscription models) continue to generate significant attention, but many are still pursuing midstage private funding rounds and need to prove their ability to grow revenues or diversify product and service offerings before testing the public markets.

Real Estate. Real estate issuance in 2018 remained solid, despite market volatility and a challenging fourth quarter. Real estate investment trusts (REITs) led the way, accounting for over half of the total issuance, followed by lodging, gaming and real estate services companies. In the year ahead, investors may look to the real estate sector, and REITs in particular, as a defensive sector that can provide more stable returns in a rising interest rate environment. With funds continuing to pressure managers to be more selective in allocating capital, issuances from REITs with active growth opportunities through either acquisitions or developments likely will continue to garner investor attention and drive equity issuance. The alternative real estate sector (such as retirement living, student housing and private hospitals) also may see increased activity, as real estate investors seek ways to generate higher returns relative to the broader REIT universe.

Energy. High expectations in 2018 for capital markets activity in the energy sector turned out to be largely misplaced. U.S. crude oil prices reached $75 a barrel in July 2018 (their highest level since 2014) before dropping sharply, ending the year at around $54 a barrel. Volatility in oil prices and concerns about slowing economic growth and an oversupplied oil market are likely to continue, causing uncertainty in the new issuance market. Some still see potential for deals driven by M&A financing needs, particularly in the exploration and production space, while others view dividend-yielding stocks in the upstream and midstream sectors as an attractive place for investors to put money to work. While there is a substantial deal backlog in the oilfield services space (some of the pent-up supply began to emerge in 2018, but not at anticipated levels), volatile oil prices could suppress activity.

Click here for a full list of capital markets-related articles authored by Skadden attorneys in the last year.

SEC Continues Steady Progress With Regulatory, Enforcement Goals

Contributing Partners

Brian V. Breheny / Washington, D.C.

Andrew M. Lawrence / Washington, D.C.

Colleen P. Mahoney / Washington, D.C.

Law Clerk

Matthew A. Rowley / Washington, D.C.

As the Securities and Exchange Commission (SEC) enters the third year of the Trump administration, its regulatory and enforcement goals remain largely unchanged. At the direction of Chairman Jay Clayton, the SEC continues to focus on protecting Main Street investors, streamlining regulations and encouraging capital formation. Despite some recent and expected turnover on the Commission, the agency has made steady progress toward these goals thanks to the continuity of its leadership. All SEC division directors remain the same heading into 2019.

Commissioner Priorities

Elad L. Roisman, formerly chief counsel for the Republican-led Senate Banking Committee, joined the SEC in September 2018 as its newest commissioner, replacing Michael S. Piwowar. Roisman has identified increasing capital formation and instilling investor confidence as his top priorities.

Although each of the commissioners has advocated similar regulatory priorities, it is not clear that they agree with how those priorities should be addressed. For instance, Commissioners Hester M. Peirce and Robert J. Jackson Jr. have advocated different approaches to the regulation of investments in crypto assets. Peirce has urged the SEC to be less conservative in its approach to such investments and has said she would like to leave decisions about crypto assets to individual investors. Jackson, on the other hand, favors a cautious approach, citing investor inexperience and the current threat of fraud in the cryptocurrency market. (See "As Interest in Blockchain Technology Grows, So Do Attempts at Guidance and Regulation.")

The withdrawal by the SEC staff of two letters issued to proxy advisory firms Institutional Shareholder Services and Glass Lewis that addressed conflicts of interest and the ability of investment advisers to satisfy their fiduciary duties in reliance on the voting recommendations by the firms also was a point of contention among the commissioners. Clayton touted the withdrawal as an accomplishment that allowed for a wider discussion of the role proxy advisory firms play and as a step toward his goal of modernizing the SEC's rules. However, Jackson downplayed the move, saying, "The law governing investor use of proxy advisors is no different today than it was yesterday."

To date, these differing opinions on how best to accomplish the SEC's broader goals has not impacted the advancement of Clayton's priorities. Indeed, rule changes under Clayton have often been approved unanimously by the SEC. The differing views on the Commission, however, could have a more significant impact on future progress. This may be even more relevant depending on who is identified to replace Commissioner Kara M. Stein. Her term concluded at the end of December 2018, and thus far no one has been nominated to replace her.

Regulatory Trends

IPO Participation. In 2018, the SEC continued to take steps to tackle the issue of companies delaying initial public offerings (IPO) and relying on private capital. For example, the SEC sought to make IPOs more enticing by expanding the scope of the nonpublic review program set forth in the JOBS Act. The agency also increased its definition of "smaller reporting company" to allow even more issuers to use scaled disclosures. Likewise, the SEC is continuing to look for ways to modernize and simplify disclosures to decrease the financial burden that comes with registration and capital access. In late December 2018, the SEC changed its rules to allow all public companies to rely on Regulation A, one of the exceptions from its securities registration requirements. The SEC's efforts have been helped by positive market conditions, and the number of IPOs has increased from 103 in 2016 to 163 in 2017 and 199 in 2018, according to Thomson Reuters.

U.S. Proxy Voting System. The SEC also has taken the first steps toward pursuing long-requested changes to the U.S. proxy voting system. In November 2018, the SEC hosted several roundtable discussions that covered a number of areas of concern in the proxy system. Specifically, the roundtables centered on the proxy voting process, the shareholder proposal process and the increasing role proxy advisory firms play. The discussion regarding proxy advisory firms garnered the most attention. The SEC sought input on three main topics: proxy advisory firms' conflicts of interest; their effect on investor voting and industry practices; and their regulation moving forward. What, if any, regulation will emerge from the roundtable remains to be seen. However, the growing importance of proxy advisory firms, coupled with the occurrence of the roundtable, signals that the SEC is considering regulations in this area. Further, in unofficial statements following the roundtable, Roisman expressed an openness to regulations that would create a rebuttal period following the issuance of a proxy firm opinion.

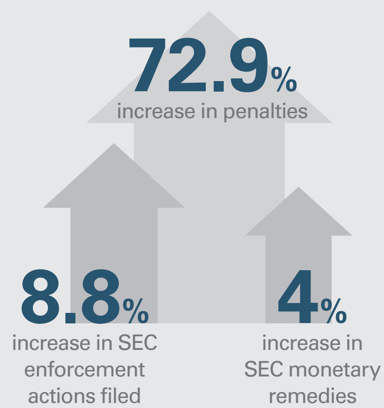
Cybersecurity. Cybersecurity matters will remain a key focus for the SEC in 2019. In particular, the SEC is expected to scrutinize company disclosures and policies related to cybersecurity. In public statements and guidance, the SEC has emphasized the importance of cybersecurity disclosures in the material risks section of mandatory filings, as well as the importance of proper implementation and disclosure of board oversight programs designed to avoid cyberrisks.

Risk Disclosures. Based on its actions in 2018, the SEC is expected in 2019 to remain focused on the obligations of companies to ensure that all their public disclosures are complete and accurate, and that investors are alerted to trends and developments that could impact the company's business and prospects. The SEC brought a number of high-profile enforcement actions in 2018 that signaled its desire for companies to look beyond just the specific disclosure requirements of SEC forms. There are a number of significant developments already expected in 2019 that could trigger a requirement for updated disclosures, including Brexit and the end of Libor. The SEC staff has publicly stated its intent to track these and other market developments and the responses made by companies.

Enforcement Activity

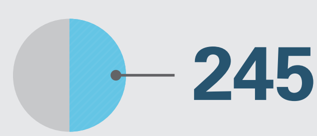
The number of enforcement actions the SEC filed in fiscal year 2018 increased by approximately 8.8 percent from fiscal year 2017, and total penalties ordered increased approximately 72.9 percent, to $1.44 billion, according to SEC statistics. Overall monetary remedies obtained by the SEC (penalties and disgorgement) increased by a more modest 4 percent, to $3.95 billion. (A significant driver of the increase was a settlement in which a Brazilian company agreed to pay $933 million in disgorgement and an $853 million penalty.)

Fiscal Year 2018



Focus on Protecting Retail Investors. While overall enforcement activity increased in fiscal year 2018, the SEC's focus on financial institutions has diminished under the Trump administration. Likewise, a November 2018 *New York Times* article noted a significant decline in actions against large public companies. Instead, the SEC continues to prioritize cases involving protection of retail investors, with half of the 490 stand-alone enforcement actions brought in fiscal year 2018 involving allegations or findings of wrongdoing that harmed such investors.

Stand-Alone Enforcement Actions in 2018



Half of the 490 actions involved allegations or findings of wrongdoing that harmed retail investors

Individual Accountability. The SEC also is focused on individual accountability, especially as it relates to senior corporate officers and other prominent figures within organizations. We expect that focus to continue. In fiscal year 2018, 72 percent of the SEC's stand-alone enforcement actions involved charges against at least one individual, including a U.S. congressman as well as the former CEO and chief financial officer of Walgreens Boots Alliance, Inc.

Tailored Remedies. The SEC is tailoring remedies, including ordering equitable relief in the form of specific undertakings, to address particular misconduct. This willingness to use a wide range of remedial tools in novel ways to address misconduct was evident in the enforcement actions against the CEOs of Theranos Inc. and Tesla Inc. In its settlement with Theranos, the SEC included undertakings that required the CEO to relinquish her voting rights and guarantee that she would not profit from a sale of the company unless other investors were compensated first. According to the SEC, these requirements were meant to protect investors from the CEO's potential misuse of her controlling position. In the Tesla matter, the SEC was concerned about the CEO's communication practices and the alleged lack of sufficient oversight and control over those communications. The specifications in that settlement included that the CEO resign as chairman of the company, and that Tesla add two independent directors to its board and establish a committee of independent directors to oversee the CEO's public communications.

In addition to these types of customized undertakings, the SEC is increasingly imposing conduct-based injunctions specifically calibrated to address the infraction that was the object of the enforcement action. The goal of these injunctions is to require specific changes in offending companies that address the conduct at issue. The Enforcement Division is expected to continue to seek these types of narrowly focused remedies in the coming year.

Cybersecurity. The SEC's enforcement staff also is increasingly focused on cybersecurity and related issues, including the timeliness and accuracy of disclosures of cyber-related issues and the need to implement sufficient internal accounting controls to prevent cyber breaches. The SEC announced the creation of its Cyber Unit in September 2017, and in fiscal year 2018, it brought 20 stand-alone cases related to cyberfraud. By the end of the fiscal year, the Cyber Unit had more than 225 ongoing cyber-related investigations. It is notable that, in many of these investigations, companies that were victims of cyberattacks now find themselves under investigation for how they responded to the attacks.

225+
ongoing cyber-related investigations at end of 2018 by SEC Cyber Unit

The Commission is focused on public companies' and financial institutions' policies surrounding cybersecurity, emphasizing the need for public companies to make prompt and accurate cyber-related disclosures. In April 2018, the Cyber Unit was involved in bringing a cyber-related enforcement action against a technology company for allegedly misleading shareholders by not disclosing a data breach in its public filings for nearly two years. The $35 million settlement was the first SEC enforcement action against a public company relating to the disclosure of a data breach.

The SEC also is sending a clear message that it expects issuers to not only act responsibly in the event of a cybersecurity incident but also to institute appropriate controls to mitigate the risks of cyber-related threats and safeguard company assets from those risks. In October 2018, the SEC issued an investigation report detailing the Enforcement Division's probe into the internal accounting controls of nine issuers that were victims of "business email compromises," a form of cyber fraud. The SEC issued the report of investigation, forgoing a traditional enforcement action, to communicate the SEC's view that this issue is problematic and to put issuers and individuals on notice that the SEC intends to pursue enforcement actions concerning similar conduct in the future.

Similarly, the SEC is sending the message to financial institutions that they also must have sufficient safeguards in place to protect sensitive client information. The SEC brought proceedings against a broker-dealer and investment adviser related to alleged failures in cybersecurity policies and procedures following a cyberattack that compromised the personal information of thousands of customers in violation of Regulations S-P (Privacy of Consumer Financial Information) and S-ID (Identity Theft Red Flags).

Also in the past few years, the number of digital assets and crypto asset offerings, mainly initial coin offerings (ICOs), have increased significantly. In response, the Cyber Unit began to address misconduct relating to digital assets and ICOs. As of the end of fiscal year 2018, the Commission had brought over a dozen enforcement actions involving ICOs, focusing on allegations of fraud as well as compliance with the registration requirements of the federal securities laws. Additional ICO enforcement actions are likely in 2019.

Takeaways

We expect the SEC to continue to streamline current regulations and focus its enforcement efforts on protecting retail investors. This focus, however, should not be interpreted by companies as a signal that the SEC will be lax in enforcing remaining regulations. Companies need to be careful to produce timely and accurate disclosures, especially when discussing risk factors and cybersecurity. Companies also should not assume that the focus on protecting retail investors indicates that the SEC has relaxed its enforcement efforts against other market participants. Rather, SEC enforcement statistics from 2018 reflect a continued robust enforcement program, particularly in areas such as cybersecurity.

Click here for a full list of SEC reporting and compliance-related articles authored by Skadden attorneys in the last year.

New UK IPO Rules Encourage Independent Research, Address Perceived Conflicts of Interest

Contributing Partner

Danny Tricot / London

Associate

Richard Ho / London

In July 2018, changes came into effect to improve the range, quality and timeliness of information available to the market and to remedy certain perceived conflicts of interest during the U.K. initial public offering (IPO) process. The new rules have met the U.K. Financial Conduct Authority's (FCA) policy objectives of ensuring the availability of information to the market earlier in the IPO process. Generally speaking, investors now have an additional week to review and consider the registration document and announcements that the issuer publishes before considering research reports, thus supporting a more meaningful investor education and price formation process.

The new rules also have responded to buy-side demands for the production of independent, or unconnected, research, while respecting the value that certain market participants place on connected research. However, initial take-up by unconnected analysts has been low, and it remains to be seen if broader independent research will become commonplace in the future.

Past Practice

Prior to these changes, the FCA-approved prospectus was published by an issuer late in the IPO process. The primary source of information available to the investor community was research reports published by analysts connected to syndicate banks underwriting the IPO. Unconnected analysts generally were excluded and lacked access to the issuer and information needed to produce independent research.

Additionally, perceived conflicts of interest arose because connected analysts often met with the issuer and participated in pitching activities prior to the issuer awarding an IPO mandate. This resulted in concerns that connected analysts would convey positive research messages to the issuer in order to secure an underwriter appointment or a particular position within the underwriting syndicate.

As a result, the FCA was concerned that investor education and the price discovery process were based in large part on connected research that was potentially biased and prepared with a view to ensuring a successful IPO.

New Rules

The new rules are aimed at:

- restoring the centrality to the IPO process of an approved disclosure document;
- creating the conditions for independent research to be produced during the IPO process by establishing a level playing field for connected and unconnected analysts; and
- addressing perceived conflicts of interest relating to interactions between connected analysts and issuers in the pitching and appointment stages of the IPO process.

Under the new rules set out in the FCA Handbook's Conduct of Business Sourcebook:

- Syndicate banks must undertake an assessment of the potential range of unconnected analysts able to produce research on the issuer and ensure that such analysts have the same level of access to the issuer and are provided with identical information as connected analysts without unreasonable restrictions;

- Issuers must publish an FCA-approved registration document or prospectus before the publication of any connected research;
- Connected research may be published one day after the publication of the FCA-approved disclosure document if unconnected analysts are given access to the issuer at the same time as connected analysts, or after seven days if unconnected analysts are given separate access to the issuer; and
- Connected analysts are prohibited from participating in pitches and may only interact with the issuer after the appointment of the syndicate bank has been confirmed in writing.

Emerging Trends Under New Rules

Since the new rules came into effect, a number of issuers have completed their IPOs, with notable trends and market practices beginning to emerge.

Unconnected Analysts

All issuers have opted to provide separate access for unconnected analysts after the approved registration document has been published. This practice is expected to continue, given the overriding concern about maintaining the confidentiality of the IPO before it is announced. Many issuers continue to seek to control — to the extent possible — the narrative around their IPO, which is easier to do when access to the unconnected analysts is left until later in the process.

In addition, despite the level playing field resulting from the new rules, the number of unconnected analysts who have registered to receive information and subsequently published independent research during the IPO process has been limited.

Registration Document and Prospectus

A prospectus can take the form of a single document or a compilation of three separate documents: a summary, a registration document and a securities note. The registration document contains information about the issuer, including business disclosure and risk factors, and the securities note contains information about the securities and offering.

Although the new rules provide issuers the option to publish either an approved registration document or a prospectus prior to the publication of connected research, it is not possible to produce a full prospectus containing all required information at the start of the IPO process. Issuers therefore have opted to publish a registration document at the start. They also have opted to publish a single, approved prospectus later in the process that contains all relevant information on the issuer and offering, as investment banks have generally considered this preferable from a marketing standpoint.

Announcements

Issuers have traditionally published an intention to float (ITF) as the first public announcement of their IPO. The ITF contains summaries of the issuer's business, strengths and strategies, management, and key offering information.

While no regulations require publication of an ITF, the FCA indicated during the consultation process that it expected issuers to publish the ITF on the date that connected research is published (typically seven days after publication of the registration document). This would mean that the registration document is published in isolation. As a result, issuers have opted to publish a "pre-ITF" announcement on the date of the registration document, providing in it context for the registration document and guiding the narrative for the potential IPO. The pre-ITF announcement contains a summary description of the issuer, its preliminary intention to carry out the IPO and an invitation to unconnected analysts to register to receive information, but it omits information specific to the offering. On the date of publication of connected research, issuers have published a further announcement confirming their intention to proceed with an IPO, providing details of the offering and any updates to the pre-ITF announcement. The bifurcation of the ITF is expected to continue and supports increased issuer engagement with the market.

Conclusion

Although notable trends and market practices have begun to emerge, the number of IPOs coming to market has been limited due to market conditions and uncertainties surrounding Brexit. In addition, while organizations such as the Association for Financial Markets in Europe have published guidance and process papers on the new rules, each underwriting bank may have its own internal compliance policies for the new rules. As such, practices are likely to continue to evolve.

Click here for a full list of capital markets-related articles authored by Skadden attorneys in the last year.

New HKEx Rules Spur Bumper Year in Hong Kong Capital Markets, but Lasting Impact Remains Unclear

Contributing Partner

Christopher W. Betts / Hong Kong

Of Counsel

Antony Dapiran / Hong Kong

Paloma Wang / Hong Kong

In April 2018, the Hong Kong Stock Exchange's (HKEx) rule amendments permitting the listing of innovative, high-growth companies with dual-class share structures and pre-revenue biotech companies went into effect. The long-awaited amendments also facilitated the secondary listing in Hong Kong of Chinese companies with an existing listing on another stock exchange.

As if on cue, Xiaomi Corporation, a leading Chinese technology company, filed its listing application a few days later, to considerable fanfare. Xiaomi's eventual $5.4 billion initial public offering (IPO) in July 2018 was followed two months later by the $4.2 billion IPO of Meituan Dianping, a leading Chinese e-commerce platform for services. These were the two largest IPOs for Chinese private technology companies in Hong Kong's history. Meanwhile, leading biotech companies, including BeiGene and Innovent, took advantage of the new rules to complete $903 million and $421 million IPOs, respectively, as part of the first wave of pre-revenue biotech companies permitted to list on the HKEx.[1]

The HKEx's data indicates that it led all stock exchanges worldwide in terms of IPO funds raised in 2018, with the more than 200 companies listing on the HKEx raising a total in excess of $36 billion, up from approximately $14 billion in 2017. But whether the new rules will lead to a long-term increase in Hong Kong's competitiveness as a capital-raising venue remains to be seen. More than eight months after the rules went into effect, Xiaomi and Meituan Dianping remain the only two companies with dual-class share structures listed on the HKEx, and the exchange has made it clear that it intends to pick and choose which companies it considers sufficiently "innovative" to list under the rules. Notably, Tencent Music, the last major Chinese technology company to file an IPO in 2018, chose to undertake its $1.1 billion offering on the New York Stock Exchange.

200+ companies

listed on the HKEx in 2018 raised more than

$36 billion

Meanwhile, fewer than 10 pre-revenue biotech companies, all of which have China-focused businesses, have taken advantage of the new rules to list in Hong Kong (compared, for example, to the more than 400 biotech companies listed on the Nasdaq Stock Market), and questions remain as to whether Hong Kong can develop the necessary market ecosystem — including expertise among investors, professional advisers, analysts and the regulators themselves — to support a healthy long-term biotech market.

At the same time, rules permitting the trading of companies with dual-class share structures through the Shanghai and Shenzhen Stock Connect programs

[1] Skadden advised all four companies on their IPOs.

(which enable mainland China-based investors to trade directly in certain HKEx-listed securities and Hong Kong-based investors to trade directly in certain Shanghai and Shenzhen Stock Exchange-listed securities) are yet to be promulgated, though the HKEx announced in December 2018 that it would formulate such rules by mid-2019. The delay in rulemaking may have deterred some companies — in particular those that are already listed on another exchange and not necessarily in need of a new fundraising channel — from pursuing a Hong Kong listing.

Overshadowing the activity in Hong Kong was the roughly 25 percent fall in China's domestic equity markets, which saw the Shanghai Composite Index end the year as the world's worst-performing major equity index. The National Bureau of Statistics of China announced that the nation's official rate of gross domestic product growth for the year through September 2018 was 6.5 percent, down from 6.7 percent for the year through June 2018 and significantly down from the more than 10 percent growth rates seen as recently as 2009 and 2010. If the Chinese economy continues to slow, it could have a more sustained negative impact on Asian capital markets activity in the coming year. That said, China remains a developing economy, and there are still numerous rapidly growing companies with ongoing capital needs not being fully met by the largely state-controlled lending market in China that will consider using public equity markets to create a platform for raising capital and enhancing their profiles.

More broadly, the March 1, 2019, deadline for the Chinese government to reach a trade deal with the U.S. will loom large in the early part of the year, and the outcome of the ongoing negotiations may very well play a significant role in determining the trajectory of the Chinese economy for 2019 and beyond. Should a deal be reached, it would potentially remove a significant overhang for the capital markets and boost activity.

Click here for a full list of capital markets-related articles authored by Skadden attorneys in the last year.

Recent Trends in Renewable Energy

Contributing Partners

Lance T. Brasher / Washington, D.C.

Paul S. Kraske / Washington, D.C.

Associate

Mark A. Schlackman / Houston

The renewable energy sector has benefited in recent years from its growing cost-competitiveness, favorable climate change-related policies, and significant new capital investment from traditional and nontraditional debt and equity financing sources. The increased availability of capital since the last economic recession has supported the rise of renewable energy as a mature and cost-competitive asset class in many power markets around the globe. These trends likely will continue in the coming year, as the sustainable features of well-structured renewable generation assets with contracted output, low operating costs, and predictable revenue and cost streams remain attractive in the market.

Areas of the sector where much focus and momentum will build in 2019 include the following:

Portfolio Transactions

In the past several years, the renewable energy sector has been highly attractive to private equity, pension and infrastructure funds seeking to deploy substantial amounts of capital in increasingly large portfolios of renewable generation assets. We expect the formation of funds serving the sector to continue to increase as demand from a variety of financial investors grows for portfolios of high-quality, renewable generation assets. We also anticipate that project sponsors will continue to pursue the most competitive capital sources using innovative transaction structures at the portfolio level to complement the wide variety of construction debt, tax equity and other more traditional sources of project-level financing available in the market.

Offshore Wind

The development pipeline for new offshore wind projects in the United States has grown substantially in recent years, to approximately 25 gigawatts, according to U.S. Energy Information Administration estimates. Most will be located along the Northeast and Mid-Atlantic regions, primarily using proven fixed-platform technologies. Key opportunities on the West Coast are behind in development, and some require the use of newer floating technologies as a result of the deeper waters — an additional challenge for developers to overcome. The offshore wind market in Europe is further ahead of the United States, and several large European offshore wind developers are pursuing new projects that may enter the markets for financing and commence construction as early as this year.

Electricity Storage

One of the challenges the industry faces is the potential for large-scale deployment of renewable energy to raise grid reliability issues, since renewable generation assets depend on the availability of intermittent resources to produce power (*e.g.*, wind or sun). Advancements in energy storage technology have made the development of battery storage projects attractive opportunities that would help mitigate reliability concerns. As such, the number and size of battery storage projects is expected to continue to grow. In order to support the growth of storage, developers and sponsors of renewable energy projects are pursuing state policies similar to renewable energy portfolio standards that would raise the minimum amount of electric storage generation assets in states' power procurement efforts, or otherwise incentivize the development of additional storage capacity. While storage technology continues to advance, revenue models to facilitate broad implementation are still in development and remain an obstacle to investment.

Construction and Ownership by Regulated Utilities

Vertically integrated utilities have typically owned very limited numbers of renewable generating assets, relying instead on power purchase agreements (PPAs) with independent power producers. Within the last few years, however, several regulated utilities have been able to enter into arrangements for the acquisition and construction of renewable energy projects and have gained the support of public utilities commissions for these investments. Increased ownership of renewable energy projects by regulated utilities has the potential to alter the market landscape, as more regulated utilities choose to own renewable power generation assets rather than contract with developers to purchase power, but ultimately this could result in the deployment of more renewable energy.

Financial Hedges

The explosive growth of renewable energy in the U.S. has been facilitated significantly by long-term PPAs with load-serving entities seeking to comply with renewable energy portfolio requirements. In recent years, however, long-term PPAs have become more and more scarce in the market. Consequently, developers are increasingly relying on alternatives, such as financial hedges with banks and other counterparties, whether through contracts for differences, revenue puts or synthetic heat rate call options.

Corporate PPAs

Corporations have become significant procurers of renewable energy in recent years, including many high-profile multinational corporations such as Facebook, Google, Amazon, AT&T, Microsoft and Walmart. Corporate buyers view renewable energy procurement as part of their energy cost management strategy and seek to benefit from a marketing standpoint in making a contribution toward carbon neutrality. While corporate PPAs are generally structured as financial hedges, some provide for physical delivery. As additional companies look to take advantage of new opportunities in renewable power, demand for corporate PPAs should expand.

Pending Expiration of Federal Tax Incentives

Federal tax incentives that have supported the development of the renewable energy industry will be winding down in coming years as the sunset provisions in current tax laws begin to take effect. As a result, developers will be keenly focused on taking advantage of the remaining opportunities for available tax credits, and will utilize substantial near-term efforts to satisfy construction commencement requirements and qualify assets for safe harbors, including through the repowering of existing wind projects.

Climate Change and Clean Energy Initiatives

The renewable energy industry likely will continue to benefit from favorable climate change policies and other clean energy initiatives in 2019. Despite the stepping-down of key tax credits and certain policies within the federal government to bolster the U.S. fossil fuel industries and lighten environmental and other regulatory requirements, renewable energy policies continue to expand at the state level. California recently enacted a bill that will increase its renewable portfolio standard to 60 percent by 2030 and move the state to 100 percent zero-carbon electricity by 2045. Several states are expected to follow this trend given the outcome of the recent elections, and other state efforts to increase renewable generation capacity are well underway, including through additional offshore wind procurement and increased public utilities commission support for renewable energy acquisitions.

In sum, the renewable energy sector is expected to remain strong in 2019 as it continues to evolve in a robust environment with many new opportunities.

Click here for a full list of energy and infrastructure projects-related articles authored by Skadden attorneys in the last year.

Second Circuit Adopts Secured Creditor Cramdown Standard Based on Market Efficiency

Contributing Partner

Paul Leake / New York

Associate

Cameron M. Fee / Wilmington

In 2017, the U.S. Court of Appeals for the Second Circuit held in *In re MPM Silicones, LLC* that the appropriate interest rate for replacement notes issued to secured creditors under a "cramdown" Chapter 11 plan must be a market rate if an "efficient market" exists. If no such market exists, however, the formula rate (effectively, the prime rate plus 1-3 percent) must be applied. While the decision settled the question concerning the applicable cramdown interest rate methodology in the Second Circuit, it left unresolved a critical element of that methodology: What constitutes an "efficient market"?

A close reading of *In re MPM* and the precedent upon which it relied reveals that a practical, transaction-based approach should be used in assessing market efficiency rather than an economic theory approach (*e.g.*, the efficient capital market hypothesis).[1]

Chapter 11 'Cramdown'

The Bankruptcy Code provides two paths by which a Chapter 11 plan can be confirmed — consensual or nonconsensual — depending on how creditor classes vote. If a class of creditors rejects a plan, a debtor can still confirm it if it does not "discriminate unfairly, and is fair and equitable" with respect to the dissenting class. In the lexicon of bankruptcy practitioners, this latter confirmation method is colloquially referred to as "cramdown."

Under the Bankruptcy Code, a plan is fair and equitable to a class of secured claim holders if such holders receive deferred cash payments totaling at least the allowed amount of their claims. The central inquiry under this present value calculation is the appropriate interest rate, called the discount rate, to apply to the debtor's deferred cash payments so that the sum of these payments equals the allowed amount of the secured creditor's claim. Despite the discount rate playing such a central role in this calculation, the Bankruptcy Code is silent as to how to determine it, which has resulted in courts developing many different approaches for determining the discount rate in Chapter 11 cases.

MPM Decision

In April 2014, Momentive Performance Materials Inc. (MPM) filed for relief under Chapter 11. Under MPM's Chapter 11 plan, its senior lien noteholders could choose between (1) accepting the plan and receiving full payment in cash, but without any make-whole claim; and (2) rejecting the plan, preserving their right to litigate the make-whole claim and "receiving replacement notes with a present value equal to the Allowed amount of such holder's Claim." The senior lien noteholders rejected the plan, and consequently, MPM sought to confirm its plan by cramming down these dissenting holders using the formula rate. The bankruptcy court held that the formula rate applies, and the district court affirmed, after which the senior lien noteholders appealed.

The Second Circuit disagreed that the formula rate should always apply and held that a two-step approach must be used in determining the appropriate cramdown interest rate in Chapter 11. A market rate should apply in Chapter 11 cases where an efficient market exists; if an efficient market does not exist, the formula rate

[1] This article was adapted from "*Momentive* and the 'Efficient Market': The Cramdown Saga Continues," published in *Norton Annual Survey of Bankruptcy Law*, 2018 ed., with permission from Thomson Reuters.

applies. Relying heavily on the 2004 U.S. Supreme Court decision *Till v. SCS Credit Corp.*, the court reasoned that this two-step approach best aligns with the Bankruptcy Code and relevant precedent. Ignoring efficient market rates would depart from long-standing precedent directing that the "best way to determine value is exposure to a market." The court observed that where some market valuation may be available, such valuation should be favored over decisions untested by a competitive choice. The Second Circuit ultimately remanded to the bankruptcy court to ascertain if an efficient market exists and, if so, to apply the market rate.

Implications

In re MPM is a significant decision for the secured lending community. A debtor in the Second Circuit — one of the largest forums for corporate bankruptcy cases — now cannot force a secured creditor into below-market paper if an efficient market exists. Notably, the delta between the formula rate and market rate can be substantial. For example, in *In re MPM*, the first-lien noteholders estimated that using a market rate (roughly 5-6+ percent) instead of the formula rate (4.1 percent) would result in them receiving approximately $150 million more in aggregate interest payments.

But the question of what constitutes an efficient market remains unanswered. Should market efficiency be tested in the same manner as it is in the securities law context under Rule 10(b)-5 of the Securities Exchange Act, for which there is a substantial body of case law evaluating market efficiency, or some other method given that the relevant market is arguably original issuance because specific debt is being issued by a specific debtor?

In *In re MPM*, the Second Circuit seems to define an efficient market differently, and substantially more narrowly, than has been assumed in the securities law context. In describing what constitutes an efficient market, the Second Circuit explained that "courts have held that markets for financing are 'efficient' where, for example, 'they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under the cramdown plan.'" The court found that a market is efficient if it "generates an interest rate that is ... acceptable to sophisticated parties dealing at arms-length." These descriptions of efficiency are substantially narrower than the robust, open and transparent trading markets required by courts in the securities law context.

In relying on *Till*, the Second Circuit seems not to be seeking a sea change to Chapter 11 practice. *Till* held that the formula rate should apply for calculating the cramdown interest in Chapter 13. In arriving at this conclusion, *Till* emphasized that the method for determining the appropriate cramdown interest rate should not be complex, costly or outside the bankruptcy court's area of expertise. Moreover, in rejecting various other approaches, *Till* explained that these methods were complicated and imposed significant evidentiary costs, whereas the formula approach involved "a straightforward, familiar, and objective inquiry, and minimize[d] the need for potentially costly additional evidentiary proceedings."

The Second Circuit seemingly adopted a similarly practical, objective approach to determining market efficiency — one consistent with Supreme Court precedent and squarely within the bankruptcy court's bailiwick. In *dicta*, the Second Circuit observed that while MPM obtained offers from only three exit lenders during its bankruptcy case, if the bankruptcy court had given credit to the expert testimony regarding the exit financing available to MPM, that testimony "would have established a market rate." Thus, the Second Circuit implicitly suggested that such facts — obtaining exit financing offers (potentially as few as three) — constitute an efficient market.

The Second Circuit's two-step approach will likely result in lengthy and expensive evidentiary hearings until the lower courts agree on how to assess market efficiency. Recently, the bankruptcy court in MPM conducted a two-day trial on whether an efficient market existed — and if one existed, what should be the market rate. The trial consisted of a classic battle of the experts over how to assess market efficiency.

Although the bankruptcy court has not yet ruled, the judge remarked at the trial that courts applying a market-based approach have done so primarily based on what has happened in the case, as opposed to extensive expert testimony on debt markets and whether the parties were sophisticated and dealing at arm's length. He further observed that a market-based approach would be fairly easy to apply. *In re MPM* and *Till* both teach that just such a straightforward, less expensive and familiar approach should be used in evaluating market efficiency in Chapter 11.

Click here for a full list of corporate restructuring-related articles authored by Skadden attorneys in the last year.

2019 US and Global M&A Outlook: Despite Mounting Headwinds, Potential Remains for the New Year

Contributing Partners

Stephen F. Arcano / New York

Thomas H. Kennedy / New York

Mergers and acquisitions activity in the U.S. and globally was again robust in 2018. Despite concerns early in the year that activity could be dampened by emerging worries over trade, rising interest rates and global political uncertainties, deal activity remained resilient, facilitated by relatively stable equity markets and readily available financing that prevailed for a significant portion of the year. However, the pace of activity slowed over the second half, particularly in the fourth quarter as market volatility grew and financing markets tightened.

The value of announced transactions in 2018 increased substantially from 2017, with global transaction volume of over $3.5 trillion, and U.S. volume of approximately $1.5 trillion, up roughly 11.5 percent and 15.4 percent, respectively, from 2017, according to Mergermarket. While not record-setting, these volume levels are close to the high-water marks of 2015 and 2007. The number of "megadeals" — the majority of which were announced in the first six months of the year — was notable, with at least 36 deals having a transaction value in excess of $10 billion. The number of transactions with an announced value greater than $5 billion increased substantially both globally and in the U.S., and accounted for over a third of M&A value. Notably, while average deal values increased from the prior year, the number of transactions was down.

Activity was again driven primarily by strategic transactions, as corporations continued to be willing to make substantial investments to respond to the imperatives of growing earnings and enhancing competitive platforms by augmenting technological capabilities, product offerings and geographic reach. Private equity (PE) activity picked up early in the year as financial sponsors sought to deploy record levels of available capital into bigger transactions, although activity moderated in the second half.

Rise of 'Megadeals'

at least

36 deals

valued over $10 billion

Selected 2018 Trends

Seeking Scale. Many of the large transactions in 2018 involved expansion by companies in their existing industries, seeking to grow customer base through horizontal transactions and to broaden offerings to existing customers through vertical acquisitions. This strategy of pursuing revenue and margin growth through scale is a perennial driver of merger activity but was notable in 2018 because it drove a number of sizeable transactions, as even large companies sought significant deals capable of moving the needle in industries as diverse as health care, technology, media and industrials.

Impact of Disruption. Technology's potential to significantly alter business models and reshape entire industries, and its impact on the M&A market, was one of the most significant trends to emerge in this M&A cycle. Acquisitions of technology businesses by nontechnology companies, and acquisitions of new technology by technology businesses, contributed significantly to 2018 activity levels in the U.S. and globally.

Activism. Activist funds continue to have a meaningful impact on corporate strategic activity. Assets under management at activist funds remain high, the number of campaigns and amount of capital being deployed continue to mount, and the influence of large U.S. funds beyond North America continues to grow. 2018 saw numerous campaigns seeking to pressure corporations to pursue strategic changes, most frequently including board change and M&A initiatives such as sale of the company, or the sale or spin-off of businesses. Consistent with trends in recent years, a significant number of campaigns were pursued by first-time activists and "occasionalists." Traditional institutional investors took a vocal role, providing their views through engagement with both those in management and activists. Deal activism, in which activist funds seek to renegotiate price (known as "bumpitrage") or stop a transaction altogether, was pursued at both targets and acquirers. Continued market volatility provides both opportunities and challenges for activist funds. Given the prevalence of activism and the potential for unsolicited activity on the part of strategic acquirers, boards and management teams must be prepared, particularly in the context of considering transactions.

Decreased Acquirer Shareholder Support. Shareholders of target companies have been less supportive of transactions than they were earlier in the cycle, reflecting growing concerns over strategic fit, asset prices and leverage levels. Excess returns for acquirer shareholders upon transaction announcement have been in decline for several years, reversing the trend of positive returns on announcement of these transactions experienced earlier in this M&A cycle. Coupled with increasing activist challenges to transactions (and strategies seeking profit from transaction withdrawal), this has caused transaction parties to tread more cautiously.

Private Equity. In recent years, private equity firms have struggled to find attractive targets and compete with strategic acquirers. In 2018, however, private equity seemed to once again find greater success in sourcing deals. Sitting on more than $1 trillion of dry powder in 2018, these firms were willing to take on larger transactions, particularly in the first half of the year. Globally, leveraged buyouts activity for the year was up by over 25 percent in value. Private sources of capital in addition to traditional PE firms such as family offices and multifamily funds likewise were active players in the M&A arena. In 2019, private capital buyers may benefit from opportunities created by equity market volatility. However, if challenges in leveraged financing markets continue into the new year, that could affect the ability to take advantage of some of those opportunities.

Regulatory. There has been significant focus over the past year on regulatory challenges to merger transactions, primarily involving antitrust/competition and national security approvals. In the antitrust/competition arena, regulatory agencies have brought several high-profile merger challenges in the U.S., Europe and China; however, it is unclear at this point if these are attributable to changes in enforcement policy, a function of corporations pursuing more aggressive transactions or other factors. (See "US and EU Antitrust Enforcers Remain Active and Aggressive, With Some New Wrinkles.") New or revised regimes for national security review of transactions in a number of jurisdictions, coupled with heightened scrutiny of sensitive acquisitions, have created greater uncertainty and increased the challenges associated with completing cross-border transactions in certain industries. (See "Foreign Investment Control Reforms in Europe.")

Looking Ahead

Notwithstanding the robust level of M&A activity in 2018, cautionary signs have appeared in the market. Activity slowed meaningfully later in the year, with the value of transactions in the second half being more than 25 percent lower than the first-half value, and fourth-quarter value of approximately $700 billion being the lowest level since 2013. The decline in transaction volumes in the second half of the year, particularly in the fourth quarter, is a concerning sign, as is the decrease in number of transactions compared to 2017. As we move later into the market's current cycle, there is a mounting sense of nervousness that what were once viewed as potential concerns have become issues of more immediate importance. Some of these headwinds include apprehension over the duration of the economic cycle and the growing consensus that the rate of economic growth will slow in the coming year; trade and tariffs; increased equity market volatility; rising interest rates; and increased volatility in leveraged loan markets and tightening of borrowing conditions. (See "Enhanced US Export Controls and Aggressive Enforcement Likely to Impact China" and "US Capital Markets Face Uncertainty Entering 2019, With Volatility Likely to Continue.")

At the same time, several factors suggest significant M&A activity can continue in the coming year. Most importantly, the strategic imperatives to grow earnings and optimize business platforms driving corporate merger activity in the past few years have not diminished. Furthermore, activist funds are continuing to pursue platforms involving the sale of public companies or the disposition of their businesses (reinforcing companies' pursuit of corporate clarity through the sale or spin-off of noncore businesses). Corporate buying power remains high, with access to significant balance sheet cash and to the debt financing markets, although there have recently been challenges in leveraged loan/high-yield markets. Finally, private equity buyers remain anxious to deploy substantial capital. Absent meaningful deterioration in fundamental economic conditions or sustained disruption of access to deal financing, these drivers should continue to support significant transaction levels in the coming year.

Click here for a full list of mergers and acquisitions-related articles authored by Skadden attorneys in the last year.

Latin America Trend to Watch: Representations and Warranties Insurance

Contributing Partner

Paola Lozano / New York

Counsel

Ralph E. Pérez / Chicago

Over the course of the past year, we have observed a progressive increase in the frequency with which representations and warranties insurance (RWI) has been considered for Latin America M&A transactions. The increase in private equity-led Latin America M&A transactions likely has had an impact on the rising interest in RWI, in no small part as a result of the life expectancy of private equity funds. As more region-specific funds reach maturity and the return of capital to their investors becomes imminent, the pressure increases to seek clean exits where a selling fund does not retain significant post-closing financial risk through indemnity covenants.

Deal-makers also have been motivated to find alternatives to traditional post-closing risk allocation in Latin America because of the increased complexity of deals, the number of regulatory or court-mandated transactions and distressed divestments, the increased sophistication of passive investors that are unwilling to assume direct risk, and the more competitive nature of global auction processes.

The coming year is expected to bring an uptick in deal-makers seeking to deploy RWI in Latin America's complex M&A transactions.

Rise of RWI

RWI protects the insured party against financial losses resulting from unknown breaches by a seller or target of their representations and warranties (including litigation costs) in a transaction agreement. As with other novel legal and financial risk allocation structures and solutions that have been introduced in Latin America, RWI policies first took root elsewhere.

In the U.S., RWI has been around since the late 1990s and gained meaningful traction in 2011. RWI policies written by finance and insurance company AIG between that year and 2016 (the last year covered by AIG's most recent RWI report) represented a significantly larger pool of transactions than the period prior to 2011. Global demand for RWI policies also has more than tripled since that year, according to reinsurance company Munich Re. Latin America deal-makers have been paying close attention to this evolution. According to insurance brokerage and risk management services firm Arthur J. Gallagher & Co., AIG has noted at seminars that it alone has paid more than $100 million in claims.

Such favorable reports of claims being paid and RWI carriers acting reasonably throughout the claims process, coupled with increased recognition of the benefits of RWI for buyers and sellers, are luring Latin America deal-makers previously on the sidelines into the game.

However, Latin America deal-makers should proceed with caution and work with their RWI brokers as early as possible to confirm the insurance is available to them and the cost is acceptable under the specific circumstances. While RWI policies have been implemented in a broad range of industries across Latin America, not all countries are regarded as equal by RWI carriers. It appears Chile and — at least until the first quarter of 2018 — Mexico have had higher levels of RWI carrier interest than other significant jurisdictions, such as Argentina, Brazil and Colombia. As the region continues to warm up to the concept of fronting some costs for unknown risks that may never materialize, RWI carriers also are being cautious. Each market is different, and the common perception of higher political and economic volatility — including widespread corruption scandals, which tend to increase fears of fraud — may cause RWI carriers to be more prudent and increase prices in emerging markets. Similarly, less deal flow and higher perceived uncertainty on underlying applicable law of the representations and warranties' subject matter also makes it more challenging to put a price tag on unknown risks.

The Latin America M&A transactions that are likely to fare the best in terms of RWI coverage and cost have the following characteristics:

- a well-regarded ultimate beneficial owner of the insured party;
- an insured party in the U.S. or other jurisdiction with high historical deal flow;
- a simple business model that is not heavily regulated;
- sophisticated counsel and accountants;
- an English-language acquisition agreement governed by U.S. or U.K. law;
- a high-quality due diligence process with a U.S.-style detailed diligence report; and
- arm's length negotiation of representations and warranties.

Implementation of RWI in Latin America

While there is no shortage of RWI guides for the U.S., such resources with respect to Latin America are limited. The discussion below of the main features of RWI in Latin America draws on our deal experience and on information that key RWI brokers have provided us.

RWI Basics. A policy issued to a buyer, known as a buy-side policy, requires the carrier to pay the buyer upon a verified claim. One issued to a seller, known as a sell-side policy, requires the carrier to pay the seller following a verified payment by the seller to the buyer with respect to an indemnity claim.

RWI significantly reduces the scope of a seller's indemnity obligations, as the buyer looks mostly to the RWI carrier instead of to the seller for recovery in the covered areas. SRS Acquiom's 2018 Buy-Side Representations and Warranties Insurance Deal Terms Study found that, where buy-side RWI is present, the median size of the seller's escrow expressed as a percentage of the purchase price drops from 10 percent to just 1 percent.

Since the buyer looks to the RWI carrier instead of the seller for recovery in the covered areas, RWI significantly reduces a buyer's exposure to the risks of seller credit and enforcement of foreign judgments. The latter is of particular importance to a buyer if, as is the case in many Latin America M&A transactions, the seller holds assets in multiple jurisdictions, and certain jurisdictions in the region have complex foreign judgment enforcement rules.

RWI can be a useful tool for a buyer entering a Latin American market for the first time. Such a buyer often keeps much of the target business' existing management in place after the closing and may structure the transaction so the seller keeps an ownership stake, even if temporarily, in the target business post-closing. Under those circumstances, the buyer's assertion of an indemnity claim could sour its relationship with its new employees and partner. A buy-side RWI policy might enable the buyer to avoid this awkward situation, since the buyer would make the claim to the RWI carrier.

In a hotly contested auction, a prospective buyer can make its bid stand out by easing the seller's indemnity obligations in reliance on a buy-side RWI policy. This is especially true in Latin America M&A, as RWI is not yet as common.

RWI also can benefit both sellers and buyers in an M&A transaction with multiple sellers, where sellers — whether as a matter of policy or simple financial wherewithal — do not offer joint and several liability for indemnities, because RWI obviates the need to pursue multiple parties for varying percentages of losses and allows a single process with the RWI carrier.

RWI policies that have been bound for Latin America M&A transactions have mostly been buy-side. It is unclear whether this is due to RWI carriers having less of an appetite for sell-side RWI policies or sellers not being willing to cover the cost of the policy or accept the mechanics of the seller first fronting the indemnity payments and then getting reimbursed by RWI carriers.

Cost. Generally, RWI policies are more expensive in Latin America than in the U.S. For instance, premiums, which are one-time and usually expressed as a percentage of the RWI policy limit, range at least 0.5 percent higher on each end for a Latin America transaction than the 2-4 percent in the U.S. There is no difference in cost when it comes to RWI broker fees and taxes on the policy (which typically are dependent on the registered address of the insured party). Some expected cost differences also exist among different Latin America jurisdictions that may be driven by deal flow, legal certainty and the perceived macroeconomic risk (including currency risk) in each locale.

Time. Some brokers indicate that the RWI process in Latin America is only a couple of days longer than for a U.S. policy, while others suggest it's an additional three weeks. Other than taking slightly longer to complete, the process for a Latin America RWI policy is no different than for a U.S. one. The duration of the process may depend on whether the RWI carrier is willing and able to rely on the buyer's diligence reports rather than require full-blown diligence by its independent U.S. and local counsel.

Policy Provisions. The deductible/retention for Latin America RWI policy often is in the 1-2.5 percent range, compared to generally below 1 percent for a U.S. policy. As for a policy limit, it is unclear whether it is lower in Latin America than in the U.S. Some RWI brokers say that Latin America RWI policies have lower limits due to limited RWI carrier appetite. Others maintain that RWI policy limits in Latin America tend to be higher because of smaller deal sizes. Still others believe the limits are comparable to those in the U.S., at 10 percent of the purchase price.

Exclusions. Insurers protect against unknown risk. Therefore, as is the case in other jurisdictions, RWI policies typically do not cover known issues, including those revealed in the diligence process or identified in the disclosure schedule. There also are various subject areas that RWI carriers will generally attempt to exclude from RWI policies, including data protection and cyberattack matters, compliance with certain labor and employee benefits laws (including on wages and pension matters), certain tax matters such as the ability or time frame in which a target or buyer may utilize net operating losses, open audits, transaction-related taxes and product liability, and fraud by the insured party. Additional subject areas that RWI carriers typically seek to exclude for Latin America RWI policies include bribery and corruption, money laundering, and expropriation risk.

Among other issues, quantifying such risks is extremely difficult for RWI carriers on the basis of transaction diligence, and although they may be perceived as having a low likelihood of occurring, these risks have been more pervasive in Latin America than elsewhere in the past couple of years. Furthermore, when the risk materializes, it tends to have a severe and long-lasting negative impact not only on the target but also on the buyer. Separate, additional insurance policies to cover gaps in the RWI policy may be available at increased cost for some, but not all, of these exclusions.

Conclusion

With its expected increased prominence in the new year, now is the time for deal-makers with roles in premier Latin America M&A transactions to get up to speed on RWI.

Click here for a full list of mergers and acquisitions-related articles authored by Skadden attorneys in the last year.

US and EU Antitrust Enforcers Remain Active and Aggressive, With Some New Wrinkles

Contributing Partners

Kenneth B. Schwartz / New York

Ingrid Vandenborre / Brussels

Associates

Michael J. Frese / Brussels

Michael J. Sheerin / New York

Antitrust enforcement agencies in the U.S. and Europe were once again busy in 2018, particularly in the area of merger review. In the U.S., despite new leadership at both the Department of Justice (DOJ) and the Federal Trade Commission (FTC), the pace of and approach to merger enforcement largely remained unchanged from the Obama years. The European Commission also was active in 2018 and continues to explore new theories of potential harm.

US Enforcement Stays the Course, With Renewed Interest in Vertical Mergers

Both U.S. antitrust agencies pursued vigorous merger enforcement agendas in 2018. The DOJ attracted the biggest headlines when it sought and failed to enjoin AT&T's proposed acquisition of Time Warner. It was the first time in 40 years that either agency requested to enjoin a vertical merger, and it represented the DOJ's first loss in a merger case in more than a decade. The AT&T case also reflected the most notable change in the DOJ's enforcement approach in 2018: a complete unwillingness to accept behavioral remedies (*i.e.*, commitments by merging parties to engage in certain behavior) as an alternative to structural relief (*i.e.*, divestitures). This is notable because Comcast's 2011 acquisition of NBC Universal — which raised very similar issues to those in the AT&T deal — was resolved with behavioral remedies without a lawsuit. The DOJ also was very active in a slew of other deals, suing to block a consummated merger, causing parties to abandon several deals in response to DOJ objections and obtaining divestitures in several transactions.

The FTC was equally busy, obtaining injunctions against two mergers in federal court and obtaining divestitures or behavioral relief in several other transactions. (The FTC has not adopted the DOJ's hard line on behavioral remedies.) As with the DOJ, new leadership (in the case of the FTC, a completely new slate of FTC commissioners) has not appeared to result in any drop-off in merger enforcement activity.

Behind the curtain, we also are seeing both agencies step up their scrutiny of and standards for proposed remedies, even aside from the DOJ's new policy on behavioral remedies. This does not come as a surprise, as Assistant Attorney General Makan Delrahim, who heads the DOJ's Antitrust Division, and FTC Chairman Joseph J. Simons promised changes in this area during their respective confirmation hearings. As a result, parties should expect a lengthy and onerous review process when proposing divestitures or other remedies to get a deal done.

We did not see any material changes to the substance of merger review in 2018, and we expect that to remain the case in the new year. Both agencies have demonstrated they will continue to scrutinize horizontal transactions in concentrated industries in which the merging parties appear to be close competitors. In addition, following AT&T, both agencies seem to have a renewed interest in vertical mergers, particularly those involving parties with a significant presence at one or both levels of a supply chain (*e.g.*, AT&T has a significant presence in television distribution and Time Warner in producing television content for distribution). The agencies also have discussed issuing new guidelines for nonhorizontal mergers, but the timing and process for issuing such guidelines largely remain unknown. While the agencies remain active, they have shown little appetite to heed populist calls for enhanced enforcement efforts, including revisions to the antitrust laws, based on less traditional theories of antitrust harm (*e.g.*, big data, privacy, innovation, conglomerate effects). These theories are gaining traction in the academic community and in other jurisdictions, but as of yet little evidence indicates that they will meaningfully influence the outcome of U.S. merger reviews.

New leadership at the agencies appears open to applying their experiences from private practice to improve the merger review process. In September 2018, Delrahim took the lead in this respect when he announced a series of potential reforms designed to "modernize the merger review process" to avoid "unduly long merger reviews ... [that] waste public and private resources." Among other promises, the DOJ has said it will resolve most merger investigations within six months, limit the scope of burdensome requests for information and afford parties greater access to key DOJ decision-makers earlier in the process. Delrahim has been clear, however, that parties should not expect faster results unless they are willing to do their part by being transparent, providing information in a timely manner and foregoing the alleged gamesmanship that the agencies have seen in some investigations (*e.g.*, over designations of privileged documents).

Although these are welcome promises, it remains to be seen when these policies will be implemented and to what extent the DOJ will adhere to them. In addition, it is unclear whether the FTC will follow suit. If not, there may be substantial differences in the duration of merger reviews at the two agencies. This is noteworthy, as the agencies appear to be fighting with greater frequency for clearance to review major transactions. As a result, developing a comprehensive antitrust strategy in advance of signing a transaction agreement is crucial, including how and when to engage with the antitrust agencies.

A Steady Path in the EU Despite Leadership Changes at the European Commission

The current European Commission's term comes to an end on October 31, 2019, and changes in leadership are anticipated. Unless Commissioner Margrethe Vestager is reappointed, someone else will take the helm of the European Union's main merger and antitrust authority. Additionally, the head of mergers within the Commission's Directorate-General for Competition (DG Comp), Carles Esteva Mosso, will move to the state aid directorate. He will be succeeded by Cecilio Madero Villarejo, who will be vacating DG Comp's top job for antitrust.

In terms of case practice in 2019, we expect a continuation of themes that characterized merger and antitrust activity in 2018: online sales, pricing and margins, innovation, and big data. Digitization, which comprises not only questions around big data but also various other implications of new-generation information technologies, may become a new focus area. The Commission has appointed three outside advisers to report on competition challenges associated with digitization. The report is due on March 31, 2019.

Online Sales. Since 2015, the "EU digital single market" has been the Commission's flagship policy, through which it has attempted to break down e-commerce barriers across the European Economic Area using legislative initiatives and antitrust investigations. In 2018, the Commission issued two infringement decisions, fining four electronic appliance manufacturers and clothing company Guess for allegedly restricting online cross-border sales. There are ongoing investigations in the areas of pay-TV services, merchandising rights, hotel bookings and video games. 2019 will be the year in which we will see the Commission's attitude toward enforcement take shape, in particular regarding whether it will seek fines.

Pricing and Margins. Pricing and margins came under increased scrutiny at the Commission in 2018 as well. One of the electronic appliance cases mentioned above was the first case in which the Commission took issue with pricing algorithms — in that case, to monitor resale prices. But pricing is also central to some ongoing investigations, both by the Commission and national regulators. The pharmaceutical industry has been the main target of these investigations, which are based on concerns over "excessive pricing" by a dominant company. Commission officials also have been focused on high prices in the area of merger control. On several occasions in 2018, DG Comp's chief economist stated that high profit margins may increase the risk of anti-competitive leverage and should therefore be part of the review process.

Innovation. Concerns around potential reductions in innovation were another driver of the Commission's enforcement agenda. In the area of mergers, the Commission has not shied away from remedies to maintain premerger innovation levels. Its investigation into potentially collusive conduct with respect to car emission technology shows that the innovation agenda is not limited to merger control. Other cases relating to new-generation information technologies may follow, depending on what the digitization report concludes.

Big Data. Another hot topic in competition law circles across Europe was big data and platforms, and this is expected to continue in 2019, especially given the Commission's interest in digitization. One of the key questions is whether, and to what extent, access to and use of big data can be considered to confer market power in relation to particular goods or services. This has become a thorny issue in the context of merger control. Another central issue is to what extent platform and network hosts can collect and make use of user data, including when host and user offer competing products or services through the platform. We expect more clarity on these issues in 2019 as the German investigation into Facebook's data collection practices runs its course.

Click here for a full list of antitrust/competition-related articles authored by Skadden attorneys in the last year.

US Corporate Governance: Turning Up the Heat

Contributing Partner

Marc S. Gerber / Washington, D.C.

U.S. public companies face a wide array of challenges, from greater market volatility and increasing economic and geopolitical uncertainty to disruptive technologies, artificial intelligence, social media and cybersecurity incidents. The new year also began with a shutdown of the federal government and a divided government, reflecting deep societal schisms on numerous and varied questions that may impact the environment in which companies and boards operate.

Public companies face traditional challenges regarding long-term financial performance and earnings growth, as well as newer ones presented by a range of topics that fall within the umbrella of environmental, social and governance, or ESG. The "E" and "S" topics include items such as sustainability, climate change, use of plastics, water management, human capital management, gender pay equity, diversity, supply chain management, political and lobbying expenditures, the opioid crisis and gun control. For some, these issues raise fundamental questions about the role of corporations and businesses in society.

The common denominator among all of these items is risk. The increased level of risk will result in investors seeking to better understand a company's business strategy; how the company manages and mitigates these risks; and whether the company's board of directors is well-suited — including in terms of skills and experiences, diversity of viewpoints and fresh perspectives — to oversee management's execution of that strategy and mitigation of those risks. The questions investors pose will not be new, as many have been asked with increasing frequency over the past decade. But with U.S. corporations entering a period of increased risk and volatility, companies and boards should expect these questions to be asked with greater frequency and urgency, and should expect lackluster responses to be met with less patience and increased demands for change — in strategy, management and even board composition.

The Role of Corporations, Business Strategy and the Rise of ESG

The level of ESG-focused investment exceeds $20 trillion of assets under management, and new ESG funds and investment vehicles are being launched with increasing frequency. None of those factors changes the fundamental premise that investments are made to achieve financial returns. In its 2018 annual letter to CEOs, titled "A Sense of Purpose," BlackRock reiterated its request that companies publicly articulate their strategic framework for long-term value creation, noting that a company's strategy must include a path to achieving financial performance.

The challenge companies, investors and policymakers face is to better understand and account for the nexus (if any) between various ESG matters and long-term value creation. As articulated in BlackRock's 2018 letter:

> Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.

Along those lines, in 2018, Sen. Elizabeth Warren, D-Mass., introduced the Accountable Capitalism Act, which would require companies with more than

$1 billion in revenues to obtain a federal charter stating the company's "purpose of creating a general public benefit," defined as "a material positive impact on society resulting from the business and operations" of the company. While this legislation is unlikely to be enacted, the bill reflects the larger debate regarding the role of corporations in society and calls into question the fiduciary model of shareholder primacy that governs corporations organized under the laws of Delaware and many other states.

Larger philosophical questions aside, investors are increasingly focusing on ESG matters as part of their investment theses, whether seeking superior returns from companies positively addressing environmental or social issues, factoring ESG into their analyses of risk-adjusted returns or divesting from sectors viewed as presenting long-term risks that outweigh current returns. The increase in ESG investing has, in turn, resulted in a corresponding increase in ESG ratings and requests for companies to increase and improve their ESG disclosures, including calls to comply with the many frameworks developed by assorted groups and a petition for the Securities and Exchange Commission (SEC) to require ESG disclosures.

Importantly, in a December 2018 speech, SEC Chairman Jay Clayton reminded companies and investors of two key principles: that companies should focus on disclosing material information that investors need to make informed investment and voting decisions, and that investors should focus on each individual company's facts and circumstances. Although these principles represent important guideposts, the level of ESG disclosures by companies has increased significantly, often in the form of sustainability or similar reports posted on websites and, to a lesser degree, in proxy statements, annual reports and other investor presentations. All signs point to the continuing growth of ESG disclosures so that companies can better control the narrative rather than cede the space to ESG raters and other third parties.

The 'New' Risks: Cyber, Human Capital and Company Culture

As noted above, companies will continue to face all of the traditional business risks, including those relating to the economy, trade issues, a competitive and dynamic marketplace, technological disruption, and changes in consumer tastes and spending patterns. In addition, less traditional risks continue to emerge and evolve.

Cybersecurity

Varied forms of cybersecurity risk remain an ongoing corporate issue. In addition to cyber intrusions, hacking and theft of confidential or personal information, the SEC reminded companies in October 2018 that many are victimized by cyber fraud in the form of "business email compromises": fraudulent emails that appear to come from a senior executive to an employee or from a vendor to the company, and directing payment of funds to a particular account. SEC guidance earlier in the year, followed by enforcement actions, also reminded companies of the need to consider disclosure obligations in connection with cyber incidents and to consider closing securities trading windows for employees in the wake of potentially material cyber incidents.

Human Capital Management

Consistent with an economy in which a corporation's significant assets are in the form of people who can walk out the door, investors have increasingly focused on "human capital management," which includes topics ranging from employee health and safety to workplace diversity to employee training and development. Although many of these historically may have been viewed as topics for management and not the board, investors have expressed an expectation that boards of directors be engaged in oversight of a company's human capital management as part of the board's oversight of business strategy and risk management. In one of the latest manifestations of investor focus on these topics, in December 2018, the New York City pension funds and New York City Comptroller Scott M. Stringer called on portfolio companies to end "inequitable employment practices" such as mandatory arbitration for employment-related claims and nondisclosure requirements in settlement agreements relating to claims of unlawful workplace harassment.

Company Culture

More broadly, various instances of alleged sexual harassment by senior executives and alleged improper or unethical workplace or business practices have caused investors to focus on the question of the board's oversight of company culture. Beyond setting the right tone at the top in terms of legal compliance, many have recognized that lack of a healthy corporate culture can present a significant business risk. As a result, the emerging expectation is that boards will exercise increasing oversight to make sure that company culture is aligned with and supports the company's long-term business strategy.

Board Composition

Increased investor scrutiny of business strategy and risk oversight, as well as investor questions regarding board composition and, if problems arise, management competency, should be anticipated. Certainly, activist investors have not shied away from agitating for changes in management and board composition at targeted companies. In addition, traditionally less vocal investors also are adopting more activist strategies for certain of their investments. Also, index funds, which often view themselves as "permanent capital," have increasingly focused on whether the "right" directors are in the boardroom — in terms of director skills, diversity and tenure.

Following the 2018 proxy season, the New York City comptroller announced that his "Boardroom Accountability Project 2.0," launched in September 2017 to make boards "more diverse, independent and climate-competent," had resulted in more than 85 companies adopting improved processes and increasing transparency regarding board quality, diversity and refreshment. The comptroller has continued to advocate for such changes, sharing examples of disclosures his office views favorably concerning board skills, diverse director candidate searches and board self-evaluation processes.

Director tenure remains an issue in that it feeds investor concerns regarding staleness of director skills and lack of board diversity. Tenure can be viewed in various ways — as the average number of years directors serve on a board, the percentage of directors perceived as having "lengthy" tenure or the amount of time lapsed since the addition of new board members.

Although the number of all-male boards of directors continues to decrease, gender diversity remains a top priority for many institutional investors. Vanguard describes its concern over this issue as an economic imperative, and BlackRock's voting guidelines state that it expects to see at least two female directors on every board. Proxy advisory firms Glass Lewis and Institutional Shareholder Services will start recommending against nominating committee chairs of all-male boards in 2019 and 2020, respectively. Companies headquartered in California face the prospect of fines if they fail to meet board gender quotas by the end of 2019. Further, investors are looking beyond the number of female directors to whether those women have leadership roles on the board, for example as lead independent directors or as committee chairs. Investors also expect that boardroom diversity will lead to C-suite diversity, and investors may be likely to inquire further where they see a lack of diversity among the management ranks.

Advice to Companies: Be Proactive, Engage and Communicate

Similar to the questions from investors, the advice to boards of directors and companies is not new but takes on greater urgency. On all fronts — business strategy, ESG, risk oversight and board composition — companies and boards should be proactive in analyzing the company through an investor lens, anticipating investors' questions, and preparing to respond in a way that reflects the board's awareness and attention to investor concerns. Investors continue to expect direct engagement with directors (coordinated through the company) where they have concerns regarding items such as board refreshment or executive compensation.

Finally, companies should take a fresh look at their various forms of investor communications, including for example proxy statements, investor day presentations and sustainability reports, to ensure that the company is articulating: its business strategy, its oversight of risk, its approach to relevant ESG matters, and the board's active engagement on, and understanding of, these matters.

Click here for a full list of corporate governance-related articles authored by Skadden attorneys in the last year.

Trending Topics in Executive Compensation

Contributing Partners

Regina Olshan / New York

Erica Schohn / New York

Counsel

Thomas M. Asmar / Palo Alto

In 2018, a number of executive compensation issues made headlines, with trending topics including director compensation litigation, the impact of the recent U.S. tax reform on performance-based compensation, the influence of the #MeToo movement, persisting gender pay disparity issues and enforcement actions by the Securities and Exchange Commission (SEC) on executive perquisite disclosure. We expect further developments on these topics in 2019 and beyond and encourage companies to consult with their legal advisers as needed in order to stay informed and prepare for new developments in the rapidly changing landscape of executive compensation.

Delaware Case May Shift Approach to Director Compensation

On December 13, 2017, the Delaware Supreme Court issued an opinion in *In re Investors Bancorp, Inc. Stockholder Litigation,* which has caused companies to rethink the shareholder-approved director compensation limits in their equity plans. This case involved allegations of self-dealing and corporate waste due to excessive director compensation. Prior to this case, courts typically applied the business judgment standard of review, which establishes a presumption that the board acted in good faith and in the best interest of the company's stockholders with respect to decisions relating to director compensation. This presumption applies if the compensation was awarded pursuant to a plan that stockholders ratified and that contained "meaningful limits" on director compensation. As a result, many cases regarding these types of allegations were dismissed at an early stage of the litigation process. In *In re Investors Bancorp*, the court held that a decision to grant awards to directors was not entitled to the protection of the business judgment rule at the pleading stage if the plaintiff properly alleged that the discretion was inequitably exercised. This is the case even if the awards otherwise fell within the shareholder-approved limit. Rather, the court applied the more onerous entire fairness standard of review, under which courts assess whether the decision is entirely fair to the corporation. (For more on *In re Investors Bancorp*, see our December 19, 2017, client alert "Boards Beware: Delaware Supreme Court Limits Application of Deferential Standard for Reviewing Director Equity Awards.")

Companies should consider how to reduce their risk of director compensation litigation by, for example, retaining any existing limits in their incentive compensation plans, ensuring there is a rigorous process for establishing director compensation, working with a compensation consultant to review grants by peer companies, carefully documenting the review of director compensation, and providing enhanced proxy disclosure regarding the process for determining director awards. Some companies also may want to consider a formula-based determination of equity grants, which, although currently uncommon, has been implemented by some companies.

In response to the focus on excessive director pay, Institutional Shareholder Services (ISS) introduced a policy in 2017 that would potentially result in adverse vote recommendations for directors responsible for approving or establishing director pay that ISS determines fits an established pattern (two or more consecutive years) of excessive pay levels without a compelling rationale or other clearly explained mitigating factors. In 2018, ISS announced that it will be revising its methodology for identifying excessive director pay and delaying the first possible adverse vote recommendations under the policy until 2020.

Impact of Tax Reform on Performance-Based Compensation

The Tax Cuts and Jobs Act that was enacted on December 22, 2017, amended Section 162(m) of the Internal Revenue Code, which generally imposes a $1 million annual deduction limit for compensation paid to covered employees. (See "US Tax Reform and Cross-Border M&A: Considering the Impact, One Year In.") Statutory changes include eliminating the qualified performance-based compensation exception to Section 162(m), expanding the definition of a covered employee and broadening the scope of companies that are subject to Section 162(m). These changes do not apply to compensation under written binding contracts in effect as of November 2, 2017, so long as those contracts are not materially modified. On August 21, 2018, the Internal Revenue Service (IRS) issued Notice 2018-68, which provides guidance on this transition rule and the new rules for identifying covered employees. One of the key takeaways from the notice is the IRS view that awards are not grandfathered if companies are permitted to exercise negative discretion to reduce or eliminate the award amount, regardless of whether that discretion is exercised, unless the employee is entitled to the amount under applicable state law. This is a fact-intensive and complex issue that should be carefully considered.

Companies should continue to assess the impact of the changes to Section 162(m) on their compensation arrangements. The new rules may provide more freedom to design executive compensation programs that address pay for performance without having to comply with the strict rules of the performance-based compensation exception. In addition, companies may consider alternative compensation designs in an attempt to fit within Section 162(m)'s annual $1 million deduction limit. They should review the terms of their incentive compensation plans and arrangements with their legal advisers to determine whether grandfathering may be available and, if so, exercise caution to avoid either inadvertently losing grandfathered status when contemplating any modification to pre-existing arrangements or otherwise risk jeopardizing the deductibility of compensation paid to covered employees for current and future taxable years.

#MeToo and Executive Compensation

The #MeToo movement has caused many companies to take a more active role in preventing and responding to sexual harassment or sexual misconduct in the workplace. (See "Expanding Theories of Liability in the #MeToo Era.") In addition to re-examining the code of conduct policy and other related policies and procedures, some have included or modified specific terms in individual compensation arrangements with executives to address the consequences of sexual harassment or sexual misconduct, such as with respect to the definition of "cause" under employment, severance and similar agreements. In addition to serving as an incentive to prevent this type of behavior, specifically addressing the issue in the definition of "cause" under these agreements may more clearly permit a company to avoid paying severance benefits upon a termination of employment of an executive who engages in sexual harassment or sexual misconduct.

In further response to the #MeToo movement, some companies are considering updating their compensation recovery policy to provide for a clawback or forfeiture of previously paid compensation if an executive engages in sexual harassment or sexual misconduct in the workplace. Recently, some also have been asking newly hired executives to include an affirmative representation to the effect that they have not been the subject of any sexual harassment or sexual misconduct claim or otherwise engaged in any such behavior. It remains to be seen whether these provisions will evolve into standard practice, but we anticipate that more companies will modify their executive compensation programs and agreements in some manner to discourage sexual harassment or sexual misconduct in the workplace as these issues continue to receive attention.

Gender Pay Disparity

Recent studies show that gender pay disparities continue to be a significant issue in executive compensation. In particular, a significant discrepancy in the level of incentive compensation exists for men and women serving similar roles. In 2017, the Trump administration suspended the equal pay rule that was initiated by the Obama administration and would have required large companies to report pay by race and gender to the government. Meanwhile, in the United Kingdom, 2018 marked the beginning of a regulatory requirement for U.K. companies with more than 250 employees to annually report the results of certain "pay gaps" between male and female employees on both a government website and the company's own website. In the United States, despite companies reaffirming their commitment to eliminate gender pay disparities, legal and regulatory efforts, social activism and ongoing research indicate that more work needs to be done. Companies are encouraged to remain vigilant in this area by reviewing internal processes, designing and implementing executive compensation philosophies and programs, and staying informed of regulatory and legislative developments with the goal of eliminating the disparities. (See "Responding to the Call for Equal Pay.")

SEC Enforcement on Executive Perquisite Disclosure

Over the last several years, the SEC has pursued several enforcement actions against companies for failing to disclose executive perquisites in their public filings. In the most significant enforcement action, on July 2, 2018, the SEC announced that a company agreed to settle charges relating to the understatement of and failure to disclose certain perquisites by paying a $1.75 million civil penalty. The SEC also required the company to hire an independent consultant for one year to review and evaluate its policies, procedures and controls regarding perquisite disclosure, and implement the consultant's recommended changes. Companies should review internal perquisite policies and procedures as well as director and officer questionnaires to help identify perquisites disclosable as executive compensation.

Click here for a full list of executive compensation and benefits-related articles authored by Skadden attorneys in the last year.

Litigation / Controversy

2018-19 Supreme Court Update

Contributing Partner

Boris Bershteyn / New York

Law Clerks

Lekë Badivuku / New York

Leonardo Villalobos / New York

Much of the attention on the U.S. Supreme Court in the 2018-19 term has concerned its composition or its handling of cases involving some of the signature initiatives of President Donald Trump's administration. Less noticed is the Court's extensive docket of potentially significant disputes relevant to businesses, including those involving administrative law, the First Amendment, antitrust, securities, arbitration and class actions.

Administrative Law

The doctrine of so-called *Auer* deference may, in the words of Justice Clarence Thomas, finally draw its last gasp. On December 10, 2018, the Supreme Court granted *certiorari* in *Kisor v. Wilkie* to determine whether courts should continue to defer to an agency's interpretation of its own regulations when they are ambiguous. For over 70 years, Supreme Court precedent has directed courts to do just so, adding an important weapon to federal agencies' legal arsenal. But several members of the current court — Chief Justice John Roberts and Justices Samuel Alito, Neil Gorsuch and Thomas — have over the years called the doctrine into question. In *Kisor*, which involves an interpretation by the Department of Veterans Affairs of its own regulation, the Supreme Court will finally resolve the uncertainty regarding the doctrine's viability. The U.S. Chamber of Commerce has argued in an *amicus* brief that *Auer* deference heightens regulatory uncertainty and harms business interests.

Trademarks and First Amendment

In its 2017 decision in *Matal v. Tam*, the Court held that a provision of the Lanham Act prohibiting trademarks that "disparage" persons, institutions or beliefs violated the First Amendment. Now, the Court will consider whether a similar provision within the Lanham Act — one prohibiting "scandalous" or "immoral" trademarks — also violates the First Amendment. The case is *Iancu v. Brunetti*, where the respondent is attempting to register the mark "FUCT" in connection with his clothing line.

The respondent argues that the "scandalous" clause at issue here should be treated no differently than the "disparagement" clause in *Tam* — both are unconstitutional restrictions on speech. The U.S. Court of Appeals for the Federal Circuit found in his favor, but the government is defending the law by arguing that the decision in *Tam* does not apply because no rationale for striking down the "disparagement" clause garnered the assent of a majority of the court. And, in any event, the court in *Tam* said that the "disparagement" clause discriminates based on viewpoint, whereas — according to the government — the "scandalous" clause at issue here does not. The Supreme Court granted *certiorari* on January 4, 2019.

The decision will either narrow or expand *Tam*'s holding and perhaps establish a clear rule regarding how the First Amendment interacts with trademark law.

Antitrust Standing

In 1977, the Supreme Court held in *Illinois Brick Co. v. Illinois* that only direct purchasers of a product can seek remedies for federal antitrust violations. This term, the Court will assess this doctrine's applicability in a digital marketplace in *Apple* *v. Pepper* — a dispute involving Apple and iPhone users who make purchases from Apple's App Store.

iPhone users allege that Apple has created a "monopoly app store" that overcharges for iPhone apps. They argue that they have standing as direct purchasers because they buy the apps directly from Apple's App Store, and Apple itself receives the payment. Apple, however, argues that iPhone users are indirect purchasers because app prices are set by third-party app developers, thus breaking the causal chain between Apple's actions and consumers' damages. The district court sided with Apple, but the U.S. Court of Appeals for the Ninth Circuit reversed.

At oral arguments presented to the Supreme Court, several justices questioned Apple's characterization of app developers as middlemen between itself and iPhone users, with Justice Elena Kagan saying, "I mean, I pick up my iPhone. I go to Apple's App Store. I pay Apple directly with the credit card information that I've supplied to Apple. From my perspective, I've just engaged in a one-step transaction with Apple."

The justices questioned counsel for iPhone users about coherence of their theories of damages or monopolization. And Justice Gorsuch asked why the users did not seek a more comprehensive revision of *Illinois Brick* — a doctrine that has been expressly rejected by many states' antitrust laws. Indeed, a bipartisan group of 31 states filed an *amicus* brief arguing that *Illinois Brick* was wrongly decided or no longer relevant in the modern economy.

Should the Supreme Court side with iPhone users, online distribution platforms may face increasing antitrust exposure. No matter what happens, the decision will shed light on *Illinois Brick*'s applicability in today's markets.

Federal Securities Laws

Federal Merger Litigation

Shareholder litigation concerning the adequacy of disclosures made in connection with a merger or acquisition has increasingly been brought through an implied cause of action under Section 14(e) of the Securities Exchange Act. On January 4, 2019, the Court granted certiorari in *Emulex Corp. v. Varjabedian* to consider whether a defendant violates Section 14(e) only if shareholders can prove that the defendant intended to make a material misstatement or omission — or (as the Ninth Circuit has held) if the defendant was merely negligent. As *amicus* in support of *certiorari*, the Securities Industry and Financial Markets Association argued that a lower standard of liability would invite litigation against the financial institutions that advise on a merger or acquisition. Another *amicus*, the U.S. Chamber of Commerce, asked the court to go further and decide that Section 14(e) does not provide for a private cause of action in the first place — a question the court has never addressed.

Material Misstatement Liability

In 2011, the Court held that only the "maker" of a fraudulent statement is primarily liable under SEC Rule 10b-5(b). Persons who prepare the statement and do not retain the ultimate authority on whether and how to communicate it are, at best, secondarily liable. This term, in *Lorenzo v. SEC*, the Supreme Court will consider whether the preparer, even if not primarily liable for a Rule 10b-5(b) violation, can be held primarily liable for the same conduct under the fraudulent scheme provisions of the securities laws. The Court's opinion will be of interest to the business community for its guidance on fraudulent scheme liability in general and its overlap with false statement liability. (See "Securities Class Action Filings Show No Signs of Abating.")

Arbitration

The Court took an opportunity early in the term to resolve two issues concerning the scope of arbitrable disputes under the Federal Arbitration Act (FAA). Although both cases were decided unanimously, one decision generally favored arbitration and the other did not.

Delegation Provisions

Courts generally decide gateway questions about arbitrability, such as whether an arbitration agreement covers a particular controversy. Parties can agree, however, to have arbitrators decide these questions by including a delegation provision. In one of the term's first decisions, the Supreme Court unanimously held in *Henry Schein, Inc. v. Archer & White Sales, Inc.* that when parties contractually delegate the arbitrability question to arbitrators, courts must respect that decision, even when one party contends that the argument for arbitration is "wholly groundless." Issuing his first opinion for the Court, Justice Brett Kavanaugh wrote that the "wholly groundless" exception is inconsistent with the FAA's text and "confuses the question of who decides arbitrability with the separate question of who prevails on arbitrability." The decision reinforces the long-standing principle that arbitration is a matter of contract and reassures contractual parties that courts will be hesitant to override provisions of arbitration agreements.

Class Arbitration

Does an arbitration agreement authorize class arbitration if it includes commonly used, broad language such as "arbitration shall be in lieu of any and all lawsuits or other civil legal proceedings"? In *Lamps Plus, Inc. v. Varela*, the Supreme Court will consider the standard a court should apply in determining whether an arbitration agreement authorizes class arbitration and whether the FAA constrains state law interpretation of the issue.

The Supreme Court's opinion may give the business community greater clarity about the contractual language it should use to address class arbitration. But, as so often happens before the Court, procedural hurdles may interfere. At oral argument on October 29, 2018, some of the justices indicated that jurisdictional questions may lead the Court to avoid reaching the class arbitration issue. (See "Significant Rulings Expected for Ongoing Mass Tort, Consumer Class Action Issues.")

Exemption for Independent Contractors

The FAA does not apply to "contracts of employment" for any "class of workers engaged in foreign or interstate commerce." On January 15, 2019, the Supreme Court unanimously decided in *New Prime Inc. v. Oliveira* that this exemption (found in Section 1 of the FAA) applies to independent contractors working in transportation industries.

Dominic Oliveira, a truck driver who signed an agreement designating him as an independent contractor, argued that he could not be compelled to arbitrate because the "contracts of employment" exemption encompasses independent contractors. New Prime, an interstate trucking company, argued for a narrow reading of "contracts of employment" that included only employer-employee relationships. The U.S. Court of Appeals for the First Circuit sided with Oliveira, and the Supreme Court affirmed.

In his opinion for the Court, Justice Gorsuch endorsed the broad reading of the exemption, holding that "contracts of employment" refers to any agreement to perform work. He reasoned that the statute, construed against the background of its enactment in 1925, evinced no intent to distinguish between independent contractors and traditional employees in the exemption.

Some of the *amici* in support of Oliveira had asserted that employers in transportation industries might deliberately classify their workers as independent contractors to avoid the exemption and compel arbitration when disputes arise. But the Court's decision means that the exemption's applicability will not depend on whether a relationship is structured as an "employer-employee" relationship or an "independent contractor" relationship.

Class Actions

Cy Pres Settlements

In *Frank v. Gaos*, the Court will address the permissibility of "*cy pres* only" settlements under the Rule 23(e)(2) of the Federal Rules of Civil Procedure, which states a court can approve a class action settlement only if it is "fair, reasonable, and adequate." Does a settlement that distributes none of the proceeds to class members, but rather allocates them among organizations related to the subject matter of the case, meet this standard? Proponents argue that such settlements can be more efficient than minimal monetary awards to class members, and that nothing in the text or history of Rule 23 bars them. The Ninth Circuit agreed, but certain class members contend before the Court that awards to class members were feasible and that class counsel should not have incentives to divert settlement funds toward causes of their choosing. The case was argued on October 31, 2018, with the justices expressing skepticism of *cy pres* settlements and also questioning whether the plaintiffs have standing to begin with. Should the Court reach the merits, it could affect the distribution — and perhaps the likelihood and amount — of certain class action settlements.

Equitable Exceptions

On November 27, 2018, the Court heard arguments for another class action case — *Nutraceutical Corp. v. Lambert* — concerning the timeliness of a plaintiff's petition for permission to appeal an order decertifying the class. Rule 23(f) of the Federal Rules of Civil Procedure establishes a 14-day deadline for such petitions, and the plaintiff missed that deadline by several months. Yet the Ninth Circuit applied an equitable exception and accepted the petition because the plaintiff's counsel told the trial court (before the deadline) that he intended to seek reconsideration.

The case may boil down to a distinction between jurisdictional rules and nonjurisdictional claim-processing rules. Whereas the former require strict compliance, the latter are generally subject to equitable exceptions — unless expressly made mandatory. The Court's decision will affect how diligently the parties must seek review of class certification decisions.

Click here for a full list of Supreme Court-related litigation articles authored by Skadden attorneys in the last year.

Securities Class Action Filings Show No Signs of Abating

Contributing Partners

Jay B. Kasner / New York

Scott D. Musoff / New York

Susan L. Saltzstein / New York

As anticipated, securities class action filings remained high in 2018, with more than 400 filings in federal court, and the number is expected to remain high in 2019. While the total number is slightly less than in 2017, it is still well above historical averages, and the chances of being named as a defendant reached an all-time high (in light of the continued reduction in the number of public companies). In addition to a significant number of cases brought by those objecting to mergers, which historically had been the province of state courts (most notably the Delaware Court of Chancery), filings in 2018 included a large number of more traditional stock-drop cases. We expect this trend to continue, particularly if the volatility in the markets extends into 2019.

Foreign issuers were far from immune to securities filings in 2018, and the plaintiffs' bar continued to target companies from Latin America and Asia. So-called event-driven litigation also is on the rise. These cases typically are filed upon the disclosure of a negative event that was not necessarily tied to financial statements, such as stock declines following a Foreign Corrupt Practices Act or other regulatory investigation, an environmental incident or even a plane crash. While we anticipate the ever-increasing number of securities filings to continue into 2019, the good news for corporate America is that the number of dismissals also appears to be increasing. From experience, we have noted an increased receptivity to dismissals even beyond New York and California, where the majority of such cases are filed.

State Court Filings

One trend that began in the latter half of 2018 and that we expect to continue in 2019 is an increase in the number of state court filings for claims under the Securities Act of 1933 following an initial public offering. In March 2018, the U.S. Supreme Court held in *Cyan, Inc. v. Beaver County Employees Retirement Fund* that the Securities Litigation Uniform Standards Act of 1998 did not authorize the removal of cases brought under the Securities Act, nor did it strip the state courts of jurisdiction. As a result of *Cyan*, plaintiffs may be free to assert such cases in state courts throughout the country. And in December 2018, the Delaware Court of Chancery rejected a forum selection clause in the articles of incorporation of a Delaware corporation that attempted to require the filing of such suits in federal courts. (See "Key Delaware Corporation Law Developments.") Not surprisingly, we have seen an increase in the number of state court filings as well as an increase in parallel litigation — with dueling cases filed in both state and federal courts. Parallel litigation creates inherent coordination difficulties because there is no defined procedural mechanism designed for such coordination (such as the Judicial Panel on Multidistrict Litigation in federal court) and often requires unique defense approaches to ensure that both sets of cases do not move forward independently.

The increase in state court cases also has resulted in litigation concerning the applicability of certain provisions of the Private Securities Litigation Reform Act of 1995 (PSLRA) to state court actions. Through the PSLRA, Congress afforded defendants various protections that were intended to help weed out meritless cases and prevent the threat of facing a class action to force unwarranted settlements unrelated to the merits. The plaintiffs' bar appears to be targeting New York state courts in particular. Indeed, for the first time since the mid-1990s, the New York state courts are grappling with questions that have arisen in *Cyan*'s wake, including whether the PSLRA's automatic stay of discovery pending a motion to dismiss applies with equal force to state court actions.

We anticipate that these and other related issues will continue to percolate as we continue to experience an increase in state court filings.

Potential Clarification on the Reach of *Janus*

In 2019, the Supreme Court again will have a chance to put its stamp on the securities litigation arena. In 2011, the Court decided in *Janus v. First Derivative Traders* that only a "maker" of a statement can be liable under SEC Rule 10b-5(b). This term, the Court will have an opportunity to clarify the reach of *Janus* in *Lorenzo v. SEC*. In that case, the defendant, an investment banker, purportedly copied and pasted alleged misstatements written by his boss and emailed those statements to prospective investors at his boss' direction. Because the defendant did not control the contents of the statements, the U.S. Court of Appeals for the District of Columbia Circuit held that he was not the maker of such statements under Rule 10b-5(b). But the court held that this did not prevent liability from attaching under other provisions, such as Rule 10b-5(a) or Rule 10b-5(c), which reference scheme liability.

Justice Brett Kavanaugh issued a strong dissent in the D.C. Circuit and has recused himself from the Supreme Court deliberations, which could translate into a 4-4 decision. If that happens, the D.C. Circuit decision would stand. Oral argument was held on December 8, 2018, and several justices appeared receptive to the lower court's interpretation. Such a ruling presents a risk of opening a back door of sorts to primary and secondary liability and marks a change in tenor from prior Supreme Court precedent, which foreclosed aiding-and-abetting liability (*Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*) and precluded liability of secondary actors upon which investors did not directly rely (*Stoneridge Investment Partners v. Scientific-Atlanta, Inc.*).

Class Certification

Class certification will continue to be a battlefield in 2019, with issues relating to the domesticity of transactions, the applications of statutes of repose and the contours of what needs to be demonstrated regarding price impact. As more cases are filed relating to globally offered securities, court scrutiny is likely regarding the issue of what constitutes a domestic transaction — a necessary element for the federal securities laws to apply — and whether that determination creates individualized issues that predominate (and thus preclude class certification). As noted last year, the U.S. Court of Appeals for the Second Circuit in the *In re Petrobras Securities* case remanded this issue to the district court, vacating that court's certification of a class. The Petrobras class action was settled before the district court had an opportunity to review the issue directly, although the settlement approval process, which is once again before the Second Circuit, may include rulings on related issues.

The U.S. Court of Appeals for the Fifth Circuit had an opportunity to decide whether the statute of repose under the securities laws precludes the certification of a class after the statute of repose expired, but that case, too, settled before the court could rule. And finally, the Second Circuit will again have an opportunity in 2019 to clarify what defendants need to show on class certification to demonstrate that the revelation of the alleged misstatements did not have a price impact on the security at issue. Among others, these important issues will continue to make the class certification stage a significant area of attack for defendants.

Click here for a full list of securities litigation-related articles authored by Skadden attorneys in the last year.

DOJ Policies Aim to Reduce Enforcement Burden on Cooperating Entities

Contributing Partner

Jocelyn E. Strauber / New York

Associate

Micah F. Fergenson / New York

The Department of Justice (DOJ) appears to be continuing to revamp its approach to companies suspected of financial crimes, and emphasize the importance of prosecutions of individuals. In a number of speeches in 2018, senior department officials, including Deputy Attorney General Rod J. Rosenstein (who reportedly will leave the DOJ upon confirmation of Attorney General nominee William Barr), indicated that prosecuting culpable individuals can be a more effective deterrent than corporate penalties. Consistent with that perspective, recent department policies have sought to reduce investigative burdens on companies, particularly those that seek to cooperate. However, setbacks to the DOJ in a number of notable 2018 trials may impact the DOJ's bullishness on individual prosecutions in this year.

Policy Changes

In 2018, the DOJ continued to expand the application of its 2017 Foreign Corrupt Practices Act (FCPA) Corporate Enforcement Policy, applying it as nonbinding guidance in criminal cases beyond the FCPA context. That policy expansion was announced in a March 2018 speech by John P. Cronan, then-acting assistant attorney general of the Criminal Division, and Benjamin Singer, then-chief of the Fraud Section's Securities and Financial Fraud Unit, at the American Bar Association's white collar crime conference.

The speech seemed to encourage corporations to self-disclose in other types of investigations by highlighting the significant reduction in penalties that can result, with Cronan and Singer pointing to a recent foreign exchange "front-running" investigation in which a financial institution received a formal declination letter based on its self-reporting, full cooperation and enhanced compliance program. The financial institution paid $12.9 million in restitution and disgorgement, compared to a deferred prosecution agreement and payment of $101.5 million in penalties and disgorgement following a similar investigation of a different bank in which, according to the DOJ, the bank did not self-report or fully cooperate with the investigation at its outset.

The DOJ policy against piling on — when multiple agencies investigate and punish companies for the same underlying misconduct — was announced in May 2018 and seems similarly designed to reduce the burden of enforcement activity on corporations, particularly when the entity cooperates. The policy encourages DOJ attorneys to coordinate, where possible, both within the department (where multiple components are investigating the same corporate entity) and with other federal, state, local and foreign investigating authorities, to alleviate the overlapping demands multiple investigations can place on corporations and eliminate "the unnecessary imposition of duplicative fines, penalties and/or forfeiture against the company." That said, the DOJ continues to emphasize in public statements its cooperation with other authorities as a means of increasing available evidence and facilitating far-reaching investigations of wrongdoing, an approach that naturally increases the burdens on corporations under investigation, particularly in the cross-border context. It therefore remains to be seen whether the so-called anti-piling on policy will in fact benefit such corporations.

The DOJ's recent revised guidance on the imposition of monitors, which calls for doing so "only where there is a demonstrated need for, and clear benefit to be derived from, a monitorship relative to the projected costs and burdens," is another indication of the current department's sensitivity to corporate concerns. In announcing the revised guidance in October 2018, Assistant Attorney General Brian A. Benczkowski stated that monitors should be "the exception, not the rule." The so-called Benczkowski memorandum strongly suggests that the DOJ is narrowing the set of circumstances in which a monitor is required and limiting the role of appointed monitors. Indeed, the policy seems to give companies the opportunity to establish that a monitor is not required on the basis of factors including the company's investment in its own compliance program and internal controls, as well as its ability to demonstrate that those controls can detect and prevent misconduct.

Finally, and most recently, on November 29, 2018, Rosenstein announced a revised policy concerning individual accountability and cooperation credit for corporations. A refinement of the 2015 memorandum by then-Deputy Attorney General Sally Yates on the same topic, the updated policy takes a more practical, less burdensome approach to the requirement that cooperating corporate entities provide information about culpable individuals. For example, it no longer requires that companies identify "all relevant facts about the individuals involved" in order to receive cooperation credit. Instead, companies need to provide relevant facts only about individuals who were "substantially involved in or responsible for" the potential criminal misconduct. Moreover, the revised policy allows a company potentially to receive cooperation credit even where it is "unable to identify all relevant individuals or provide complete factual information despite its good faith efforts to cooperate fully."

To be sure, these policies do not upend the fundamentals of the DOJ's approach to enforcement and corporate cooperation. But they do reflect a change in tone and a growing apparent recognition of the burdens companies face under investigation. They also encourage voluntary self-disclosure by increasing and clarifying the benefits of and removing obstacles to obtaining cooperation credit.

Recent Enforcement Actions

The DOJ's approach to corporate enforcement also is evident in actions brought and declined in 2018. For example, under the FCPA Corporate Enforcement Policy and the pilot program that preceded it, the DOJ declined prosecution in 11 of 13 cases where a company had voluntarily self-disclosed. (The remaining two investigations were resolved with nonprosecution agreements, and no monitors were imposed.) That said, the volume of FCPA actions brought and the penalties in those actions remained relatively constant in 2017 and 2018, suggesting that in circumstances where companies fail to self-disclose, enforcement activity continues to be relatively robust.

Outside the FCPA context, cases against banks and companies for financial crimes appear to have declined in 2018, with fewer industrywide actions than in prior years. One year is likely too short to define a trend. It is, of course, possible that the DOJ has been involved in nonpublic investigative activity during this time, and such cases typically take months, or even years, to build. Where financial crime cases have been brought, the penalties are 72 percent lower than during the prior administration, according to a *New York Times* analysis. If the data holds, overall, corporations dealing with potential criminal misconduct may be better-positioned to resolve investigations on more favorable terms than in the past, particularly if they are willing to self-disclose or, at a minimum, provide substantial cooperation. Companies with robust compliance programs and the ability to track and substantiate their effectiveness may fare particularly well.

While the DOJ appears committed to individual prosecutions, particularly those arising out of broader investigations begun in the prior administration in such areas as the FCPA, criminal antitrust, and fraud and market manipulation, the DOJ suffered setbacks in 2018 that may impact its approach to individual prosecutions in the future.

Hoskins. The U.S. Court of Appeals for the Second Circuit's decision in *United States v. Hoskins* limits the DOJ's reach in FCPA actions against individuals, particularly foreign nationals. Lawrence Hoskins, a non-U.S. citizen charged with conspiring to violate the FCPA, was an employee of a U.K. subsidiary of a French company and never entered U.S. territory during the period of the criminal scheme. The Second Circuit held that Hoskins therefore fell outside the categories of persons generally covered by the FCPA, and because he could not be charged with a substantive FCPA violation, he could likewise not be charged with conspiring or aiding-and-abetting violations of the FCPA. (For more, see our September 4, 2018, client alert "Second Circuit Curtails Use of Conspiracy and Complicity Statutes in FCPA Actions.") While this decision does not entirely foreclose the possibility that a non-U.S. citizen acting outside the U.S. could be charged with an FCPA violation — indeed, the Second Circuit expressly left open the possibility that Hoskins could be charged as an agent of the company's U.S. subsidiary — the DOJ certainly will consider *Hoskins* when deciding whether to pursue an individual in similar circumstances.

Usher. In the antitrust context, the DOJ failed to obtain convictions after a jury trial in *United States v. Usher,* a prosecution of three foreign exchange traders charged in 2017 with conspiring to violate the Sherman Act by allegedly "bid rigging" in their trading of the euro/dollar currency pair. The defense argued, among other things, that trading data showed in many instances that the defendants were not coordinating trades.

Connolly. A case arising out of global investigations into the setting of Libor rates, *United States v. Connolly* ended in guilty verdicts for both defendants, but a pending post-trial motion raises significant questions about the implications of extensive law enforcement involvement in the relevant bank's internal investigation. Before trial, one of the defendants, Gavin Black, challenged the admission of statements he made to outside counsel conducting an internal investigation of the conduct of the bank's traders involved in setting Libor rates. During the internal investigation, Black was interviewed by outside counsel under threat of termination, and he claimed his statements were compelled in violation of the Fifth Amendment due to extensive law enforcement involvement in the bank's investigation, which had "federalized" outside counsel. While the government tried to moot the issue by opting not to offer his statements at trial, Black has moved, post-trial, to vacate his conviction and dismiss the case under *Kastigar v. United States*, which bars the use of compelled testimony, and evidence derived directly and indirectly therefrom, on Fifth Amendment grounds. Judge Colleen McMahon of the U.S. District Court for the Southern District of New York stated in a recent order that the "*Kastigar*/outsourced investigation motion" is "where the Government should be concentrating its efforts" in terms of post-trial briefing. Should Judge McMahon find a *Kastigar* violation and order a new trial or a dismissal of the charges, the ruling will have a significant impact on law enforcement's interactions with outside counsel handling internal investigations in future cases.

Conclusion

The DOJ's consideration of the burdens its investigations and resolutions impose on corporations and financial institutions, and its messaging that it may seek to alleviate those burdens while continuing to investigate and prosecute individual misconduct, seem likely to continue into 2019. Depending on the circumstances, some institutions may seek to benefit from the DOJ's current approach by voluntarily disclosing misconduct or at least providing substantial assistance to the government, including with respect to culpable individuals. Indeed, because the DOJ remains committed to individual prosecutions, companies can expect the department to continue to seek their assistance in investigating the conduct of culpable employees. And while the DOJ's 2018 prosecutions have not been entirely successful, its policies and public statements suggest it will continue to aggressively investigate wrongdoing by corporate employees into 2019. If anything, the DOJ's 2018 setbacks may cause it to seek even more information, evidence and assistance from cooperating corporations, in order to support its efforts to successfully prosecute culpable employees.

Click here for a full list of government enforcement and white collar crime-related articles authored by Skadden attorneys in the last year.

Expanding Theories of Liability in the #MeToo Era

Contributing Partners

Susan L. Saltzstein / New York

Jocelyn E. Strauber / New York

Alleged workplace harassment is not a new phenomenon, but in the wake of allegations of sexual misconduct in the corporate context, plaintiffs increasingly are targeting an expanded group of defendants, including public companies, senior executive management and boards of directors. With the publicity that has attended the #MeToo movement in recent years, allegations relating to sexual harassment have spurred the filing of derivative actions (claiming harm to the corporation) and securities class actions (claiming a stock price reaction) purportedly due to executives' and the board's response (or lack thereof) to those allegations and related disclosures.

In early 2018, we noted that the plaintiffs' bar was seeking opportunities to assert these lawsuits, and, indeed, between January 2017 and December 2018, approximately 15 to 20 such cases were filed against public companies. In some instances, both derivative and securities complaints have been filed against the same company based on overlapping factual allegations. As publicity tends to follow the often salacious tales of sexual misconduct in the workplace, we believe that observable trends of follow-on harassment-related litigation will continue in 2019. An understanding of the nature and focus of shareholder suits in this context can assist public companies, their executives and board members in determining how best to avoid and manage this emerging litigation risk.

Shareholder Derivative Claims: Allegations and Pleading Challenges

Investors assert shareholder derivative actions purportedly on behalf of a corporation against corporate officers or directors (or other corporate insiders) for alleged harm to the corporation. Breach of fiduciary duty claims typically are governed by the law of the state of incorporation.

Derivative Allegations

In the workplace harassment context, derivative claims may allege a failure to address appropriately underlying allegations of sexual misconduct resulting in purported financial and reputational harm to the corporation. Specifically, derivative complaints may allege that directors or other executives breached their fiduciary duties (duties of care/loyalty/good faith), committed corporate waste or were unjustly enriched by:

- failing to establish and implement appropriate controls to prevent the misconduct;
- failing to appropriately monitor the business and properly investigate red flags;
- willfully ignoring misconduct and allowing a hostile culture to persist;
- failing to sanction misconduct;
- affirmatively condoning misconduct by settling lawsuits;
- approving severance or other payment to wrongdoers; or
- minimizing exposure or assuring the public that nothing was wrong.

Pleading Challenges

Plaintiffs who bypass the procedural route of making a demand on the target company's board of directors to take action in the wake of a workplace harassment-type claim may face a defense challenge to the assertion that a pre-suit demand on the board would be futile. Specifically, plaintiffs are often required to plead demand futility with particularity. Despite any pleading challenges involved, however, the mere filing of a derivative claim against the corporation can magnify the issues on which the claim is based, namely by increasing public exposure, disrupting business and creating associated costs, including potential costly settlement of the suit.

Moreover, these pleading hurdles are not insurmountable, as demonstrated by a recent state court decision that denied a motion to dismiss a derivative action on demand futility grounds, finding the complaint sufficiently alleged, among other things, that the board knowingly failed to take action in the face of allegedly corroborated reports of sexual harassment at the company. Furthermore, derivative claims relating to sexual misconduct allegations have been settled for payments of tens of millions of dollars and the establishment of corporate governance measures.

It is therefore crucial that corporate executives and board members understand the developing legal landscape. By doing so, the company can position itself to address proactively both the underlying issues and the possibility of derivative liability.

Securities Class Actions: Allegations and Potential Hurdles

Securities fraud class actions under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder are predicated on alleged material misstatements or omissions that purportedly rendered a statement false or misleading, and often are asserted along with control person (culpable participation) claims under Section 20(a) of the Exchange Act.

Securities Fraud Allegations

In the context of underlying sexual misconduct allegations, investors' securities fraud claims typically concern public statements issued by a company with respect to corporate values, integrity, and adherence to ethical standards and internal policies, juxtaposed with executives' and boards' alleged knowledge of any actual misconduct within the company, that contradict those policies. Plaintiffs generally claim that the stock price declined as a result of allegations of misconduct becoming public.

Pleading Challenges

As with derivative cases, plaintiffs must clear a high pleading bar in order to pursue claims predicated on Rule 10b-5 liability. Specifically, Rule 10b-5 claims are subject to the heightened pleading requirements under the Private Securities Litigation Reform Act and Federal Rule of Civil Procedure 9(b). Often, these claims are met with challenges to the sufficiency of the pleading, particularly in instances where the claims target "soft" representations of corporate culture. Challenges to the legal sufficiency of the complaint may include arguments that:

- codes of conduct or public statements concerning corporate culture are merely immaterial aspirational statements or "puffery";
- a duty to disclose the alleged misconduct does not exist;
- the alleged facts fail to support a strong inference that the defendants acted with an intent to mislead investors;
- statements about ethical conduct did not alter the "total mix" of information available to stockholders in their decision-making; and
- the stock price declined due to factors other than a revelation that statements about ethical corporate conduct were false.

However, with increased litigation in this area based on disparate facts, courts have been tasked with reviewing harassment-related securities claims with more frequency, and the results have not been uniform.

A comparison of cases demonstrates the point. A 2016 decision, *Lopez v. CTPartners Executive Search Inc.*, squarely found that certain statements — including statements that touted an inclusive and positive working environment, the promotion of honest and ethical conduct, and a transparent and objective compensation structure — were "immaterial puffery" because a reasonable investor would not rely on such general statements as a "guarantee" of particular facts. In 2017, in *Retail Wholesale & Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co.*, the Ninth Circuit similarly found statements in a code of conduct to be "inherently aspirational." In 2018, in *In re Signet Jewelers Ltd. Securities Litigation*, however, a court denied a motion to dismiss, finding that representations contained in a code of conduct, "which state, *inter alia*, that the company 'bases ... decisions solely on a person's [merit and]' ... has '[c]onfidential and anonymous mechanisms for reporting concerns' ... and that '[t]hose who violate the standards in this Code will be subject to disciplinary action' ... are directly contravened by allegations in the [complaint] ... ." As a result, the representations were actionable. Notably, the latter decision described the case as "a garden variety securities fraud suit." Accordingly, as with derivative cases, it is crucial to examine the evolving case law in this area, even within the same jurisdiction, to address effectively and defend against these types of allegations.

SEC Regulations and Investigations

Corporate public statements in the wake of sexual misconduct allegations also could result in a Securities and Exchange Commission (SEC) investigation or enforcement action based on the purported failure to disclose material information to investors. While we are unaware of any such actions to date, companies should be mindful of the risk that alleged public misstatements concerning corporate culture, and the existence and adherence to company policies concerning workplace behavior and inclusion, could give rise to such enforcement actions if and when allegations of sexual misconduct are revealed. Moreover, in some instances, private plaintiffs may support a securities fraud material omission claim on the basis of a failure to disclose SEC-required information.

For example, Item 303 of Regulation S-K requires a company to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." In light of the current environment, and to the extent that public revelations of sexual misconduct in the corporate context continue to increase and companies continue to experience unfavorable consequences as a result, the bounds of this regulation may be tested in future cases.

Takeaways

To ensure that any underlying misconduct is addressed, and that the response to such misconduct is as effective as possible, companies should consider the following:

Strong Protocols, Policies and Training. These should be reviewed regularly and updated as necessary, provided at regular intervals and enforced at the organizational level. Corporate counsel also ought to ensure awareness of, and compliance with, rapidly changing local requirements in this area.

Nondisclosure Agreements. In some jurisdictions, such as New York and California, requiring nondisclosure agreements (NDAs) in settlements pertaining to sexual harassment and discrimination is limited or prohibited. Where they are permitted, carefully consider NDAs or confidentiality provisions, recognizing that such provisions may be perceived as silencing the alleged victim while shielding the alleged perpetrator.

Internal Investigations. Consider proactively conducting an internal investigation to identify issues and facilitate improvements before lawsuits and reputational harms occur. Companies can consider a comprehensive investigation in response to complaints or other red flags, or a more limited review in the absence of specific reported issues.

Board Considerations. Consider when to escalate allegations to the board, and the board's role in preventing and responding to sexual harassment allegations. Relatedly, companies ought to be mindful of the number of women in high-level positions and on the board so as to ensure a more inclusive environment at the top. For example, California requires that publicly held corporations whose "principal executive office" is located in California include at least one female board member by 2019 and either two or three by 2021, depending on the size of the board. In addition, several companies have announced various high-profile initiatives to support gender diversity in both internal leadership and external roles.

Outward-Facing Statements. Take into account potential legal implications of the substance and tone of outward-facing statements and any disclosures about corporate values, policies and culture.

Additional Considerations. Review severance packages for adequate consideration, consider the timing of termination and succession plans, and understand directors and officers liability insurance and coverage.

Associates Ella R. Cohen and Amanda C. Strauss, and law clerk Chloe C. Bootstaylor contributed to this article.

Click here for a full list of government enforcement and white collar crime-related articles authored by Skadden attorneys in the last year.

Click here for a full list of securities litigation-related articles authored by Skadden attorneys in the last year.

Compliance Investigations in China Take On New Urgency

Contributing Partners

Bradley A. Klein / Hong Kong

Steve Kwok / Hong Kong

The ongoing trade tensions between the U.S. and China have caused some U.S. companies to become increasingly concerned that the Chinese authorities may subject their local operations to closer scrutiny, leading these companies to conduct internal compliance reviews to minimize any risks to their businesses. For their part, U.S. authorities have stepped up scrutiny of Chinese companies, as evidenced by the Department of Justice's (DOJ) "China Initiative." (See our November 29, 2018, client alert "DOJ Announces 'China Initiative' to Investigate and Prosecute Chinese Companies.") Prudent executives of multinational companies are right to be vigilant in ensuring that any compliance and employee misconduct issues in their China-based operations are promptly detected, investigated and remediated. U.S. companies doing business in China also should pay close attention to key areas of interest to the local authorities.

Be Mindful of Local Laws

For U.S. lawyers, the instinctive response upon being alerted to potential misconduct is to gather all the relevant facts — immediately, if possible. This instinct must be tempered with caution when the matter requires evidence-gathering in China, as Chinese authorities, to avoid infringement on the country's sovereignty and the privacy rights of its citizens, impose strict limits on the types of "investigations" that nongovernmental and unlicensed actors can conduct. China also has increasingly stringent laws relating to data collection that, if breached, can expose a company to civil and criminal liabilities in China.

Protect the Attorney-Client Privilege

While Chinese attorneys are prohibited from breaching client confidences, disclosing information to the authorities is permitted — indeed, required — in various circumstances. Chinese law does not provide analogous concepts to attorney-client privilege and the work-product doctrine that entitle the attorney to resist, on the client's behalf, the Chinese government's requests for information. Because of the absence of legal privilege in China, U.S. courts have upheld subpoenas and discovery requests directed at communications between Chinese counsel and their clients. To preserve the privilege under U.S. law, companies should structure China-based internal reviews — particularly those that may also implicate issues of U.S. law — under the direction of U.S.-qualified attorneys and memorialize this arrangement at the outset of the engagement.

Have a WeChat Policy

WeChat, an instant communications app commonly installed on smartphones, has become so ubiquitous in China that it has largely replaced corporate email for many employees. Because a WeChat account is tied to a phone number, unless an employee uses multiple phone numbers, he or she is likely to have only one WeChat account for both personal and business use.

This raises a host of challenging compliance and legal issues, but few companies have clear policies and procedures regarding WeChat use. The DOJ's updated Foreign Corrupt Practices Act Corporate Enforcement Policy, which has been incorporated into the United States Attorneys' Manual, now conditions the award of cooperation credit on the company having a document retention policy that "prohibit[s] employees from using software that generates but does not appropriately retain business records or communications" — a description that takes direct aim at communications apps like WeChat. Companies should examine how employees use WeChat and devise policies that both comply with legal requirements and take into account the realities of modern electronic communications in China.

Stand Behind Remediation Decisions

China's labor laws are among the most stringent in existence and impose a highly demanding standard of proof. Hence, a company may devote significant resources to completing an investigation and arrive at robust remediation decisions, only to encounter substantial pushback from the human resources department or Chinese labor lawyers when they are asked to execute the disciplinary recommendations or terminate an employee. However, the failure to terminate "bad apples" or implement remediation decisions potentially exposes the company to further (and typically far more serious) violations of law and internal policies, and it may be regarded by U.S. regulators as a failure to remediate, jeopardizing the company's credibility and any cooperation credit to which it may otherwise be entitled. None of this suggests Chinese labor law considerations are secondary. However, disciplinary decisions, once made, should not be revoked lightly.

Cultivate a Robust Compliance Culture

Cultivating a robust compliance culture and a strong compliance tone from the top is paramount but may be especially difficult for multinational companies in China. Depending on the industry, foreign companies may have no choice but to partner with a Chinese joint venture (JV) to enter the Chinese market, which may have a vastly different compliance culture. Moreover, as compliance remains a relatively new business concept in China, companies in China very rarely have stand-alone compliance departments, much less ones with the stature and autonomy necessary to deter and investigate violations and change behavior. There is no magic formula to inculcating a strong culture, but being prepared is a good starting point.

Before entering into a JV relationship, companies may consider conducting enhanced due diligence to identify the areas where improvements are needed and get all parties to commit to a remediation plan as part of the deal terms. Consideration should also be given to structuring the reporting lines to enable the local compliance personnel to report directly to company headquarters instead of local business managers and supervisors, thereby insulating them somewhat from local business pressures.

Another noteworthy area is training. While easy-to-administer online trainings have their place in a company's repertoire, nothing can replace in-person, impactful sessions utilizing local and recent real-life examples delivered in the employees' native language to small groups. Recent DOJ statements make it clear that companies relying on trainings that do no more than go through the motions will not be entitled to much, if any, credit from prosecutors and regulators in the event of violations.

Conclusion

The enforcement landscape for U.S. companies with operations in China may prove challenging in the coming year. The same may be true for Chinese companies with a U.S. presence. To be prepared, companies should ensure that they have a robust compliance infrastructure in place to detect and remediate issues in their China-based operations and seek legal counsel in navigating different U.S. and Chinese legal requirements.

The authors of this article are not licensed to practice law in the People's Republic of China or provide legal advice on Chinese laws. This article is for informational purposes only; it is not intended to be legal advice. Local counsel should be consulted on legal questions under Chinese laws.

Click here for a full list of government enforcement and white collar crime-related articles authored by Skadden attorneys in the last year.

Key Delaware Corporation Law Developments

Contributing Partners

Cliff C. Gardner / Wilmington

Edward B. Micheletti / Wilmington

Associate

Art Bookout / Wilmington

The Delaware courts issued a number of significant decisions in 2018 that are likely to have ripple effects throughout 2019. Among them were a series of cases that further developed the parameters of the *Corwin* and *MFW* doctrines, a case of first impression invalidating a forum selection provision that sought to require Securities Act claims to be brought in federal court, the first-ever Delaware case approving the termination of a merger because of a material adverse effect (MAE), and the finding of "fair value" in an appraisal proceeding based on the unaffected market price of a company's stock.

Corwin's Nuances Grow

The Delaware Supreme Court's 2015 decision in *Corwin v. KKR Financial Holdings LLC* granted a potentially powerful litigation tool to corporate directors and officers — irrebuttable business judgment deference to decisions approved by a majority of disinterested, fully informed and uncoerced stockholders (the so-called *Corwin* doctrine). Among the questions left unanswered was how the Delaware courts would measure whether stockholder approval was "fully informed." The Delaware Supreme Court and Court of Chancery addressed that question in a series of opinions in 2018, holding in several notable instances that disclosures fell short of fully informing stockholders, thereby rendering the *Corwin* doctrine unavailable.

In *Appel v. Berkman*, the Supreme Court reversed a pleading-stage dismissal under the *Corwin* doctrine because a plaintiff adequately pleaded that the stockholders' decision to accept a tender offer was not "fully informed." According to the court, the recommendation statement omitted why the target company's chairman, who also was its founder and largest stockholder, had abstained from supporting merger discussions. The chairman, whom the court described as "a 'key board member' if ever there were one," had been disappointed in the price and the sale process run by management, and he did not think it was the right time to sell the company. Yet the recommendation statement said only that the chairman had abstained from the vote to approve the tender offer and had not yet determined whether to tender his shares. The court opined that "[i]t is inherent in the very idea of a fiduciary relationship that the stockholders that the directors serve are entitled to give weight to their fiduciaries' opinions about important business matters."

Similarly, in *Morrison v. Berry*, the Supreme Court reversed the Court of Chancery's dismissal under *Corwin* based on "'partial and elliptical disclosures' [that] do not satisfy *Corwin*." The action arose from the acquisition of The Fresh Market (TFM) by an entity owned by Apollo Management, L.P. through a two-step tender offer and merger. In its ruling, the court held that the proxy misrepresented the agreement allegedly reached between Apollo and TFM's founder and his son, as well as the founder's alleged preference to only deal with Apollo and his threat to sell his shares.

In *In re Tangoe, Inc. Stockholders Litigation*, the Court of Chancery denied a motion to dismiss under *Corwin* because the target company, which had been in the midst of a "regulatory storm" for some time, had failed to disclose when long-awaited audited financial statements and financial restatements would become available. The court noted that the company had been providing only "sporadic and qualified" financial information to its stockholders, had failed to file multiple Form 10 documents with the Securities and Exchange Commission, and had not provided stockholders with a quality of earnings report it had commissioned. The court also held that information about the restatement process was material "because the delisting depressed the amount potential acquirers were willing to pay for Tangoe and stockholders needed to understand whether the delisting was likely to continue or whether the Company had a legitimate prospect of completing the Restatement and regaining its listed status with NASDAQ."

These cases illustrate how full and complete disclosure in connection with a fundamental transaction can be highly case-specific, how *Corwin* can be defeated at the pleadings stage without any finding that the underlying alleged facts are actually true, and that the court will carefully review the challenged disclosures to determine whether a shortcoming exists that will prevent application of the *Corwin* doctrine. In 2019, we will be watching for further developments in Delaware disclosure law as it applies to this doctrine.

Clarification of *Ab Initio* Under *MFW*

In the 2014 case *Kahn v. M & F Worldwide Corp.* (*MFW*), the Delaware Supreme Court held that the business judgment rule could apply to so-called "squeeze out" mergers, in which a controlling stockholder uses an entity it controls to cash out or otherwise eliminate the minority stockholders in another entity it controls. Prior to *MFW*, this type of transaction would be subject to Delaware's most stringent "entire fairness" standard. Under the *MFW* doctrine, however, the business judgment rule will instead apply if, broadly speaking, the transaction (1) was approved by a well-functioning, independent special committee of directors and (2) received approval from a fully informed, uncoerced majority of the minority shares. Critically, these two procedural protections must be irrevocably put in place *ab initio*, or "from the beginning."

In *Flood v. Synutra International, Inc.*, the Supreme Court clarified that, for purposes of *MFW*, "from the beginning" means "before the start of substantive economic negotiations." This line of demarcation serves "to have both the controller and the Special Committee bargain under the pressures exerted on both of them by these [procedural] protections." Thus, "so long as the controller conditions its offer on the key protections at the germination stage of the Special Committee process, when it is selecting its advisors, establishing its method of proceeding, beginning its due diligence, and has not commenced substantive economic negotiations with the controller, the purpose of the pre-condition requirement of *MFW* is satisfied." We anticipate that 2019 will further illuminate when "substantive economic negotiations" begin — a topic of spirited debate among the academic community and Delaware law practitioners.

Securities Act Claims Cannot Be Governed by Forum Selection Provisions

In a seminal 2013 decision, *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, the Court of Chancery upheld the validity of a provision in Chevron's bylaws requiring "internal corporate claims" — *i.e.*, those claims subject to the internal affairs doctrine, such as claims for breach of fiduciary duty — to be litigated in Delaware courts. This decision was subsequently codified at 8 Del. C. § 115, which expressly allows forum selection provisions to be included in the certificate of incorporation or the bylaws of a Delaware corporation. In the years since, corporations, practitioners, scholars and the media all questioned how far the forum selection provision could extend. In December 2018, the Court of Chancery provided an answer.

In *Sciabacucchi v. Salzberg*, the Court of Chancery invalidated a forum selection provision that required any claims under the Securities Act of 1933 to be brought in federal court. Earlier in 2018, the U.S. Supreme Court confirmed in *Cyan, Inc. v. Beaver County Employees Retirement Fund* that state courts have concurrent jurisdiction with federal courts over Securities Act claims. Relying on the *Cyan* decision as well as language in *Boilermakers* emphasizing the limited scope of a forum selection provision for a Delaware company, the Court of Chancery invalidated the provision because federal law, not Delaware law, created the Securities Act claim. The court stated that the "state of incorporation cannot use corporate law to regulate the corporation's external relationships" and that a forum selection provision in a company's certificate of incorporation or bylaws cannot govern Securities Act claims "because the provision would not be addressing 'the rights and powers of the plaintiff-stockholder as a *stockholder*.'" (For more, see our December 21, 2018, client alert "Delaware Court of Chancery Invalidates Forum Selection Provisions Regulating Claims Under the Securities Act of 1933.")

The *Sciabacucchi* decision is likely to be appealed, and the outcome of that appeal will be closely watched for its potential implications for future forum selection cases.

Delaware Allows First-Ever Termination of a Merger Because of an MAE

Delaware's first judicial finding of an MAE in a merger transaction, *Akorn, Inc. v. Fresenius Kabi AG*, went from filing to affirmance on appeal in less than eight months. The case began in April 2018, when Akorn filed its complaint seeking a declaratory judgment that Fresenius could not terminate the parties' merger agreement. The Court of Chancery held that Fresenius, the acquirer, could validly terminate the merger agreement with Akorn, the seller, because of the presence of two separate and independent MAEs. First, it found that Akorn's business "fell off a cliff" right after the merger agreement was approved by stockholders, and that this decline continued for a "durationally significant" period of time (five quarters), showed "no sign of abating" and could not be attributed to general industry decline or other MAE exceptions in the merger agreement.

The court also found "overwhelming evidence of widespread regulatory violations and pervasive compliance problems at Akorn" in violation of various covenants in the merger agreement. When evaluating whether the regulatory violations and compliance problems here "would reasonably be expected to result in an MAE," the court stated that it "must consider [the] 'quantitative and qualitative aspects.'" It then proceeded to find the violations both qualitatively and quantitatively material, finding for the latter that the violations would require approximately $900 million to remediate, equating to roughly 21 percent of the total equity value implied by the merger agreement. The court concluded that a remediation cost of 20 percent of the total equity value "would reasonably be expected to result in an MAE." The court made clear that the facts presented did not produce a picture of a buyer simply experiencing buyer's remorse, concluding that the buyer acted properly and in response to serious issues at Akorn. (For more, see our October 19, 2018, client alert "Analyzing *Akorn*: Delaware's First M&A Termination Under Material Adverse Effect.")

In December 2018, the Delaware Supreme Court affirmed the Court of Chancery's judgment because it found that the "record adequately supports" the Court of Chancery's findings on both MAE points. (For more, see our December 21, 2018, client alert "Delaware Supreme Court Affirms *Akorn*.") Whether *Akorn* establishes any "thresholds" buyers must clear in order to prove an MAE or merely provides data points on an evolving landscape remains to be seen.

The *Aruba* Appeal

Appraisal law has been a significant focus of the Delaware courts over the past several years. In 2019, the Delaware Supreme Court is poised to issue a ruling in the appeal *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, an appraisal action where the Court of Chancery held after trial that Aruba Networks' most recent 30-day average unaffected market price was the best evidence of "fair value," even though that price was more than 30 percent below the merger price. The court reasoned that its use of unaffected market price was consistent with other recent noteworthy Delaware Supreme Court appraisal decisions — such as *DFC* and *Dell* — where the driving valuation argument was that the merger price (as opposed to an expert-driven valuation analysis) was the best evidence of appraisal value.

Companies, practitioners, scholars and the media are closely watching the case, and the Supreme Court's decision is one of the most highly anticipated Delaware opinions of 2019.

Click here for a full list of Delaware-related litigation articles authored by Skadden attorneys in the last year.

Significant Rulings Expected for Ongoing Mass Tort, Consumer Class Action Issues

Contributing Partners

John H. Beisner / Washington, D.C.

Jessica D. Miller / Washington, D.C.

Associates

Kara E. Cheever / New York

Donald R. Munson / New York

Jordan M. Schwartz / Washington, D.C.

In 2019, significant developments are expected on issues that have been percolating in the mass tort and class action litigation arena for several years. The U.S. Supreme Court is expected to rule on cases relating to arbitration, *cy pres*, preemption and personal jurisdiction, and resolve such questions as whether a contract that is silent on class or collective arbitration still allows it.

On the litigation reform front, efforts to combat abuses in class action and multidistrict litigation (MDL) practices may stall under the now Democrat-controlled House of Representatives, and the changes that had been implemented over the last couple of years may even be reversed.

Arbitration. A case currently before the Supreme Court, *Lamps Plus, Inc. v. Varela*, raises an issue that has greatly divided the lower courts for years: whether a contract that does not mention class or collective arbitration nevertheless authorizes it. The Court has decided numerous cases involving classwide arbitration issues in recent years, including in 2011 when it ruled in *AT&T Mobility LLC v. Concepcion* that the Federal Arbitration Act preempts state laws that condition the enforceability of arbitration clauses on the availability of classwide arbitration. Additionally, in May 2018, in *Epic Systems Corp. v Lewis*, the Court rejected the argument that class action arbitration waivers should not be enforced because they deny employees the opportunity to collectively litigate disputes in violation of their right to engage in "concerted activities" under the National Labor Relations Act. Even if the Court agrees with the U.S. Court of Appeals for the Ninth Circuit that the agreements involved in *Lamps Plus* can be construed as authorizing classwide arbitration under state contract law, that ruling may have limited practical implications given the growing prevalence of explicit class action waiver clauses in arbitration agreements, which the Court has repeatedly affirmed as enforceable.

Cy Pres. In 2013, the Supreme Court declined to take up a challenge to a class action settlement utilizing *cy pres* — the practice of distributing unclaimed class action funds to third-party charities. Although the Court denied the petition for *certiorari* in that case (*Marek v. Lane*), Chief Justice John Roberts issued an unusual statement stressing that *cy pres* is a "growing feature" of class action settlements and that "in a suitable case, this court may need to clarify the limits on the use of" that practice. In 2019, the Supreme Court is poised to do just that in *In re Google Referrer Header Privacy Litigation*, a case involving an $8.5 million settlement arising from alleged privacy violations by Google. Apart from attorneys' fees, the money in the settlement fund is to be distributed to six charities — five of which were the favored charities of Google, class counsel or both. The Ninth Circuit affirmed the class settlement, holding that it would not have been economically feasible to distribute any money to the millions of class members. While it is difficult to predict how the Supreme Court will rule, the questioning and statements from the justices at the October 2018 argument suggest that the Court might impose some limits on the *cy pres* doctrine. That said, the case may not reach the merits of the *cy pres* arguments because the Court ultimately may decide that the named plaintiff does not have standing.

Preemption. The Supreme Court is slated to clarify the standard set forth in the 2009 decision *Wyeth v. Levine* that pharmaceutical companies cannot be sued for failure to warn when there is "clear evidence" the Food and Drug Administration (FDA) would have rejected the plaintiff's proposed warning. In *Merck Sharp & Dohme Corp. v. Albrecht*, the plaintiffs alleged that the Fosamax warning label should have included a notice about the risk of atypical femoral fractures. Merck countered that it tried to add language addressing the risk but was prevented from doing so by the FDA, which stated that the justification for such language was "inadequate." The district court granted summary judgment to Merck on these facts, finding that the failure-to-warn claims were preempted under *Levine* because the "clear evidence" standard demonstrated that the FDA would not — and did not — approve of the proposed label change. The U.S. Court of Appeals for the Third Circuit reversed, holding that Merck had not demonstrated that the FDA would have rejected a "properly worded" warning, which was a question for the jury. The Supreme Court not only granted *certiorari* but also invited the solicitor general to weigh in on the case; the solicitor general sided with Merck in arguing that preemption should be decided by a judge, not a jury. While a win for Merck (and, by extension, pharmaceutical companies across the country) is by no means a foregone conclusion, the Supreme Court's recent preemption jurisprudence suggests that the Third Circuit's ruling is in doubt.

Personal Jurisdiction. In its landmark 2017 ruling in *Bristol-Myers Squibb Co. v. Superior Court of California* (*BMS*), the Supreme Court held that state courts presiding over nationwide mass tort actions lack personal jurisdiction over out-of-state defendants as to claims plaintiffs brought in a different state — even when those claims are substantially similar to those of in-state plaintiffs in the same proceeding. Since then, most courts have put an end to nationwide mass actions where plaintiffs have no connection to the forum state. However, a handful of state courts in Missouri and Pennsylvania have exercised jurisdiction over out-of-state manufacturers based on their use of entities in the forum state to help introduce a product into the stream of commerce. Another recurring issue in the wake of *BMS* is whether the Supreme Court's ruling applies to class actions and, if so, whether nationwide class actions can be brought against a defendant in a forum other than where the defendant is subject to general jurisdiction — *i.e.*, its principal place of business or state of incorporation. So far, federal district courts have been divided on this fundamental question, and it looks like the U.S. Court of Appeals for the District of Columbia Circuit will be the first federal circuit court to delve into the debate, after the district court certified for interlocutory appeal its prior ruling refusing to apply *BMS* to absent class members in *Molock v. Whole Foods Market, Inc.*

Litigation Reform Efforts. The past couple of years provided litigation reform advocates with a glimmer of hope that there would be changes to curtail what they viewed as abusive class action and MDL practices. Most notably, the House of Representatives passed the Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2017 (FICALA), which addressed a number of issues, including no-injury class actions, discovery practices and undisclosed third-party funding. The Senate ultimately declined to take up FICALA, and its fate is likely moribund with the end of the 115th Congress. And with Democrats now in control of the House, it is unlikely that reform packages like FICALA will see the light of day in 2019. Indeed, the House could even bring to the floor proposals that would make it easier to certify class actions or weaken prior reforms that have expanded federal jurisdiction over interstate class actions. As a result, the most likely avenue for legal reform in the upcoming year is the Advisory Committee on Civil Rules, an arm of the federal judiciary that is actively investigating alleged abuses in MDL proceedings and the prevalence of third-party litigation funding.

Click here for a full list of mass torts, insurance and consumer litigation-related articles authored by Skadden attorneys in the last year.

Trade Secrets Take Center Stage, and Contracts Play a Lead Role

Contributing Partners

Douglas R. Nemec / New York

P. Anthony Sammi / New York

The stars of intellectual property law have historically been patents, copyrights and trademarks. Trade secrets have long been legally recognized but only recently have begun to share equal billing. The 2016 passage of the Defend Trade Secrets Act (DTSA), the first-ever federal statute pertaining to trade secret law, was instrumental in paving the way for a growing body of law on trade secret enforcement, and that enforcement indicates that tailored agreements provide important protection against misappropriation of trade secrets.

Trade secrets differ in important respects from other forms of intellectual property. For instance, the rules for what constitutes a trade secret are nebulous compared to those for patents, copyrights and trademarks; and unlike patents, they do not exclude commercially valuable subject matter areas (such as business methods and diagnostic techniques). This broad coverage comes with no examination delays, no acquisition cost and no expiration date, provided the secret stays secret. Trade secret claims also can be pursued in state or federal court, and the general perception is that courts are more receptive to exigent relief (such as temporary restraining orders and preliminary injunctions) in trade secret cases than in other intellectual property cases. For better or worse, trade secret damages also can reach gargantuan levels because a case of misappropriation may carry with it both the risk of lost revenues or sales and the loss of the intellectual property itself.

Growing Emphasis on Contracts

With increasing attention on trade secrets and a developing body of case law around DTSA claims, an emphasis on contracts also is growing. Breach-of-contract claims frequently have appeared alongside trade secret claims in lawsuits over the years and often materially impacted the results. But a contract should not be viewed as a mere alternative to trade secret protection. Properly crafted, and if necessary properly litigated, a contract can both strengthen and expand the reach of a trade secret claim. As the examples below demonstrate, recent cases reveal a variety of ways in which minor adjustments to nondisclosure agreements (NDAs), collaboration agreements and the like can yield better protection for owners of valuable proprietary information. Conversely, those poised to receive proprietary information from third parties should bear in mind the lessons from these examples.

Defining Confidential Information

When a trade secret misappropriation issue arises vis-à-vis a party that first came into possession of information through rightful means (*e.g.*, a former employee or collaboration partner), there are typically contracts between the parties. Ideally, those contracts contain provisions governing the handling and use of confidential information. Even better, the contract or contracts will contain something more than boilerplate confidentiality provisions recycled from an old template. Confidentiality provisions should supplement the protections afforded by trade secret law, not merely duplicate them. In particular, NDAs often exclude publicly available information from the scope of "confidential information," and the rationale is hard to dispute — no one wants to commit themselves to keeping a secret that is not actually secret. Defining "confidential information" in this way roughly aligns with the requirements for proving the existence of a trade secret under the DTSA and most state laws, which is to say that information available to the public cannot qualify as a trade secret.

This approach can be a missed opportunity for a disclosing party, as evident in the recent dispute is which Freeman Investment Management asserted trade secret misappropriation and breach of contract claims on the grounds that Frank Russell Company had misused proprietary investment volatility data. In March 2018, the U.S. Court of Appeals for the Ninth Circuit affirmed dismissal of Freeman's case on both trade secret and contract grounds. Central to the court's holding on the contract claim was the fact that the NDA in question was limited to "nonpublic information" and therefore essentially coextensive with what the law will protect as a trade secret.

Nothing in the law precludes a contracting party from defining "confidential information" more broadly in agreements. For example, rather than excluding all publicly known information, one could exclude only what was already known to the receiving party when the disclosing party provided it. If an accused counterparty's after-the-fact research reveals that the alleged trade secret was available in the public domain, contracts that define confidential information in this fashion provide the disclosing party with an added layer of protection.

Term Limitations and Their Risks

No matter how "confidential information" is defined, the definition almost certainly will encompass trade secrets, in addition to proprietary information that might not rise to the level of trade secrets. Accordingly, any limitations on the protection of confidential information in an agreement also will amount to limitations on the ability to protect trade secrets shared under that agreement. Term limitations in contracts are commonplace, but companies should take heed when those term limitations extend to confidentiality obligations. In the extreme case, a closed-ended confidentiality provision could put a shelf life on trade secrets or even extinguish trade secret eligibility entirely.

A case in the U.S. District Court for the Northern District of California underscores this point. In January 2018, Alta Devices, Inc. sued LG Electronics, Inc. for trade secret misappropriation and breach of contract, alleging that LG had misused allegedly proprietary solar cell technology that Alta had originally disclosed to LG under an NDA. In October 2018, Alta narrowly avoided dismissal of its trade secret claims in the face of an argument by LG that the term provision in the contract ended a duty to hold the allegedly proprietary information in confidence. While the term limitation did not defeat the trade secret claim as a matter of law, the record suggests that it will present a factual obstacle in the case going forward.

If the term of a confidentiality obligation must be limited, consider carving out trade secrets for indefinite protection. While distinguishing trade secret information from merely confidential information may add complexity at the time of disclosure, the benefits of doing so will often outweigh the cost — particularly if the alternative is starting the clock to eventual disclosure of those trade secrets.

Maintaining Confidentiality

Disclosing parties are often reluctant to take on onerous responsibilities for marking their confidential information, following up conversations with emails to confirm confidentiality and the like. In turn, receiving parties often balk at "need to know" restrictions, obligations to log derivative works and the need to purge their files at the conclusion of a relationship. But adopting measures such as these will pay dividends to trade secret owners if they ever need to enforce their rights, even against someone other than the contractual counterparty. This is because under the DTSA and most state laws, proving the existence of a trade secret implicates evidence that the trade secret owner has taken "reasonable measures to keep such information secret." In some cases, contractual restrictions on the handling of information may be the best or only contemporaneous proof of such measures.

As one example, TLS Management recently secured a judgment for trade secret misuse to the tune of $4 million against Mardis Financial Services in the U.S. District Court for the Southern District of Mississippi. In its August 2018 opinion, the court specifically credited NDAs requiring the return of all business and customer information at the conclusion of a business relationship as evidence of reasonable efforts to maintain the secrecy of trade secret information.

On a more basic level, measures of this kind provide a benefit to both disclosing and receiving parties that justify any added burden because they decrease the odds that sensitive information will be misused or disclosed either deliberately or accidentally.

Takeaways

In all likelihood, a party disclosing or receiving confidential information will not be able to negotiate every term highlighted above to its satisfaction. After all, contractual confidentiality provisions are the only form of intellectual property that comes into being through a direct negotiation between the intellectual property owner and potential future infringer. Nonetheless, attention to how trade secrets and accompanying agreements fare in litigation should encourage companies to put away the boilerplate, learn from the experience of others and tailor each new agreement with the benefit of that knowledge.

Click here for a full list of intellectual property litigation-related articles authored by Skadden attorneys in the last year.

Preparing for Democratic Oversight Investigations

Contributing Partners

Margaret E. Krawiec / Washington, D.C.

David B. Leland / Washington, D.C.

Ivan A. Schlager / Washington, D.C.

Following eight years of Republican majorities in Congress, Democrats took control of the House of Representatives in January 2019, thereby regaining the ability to control committee and subcommittee agendas, hold hearings and issue investigative subpoenas.

Companies can expect the new Democratic majority to employ these tools to vigorously pursue vastly different legislative and investigative priorities than Republicans, including issues affecting the health care industry (access to health care and high drug prices); the financial services industry (deceptive consumer practices); for-profit colleges (student debt issues); oil and gas companies (relaxation or deregulation of environmental protection rules); and technology companies (election interference and data privacy issues). Companies in these industries should anticipate that House Democrats will launch a number of investigations that reach beyond the activities of the Trump administration, and they should prepare a game plan for responding to a subpoena or other inquiry in the event they are affected by one of these investigations.

Chairs of key oversight committees have expressed an interest in pursuing a range of investigations. Rep. Elijah Cummings, chair of the House Oversight and Government Reform Committee, has indicated that one of his highest priorities will be drug pricing. Rep. Adam Schiff, chair of the House Intelligence Committee, has stated that he plans to reopen the Russia probe and likely pursue angles that Democrats claim were not fully explored by Republicans, including gathering further information from social media companies and banking records from financial institutions. Rep. Jerrold Nadler, chair of the House Judiciary Committee, has expressed an interest in Russian election interference issues as well as drug pricing. Nadler also would lead impeachment efforts if Democrats pursue that path. Rep. Maxine Waters, chair of the House Financial Services Committee, has stated that her priorities will include banking relationships with President Donald Trump and such consumer protection issues as deceptive sales practices. Waters also will focus on restoring the intensity of enforcement and regulatory activities of the Consumer Financial Protection Bureau. (See "Despite Leadership Changes, No Pivot in Priorities Expected for Consumer Financial Services Enforcement.")

Democratic Priorities

Congress can broadly investigate any matter for which it can propose and enact legislation. As a result, few companies or industries are beyond the reach of a congressional subpoena. Democrats' investigative priorities the past two years have been evident in the letter requests they have issued to companies; reports they have solicited from the Government Accountability Office (GAO) — an independent, nonpartisan legislative agency that investigates federal spending and federal programs, and assists Congress in making effective policy and oversight decisions; investigations by Democratic state attorneys general; and oversight letters issued by Democrats to the Trump administration. Further, Democrats likely will use their oversight efforts to scrutinize those initiatives that Trump has touted to date.

Letter Requests. As the minority party, Democrats lacked subpoena power to compel witness testimony and document production. Accordingly, they often resorted to the issuance of letter requests in an effort to increase the visibility of issues and potentially convince the chairman or majority members that a thorough committee investigation was warranted. With a House majority, Democrats in committee chairs likely will issue legally enforceable subpoenas demanding similar information, particularly where companies have not responded to or are perceived to have otherwise mishandled earlier informal requests.

Many of these letter requests — the recipients of which included pharmaceutical companies, financial institutions and social media companies, among others — have been sent to multiple companies within an industry, particularly when the issue being raised was an industrywide one. Congressional Democrats also have called on the Department of Justice, the Securities and Exchange Commission (SEC) and other federal regulators to either investigate or provide information regarding a number of companies.

GAO Reports. Like letter requests, GAO reports often become talking points aimed at spurring a more thorough investigation or hearing. A review of GAO reports issued over the 13 months starting with November 2017 (see our November 7, 2018, client alert for a list of GAO reports that Democrats in Congress requested during that time) shows that a substantial number of these reports were issued solely at the request of Democratic members of Congress and focused on the health care industry (*e.g.*, the opioid crisis; open enrollment outcomes in the Affordable Care Act health insurance exchanges; profits and research-and-development spending; and merger and acquisition activity in the pharmaceutical industry).

Other topics that appear to be the focus of Democrat-requested GAO reports include:

- Trump administration programs and priorities (*e.g.*, family separations at the border, deregulation of environmental protection standards, implementation of recent tax cuts);
- education and student lending (*e.g.*, federal student aid, public service loan forgiveness, school accreditation);
- the mining and oil and gas industries (*e.g.*, oil and gas lease management, coal mine reclamation, natural gas storage);
- the financial services industry (*e.g.*, lending to low- and moderate-income communities, large bank supervision, workplace retirement accounts); and
- climate change (*e.g.*, SEC requirements for disclosures of climate-related risks, Department of Defense climate change adaptation planning).

Democratic State Attorneys General Investigations. More than 20 Democratic state attorneys general have pursued investigations and enforcement actions that also may be useful in assessing the potential investigative interests of the new House majority.

New York has been particularly active, using the state's expansive anti-fraud law and other regulatory tools to pursue investigations into and lawsuits against a number of public companies. Among other active matters during the past year are:

- a New York state lawsuit against an oil and gas company for its disclosures relating to climate change;
- subpoenas issued to trade groups, lobbying firms and advocacy organizations over allegedly fraudulent net neutrality comments; and
- the pursuit of consumer protection issues across various industries, including the financial services sector.

Other examples include North Carolina's and Massachusetts' investigations into e-cigarettes and New Jersey's settlements with oil and gas companies for alleged environmental damage caused by a gasoline additive.

Oversight Letters to the Trump Administration. Senate Democrats have sent a number of oversight letters to various federal agencies that appear to remain outstanding and could have implications on the private sector if pursued. Such letters include requests for information regarding or relating to:

- loopholes in the Buy American laws;
- alleged malfeasance of federal agency heads (*e.g.*, stock market trading activities; conflicts of interest with private sectors, such as oil and gas companies, Russian investors and higher education companies);
- the approval and construction of oil pipelines;
- alleged Russian interference in the 2016 election;
- drug pricing issues;
- Americans' access to health insurance coverage information; and
- health care enrollment issues.

While the Democrats will no doubt focus on Trump himself — his tax returns, family businesses and alleged dealings with Russia, among other issues — they are expected to also follow up on outstanding requests that may have a wide reach beyond the Trump administration.

Trump Administration Accomplishments and Priorities. Democrats are expected to use their control of oversight committees and subcommittees to scrutinize the policy initiatives of the Trump administration. For example, Trump has repeatedly touted the passage of the tax bill, which, among other changes, lowered the corporate tax rate from 35 percent to 21 percent. He also has stated his desire to further reduce the corporate tax rate. (See "US Tax Reform and Cross-Border M&A: Considering the Impact, One Year In.") Democrats will do their best to oppose such efforts by shining a spotlight on provisions of the tax code that they perceive as disproportionately benefiting large corporations. As part of their efforts, Democrats may turn to corporations for information and set public hearings where CEOs are called to testify and disclose the amounts saved as a result of the tax cuts as well as how these savings were used.

Trump also has taken steps to cut regulations that he argues diminish the growth of the U.S. economy. For example, he has moved toward expanding drilling in the Gulf of Mexico and the Arctic. Democrats have strongly denounced the Trump administration's environmental record and contend that changes at the Environmental Protection Agency have not only harmed the environment but also damaged how the U.S. is viewed around the world. Deregulation will likely remain a priority of the Trump administration, and Democrats are expected to devote substantial oversight efforts to identifying and publicizing any regulatory changes with which they disagree.

Responding to Congressional Inquiries

Congress frequently has used investigations to force industrywide changes. For that reason, companies that have received letter requests from Democrats in Congress, or whose industry has been the subject of a GAO report or state attorney general investigation, should take steps to prepare for potential congressional investigations. For example, companies should assess whether to make changes to policies, procedures or business practices that may be scrutinized. Companies also might consider identifying and reviewing documents that may need to be produced in the event of a congressional subpoena. Additionally, companies involved in transactions should consider assessing the risk of congressional oversight — which could impact the value of the acquisition — as part of their due diligence.

Click here for a full list of government enforcement and white collar crime-related articles authored by Skadden attorneys in the last year.

International Arbitration Community Turns Its Focus to Cybersecurity

Contributing Partners

Julie Bédard / São Paulo

Lea Haber Kuck / New York

Timothy G. Nelson / New York

International arbitration has long offered participants the benefit of maintaining confidentiality in high-stakes cases. Like virtually all modern activity, however, it has become potentially vulnerable to cyberattacks. The threat extends not only to the information of the disputing parties and their counsel, but also to the internal deliberations and draft decisions of the arbitrators themselves, which can be highly sensitive. Combined with reports of breaches in other contexts, this underscores the importance of maintaining the security of the information exchanged in the course of an arbitration, and communications among arbitrators and with arbitral institutions. As a result, the international arbitration community has been increasingly focused on the security of the information exchanged during the arbitral process.

The need for cybersecurity measures in international arbitration is heightened by the contentious backdrop, the high-value and high-stakes nature of disputes, and the involvement of multiple actors who are digitally interdependent. One widely reported cyberattack occurred in July 2015 during the arbitration between the Philippines and China over disputed waters in the South China Sea. The attack, which some commentators claimed originated from China, targeted the Permanent Court of Arbitration in The Hague, which was administering the arbitration; the Philippine Department of Justice; and the law firm representing the Philippines.

In late 2017, representatives of the International Council for Commercial Arbitration, the International Institute for Conflict Prevention and Resolution, and the New York City Bar Association came together to create the Working Group on Cybersecurity in Arbitration, which was charged with evaluating these issues and making recommendations.[1] The working group released the Draft Cybersecurity Protocol for International Arbitration in April 2018. A final document is expected to be released later in 2019 and will take into account input the working group has received both at public workshops it has held throughout the world and in written form from a variety of bar associations and other interested organizations.

As explained by the working group when issuing the draft for consultation, the draft protocol "suggests a procedural framework for developing specific cybersecurity measures within the context of individual cases, recognizing that what constitutes reasonable cybersecurity will vary from case-to-case based on a multitude of factors." It recommends that cybersecurity be addressed in the international arbitration process as early as practicable, ordinarily no later than the first case management conference and before the parties begin their exchange of information. In some cases, however, such as where the arbitration demand itself contains sensitive information, it may be necessary for parties and arbitral institutions to address this issue at the very outset of the proceeding.

[1] Lea Haber Kuck is a member of the working group, and associate Eva Y. Chan is its secretary. The draft protocol is available here.

Rather than advocate a one-size-fits-all approach to cybersecurity, the draft protocol provides a framework for parties and arbitrators to determine appropriate measures in the context of each case. As discussed in the draft protocol, factors that may influence the determination of what measures are reasonable include:

- the nature of the information expected to be exchanged in the arbitration, including any confidential commercial information and personal data;
- the potential cybersecurity threat based on the identity of the parties, and the nature and size of their dispute;
- the resources of the parties, including the existing digital infrastructure of the arbitral participants and any potential technical impediments to implementing cybersecurity measures; and
- the severity of the potential consequences of a cyberattack, which may vary depending on the value of the information to third parties; the nature, type and amount of personal data being processed and whether it is legally regulated; potential embarrassment or damage caused by public disclosure of the information; and whether and how the information could be misused by a third party (*e.g.*, politically, for extortion purposes, for insider trading purposes or to obtain a competitive advantage).

The draft protocol also recognizes that cybersecurity measures will necessarily need to evolve with changing technology and regulation.

Additionally, because cybersecurity is a shared responsibility of all participants in the arbitration process who are digitally interdependent, the protocol recognizes that the "security of information ultimately depends on the responsible conduct and vigilance of individuals." As it notes, "any individual actor can be the cause of a cybersecurity breach; [m]any security breaches result from individual conduct rather than a breach of systems or infrastructure." Accordingly, the draft includes a schedule of "General Cybersecurity Practices" highlighting steps participants, including parties, counsel, arbitrators and experts, should consider taking to make sure that information in their possession remains secure. These steps may include creating access controls through strong passwords with multifactor authentication; guarding digital perimeters using measures such as firewalls, anti-virus and anti-spyware software, operating system updates and other software patches; making routine back-ups; and being mindful of public internet use.

Arbitral institutions likely will further address this issue in their own infrastructure, internal procedures, arbitral rules and the training of arbitrators they appoint. Arbitrators will need to make sure that they are conversant in basic cybersecurity practices in order to meet the expectations of parties that have long been focused on protecting their confidential business information.

Best practices will continue to evolve as developments in technology and the regulatory landscape become increasingly complicated.

Click here for a full list of international litigation and arbitration-related articles authored by Skadden attorneys in the last year.

Regulatory

Financial Regulation

Foreign Investment Control Reforms in Europe

Contributing Partners

John Adebiyi / London

Pascal Bine / Paris

Matthias Horbach / Frankfurt

Dmitri V. Kovalenko / Moscow

Associates

Jason Hewitt / London

Mikhail Koulikov / Moscow

The geopolitical environment continues to drive reform of foreign investment rules in Europe, with government proposals clarifying and tightening such rules in the interest of national security. Recent foreign state-backed investments in critical European Union infrastructure, in particular, have sparked concerns that the EU's collective security is jeopardized by the lack of a harmonized foreign investment control framework.

The current focus on foreign investment in Europe mirrors developments across the world, including recent CFIUS reform. (See our August 6, 2018, client alert "US Finalizes CFIUS Reform: What It Means for Dealmakers and Foreign Investment.") With incoming EU and U.K. regimes, as well as recent developments in France, Germany and Russia, long-standing CFIUS experience in the U.S. has the potential to be a useful gauge for future developments (for example, the jurisdiction expansion to noncontrolling investments).

The new CFIUS reforms instruct the CFIUS chairperson to establish a formal process for information sharing with allies and other U.S. partners, which may lead to cross-jurisdictional engagement by regulators becoming a more prominent feature of global transactions (even where reviews are not triggered).

Foreign investors doing business in Europe — particularly those from countries that might be deemed a risk — should be mindful of the changing landscape. Specifically, governments have expanded or are looking to expand the industries deemed critical to national security, reduced the level of investment required to trigger a review, or created new methods of review and/or enforcement for national security issues. However, the increased tightening of controls and scrutiny of the underlying motives of state-backed investors has the potential to free up investment opportunities for those investors in countries less likely to be deemed a risk.

Insight into the more mature CFIUS process provides a valuable road map for investors in approaching European regulators and overall transaction management, such as advance planning to ensure foreign investment and national security issues are assessed early in a deal's life cycle.

European Union

The European Parliament, Council and Commission reached an agreement in November 2018 on an EU legal framework for screening foreign direct investments into the EU, which will apply to investments by non-EU investors. The centralized framework was formally unveiled in the EU during President Jean-Claude Juncker's September 2017 State of the Union address, which placed particular emphasis on foreign state-backed acquisitions of European infrastructure and technology. The framework reportedly now has sufficient support among member states, and the European Parliament is expected to vote on it in the first quarter of 2019.

The framework focuses on investments that affect the EU's collective security, as highlighted by Juncker's remarks: "If a foreign, state-owned, company wants to purchase a European harbour, part of our energy infrastructure or a defence technology firm, this should only happen in transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed."

Key sectors that will be subject to the framework are: critical infrastructure, critical technologies (*e.g.*, artificial intelligence (AI), robotics, semiconductors, dual-use, cybersecurity, space, nuclear), critical inputs, sensitive information, media, land and real estate, water supply infrastructure, data processing and electoral infrastructure. The EU proposal also identifies control of a foreign investor by the government of a country outside the EU, including through significant funding, as a potentially sensitive factor.

The framework stops short of creating a centralized review (*i.e.*, approval/rejection) mechanism but does provide for closer cooperation and coordination among member states. The screening member state must notify other member states and the European Commission of any foreign investment under its review. Other member states and the European Commission may issue nonbinding opinions to the screening member state if they believe the relevant foreign investment may affect EU security or public order. The European Commission also may carry out its own review of foreign investments that are likely to affect projects or programs of EU interest. Member states retain final decision-making power regarding foreign investments in their respective territories. In light of this type of coordination, investors should consider national security implications across all relevant EU member states, not just the primary jurisdiction of a target.

Given the current uncertainty relating to Brexit — particularly after the U.K. Parliament rejected the draft withdrawal agreement on January 15, 2019 — it is not clear how the proposed EU legal framework will apply to the U.K. The draft agreement generally provided for the U.K. to continue to be treated as an EU member state (aside from rights to participate in EU institutions) until the end of the agreed transition period. If an agreement is not ultimately approved, the U.K. will lose its member state status on March 29, 2019.

Some EU member state screening regimes treat EU/European Economic Area (EEA) investors differently than they do non-EU/EEA investors (for example, Germany, where investments by EU/EEA investors are generally not reviewable, except in specific sectors such as defense and information technology (IT) security for government classified information). Accordingly, Brexit may result in the U.K. being subject to different foreign investment rules in relevant EU jurisdictions beginning in March 2019.

France

In June 2018, the French government introduced a proposal to reform its foreign investment rules as part of the PACTE Law (Action Plan for Business Growth and Transformation). The purpose of the reform is to strengthen French foreign investment control and make the French clearance process more efficient vis-à-vis foreign investors. The PACTE Law was amended and adopted by the National Assembly in October 2018 but still requires Senate approval. The bill is expected to be passed in the first half of this year.

Covered investments under French foreign investment law currently require prior authorization by the French minister of the economy. This authorization is generally conditioned upon the foreign investor entering into certain commitments pertaining to the preservation of activities, resources and information that are sensitive from a French national defense or security standpoint. The ongoing reform would give the French authorities clearer and broader remedial powers to enforce compliance with the prior authorization requirement and foreign investors' national security commitments:

- If an investor does not submit a covered investment for authorization, the French authorities would be entitled to enjoin the investor to request authorization ex post or modify or unwind the transaction at the investor's expense.
- If, after completion of the investment, the investor fails to comply with its national security commitments, the French authorities could, among other actions, withdraw the initial authorization (in which case the investor will be required to request a new authorization or unwind the transaction) and impose new binding obligations on the investor, including the sale of sensitive French assets to a third party.
- In certain circumstances, the French authorities also would be entitled to (1) suspend voting rights and dividend distributions with respect to a portion of the French company's shares held by the investor, (2) appoint a special trustee in charge of preserving national interests at the French company level, and (3) restrict the investor's ability to dispose of sensitive French assets.
- The PACTE Law also would allow the French authorities to apply more effective financial sanctions against a foreign investor in the following four situations: (1) if an investor fails to seek prior authorization for a covered investment, (2) if the French authorization is fraudulently obtained, (3) if an investor does not comply with its commitments vis-à-vis the French state, and (4) if an investor fails to comply with an injunction order from the French minister of the economy.

Additionally, the PACTE Law reform would increase transparency by requiring the French government to publish annual statistics on the control of foreign investments in France and establishing a parliamentary delegation on economic security matters in charge of monitoring the French government's actions in this area.

Pursuant to a decree dated November 29, 2018, the scope of French foreign investment control has been expanded to cover the following activities: space operations, storage of sensitive data, operation of electronic and IT systems required for public security purposes, and activities relating to equipment for capturing computer data, as well as research and development activities in the following sectors: semiconductors, AI, cybersecurity, robotics, additive manufacturing, and dual-use goods and technologies. The new scope became effective on January 1, 2019.

Lastly, the November 29, 2018, decree allows a French target company to submit a request to the French authorities to ascertain whether a proposed transaction falls within the scope of the French prior authorization regime. (That option was previously open only to foreign investors.) The decree also extends the scope of reasons the French authorities may validly consider in order to block a proposed foreign investment.

Germany

Effective December 29, 2018, the German government reduced the review threshold for foreign investments in companies in certain industries to 10 percent of the company's voting rights. The previous threshold of 25 percent remains applicable for investments in companies outside those industries. Minority investors that have been exempt from foreign investment review in the past will have to consider the new threshold, which applies to industries deemed of particular interest for national security reasons, including defense and IT security for government classified information as well as critical infrastructure (*e.g.*, energy, telecommunications, transport and traffic, health, water and food suppliers, finance and insurance). The new rules now also list as critical infrastructure media enterprises that contribute to the formation of public opinion.

The updated German Foreign Trade and Payments Ordinance ("Außenwirtschaftsverordnung") comes at a time of intense public discussion over security concerns and the protection of technology, resulting from high volumes of investments from China as well as supply chain and, more generally, trade policy considerations. Significant foreign investments in key technologies have spurred concerns that the security and infrastructure of the country as well as the supply of German industry might become dependent upon investors from non-EU/EEA jurisdictions. Elements of trade policy are evident in recent initiatives by the Federal Ministry for Economic Affairs and Energy to promote the production of battery cells for electric vehicles in Germany and to support companies active in the development of artificial intelligence. In this context, the ministry has even suggested that the government create a state fund that could intervene and purchase entities that undesirable investors may be seeking to acquire. While at this time the suggestion is not being implemented, it appears realistic that the idea of a state fund will be further pursued in the long term.

In addition to the ordinance update, the ministry has significantly intensified its reviews of foreign investments, resulting in proceedings taking significantly longer than in the past — often between six and 12 months, compared to one to two months previously. It also has taken more actions to intervene on possible foreign investments than it typically had.

When State Grid Corporation of China considered a 20 percent investment into the German electricity network operator 50Hertz Transmission GmbH in mid-2018, the German government found it could not rely on the foreign investment regime to intervene, given the 25 percent threshold requirement. However, it considered the Chinese entity's interest a concern for national security reasons and reviewed other channels to stop the investment. Ultimately, German government-owned development bank KfW entered into an arrangement with the majority shareholder of 50Hertz, Belgian corporation Elia System Operator. Under that arrangement, Elia exercised its right of first refusal of the 20 percent stake in 50Hertz that had been offered to State Grid Corporation and sold that interest to KfW on the same terms. This move serves as an example of the German government's increased desire to become involved and was one of the trigger points for the initiative to reduce the review threshold for critical infrastructure to 10 percent.

Russia

In June 2018, the Russian parliament adopted a number of significant amendments to the Russian Strategic Enterprises Law and Russian Foreign Investments Law.

Russian Strategic Enterprises Law

Effective June 12, 2018, the concept of offshore investors has been removed from the Russian Strategic Enterprises Law. This concept was added under amendments made in July 2017, which extended the rules restricting the acquisition of certain interests in Russian strategic enterprises by a foreign state or international organization (or persons controlled by them) to any investor incorporated in an offshore jurisdiction or controlled through an offshore entity.

The rules that previously applied to offshore investors will now apply to foreign legal entities and foreign unincorporated organizations (foreign investors) that do not disclose to the Federal Antimonopoly Service of Russia their controlling persons, beneficiaries (those individuals for whose benefit the foreign investor acts) and beneficial owners (those individuals who, directly or indirectly, have an interest of more than 25 percent in the foreign investor or have the ability to control the foreign investor's decisions). The procedure for disclosure also was detailed in the amendments.

Under the rules, an acquisition by a foreign investor of control of a Russian strategic enterprise (generally, more than 50 percent of the voting rights of a Russian strategic enterprise, or 25 percent or more in the case of a subsoil user) requires the prior approval of the Russian government following a disclosure and is prohibited without such disclosure. An acquisition by a foreign investor of more than 25 percent of the voting rights of a Russian strategic enterprise (or more than 5 percent in the case of a subsoil user) but less than control is permitted without prior approval so long as the foreign investor makes the appropriate disclosure; if the foreign investor does not make the disclosure, the prior approval by the Russian government is required.

Russian Foreign Investments Law

In July 2017, the Russian Foreign Investments Law was amended to permit the Russian government to review any transaction entered into by a foreign investor with respect to any Russian legal entity if necessary for ensuring national defense and state security. At that time, the term "foreign investor" for the purposes of the Russian government's review of such transactions was expressly extended to apply to Russian nationals with dual citizenship and organizations — including those incorporated in Russia — that are controlled by foreign investors.

While such a review regime is still applicable to this category of foreign investors in accordance with the procedure set out in the Russian Strategic Enterprises Law, starting on June 12, 2018, the following persons are no longer considered foreign investors for the purposes of the guarantees and protections provided under the Russian Foreign Investments Law:

- a foreign legal entity controlled by a Russian citizen and/or by a Russian legal entity;
- a foreign unincorporated organization controlled by a Russian citizen and/or by a Russian legal entity; and
- a foreign citizen who also has Russian citizenship.

Notably, the term "foreign investment" has changed to include only those investments made by a foreign investor "directly and on its own." It appears that this amendment has been designed to make the guarantees and protections provided under the law inapplicable to those investors who fall into any of the categories listed above.

United Kingdom

In July 2018, the U.K. government published a white paper in which it proposed changes to the national security screening regime for public consultation. The proposals represent a significant expansion of the government's powers to intervene in transactions on national security grounds and, if enacted, could bring about material changes to the management of transactions in what has historically been one of the world's most liberal and open economies from the perspective of inward investment.

Of course, given the importance of foreign direct investment to the U.K. economy (the white paper notes that on average, between 2007 and 2017 the U.K. ranked third among G-20 nations for flows of inward foreign direct investment) and the current uncertainties as to the impact of Brexit on the U.K. economy, these new proposals come at a particularly sensitive time. The U.K. government has emphasized that it understands the importance of foreign investment to the U.K. but believes that the reforms are needed to address the challenging and changing national security threats it faces. The white paper notes that the challenges raised by the activities of hostile states, technological advances and developments in the global economy have led to other advanced economies, such as Germany, Japan and Australia, also reforming their approaches to the review of foreign investments, and that the government's proposals are consistent with this global trend. A number of responses to the government's consultation have stressed the need for clarity and proportionality in the final legislation and its application so as to avoid any chilling effect on investment in the U.K.

The white paper proposes a regime whereby parties to a transaction would notify the government if certain "trigger events" (such as the acquisition of more than 25 percent of the votes or shares in an entity, the acquisition of "significant influence or control" over an entity or the acquisition of more than 50 percent of, or significant influence or control over, an asset) raise any national security concerns. Under the proposed regime, the government would have the power to clear notified transactions, require compliance with certain conditions or block transactions entirely. If the parties do not voluntarily notify the government, but a transaction is subsequently identified as raising national security issues, the government would be able to review the transaction for up to six months after it takes place. If necessary, it could take remedial action, including requiring the transaction to be unwound.

The focus of the proposed regime is on certain core areas of the economy, including national infrastructure (civil nuclear, communications, defense, energy, transport), certain advanced technologies, critical direct suppliers to government and emergency services, and military or dual-use technologies. However, the white paper makes it clear that the potential scope of the proposal is much wider and would extend to any proposed investments in areas of the economy where the government deems it necessary to intervene to protect national security.

The U.K. government is expected to report on its findings following its review of public responses in early 2019. Investors should watch this space carefully. If the proposed regime is introduced, many of the techniques used successfully in other jurisdictions with long-standing national security review regimes of a similar nature such as the U.S. — particularly with respect to due diligence and transaction planning and structuring — could be applied in the U.K. to a much greater extent than before.

Click here for a full list of CFIUS-related articles authored by Skadden attorneys in the last year.

Trump Policy Actions Could Reshape Health Care and Life Sciences Landscape

Contributing Partners

John T. Bentivoglio / Washington, D.C.

Jennifer L. Bragg / Washington, D.C.

Maya P. Florence / Boston

In 2018, President Donald Trump and numerous executive branch agencies announced proposals that, if implemented, will reshape the landscape for virtually every sector of the health care industry. Many of these proposals are consistent with the administration's deregulatory agenda, from relaxation of health insurance rules to a decidedly pro-business approach, to enforcement of federal health care fraud and abuse laws. Other proposals have enjoyed more bipartisan support and have been driven by the rapid introduction of big data and other digital technologies into the health care space. Still others, most notably the president's proposals to reign in drug prices, are more in line with the views of many Democratic lawmakers. This creates a challenge for congressional Republicans and some agency heads to do something about drug prices while staying true to the administration's overall goal of driving economic growth through market-friendly approaches.

With major bipartisan health care legislation unlikely in the newly elected Congress, those in the health care industry should closely follow the administration's executive actions, which may be the most accurate reflection of the future regulatory landscape.

Affordable Care Act

Despite failing to repeal and replace the Affordable Care Act (ACA) in 2017, the Trump administration continued to take steps to weaken some of the ACA's requirements and push market-driven approaches to health care reform. These efforts began with an executive order on the president's first day in office and have included the Labor Department's proposal to expand association health plans, which operate largely outside the ACA framework; expanding the short-duration coverage rule that permits low-cost/low-coverage plans to operate free of ACA requirements; and allowing states to alter their essential health benefit requirements, reduce transfers among insurers under the risk adjustment program and diminish required insurer medical-loss ratios.

Despite the administration's regulatory efforts, much of the ACA remains largely in place. The cost of coverage in the individual market for people who lack subsidies has grown substantially, but marketplace premiums and insurer margins are stabilizing, and new insurers are entering some markets. The availability of premium tax credits has been a balancing force that has offset the shocks the individual market continues to absorb, according to the health policy nonprofit The Commonwealth Fund. The number of uninsured individuals increased by 700,000, to 27.4 million in 2017, the first increase since passage of the ACA in 2014, according to the nonprofit Kaiser Family Foundation.

The December 2018 federal district court decision in Texas declaring the ACA unconstitutional in light of Congress' elimination of the individual mandate makes the law's fate even more uncertain as the decision is appealed. The administration is likely to proceed cautiously in its litigation strategy through the appeals process in order to avoid disrupting the current ACA coverage for millions of Americans, especially in the lead-up to the 2020 elections.

Digital Health Initiatives

In the past five years, an explosion in digital health innovation has prompted policymakers to address a number of regulatory issues, with technologies emerging to encourage healthy lifestyles; facilitate disease prevention; enable early diagnosis; identify treatment options; support disease management; and assist health care professionals, patients and caregivers in a wide range of scenarios. These technologies promise better-informed decisions, new treatment options and more efficient services. They also involve new challenges, including products that are ill-suited to the Food and Drug Administration's (FDA) traditional medical device regulatory paradigm, manufacturers and developers that have not previously been regulated by the FDA, increased cybersecurity risks, and interoperability demand.

In July 2017, just two months after taking office, FDA Commissioner Scott Gottlieb announced the agency's Digital Health Innovation Action Plan, which recognized that "digital technology has been driving a revolution in health care" and outlined the agency's "vision for fostering digital health innovation while continuing to protect and promote the public health." In the 18 months since, the FDA has devoted significant attention to meeting these goals, including in many ways reimagining its regulatory approach. At the same time, it is clear that more change is in store, as the FDA continues to evaluate and amend its approach to meet the demands of the rapidly evolving digital health space, including with a request for comment regarding regulation of apps to be used with prescription drugs.

The FDA's creative approach to regulating this evolving space is not without its critics. On October 10, 2018, a group of Democratic senators sent Gottlieb a letter seeking extensive information about the FDA's regulation of digital devices and questioning its authority to implement a novel digital health software precertification (Pre-Cert) program that would exempt certain products from FDA premarket review and expedite the process of getting others to market.

Drug Pricing Receiving Scrutiny From All Sides

Trump Administration. No sector of the health care industry has drawn more criticism from the president and his administration than the pharmaceutical industry. Continuing his comments from the 2016 campaign trail, Trump has attacked drug manufacturers for high drug prices, in some cases calling out companies by name. He has asserted that U.S. consumers pay more for the same drugs than consumers in other developed countries. The administration's drug pricing blueprint proposes three changes to how Medicare pays for certain drugs (so-called Part B drugs): replace the current model, where physicians buy and bill for drugs, with a system of private pharmaceutical vendors; use a flat fee in place of the current reimbursement price (which is average sales price plus 6 percent); and implement international reference pricing. The proposals would be implemented in stages beginning in 2020, but their success remains to be seen — previous administrations unsuccessfully attempted the first two initiatives.

The Trump administration also could move forward with a proposal to rework the safe harbors under which drug manufacturers provide rebates and discounts to insurance plans and pharmacy benefit managers, which critics contend would result in higher profits to middlemen but would not result in direct discounts to consumers.

FDA. The FDA, which historically has eschewed calls for it to regulate drug prices, also has taken up the issue — albeit indirectly — by pushing for faster generic drug approvals and promoting competition. One focus Gottlieb has championed involves lowering the regulatory barriers to entry in areas with a single or small number of approved products.

Congress. For its part, Congress has shown more appetite for investigating manufacturing pricing practices than enacting legislation to lower drug prices. That may change in 2019, with Democrats taking control of the House of Representatives. (See "Preparing for Democratic Oversight Investigations.") House Democrats are likely to push proposals to bolster the ACA, expand Medicare and target drug prices, but these efforts may be focused more on framing issues for the 2020 elections than on enacting legislation that can make it through the Republican-controlled Senate. Nevertheless, key Democrats have promised to introduce legislation that would allow the Centers for Medicare and Medicaid Services to negotiate directly with drugmakers under Medicare Part D, the optional prescription drug benefit under the federal health insurance program. While the Republican-led Senate may not be willing to go that far, pressure from the House could force the Senate to do something about drug prices. Republican senators have introduced legislation to increase competition through faster generic approvals and held hearings on proposals to loosen Part D coverage mandates, and the Senate could take up one or more of these plans to demonstrate action.

Health Care Enforcement Takes Pro-Business Turn

The administration's pro-business approach has been most pronounced in the area of enforcement of health care fraud and abuse laws. Two Department of Justice (DOJ) policy initiatives already are being implemented by federal prosecutors in the courts. The first announced that prosecutors could no longer use violations of subregulatory guidance as evidence of wrongdoing in affirmative enforcement proceedings, including actions under the civil False Claims Act (FCA). The second policy stated that the DOJ will move affirmatively to dismiss nonmeritorious FCA actions (rather than simply decline intervention and allow the private *qui tam* litigator to pursue the case on his or her own). In the final weeks of 2018, the DOJ exercised this authority by moving to dismiss 11 FCA cases alleging that the operation of nurse educator programs by pharmaceutical manufacturers resulted in improper inducements to physicians. Rulings on one or more of the DOJ motions are expected in early 2019.

More generally, DOJ enforcement actions against health care organizations have declined in the past two years, as reflected in the number of and amounts recovered in major health care fraud settlements. This can be attributed to a number of factors, including the diversion of DOJ health care fraud resources to opioid cases, the administration's more business-friendly approach to white collar enforcement, and the Justice Department's focus on violent crime and immigration matters. Despite a coming change in leadership at the DOJ, the department's less aggressive approach to health care fraud enforcement against traditional industry participants is likely to continue through at least 2020.

Conclusion

Health care will remain a key political and policy issue in Washington, D.C., and the tone the House Democrats set will be closely watched. Expect executive agencies to continue to push proposals to bring more competition and market forces to the health care system, and foster more innovation around digital health issues.

Meanwhile, actions by the White House are more difficult to predict. The president likely will continue his criticism of drug prices and will encourage executive agencies and Congress to take action, but with Congress divided and a presidential election looming, major legislative action is unlikely.

The legislative and regulatory landscape will remain dynamic, and health care companies and other stakeholders will need to keep abreast of policy developments in this challenging environment.

Click here for a full list of health care and life sciences-related articles authored by Skadden attorneys in the last year.

Enhanced US Export Controls and Aggressive Enforcement Likely to Impact China

Contributing Partners

Michael E. Leiter / Washington, D.C.

Ivan A. Schlager / Washington, D.C.

Donald L. Vieira / Washington, D.C.

Counsel

Jonathan M. Gafni / Washington, D.C.

Daniel J. Gerkin / Washington, D.C.

Associate

Nicholas A. Klein / Washington, D.C.

Tariffs targeting Chinese imports into the United States garnered headlines throughout 2018. However, during the latter part of the year, the U.S. government more quietly initiated efforts that in 2019 and beyond could be more effective than tariffs in leveraging changes to Chinese behavior, particularly with respect to intellectual property protection. These efforts also could severely constrain Chinese growth, thereby preserving U.S. technological leadership. The moves are particularly aimed at the business sectors that comprise the "Made in China 2025" initiative. While these quieter efforts could benefit U.S. companies engaging with China over the long term, in the short term they are likely to increase the regulatory burdens associated with a variety of business relationships with China, including collaborative research and development projects or joint venture arrangements.

Specifically, the U.S. government: (1) proposed that a wide array of emerging technologies be subjected to enhanced controls under the Export Administration Regulations (EAR), which are administered by the Department of Commerce's Bureau of Industry and Security (BIS); (2) initiated a comprehensive review of the Commerce Control List (CCL) under the EAR to assess current controls on items to embargoed destinations, such as China; (3) sanctioned a Chinese semiconductor manufacturer under export-related authorities without a corollary finding of EAR violations; and (4) publicized significant enforcement matters pertaining to Chinese entities, including, in particular, Huawei Technologies Co., Ltd.

Treatment of Emerging and Foundational Technologies

On August 13, 2018, President Donald Trump signed into law the John S. McCain National Defense Authorization Act (NDAA) for Fiscal Year 2019. A key focus of the law is the protection of U.S. technological advances through closer scrutiny of technology transfers to foreign persons and their implications for U.S. national security and foreign policy. In addition to the Foreign Investment Risk Review Modernization Act, which enhanced reviews of foreign investment, the NDAA included the Export Control Reform Act (ECRA). The ECRA directed the establishment of a formal, ongoing interagency process to identify and review "emerging and foundational technologies that are essential to the national security of the United States" and required appropriate export controls for these technologies. The process involves the Departments of Commerce, Defense, State and Energy, along with other federal agencies as appropriate, and will identify "emerging and foundational technologies" through publicly available and classified information, as well as information derived from Commerce advisory committees and the Committee on Foreign Investment in the United States (CFIUS).

On November 19, 2018, BIS published an advance notice of proposed rulemaking soliciting comments on the criteria to be used to identify emerging technologies that are essential to U.S. national security. Such technologies could include those that have potential uses in connection with conventional weapons, intelligence collection, weapons of mass destruction or terrorist applications; or could provide the United States with a qualitative military or intelligence advantage. In publishing the notice, BIS compiled a list of technologies (*e.g.*, additive manufacturing, artificial intelligence and machine learning, biotechnology, microprocessors, robotics) for which export controls are only in place for comprehensively embargoed countries (such as Iran), countries designated as supporters of international terrorism (such as Sudan), and restricted end users or end uses. BIS says it will assess this representative list of technologies through the interagency process to identify any specific emerging technologies that are important to U.S. national security, for which effective controls can be implemented without negatively impacting U.S. leadership in the science, technology, engineering or manufacturing sectors. Enhanced licensing requirements are likely to inhibit exports of these technologies to China, thereby curtailing China's ability to rapidly scale domestic development in certain key industries.

Comments were due by January 10, 2019. As a next step, BIS will publish further proposed rules regarding the controls to be applied to specific emerging technologies, though there is no established timetable for the issuance of these rules.

BIS is expected to publish a similar notice soliciting comments regarding the identification of foundational technologies in early 2019. It has publicly suggested that such technologies are likely to be drawn from those that are currently subject only to unilateral anti-terrorism controls due to their removal from various multilateral control lists.

Comprehensive CCL Review

The ECRA also required the Departments of Commerce, State, Defense and Energy, along with other federal agencies as appropriate, to conduct an immediate review of the license requirements for the export, re-export and in-country transfer of items to countries subject to a comprehensive arms embargo (including China). The focus of this review is to assess existing export controls on items that currently do not require an export license and items destined for military end uses or end users. Commerce must implement any changes to existing export controls by May 2019. This review is likely to result in tighter controls on exports, re-exports and in-country transfers to China, in particular with an emphasis on technology with potential military applications and with military or government end users. As a consequence of this review, BIS likely will, for example, require licenses for items that currently do not require them or implement denial policies for license applications that otherwise would have been considered on a case-by-case basis.

Addition of Fujian Jinhua to BIS Entity List

Effective October 30, 2018, BIS added Fujian Jinhua Integrated Circuit Company, Ltd., a state-owned Chinese semiconductor manufacturer, to the BIS Entity List because the company "poses a significant risk of becoming involved in activities that could have a negative impact on the national security interests of the United States." The BIS Entity List comprises businesses, research institutions, government and private organizations, individuals, and other types of legal persons subject to specific license requirements for the export, re-export and in-country transfer of specified items that are supplemental to those found elsewhere in the EAR.

As a consequence, a specific BIS license is required for any person — whether located in the United States or not — to export, re-export or transfer (in-country) any commodities, software or technology that are "subject to the EAR" to Fujian Jinhua. The company is heavily reliant on U.S.-sourced hardware, and the impact of this action could cripple its ability to manufacture semiconductors. Any such license application will be reviewed in accordance with a policy of presumptive denial. Notably, the listing of Fujian Jinhua did not appear to be based on any specific activity by the company in violation of the EAR. Rather, it appeared to be tied to the November 1, 2018, indictment by a federal grand jury of Fujian Jinhua, among others, for alleged crimes related to a conspiracy to steal, convey and possess the stolen trade secrets of Micron Technology, Inc., an American semiconductor company. This novel offensive use of the BIS Entity List, even in the absence of a specific violation of the EAR, may be a harbinger of how the U.S. government intends to punish alleged trade secret theft in the future.

The BIS Entity List listing and indictment are consistent with the prior blocking of Chinese-backed semiconductor-related transactions by Presidents Barack Obama and Trump in accordance with recommendations made by CFIUS as well as the increased focus on the protection of U.S. semiconductor technology as embodied in the January 2017 "Report to the President: Ensuring Long-Term U.S. Leadership in Semiconductors," by the President's Council of Advisors on Science and Technology. The actions also are consistent with the November 1, 2018, U.S. Department of Justice (DOJ) announcement of the "China Initiative," which will be dedicated to the aggressive investigation and prosecution of Chinese companies for alleged trade secret theft, economic espionage, Foreign Corrupt Practices Act offenses and other violations of U.S. law. Taken together, these measures reflect a coordinated and sustained U.S. government response to Chinese economic development, particularly with respect to the "Made in China 2025" initiative — restricting Chinese access to sensitive U.S. technology, either via export or investment, and aggressively pursuing alleged trade secret theft, which will curb China's ability to rapidly scale development in certain key industries.

Notable Chinese-Related Export Enforcement

Bringing a notable U.S. export controls and sanctions-related enforcement action to a close in early December 2018, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) announced that Yantai Jereh Oilfield Services Group Co., Ltd. had agreed to pay $2.77 million to settle the potential civil liability stemming from violations of the Iranian Transactions and Sanctions Regulations. Yantai Jereh was alleged to have exported or re-exported, or attempted to export or re-export, U.S.-origin goods ultimately intended for end users in Iran by way of China. Yantai Jereh also allegedly exported certain U.S.-origin items with knowledge or reason to know that the items were intended for production of, for commingling with or for incorporation into goods made in China to be supplied, transshipped or re-exported to end users in Iran. Yantai Jereh, which also appears on the BIS Entity List, agreed to pay $600,000 to BIS for the same conduct.

Also in early December 2018, Canadian authorities, at the behest of the DOJ, arrested the chief financial officer of Huawei, allegedly in connection with ongoing OFAC and BIS investigations into U.S. sanctions violations. Like its competitor Zhongxing Telecommunications Equipment Corporation (ZTE), which was added to and subsequently removed from the BIS Entity List and remains subject to a suspended denial order, Huawei is alleged to have engaged in re-exports of U.S.-origin equipment to embargoed destinations, such as Iran. However, it is believed that Huawei will not be listed, primarily due to its much larger size and the adverse economic consequences such a listing would have for U.S. suppliers. Nevertheless, the threat of such a listing may well be sufficient leverage to extract trade-related concessions from the Chinese government. And Huawei is not likely to escape entirely. Indeed, it has been widely reported that BIS already has declined to renew an export license required by Huawei's Silicon Valley research and development unit, and potentially substantial penalties may yet be imposed.

BIS clearly is putting Chinese companies on notice that it will vigorously pursue export-related violations, particularly those involving U.S.-embargoed countries, and has expressed a willingness — as evidenced by the ZTE action — to choke off critical supplies of U.S.-origin hardware, software and technology. U.S. suppliers should be especially mindful of this latter risk as well as of more aggressive Chinese retaliation, including, for example, delays in processing regulatory approvals and, as with the Huawei matter, detentions of personnel traveling in China.

Tariff-Related Measures

Tariff-related measures targeting Chinese imports into the United States, including tariffs on more than $250 billion in Chinese imports as a consequence of China's alleged unfair intellectual property-related practices pursuant to Section 301 of the Trade Act of 1974, were implemented throughout 2018. The Section 301 tariffs were rolled out in three tranches, with the third targeting approximately $200 billion in Chinese imports. Currently, such imports are subject to a 10 percent tariff, but the tariff will be escalated to 25 percent on March 2, 2019 (as with tranches 1 and 2) if the governments of the United States and China do not meaningfully resolve their various trade issues.

The Office of the U.S. Trade Representative recently announced the first set of products excluded from the tariffs imposed on items covered by the first tranche but has yet to respond to all pending requests pertaining to the first and second tranches. There is no corollary product exclusion process for items currently subject to 10 percent tariffs under the third tranche.

Click here for a full list of international trade-related articles authored by Skadden attorneys in the last year.

Responding to the Call for Equal Pay

Contributing Partner

David E. Schwartz / New York

Counsel

Risa M. Salins / New York

Associate

Hannah Fraley / New York

Over the past couple of years, heightened awareness of and activism about pay inequity has resulted in public commitments from major companies to take steps to address the issue, both in the U.S. and in Europe.

In the U.S., the White House under President Barack Obama called for companies to publicly vow to take action to achieve equal pay when it launched the Equal Pay Pledge in 2016. Over 100 companies, collectively employing tens of millions of people, signed the pledge, which requires a commitment to review pay practices (including conducting an annual companywide pay analysis) and to take steps to address any pay inequality discovered. The Trump administration since has removed the Equal Pay Pledge from the White House website, but that has not stopped companies that signed it from continuing to pursue equal pay policies and practices, and others from focusing on equal pay issues.

Equal pay returned to the spotlight in the wake of the #MeToo movement and the Time's Up initiative beginning in 2017. While known for their efforts to tackle sexual harassment, both movements also created a forum for women and their champions to speak out about gender inequality in the workplace and fight for fair pay. The momentum of these efforts, along with the considerable media attention that followed, have brought renewed focus to pay equity issues in many boardrooms.

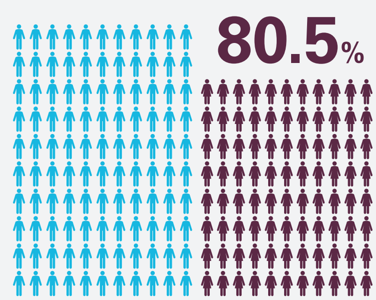
In Europe, effective April 2018, the U.K. began to require employers with 250 or more employees to report to the government annual gender pay gap statistics. France adopted similar legislation in September 2018 that, effective January 1 in 2019 or 2020 — depending on the number of employees — will require employers to report gender pay gap statistics and impose a potential fine of up to 1 percent of total payroll costs on employers that do not effectively remediate reported pay gaps within three years.

Although no federal proposals in the U.S. exist at this time for legislation requiring similar types of analysis and disclosure, and none are anticipated, a number of states — including California, Maryland, Massachusetts, New Jersey, New York, Oregon and Washington — recently have expanded their equal pay laws and placed stringent requirements on employers. Given the current climate and media attention surrounding the topic, we anticipate further developments and enforcement in this area.

State Law Expansion of Federal Equal Pay Act

According to a September 2018 report released by the Institute for Women's Policy Research, women's median annual earnings were 80.5 percent of men's median annual earnings for full-time, year-round workers in 2017, unchanged since 2016. The report also highlights a marked disadvantage for minority women, with Hispanic women earning 53 percent, and black women 60.8 percent, of white men's median annual earnings in 2017.

women's median full-time annual earnings in 2017 compared to men



Source: Institute for Women's Policy Research

Currently, 47 states have pay equity laws in effect that typically are more employee-friendly than the federal Equal Pay Act (EPA). The EPA prohibits sex-based wage discrimination for "equal work" in the same establishment. Recently enacted or amended state pay equity laws generally have put more onerous burdens on employers than the EPA, such as by covering other protected classes in addition to women, extending the statute of limitations for bringing claims (and, likewise, the lookback period for damages), making it more difficult for employers to satisfy affirmative defenses, increasing penalties for violations, and even making violations criminal offenses. One key difference between the EPA and many state pay equity laws is the standard applied for comparing employees. The EPA requires "equal pay for equal work" (*i.e.*, work requiring equal measure of skill, effort and responsibility), while a number of states require equal pay for "substantially similar" or "comparable" work. Moreover, a number of recent state law enactments or amendments, including in California, New Jersey and New York, provide that wage comparisons will be based on wage rates in all of the employer's operations or facilities. It remains to be seen whether or not employers in these jurisdictions will be able to use cost-of-living data across various geographic regions to justify pay differentials.

New Jersey's Diane B. Allen Equal Pay Act (NJ EPA), effective July 1, 2018, is considered one of the most broadly sweeping state equal pay laws in the country and may set a trend for other states to follow. The NJ EPA protects employees from wage discrimination across 17 protected classes recognized under the state's anti-discrimination law, including sex, race, national origin and age. Unlike the EPA, the New Jersey law creates a presumption of illegal discrimination whenever an employee of a protected class is paid less in wages, benefits or other compensation than a similarly situated employee who is not a member of that protected class. The NJ EPA also includes a six-year statute of limitations — compared to the EPA's two-year cap — and therefore employers may be held liable for up to six years of back pay in addition to mandatory treble damages, attorneys' fees, and costs and punitive damages (if the employer's conduct was willful).

47

states have pay equity laws that are more employee-friendly than the federal Equal Pay Act

Salary History Bans

Stemming from the latest focus on equal pay, legislation banning salary history inquiries also has been enacted in a growing number of states and localities, including California, Connecticut, Delaware, Hawaii, Massachusetts, Oregon, Puerto Rico, Vermont and New York City. This trend is expected to continue. The goal of salary history bans is to break the cycle of potential prior wage discrimination by prohibiting employers — including through agents such as outside recruiters — from asking job applicants about their compensation history. Several jurisdictions, including California and New York City, also prohibit employers from relying on an applicant's pay history to set compensation if discovered or volunteered.

Notably, consistent with this legislation, on April 9, 2018, the U.S. Court of Appeals for the Ninth Circuit ruled in *Rizo v. Yovino* that it is a violation of the EPA for an employer to use an employee's past salary, either alone or in combination with other factors, to justify pay disparities. This decision is at odds with rulings by other circuits, including the U.S. Court of Appeals for the Seventh Circuit, which have said salary history can be considered to justify a pay disparity. A petition for writ of *certiorari* seeking the U.S. Supreme Court's review of the *Rizo* decision is pending.

Takeaways

Shareholder and consumer activism regarding equal pay will continue to call for companies and boards of directors to focus on these issues. Companies, and specifically general counsels, should be prepared for mounting pressure to address pay disparities, including through an equal pay audit. Given the increasingly stringent state laws and heightened focus on pay equity generally, companies also can expect, and should be prepared for, a greater number of class actions as well as a renewed court focus on equal pay.

Employers should make equitable compensation practices a priority in 2019 by considering:

- Conducting a thorough review of job positions to assess which employees are performing similar or comparable work across all operations and facilities. The review should take into account the skills, effort and responsibility required for each position, such as the amount of revenue overseen and the number of employees managed.
- Reviewing compensation practices to ensure that only relevant nondiscriminatory factors, such as education or experience, account for pay differentials among employees performing similar or comparable jobs. If equally situated individuals who perform similar jobs receive disparate compensation, employers should work with legal professionals and human resources to create and implement equitable compensation.
- Reviewing and, if needed, updating application documents to eliminate questions seeking salary history

information. Employers should set parameters for internal and external recruiters to avoid disclosure of applicants' compensation history and implement procedures to be followed if compensation information is disclosed.

- Training human resources professionals and other employees who will be making compensation decisions to ensure they are knowledgeable of applicable equal pay laws.
- Examining existing policies related to starting compensation, pay increases and bonuses to ensure such policies are not negatively impacting a protected class. For example, employers should ensure that any merit-based pay system measures performance against uniformly reviewed, legitimate, job-related criteria and that any seniority-based pay system does not reduce seniority for time spent on leave due to pregnancy, or statutorily protected parental or family and medical leave.
- Developing and implementing policies that prohibit pay secrecy and eliminate penalties for discussing pay.

Click here for a full list of labor and employment law-related articles authored by Skadden attorneys in the last year.

Political Law: What to Consider When Providing Investment Fund Services to US State and Local Government Entities

Contributing Partner

Ki P. Hong / Washington, D.C.

Associate

Tyler Rosen / Washington, D.C.

With heightened attention to investment and depository rules as well as increased enforcement of federal and state pay-to-play rules, registered investment advisers (RIAs) and broker-dealers should address the unique legal considerations that may arise when a firm provides or seeks to provide services to U.S. state and local government entities.

Investment Rules

Jurisdiction- and government entity-specific rules apply to firms that manage, hold or invest money for the government. A government entity with significant funds will often adopt a policy specifying how the funds may be invested or what securities may be purchased — delineating the types of investments that are permissible (*e.g.*, prohibitions on swaps, equities, or investments in certain countries and industries), how the government entity views risk, how a portfolio must be diversified and the standard of care required for managers. Agreements with investment advisers or broker-dealers may even incorporate these policies by reference. Additionally, similar restrictions contained in a jurisdiction's statutes or ordinances may apply to the investments of a particular government entity or to all government funds in the jurisdiction. How restrictive they are often depends on whether the money is designated for investment, held by a retirement system or dedicated for some other particular purpose. Although government entities are less diligent about alerting investment advisers and broker-dealers to these restrictions, they can in some cases impose direct liability on the firm if it invests government funds in a manner that is not permitted by the applicable rules.

Depository Rules

The laws of many jurisdictions specify custodial requirements, such as that all government funds be maintained with approved depositories. In some jurisdictions, this means all funds must be held in banks rather than brokerage accounts. Moreover, firms typically need to go through a formal application and review process to become approved depositories.

Federal Pay-to-Play Rules

Under these rules, political contributions made by a company or its covered donors prohibit a covered company from engaging in, or receiving compensation for, certain business with state or local government entities. Importantly, federal pay-to-play rules are strict liability in nature, meaning criminal intent is not needed to trigger their prohibitions. Current federal pay-to-play rules are:

- The Municipal Securities Rulemaking Board's Rule G-37, which covers broker-dealers that underwrite municipal securities and municipal advisers who solicit investment advisory business for third parties, or provide advice to or on behalf of a government entity or obligated person with respect to municipal financial products or the issuance of municipal securities.
- The Securities and Exchange Commission's (SEC) Rule 206(4)-5, which covers registered investment advisers and exempt reporting advisers that provide investment advisory services to state or local government entities either directly (*e.g.*, via a separate managed account) or through a covered investment pool. Covered investment pools include unregistered investment funds in which a government entity invests directly, as well as registered mutual funds that are selected as an option for a participant-directed plan sponsored by a government entity.

- The Commodity Futures Trading Commission's Rule 23.451, which covers swap dealers that offer or engage in commodities-based swaps with state or local governmental counterparties.
- The Financial Industry Regulatory Authority's (FINRA) Rule 2030, which covers FINRA members engaged in soliciting investment advisory services covered by the SEC rule from state or local government entities.

State and Local Pay-to-Play Rules

Certain states and localities have laws that automatically prohibit a company from having government contracts if a covered donor makes a political contribution or solicits one for a covered official or political committee. Common categories of covered donors include:

- the firm itself;
- any affiliate or the affiliate's political action committee;
- senior officers of the firm (*e.g.*, management committee);
- members of the firm's board of directors;
- employees who solicit or manage state or local contracts; and
- in some cases, the spouses and dependent children of the individuals listed above.

These bans on business can, in some cases, last for more than five years. These laws also may impose disclosure requirements regarding political contributions. It is very common for government contracts and requests for proposals (RFP) in these jurisdictions to require a company to certify its compliance with these laws.

Lobby Laws, Placement Agent Policies and Contingent Fee Restrictions

What Triggers Lobbyist Registration

In 31 states and many localities, attempting to obtain the award of government business meets the definition of lobbying and may give rise to an obligation to register as a lobbyist. These laws vary, and many contain useful exemptions, such as for formally responding to an RFP or for in-house employees of the company who act as salespersons. In addition, some lobby laws have a threshold for triggering registration that may be based on the amount of time spent lobbying in the jurisdiction (*e.g.*, North Carolina's threshold is 5 percent of one's working time in a month), the compensation received for lobbying in the jurisdiction (*e.g.*, Indiana's threshold for executive branch lobbying is $1,000 per year) or number of contacts with covered officials (*e.g.*, San Francisco's threshold is five lobbying contacts in a month). In some jurisdictions, registration may be triggered when gifts and entertainment are provided to public officials and employees. Importantly, some jurisdictions aggregate all firm activity for these thresholds, so while a single action may not give rise to an obligation to register, it could when combined with other activities at the firm.

Requirements Once Registration Is Triggered

If registration is triggered, the individual lobbyist and/or company will need to register and report on a periodic basis. These reports typically require the disclosure of gifts and entertainment provided to public officials in the jurisdiction, compensation for lobbying and the issues lobbied. Some jurisdictions impose training requirements and special gift and political contribution restrictions on lobbyists.

Placement Agent Policies

Separate from lobby laws, government entities (particularly public pension funds) have increasingly adopted policies with respect to the use of placement agents by external investment managers. The policies range from requiring investment managers to disclose who is soliciting business to imposing outright prohibitions on investment managers' use of third-party solicitors. The rules may apply even when a firm is using in-house marketing employees to solicit business.

Contingent Fee Prohibitions

Some lobby laws prohibit the payment of contingent fees — any payment (such as a commission or formulaic bonus) that is in whole or in part attributable to a government decision (such as the decision to engage the firm). In addition, some jurisdictions (*e.g.*, Illinois, South Carolina) prohibit contingent fees paid for soliciting certain government business, even if the solicitor does not trigger lobbyist registration. Placement agent policies also can prohibit contingent fees.

Gift Laws

When providing a thing of personal value to an official or employee of a government entity, one must consider the gift rules of that jurisdiction. These restrictions apply to personal benefits such as meals, entertainment, travel and gift items as opposed to political contributions, which may be subject to pay-to-play restrictions as described above. Most jurisdictions have some restriction on gifts and entertainment for public officials, whether it be an absolute ban regardless of value, a fixed dollar limit per occasion or per month or year, or a prohibition on providing gifts that might reasonably tend to influence an official. These gift laws often extend to things of value provided to the official's spouse or dependent children. In some instances, state and local gift laws, such as those in the state of New York, can include gifts given to a third party, such as a charity, at the request or behest of a public official. As noted above, lobbyists and companies employing lobbyists often need to report the gifts or entertainment they provide. Government entities also may have policies requiring vendors or contractors to disclose gifts they provide to their officials.

Legal liability for a violation of these laws can attach to the donor, donee or both, depending on the law. This is especially important to keep in mind in light of the fact that government entities increasingly require certifications of compliance with applicable gift laws. For example, the New York City comptroller requires firms managing city pension fund money to certify they have not given anything of value to employees of the comptroller's office.

Conflicts of Interest

Dual-Hatted Situations

To the extent employees also hold positions with a government entity (such as serving on an unpaid government board), government conflict-of-interest restrictions may apply. Conflict rules frequently prohibit a government official from participating in a decision (such as that to award a contract) involving his or her private employer. In some rare cases, prohibitions can apply to contracts with that government entity even if the official fully recuses. Although legal liability for violations of these laws is typically limited to the official or former official, contracts that are entered into in violation of these conflict laws may be void or voidable by the government entity.

Post-Employment Rules

State and local laws typically restrict former public officials from appearing before their former agency for a period of time (often one or two years) after leaving government office and permanently restrict someone from working on a particular matter (such as a contract or procurement) that he or she personally worked on while in government. Thus, when vetting a prospective or new hire who is a former government official, a firm may want to consider whether the firm does or may seek to do government business in the jurisdiction where the official serves or served.

Takeaways

In addition to the ever-increasing risk of an enforcement action, potential legal violations can bring negative media attention. As such, broker-dealers and RIAs must continue to develop and refine compliance programs to address laws regulating government procurement activities. Common elements among these programs include implementing tailored policies, preclearing certain activities, providing protocols to ensure that registration and ongoing reporting requirements are met, offering training programs for certain officers and employees, and establishing procedures for keeping abreast of the latest developments in this area of law.

Click here for a full list of political law-related articles authored by Skadden attorneys in the last year.

California Privacy Law: What Companies Should Do to Prepare in 2019

Contributing Partner

Stuart D. Levi / New York

While debates about the need for a federal data protection law continued to heat up in 2018, California enacted its own comprehensive privacy law, the California Consumer Privacy Act (CCPA), creating a de facto national standard for any company that does business involving California residents. The law effectively sets the floor for nationwide privacy protection, since organizations may not want to maintain two privacy frameworks — one for California residents and one for all other citizens.

The CCPA generally gives consumers more information and control over how their data is being used and requires companies to be more transparent in their handling of it. While the law does not go into effect until January 1, 2020, and some operative provisions were delayed until July 1, 2020, the requirements under the CCPA should not be minimized, and companies should take steps to prepare for compliance in 2019 while monitoring ongoing rulemaking.

Who Is Covered?

In general, the CCPA applies to entities conducting business in California that either directly or indirectly control the collection of personal information of residents in that state and meet one or more of the following criteria:

- have annual gross revenues in excess of $25 million, adjusted for inflation;
- derive 50 percent or more of their annual revenues from selling consumers' personal information; or
- annually buy, receive for a commercial purpose, sell or share the personal information of 50,000 or more consumers, households or devices.

What Information Is Subject to the Law?

The CCPA defines personal information very broadly as information about a California resident that "identifies, relates to, describes, is capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household." The CCPA provides a lengthy list of examples that includes standard items such as Social Security, driver's license and passport numbers, as well as items such as purchasing history, internet activity, geolocation data, professional or employment-related information, and inferences drawn about a California resident (that is, using what is otherwise personal information to create a profile of a consumer, such as preferences, intelligence or abilities). Publicly available information is excepted where it is available through government offices.

Issues Businesses Should Consider

The CCPA requires covered entities to disclose, upon request from a consumer, a significant amount of information about that consumer's personal information, including what is being collected, sold or disclosed; the source of that information; the business purposes for collecting or selling it; and the categories of third parties with which the information is shared. The CCPA gives consumers the right to access a copy of their personal information "in a readily useable format that allows the consumer to transmit [the] information from one entity to another entity without hindrance." In effect, this requirement gives consumers a data portability right, since they can migrate their personal information from one service provider to another offering similar services. Companies also must honor a consumer's request to delete their personal information absent certain defined circumstances.

Implementing processes and procedures to comply with the foregoing requirements — such as being able to provide a consumer with information about their personal data or delete it from the company's systems — can be time-consuming and resource-intensive. Starting a compliance process well in advance of 2020 is strongly recommended.

The CCPA requires that companies provide consumers with the right to opt out of the sale of their personal information through a clear and conspicuous link on the company's homepage titled "Do Not Sell My Personal Information" as well as a link to the relevant privacy policies. For some companies, this will simply mean a change in their user interface. In other cases, this will impact a company's business model, since it likely will result in fewer consumers providing consent. The CCPA forbids companies from discriminating against consumers with respect to prices or services based on their exercise of their rights under the CCPA.

Companies also will need to update their privacy policies, including by describing the consumer's rights under the CCPA and providing a list of categories of personal information collected, sold to a third party or disclosed for business purposes.

Enforcement

Although the CCPA does not provide for a private cause of action (other than in data breach cases), the California attorney general can impose hefty fines for violations that include damages of up to $2,500 per violation if not cured within 30 days. It remains to be seen how California will interpret "per violation." Enforcement actions may not be brought by the attorney general until the earlier of July 1, 2020, or six months after publication of the final regulations.

The CCPA also makes it far easier for consumers to sustain a data breach claim, by not requiring a showing of harm from the incident. Consumers' inability to establish any harm has until now resulted in the dismissal of many data breach cases for lack of standing. It remains to be seen whether this aspect of the law will be challenged.

Will GDPR Compliance Also Satisfy the CCPA?

While some overlap exists between the CCPA and the European Union's General Data Protection Regulation (GDPR) (see "European Data Protection and Cybersecurity in 2019"), they differ in certain key aspects:

- The CCPA's definition of personal information is more extensive than that in the GDPR;
- The CCPA is expected to provide broader rights to request data deletion and includes different exceptions to this requirement;
- The CCPA is expected to provide more power for consumers to access personal information and does not provide all of the exceptions available under the GDPR; and
- The CCPA includes more stringent restrictions on sharing personal information for commercial purposes than does the GDPR.

While companies that have become GDPR-compliant may have an approach to data protection that will be useful in adapting to the CCPA's requirements, GDPR compliance cannot be seen as dispositive for CCPA purposes.

Key Takeaways

Many companies underestimated the time and resources required for GDPR compliance and remained noncompliant when the law went into effect. Companies would be well-served to learn from that experience and begin to implement CCPA compliance programs a year in advance. The challenge companies will face is that CCPA rulemaking is ongoing, and it remains to be seen how some provisions will be interpreted.

Click here for a full list of cybersecurity and privacy-related articles authored by Skadden attorneys in the last year.

European Data Protection and Cybersecurity in 2019

Contributing Partner

Ingrid Vandenborre / Brussels

Counsel

Eve-Christie Vermynck / London

Associate

Shannon Togawa Mercer / London

Data protection laws in Europe evolved substantially in 2018, with the implementation of the General Data Protection Regulation (GDPR) and the Directive on Security of Network and Information Systems (NIS Directive) becoming national law at the member state level. These legislative developments come on the heels of impactful international data breach and cybersecurity incidents. Together, they catalyzed calls for increased data protection and cybersecurity awareness through further proposed and enacted regulations. In 2019, the focus will transition from theory to practice, as implementation gives way to enforcement.

Far-Reaching Territoriality and Increased Data Protection Awareness

In November 2018, the European Data Protection Board (EDPB) disseminated guidelines, subject to public consultation, on the territorial scope of the GDPR, which brought long-awaited certainty to businesses outside the European Union.

First, the GDPR applies to controllers or processors with an establishment in the EU that process personal data in the context of the activities of that establishment, whether the processing happens in the EU or not (the establishment criterion). The EDPB clarifies that the applicability of GDPR to a non-EU data controller is a fact-based evaluation and not automatic. For instance, if a U.S.-based company makes one-off use of an EU-based processor, the processor can comply with its GDPR obligations without those obligations necessarily attaching to the U.S. company.

Second, the GDPR applies when a controller or processor not established in the EU processes personal data in connection with the offering of goods or services to data subjects in the EU, or monitors data subject behavior in the EU (the targeting criterion). The guidelines clarify that for the GDPR to apply to an establishment outside the EU, the establishment must demonstrate the intention of targeting a data subject in the EU and must target the subject on the basis of it being in the EU. This standard excludes de minimis processing and thus insulates a company from liability in the case of a non-EU data subject's incidental presence in the EU (*e.g.*, a U.S. mobile network company will not have to comply with GDPR solely because a U.S. data subject is using its roaming services while in the EU).

Despite further clarity on GDPR's reach, companies will need to consider what obligations they may have under the myriad new or revised national data protection laws outside the EU (*e.g.*, Brazil, India and California as well as Japan, which awaits an EU adequacy decision). Data protection awareness is a global trend to watch in the coming year.

Impact of GDPR on Corporate Transactions, Investigations and E-Discovery

Data protection legislation will, and in many cases already has, necessitated new steps in corporate transactions and litigation. Companies must now design and document more stringent methodologies and security measures in line with newly codified accountability and data minimization principles.

In transactional work, the due diligence and post-closing phases will inevitably include new dimensions to address the processing of personal data. Parties should pay special attention to data governance, privacy policies and notices, and cybersecurity standards. Corporate litigation processes should be mindful of the nature of data flows, prior information obligations to custodians, and the data minimization principle applicable to collection and review of personal data.

While steps toward GDPR compliance may seem onerous, investment at the outset will lead to more efficient internal workflows and procedures. Especially in markets with increasing appetites for data protection, companies are likely to continue streamlining data protection operations and policies and may view the GDPR as a standard-setting regulation for data protection globally in 2019.

Security and Cyberrisk

The NIS Directive, which aims to protect critical national infrastructure, is a cornerstone of EU cybersecurity. EU member states were required to transpose it into national law on May 9, 2018, and identify operators of essential services by November 9, 2018.

The NIS Directive legislates the improvement of cybersecurity infrastructures at the state and company levels, through "safeguarding obligations" (appropriate safety measures) and "information obligations" (community sharing and notification obligations). It also requires EU member states to implement structural changes, including the designation of a competent national NIS authority. The directive aims to create a culture of security through transparency and accountability.

Another step toward a more robust cybersecurity infrastructure is the European Central Bank's cyber resilience oversight expectations (CROE), published on December 3, 2018, as part of larger efforts to enhance cyber awareness and resiliency throughout the financial sector. The CROE provides specific instructions and clear expectations through a new framework for compliance.

In October 2018, the European Council called for the reform and improvement of EU cybersecurity policy. In December 2018, EU ambassadors approved a proposed Cybersecurity Act that would enable the creation of a permanent EU Agency for Cybersecurity and an EU-wide cybersecurity certification scheme. Developments in 2019 will further illustrate that cybersecurity and data protection go hand in hand, especially in sectors such as health care and transportation.

GDPR and Competition Law

Competition agencies are focusing increasingly on the value and use of personal data as a commodity with competitive significance, blurring the boundaries between competition and data protection laws. In 2016, the German Federal Cartel Office (FCO) began an investigation into Facebook for its alleged abuse of dominance in its collection of user data through third-party apps and websites. The FCO's preliminary assessment is that Facebook is abusing this dominant position by requiring users of its social network to allow it to limitlessly amass every kind of data generated by those users' third-party websites and then merging it with the user's Facebook account, not only from services owned by Facebook such as WhatsApp or Instagram, but also from websites and apps of other operators with embedded Facebook application program interfaces. According to the FCO, Facebook's terms of service violate data protection provisions to the disadvantage of its users, which in turn is deemed to constitute an abuse of the company's allegedly dominant position based on the Facebook network.

In the U.S., the Federal Trade Commission (FTC) is similarly focused on data issues. The FTC held a two-day hearing on the "intersection of Big Data, Privacy and Competition" in November 2018. At issue for U.S. authorities is whether existing antitrust and consumer protection rules are fit to address new challenges relating to big data and privacy as well as data collection and advertising practices by two-sided platforms.

Greater clarity on how competition issues involving the use of data are perceived by the European Commission and authorities of the EU member states as well as in the U.S. is expected in 2019.

GDPR Enforcement

While administrative fines under the GDPR (up to 4 percent of total worldwide annual turnover) were one of 2018's hot topics, the regulation also introduces another source of potential liability: It grants any individual the right to compensation for damage caused by a data controller or processor's breach of the GDPR requirements. Individuals who bring claims for data breaches have the option of assigning their claims to a not-for-profit, public interest group established to protect individual privacy rights. In addition, individual EU member states may legislate to provide a mechanism for individuals to litigate via collective action complaints or class actions. Exposed to both administrative and civil liability for data breaches, the financial risk for companies could be very high.

Within a short period after GDPR implementation in May 2018, enforcement became a reality: France's Commission Nationale de l'Informatique et des Libertés has multiple pending investigations and has mandated remediation actions, and the U.K.'s Information Commissioner's Office has issued warnings and small fines. Meanwhile, the Portuguese Comissão Nacional de Protecção de Dados has imposed the first GDPR fine — €400,000 — on a hospital for noncompliance with GDPR.

Enforcement actions in 2019 will reveal the contours of data protection legislation.

Click here for a full list of cybersecurity and privacy-related articles authored by Skadden attorneys in the last year.

US Tax Reform and Cross-Border M&A: Considering the Impact, One Year In

Contributing Partners

Brian Krause / New York

Moshe Spinowitz / Boston

Many of the core provisions in the Tax Cuts and Jobs Act (TCJA) — including the corporate tax rate reduction and the fundamental reworking of the U.S. international tax regime — were geared toward addressing the uncompetitive nature of the U.S. corporate tax system and its perceived role in so-called inversion transactions that had gained attention in the period leading up to the enactment of the TCJA.

With that background and a year's worth of experience under the TCJA, we can begin to assess the TCJA's impact on the structuring of cross-border M&A. The carrot-and-stick approach that the TCJA adopted with respect to inversion transactions specifically, and cross-border business activities more generally, means that the incentives driving the structuring of cross-border M&A are less certain that under pre-reform law and certainly do not point clearly in a single direction.

Ultimately, though, the TCJA's ability to fundamentally reshape the incentives driving the structure of cross-border M&A requires a global view. These drivers are not simply a function of the U.S. tax regime; they also reflect the attractiveness of the U.S. relative to other leading headquarter jurisdictions and their tax regimes. In light of broader global changes that continue to roil the international tax landscape, we appear to be facing an ongoing period of instability that will continue to shape the tax planning priorities of multinational corporations and the structuring of cross-border M&A.

Cross-Border M&A: The TCJA's Carrot-and-Stick Approach

Several new features of the U.S. international tax system introduced as part of the TCJA were meant to act as "carrots and sticks" to encourage U.S.-parented multinational companies to remain U.S.-headquartered and to locate business activity in the United States.

The largest benefit, and the centerpiece of the legislation, was the reduction of the U.S. federal corporate tax rate from 35 percent to 21 percent, bringing it more in line with the statutory rates of other member countries of the Organisation for Economic Cooperation and Development. The TCJA also provided an exemption from U.S. federal income tax for dividends received from foreign subsidiaries. In addition, the foreign-derived intangible income (FDII) regime introduced a reduced rate of tax on certain income from export sales and the sale or license of certain intellectual property to foreign persons, as part of an effort to incentivize investment in the United States and mitigate the incentives to earn income offshore.

The sticks, or possible detriments, include the new global intangible low-tax income (GILTI) and base erosion anti-avoidance tax (BEAT) regimes. GILTI is in effect an annual minimum tax imposed on U.S. parent companies with respect to much, if not all, of the earnings of their foreign subsidiaries. In concept, GILTI is intended to impose U.S. tax at a reduced rate of up to 10.5 percent on foreign income subject to low rates of foreign tax at or below 13.13 percent. In practice, given the precise mechanics of the regime, many U.S. multinational companies have come to realize that it can result in U.S. tax even on foreign income that is subject to meaningfully higher rates of local tax.

BEAT is an alternative tax intended to mitigate erosion of the U.S. tax base by essentially imposing a minimum tax on deductible payments made by U.S. corporations to related foreign parties. Payments subject to BEAT generally include items such as interest, payments for services, royalties and depreciable assets; they generally do not include the cost of goods sold.

The TCJA also introduced a variety of changes intended to strongly discourage so-called inversion transactions (defined technically for this purpose as acquisitions by foreign corporations of U.S. corporations in which, following the acquisition, the former shareholders of the U.S. corporation own at least 60 percent and less than 80 percent of the stock of the foreign acquirer) by imposing new penalties on inverted companies. First, individual shareholders of newly inverted companies are permanently ineligible for the qualified dividend income rate of 23.8 percent on dividends received from such foreign corporations. Instead, those dividends would be taxed at ordinary rates. Second, if the TCJA's one-time transition tax on accumulated foreign earnings applied to a U.S. corporation and that corporation inverts within 10 years after enactment of the TCJA, the U.S. corporation's transition tax is recomputed at a 35 percent rate, compared to the reduced 8 percent and 15.5 percent rates that had otherwise applied.

Finally, the TCJA introduced new rules that make it more difficult to engage in post-inversion tax planning, even for U.S. corporations that inverted prior to the TCJA's enactment. For inverted companies, BEAT disallows not only deductible payments made to foreign related persons but also the cost of goods sold with respect to purchases from those related parties, potentially making BEAT far more onerous for inverted companies.

Structuring Cross-Border M&A: How Have the Incentives Changed?

If one of the goals of U.S. corporate tax reform was to put an end to inversion transactions and make the U.S. more attractive for businesses, its track record is likely to be mixed, given the features of the legislation noted above.

Many of the advantages that foreign-parented multinational groups previously enjoyed have been curtailed by the TCJA, thereby reducing the incentives to relocate to a foreign jurisdiction in the context of a cross-border M&A transaction. The reduced U.S. tax rate and dividend exemption system make it less costly to remain U.S.-parented, while the BEAT regime and new limitations on interest expense deductions reduce the benefits foreign-parented companies previously had. In addition, the inversion-specific penalties can make transactions that fall within the ambit of those rules cost-prohibitive.

But certain material advantages remain for foreign-parented companies — most notably the ability to conduct non-U.S. business operations outside the potentially onerous GILTI regime. To the extent that one of the drivers of cross-border M&A pre-TCJA was the desire to grow non-U.S. businesses outside the U.S. tax system, the TCJA may have magnified that incentive through the introduction of the GILTI regime. Furthermore, the stability of U.S. tax reform, including the long-term viability of the reduced 21 percent statutory tax rate and the beneficial reduced rate for FDII, remains a concern, particularly in light of political divisions in the United States. Given these uncertainties, U.S. companies planning to combine with a foreign company in a cross-border M&A transaction will want to carefully consider which company should be the acquirer, particularly in mergers of equals and other deals that — with careful structuring — can avoid inversion-specific penalties.

Beyond the US: Creeping Global Changes in Corporate Taxation

In the face of U.S. tax reform and ongoing political dissatisfaction with the current approach to taxation of cross-border commerce, several countries, including the United Kingdom and other European Union countries, are exploring new approaches to business taxation. These include special regimes to tax digital commerce, an increased focus on taxation that relies on market-based allocations of income, expansion of controlled foreign corporations and anti-base erosion regimes that resemble the new U.S. approach, and ongoing efforts to target perceived abuses of the current international tax structure. How these regimes develop over the next several years will drive the incentives (or lack thereof) for corporations to relocate to new jurisdictions and to structure their M&A accordingly.

The TCJA may represent a once-in-a-generation rethinking of the U.S. corporate tax system, but the global changes in corporate taxation appear to just be beginning. The uncertainty surrounding the structuring of cross-border M&A appears certain to persist.

Click here for a full list of tax-related articles authored by Skadden attorneys in the last year.

Regulatory Relief May Generate Increased M&A Activity Among Banks

Contributing Partners

Brian D. Christiansen / Washington, D.C.

David C. Ingles / New York

Sven G. Mickisch / New York

In May 2018, President Donald Trump signed into law the Economic Growth, Regulatory Relief and Consumer Protection Act. Sometimes called the Crapo bill after its sponsor Sen. Michael Crapo, R.-Idaho, the act eliminated or eased a number of regulatory burdens on superregional, regional and larger community banking organizations. Also in 2018, the appointment and confirmation process for Trump nominees to lead the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) was completed. Under their new leadership, the regulators have begun implementing the Crapo bill and taking other administrative steps to provide some measure of regulatory relief to most types of banking organizations.

A general easing of the intense regulatory environment that has existed since the financial crisis is expected to lead to lower compliance costs, greater flexibility in managing capital and perhaps incrementally higher tolerance among supervisors for the risk-taking inherent in the banking business. We expect that these developments will result in greater interest and willingness among banking organizations to pursue mergers and acquisitions as a means of enhancing shareholder value.

Crapo Bill and Other Regulatory Relief

In the wake of the financial crisis, the Dodd-Frank Act was enacted in 2010 to impose stricter oversight and burdensome regulatory requirements on the industry. Among other changes, the Dodd-Frank Act created new requirements for banking organizations with $50 billion or more of total consolidated assets. This $50 billion threshold became a key break point for regional and superregional banks evaluating growth opportunities through M&A. The Crapo bill increased this key threshold to $100 billion, effective upon the bill's enactment, and it will rise to $250 billion by November 2019.

In addition, the banking agencies have taken parallel steps to ease regulatory requirements. For example, one industry criticism of the post-crisis system was its imposition of a relatively uniform package of significant additional requirements on institutions that met the single, relatively low ($50 billion) asset-size threshold. To address this concern, in October 2018, the banking regulators proposed a framework that would instead place the largest U.S. banking organizations into one of four risk categories based not only on asset size but also on certain other characteristics. Institutions in the lower-risk categories will see significant relief from a number of requirements related to capital and leverage, liquidity, stress testing, risk management, counterparty exposure limits and other areas. Institutions in the highest risk categories will see only minimal relief. The table on the next page shows the risk categories, the institutions within them and the degree of relief they can expect.

Banking regulators also are pursuing discrete areas in which the agencies can be more flexible. For example, they are working on revisions to the Volcker Rule, capital planning, resolution and recovery planning, and community bank capital

Proposal to Tailor Regulatory Requirements Based on Risk Category				
	Category I	**Category II**	**Category III**	**Category IV**
Category criteria	U.S. global systemically important banking organizations (GSIB)	≥ $700B assets OR ≥ $100B assets and ≥ $75B cross-jurisdictional activity	≥ $250B assets OR ≥ $100B assets and ≥ $75B short-term wholesale funding, nonbank assets or off-balance sheet exposures	≥ $100B assets
U.S. banking organizations within category	JPMorgan Chase Bank of America Citigroup Wells Fargo Goldman Sachs Morgan Stanley Bank of New York Mellon State Street	Northern Trust	US Bancorp PNC Financial Capital One Charles Schwab	BB&T SunTrust American Express Ally Financial Citizens Financial Fifth Third KeyCorp Regions Financial M&T Huntington Bancshares Discover
Degree of relief from regulatory requirements	Minimal relief; most stringent requirements continue to apply		Modest relief	Significant relief

requirements. The OCC has led efforts to modernize implementation of the Community Reinvestment Act, including to better reflect technological innovations and to move away from reliance on a physical geographic footprint. The FDIC has been looking for ways to make its application process for new banks faster and more transparent, and it has expressed a willingness to approve deposit insurance for newly formed industrial loan companies, which are bank-like entities attractive to many financial services firms with nontraditional business plans or ownership structures. The Federal Reserve is considering a more transparent, and perhaps less restrictive, approach for evaluating "control" for bank regulatory purposes, which would have broad implications for M&A and investment activity involving banking organizations.

Effect on Bank M&A Activity

The segment of the industry likely to see the biggest boost in M&A activity is banking organizations with $10 billion to $50 billion in assets. The increased compliance costs and regulatory scrutiny that came with exceeding the $50 billion threshold under Dodd-Frank acted as a significant disincentive for M&A. Rarely did two banking organizations each below $50 billion in assets merge as a company with combined assets above that threshold, and market reaction to the few that did tended to be negative. The threshold increase under the Crapo bill lifts the regulatory disincentive to growth through M&A for the approximately 80 banking organizations with $10 billion to $50 billion in total assets.

Banking organizations with more than $50 billion in total assets also may be in a better position to explore M&A

opportunities, to the extent that the market rewards these companies with higher trading values as a result of the relaxed regulatory burdens and reduced compliance and capital costs.

The combined effect of these regulatory developments should allow banking organizations to consider and pursue M&A transactions based on their business and financial merits, rather than being driven by somewhat arbitrary, asset-size regulatory thresholds.

Competing Factors

Nevertheless, the regulatory environment is only one important factor for banking organizations considering M&A opportunities. Bank M&A activity is significantly affected by environmental considerations, including the general economic outlook, the interest rate yield curve, market volatility and political uncertainty. Two additional factors present possible headwinds for a more widespread wave of M&A activity among banking organizations.

First, many of these organizations remain subject to regulatory enforcement action and ongoing remediation obligations arising from deficiencies in their compliance infrastructure, particularly in the areas of anti-money laundering, economic sanctions and consumer protection laws. Significantly, outstanding compliance issues generally preclude a banking organization from pursuing substantial expansionary acquisitions or investments, which reduces the universe of potential buyers.

Second, a historical driver of M&A activity among banking organizations was the objective of expanding scale and geographic footprint. However, banking organizations are reconsidering the value of traditional brick-and-mortar banking franchises. Many of the largest banking organizations are actively rationalizing their physical branch networks and eliminating less profitable branches. In addition, technological advances have changed the manner in which many banking and payments services can be delivered. Younger generations have moved away from traditional branch banking toward alternative delivery channels, such as online banking and mobile payment methods. In lieu of acquiring traditional branch-based banks, many banking organizations are more actively pursuing acquisitions of, and investments in, and partnerships with providers of, technology platforms to keep pace with these developments. These industry shifts may affect the buyer universe and valuation for multistate or regional banking franchises with broad branch-banking footprints.

For a number of years following the financial crisis, the regulatory environment represented a significant challenge and source of uncertainty for M&A activity among banks. Other than for the very largest institutions, the Crapo bill and other recent actions by the banking regulators will meaningfully ease the burdens of the post-crisis regulatory environment. Although their near-term impact may be muted by countervailing economic and industry considerations, these regulatory developments will make M&A opportunities more attractive for many banking organizations.

Click here for a full list of financial institutions-related articles authored by Skadden attorneys in the last year.

As Interest in Blockchain Technology Grows, So Do Attempts at Guidance and Regulation

Contributing Partners

Alexander C. Drylewski / New York

Eytan J. Fisch / Washington, D.C.

Stuart D. Levi / New York

Of Counsel

Jonathan Marcus / Washington, D.C.

Counsel

Eve-Christie Vermynck / London

In 2018, the number of blockchain-enabled projects increased sharply as established companies sought to apply distributed ledger technology to their existing business models and startups developed new and disruptive models employing this technology. Projects have already been implemented in the financial services, insurance and supply chain fields, and important developments are taking place in blockchain-based identity services. As use of blockchain technology has expanded, regulators from a range of geographic and legal jurisdictions have struggled to apply laws and regulations that were drafted for business activities involving a clearly identifiable service "provider" to autonomous, decentralized platforms where the actual "provider" is not evident.

For example, regulators responsible for securities, commodities, anti-money laundering (AML) and privacy all wrestled with blockchain issues in 2018. Often, the cases brought and guidance offered raised more questions than they answered. Any company implementing or investing in blockchain technology will need to pay close attention to this evolving regulatory landscape.

Securities Law

A number of noteworthy legal developments relating to cryptocurrencies emerged in 2018, providing incremental clarity for participants in this emerging area of securities law.

- **Digital Tokens.** On June 14, 2018, William H. Hinman, director of the Securities and Exchange Commission's (SEC) Division of Corporation Finance, suggested that digital tokens like Ether might initially be defined as "investment contracts" (and thus as "securities" under the federal securities laws) but that their networks and decentralized structures could evolve to a point where the tokens no longer constituted securities.
- **FinHub.** On October 18, 2018, the SEC launched the Strategic Hub for Innovation and Financial Technology (FinHub), which was designed to provide a way for technologists and their advisers "to engage with SEC staff," according to Valerie A. Szczepanik, the SEC's senior adviser for digital assets and innovation. The creation of FinHub suggests that the SEC is willing to work with developers regarding compliance rather than approach the issue solely from an enforcement perspective.
- **SEC Settlements.** On November 16, 2018, the SEC announced that CarrierEQ Inc. (aka AirFox) and Paragon Coin Inc., which sold digital tokens in initial coin offerings (ICOs), agreed to pay penalties, register under Section 12(g) of the Securities Exchange Act and offer voluntary rescission rights to investors. These settlements may provide a road map to compliance for those who have already engaged in ICOs.
- ***SEC v. Blockvest, LLC.*** On November 27, 2018, Judge Gonzalo P. Curiel of the U.S. District Court for the Southern District of California denied the SEC's request for a preliminary injunction against a company that had engaged in an ICO. Judge Curiel concluded that the SEC had not established that the Blockvest tokens at issue were securities because there were disputed facts under the U.S. Supreme Court decision *SEC v. W.J. Howey Co.*'s "investment of money" and "expectation of profits" test prongs. This

case may prove to be significant in that the court suggested the *Howey* test may not be met.

- **SEC Guidance.** On December 12, 2018, the SEC announced that it is developing guidance for cryptocurrencies that it hopes to publish in early 2019. The guidance is intended to help determine if a digital asset is a security. If it is, the guidance would detail what a business should do to comply with securities regulations. (See "SEC Continues Steady Progress With Regulatory, Enforcement Goals.")
- **Token Taxonomy Act.** On December 20, 2018, Reps. Warren Davidson, R-Ohio, and Darren Soto, D-Fla., introduced the Token Taxonomy Act, which seeks, in part, to clarify that securities laws would not apply to cryptocurrencies once they become a fully functioning network. Although we do not expect that this bill will be passed, it comes after a year of various congressional hearings on how current regulations apply to blockchain technology. We anticipate that Congress will remain focused on this issue in 2019.

FinCEN

Cryptocurrencies also have been the subject of increasing focus by the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), which exercises AML regulatory functions. Dating back to 2013, FinCEN has issued several rounds of guidance on the application of AML requirements to businesses performing certain functions or providing certain services related to cryptocurrencies. In 2018, FinCEN took additional steps toward answering outstanding questions, including in the context of ICOs. We expect FinCEN to issue further clarifying guidance in 2019.

In a February 2018 letter responding to questions from Sen. Ron Wyden, D-Ore., the Treasury Department took the position that "[g]enerally, under existing regulations and interpretations, a developer that sells convertible virtual currency, including in the form of ICO coins or tokens, in exchange for another type of value that substitutes for currency is a money transmitter" and is therefore subject to corresponding AML requirements for money services businesses. The Treasury Department, however, noted that ICOs vary in structure, and there could be circumstances in which AML requirements imposed by the SEC or Commodity Futures Trading Commission (CFTC) would apply.

FinCEN Director Kenneth A. Blanco echoed this view in an August 2018 speech at the Chicago-Kent Block (Legal) Tech Conference, stating that "[w]hile ICO arrangements vary and, depending on their structure, may be subject to different authorities, one fact remains absolute: FinCEN, and our partners at the SEC and CFTC, expect businesses involved in ICOs to meet all of their AML/CFT obligations." It is notable that Blanco did not specifically reassert the view in the Wyden letter that companies conducting ICOs generally are money transmitters. The failure to do so raises some questions as to whether FinCEN viewed the reaffirmation as unnecessary or was backtracking on the more categorical position.

FinCEN also is working with foreign governments to address risks related to virtual currencies, including through the Egmont Group of Financial Intelligence Units and through the Financial Action Task Force. Treasury Under Secretary Sigal P. Mandelker has stated that, as part of this effort, the Treasury Department is "encouraging our international partners to take urgent action to strengthen their AML/CFT frameworks for virtual currency and other related digital asset activities." We expect that efforts to align global approaches to cryptocurrencies will increase in 2019.

Applying GDPR to Blockchain Platforms

Blockchain technology has the potential to revolutionize how personal information is stored and processed. However, many of its fundamental concepts clash with the requirements of the European Union's General Data Protection Regulation (GDPR) requirements. (See "European Data Protection and Cybersecurity in 2019.")

In 2018, EU regulators began to focus on this issue, with the French supervisory authority, the Commission Nationale de l'Informatique et des Libertés (CNIL), and the EU Blockchain Observatory and Forum (the Observatory) publishing initial reflections on this matter but offering little definitive guidance. For example, the reports acknowledged that with a blockchain platform, it is difficult to determine the identity of the data controller (which determines the purpose and means of processing personal data) and the data processor, since in many blockchain platforms, multiple nodes hold the data without any single controller or processor. The reports acknowledge this issue but simply conclude it must be resolved on a case-by-case basis.

Similarly, a cornerstone of blockchain technology is the use of hashing to cloak and represent specific data sets. While many see these hashes as anonymous and therefore not subject to privacy regulations, the GDPR narrowly limits anonymization to cases where it is impossible to reverse the encryption process or link the encrypted data to an individual by studying usage patterns. Hashes may not meet this definition. Here, too, the reports acknowledge the issue but leave it to case-by-case analysis.

The GDPR also provides individuals with a series of rights, including a right in certain cases to have their data deleted (known as the right to be forgotten). This principle conflicts with the immutability of a blockchain, where once data is stored, it cannot be erased or modified. Furthermore, it is not clear who enforces this right if a data controller cannot readily be identified. The CNIL's preliminary suggestion is that encryption coupled with the destruction of the encryption key might satisfy this requirement.

Although the reports signal that regulators are beginning to focus on this issue, they may not issue any meaningful guidance for some time. Developers of blockchain platforms will need to glean what they can from these initial reports and keep compliance with the GDPR and other privacy laws in mind during the development process.

CFTC/Derivatives Law

While the CFTC has actively used its enforcement authority to police fraud and protect retail customers in the cryptocurrency markets, its formal guidance on how the Commodity Exchange Act (CEA) applies to the blockchain and cryptocurrency space has been fairly sparse. Aside from a few short releases, the CFTC's primary guidance in this area is its December 2017 proposed interpretation of what constitutes "actual delivery" in retail cryptocurrency transactions. (The CFTC regulates leveraged or margined cryptocurrency transactions involving retail customers where the cryptocurrency is not "actually delivered" within 28 days.)

Near the end of 2018, the CFTC demonstrated its continuing interest in cryptocurrencies and their relationship to derivatives markets by requesting public input (RFI) on Ether and the Ethereum network. The RFI illustrates that the CFTC is relying on market participants and the public to help inform its understanding of, among other areas, how cryptocurrencies and their networks operate, the technology they depend on, their governance structures, the purposes for which they are used, and their liquidity and susceptibility to manipulation. This information is relevant to the CFTC in deciding how to police cryptocurrency fraud and regulate derivatives contracts based on cryptocurrencies. It is evident that the CFTC also is looking beyond cryptocurrencies and closely monitoring the development of decentralized systems generally. For example, LabCFTC, the agency's initiative to engage with the fintech innovation community, recently issued a primer on smart contracts to explain the technology and related risks and challenges.

Given the CFTC's interest in blockchain applications, one area to watch in 2019 will be the CFTC's regulatory approach to emerging smart contracts. On October 16, 2018, Commissioner Brian D. Quintenz stated at the 38th Annual GITEX Technology Week Conference that the CFTC's existing regulatory authority may apply to smart contracts, encouraging innovators to engage with the commission but also focusing on potential liability for coders whose smart contracts facilitate trading in products subject to CFTC jurisdiction, such as options entered into with retail customers. The SEC recently settled an enforcement action against Zachary Coburn, the founder of EtherDelta — a smart contract-based market platform for trading digital tokens — for causing it to operate as an unregistered securities exchange. The CFTC may not be far behind in pursuing smart contract applications that may not comply with the CEA or CFTC regulations.

Associates Andrew R. Beatty, Jeongu Gim and Trevor A. Levine contributed to this article.

Click here for a full list of fintech-related articles authored by Skadden attorneys in the last year.

Despite Leadership Changes, No Pivot in Priorities Expected for Consumer Financial Services Enforcement

Contributing Partners

Joseph L. Barloon / Washington, D.C.

Anand S. Raman / Washington, D.C.

Both the Consumer Financial Protection Bureau (CFPB or Bureau) and Department of Justice (DOJ) initiated and resolved fewer fair lending and other consumer financial services enforcement actions in 2018 than in previous years. Leadership changes at both agencies may impact agency priorities in 2019, but the trend of fewer enforcement actions seems likely to continue.

Meanwhile, we expect increased activity at state regulatory and enforcement agencies — in part a response to the slowdown at the CFPB — to continue. Finally, the new Democratic majority in the House of Representatives likely will exercise its oversight authority zealously and pressure agencies to increase consumer protection enforcement. (See "Preparing for Democratic Oversight Investigations.") However, with Republicans still in control of the Senate and the White House, we do not expect to see significant legislation enacted or a marked change in the regulatory landscape in 2019.

CFPB

On December 6, 2018, the Senate confirmed Kathy Kraninger to a five-year term as the new director of the CFPB. Kraninger replaces Mick Mulvaney, who was appointed acting director of the agency in November 2017 after its first director, Richard Cordray, resigned. Consumer advocates were critical of Mulvaney, accusing him of weakening the agency's enforcement team and de-emphasizing enforcement as a general matter. Indeed, in the approximately 12 months of Mulvaney's tenure, the Bureau initiated 12 actions and settled 14, whereas during the previous 12-month period, it initiated 47 new actions and settled 42. Mulvaney also reorganized the Bureau's fair lending and student loan offices, reducing both their profile and direct authority, as part of a broad effort to re-examine the Bureau's priorities and processes.

Prior to her appointment, Kraninger served as an associate director at the Office of Management and Budget. Her views on consumer protection are not well-known, and it remains to be seen whether she will continue Mulvaney's emphasis on rulemaking rather than regulation by enforcement, and the extent to which she will fill political positions at the Bureau with new individuals rather than holdovers from Mulvaney's tenure. As her directorship begins, however, Kraninger has considerable support from the financial services industry, and she has not indicated significant disagreement with actions Mulvaney took.

As a result, many of Mulvaney's priorities during his one-year tenure are unlikely to change. In particular, the Bureau is likely to continue its efforts to clarify, via rulemaking, what constitutes "abusive" acts or practices. It also is possible that the Bureau will issue a rule regarding the disparate impact doctrine under the Equal Credit Opportunity Act. Finally, the Bureau appears to remain on path to revise its payday lending rule, which could have significant implications for short-term, small-dollar lenders.

DOJ and Other Federal Agencies

The DOJ also pursued limited consumer financial enforcement under then-Attorney General Jeff Sessions. In 2017 and 2018, the DOJ filed four lawsuits and settled four suits alleging fair lending violations — a marked decline from the level of activity under the Obama administration in 2015 and 2016, when the DOJ filed 15 fair lending lawsuits and settled 14 suits. We have no reason to expect that President Donald Trump's nominee for attorney general, William Barr, would significantly expand fair lending enforcement activity.

The Department of Housing and Urban Development (HUD), under Secretary Benjamin S. Carson, likewise appears to have scaled back its enforcement activity significantly. In particular, HUD has filed only two secretary-initiated fair housing enforcement actions over the last two years, which is a notable decrease from activity during the Obama administration in 2015 and 2016, when HUD filed seven such actions. Meanwhile, the federal bank regulatory agencies (the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, National Credit Union Administration and Federal Reserve), which are less political in nature, have continued at a relatively consistent pace in 2018, despite changes to the leadership of many of these agencies.

State Attorneys General

Some states increased their regulatory and enforcement activity during 2018 in response to the decrease in federal enforcement, both by pursuing enforcement of state laws and by exercising their authority under the federal Consumer Financial Protection Act. For example, in August 2018, the New York State Department of Financial Services announced that it would be increasing fair lending enforcement with respect to auto lending. Other states, such as New Jersey and Pennsylvania, likewise announced efforts to create their own consumer protection divisions to protect consumers. This increased focus on consumer protection at the state level should continue during 2019, particularly given that Democrats hold the majority of state attorney general positions.

Political Climate

With split control of the House and Senate, Congress is not likely to pass significant consumer financial services legislation in 2019. However, Rep. Maxine Waters, who became chair of the House Financial Services Committee in January 2019, has stated that one of her priorities is to ensure that the CFPB operates without interference from the Trump administration. We therefore expect the House committee to exercise its investigative powers broadly, both to pressure the Bureau to increase its enforcement activity and to directly investigate activities of concern to the committee. Whether such pressure will lead to increased CFPB enforcement activity, however, is an open question.

Conclusion

While a modest increase in the volume of enforcement activity is possible in 2019 — especially at the state level — we expect it to be largely "more of the same" this year, both in terms of the volume of enforcement and the subjects of interest. In particular, regulatory and enforcement agencies likely will continue to take action where they believe fair lending violations or unfair, deceptive or abusive practices exist, but at levels consistent with 2018.

The industry will keep a close eye on both the CFPB and the DOJ as they move forward under new leadership, and on the House Financial Services Committee as it puts pressure on the Bureau. As ever, financial institutions will be best served by maintaining strong compliance management programs and closely watching for developments at these agencies.

Click here for a full list of financial regulation-related articles authored by Skadden attorneys in the last year.

Significant Regulatory, Jurisdictional and Enforcement Challenges Ahead for CFTC

Contributing Partner

Mark D. Young / Washington, D.C.

Of Counsel

Jonathan Marcus / Washington, D.C.

Counsel

Theodore M. Kneller / Washington, D.C.

Rachel Kaplan Reicher / Washington, D.C.

Associates

Jeongu Gim / Washington, D.C.

In 2018, the Commodity Futures Trading Commission (CFTC or Commission) began operating with a full complement of five commissioners for the first time since 2014. Soon thereafter, it held a rare open meeting to propose major revisions to its rules for swaps trading. CFTC Chairman J. Christopher Giancarlo is the driving force behind this proposal, having long advocated for expanding swaps trading on self-regulating exchange-like platforms called swap execution facilities (SEFs). Whether Giancarlo will see his handiwork through to adoption is unclear, however, as he has announced he will be leaving the agency once his term expires in April 2019 and his successor is confirmed by the Senate. The White House already has announced its nominee to replace Giancarlo — Heath P. Tarbert, currently the assistant secretary for international markets at the Treasury Department.

Whoever is at the CFTC's helm in 2019 will face significant challenges. The European Union has indicated that it plans to adopt legislation that could subject U.S.-based clearinghouses to substantial EU oversight at a time when Giancarlo has been advocating for the exact opposite — full or at least greater deference to home-country regulators. As for enforcement, a series of court decisions has called into question some of the Commission's anti-manipulation and anti-fraud efforts. If those decisions remain the law, they will cut to the core of what must be pleaded under both the Commodity Exchange Act's (CEA) traditional anti-manipulation provisions and post-Dodd-Frank Act anti-manipulation and anti-fraud provisions.

Sweeping Amendments Proposed to SEF Rules

The CFTC proposed major changes to its swaps trading regime in November 2018, following a comprehensive white paper Giancarlo wrote urging the CFTC to revisit its 2013 swap rules. Those rules govern how swaps are traded on SEFs, which are CFTC-registered, exchange-type trading venues with self-regulatory obligations and powers. The CFTC's current SEF rules were adopted under the 2010 Dodd-Frank Act, which required the regulation of swaps trading by the CFTC for the first time. In his white paper, Giancarlo noted that all futures must by law be traded on exchanges, while swaps may be traded both on exchange-type platforms (such as SEFs) and, bilaterally, in private, over-the-counter negotiations. He urged the CFTC to revisit its swap rules to better recognize that swaps and futures are different.

In broad outline, the proposed amendments seek to increase swaps trading on SEFs — an unambiguous congressional goal — by (1) requiring additional entities to register as SEFs (including interdealer voice brokers); (2) relaxing the methods by which swaps may be traded and executed on SEFs; and (3) expanding the number and types of swaps that must be traded on SEFs.

The CFTC also proposes to allow a SEF to elect what types of market participants may access its markets. This change would enable a SEF to offer a dealer-to-dealer market and to exclude direct participation by the buy side (asset managers, proprietary trading firms and end users). Some have criticized these arrangements as giving dealers undue sway on swaps pricing.

Comments on the proposal are due February 13, 2019. Whether the final rules are adopted before Giancarlo's departure remains to be seen.

EU Derivatives Clearing Legislation

After the 2008 financial crisis, the G-20 championed increased clearing of financial derivatives contracts as a means of reducing systemic risk. The U.S. and EU, among others, responded by requiring more derivatives to be submitted for clearing and by enhancing regulatory scrutiny. While many observers consider these developments to be positive, the international nature of derivatives markets has left one substantial and thorny clearing issue to be settled: How should national regulators treat clearing providers, called central counterparties (CCPs), that offer clearing services to foreign market participants?

This question has become a highly contentious U.S.-EU battleground. In the U.S., the CFTC has taken various approaches to different markets. For exchange-traded derivatives, largely futures, it has long granted full deference to foreign regulators applying comparable regulations to foreign CCPs that clear transactions involving U.S. persons. But for swaps involving U.S. persons, the CFTC has been less deferential, subjecting at least some non-U.S. CCPs to CFTC regulation with respect to clearing for U.S. customers. The EU, by contrast, places exchange-traded and other derivatives into one basket and now is considering legislation to subject non-EU CCPs serving EU customers to considerable and aggressive EU regulation, including major U.S.-based CCPs. Giancarlo has proposed mutual and even-handed deference in a white paper on cross-border swaps regulation. For instance, with respect to jurisdictions subject to comparable regulations, he has suggested expanding the CFTC's use of its authority to exempt from its requirements non-U.S. CCPs that do not pose substantial risk to the U.S. financial system. But the EU has thus far not changed course, making it increasingly likely that the EU legislation will be enacted in 2019. That prospect has spurred Giancarlo to warn that the CFTC will be forced to consider a "range of readily available steps" to respond in kind, including withdrawing existing exemptions for EU-based entities serving U.S. customers and delaying or withholding further regulatory relief.

As the clock ticks toward the EU's adoption of its proposed CCP legislation, the threat of trans-Atlantic market disruptions looms larger on the horizon. Between this clearing dispute and the risk of a hard Brexit, 2019 promises to be a momentous year.

CFTC Enforcement and CEA Private Litigation Developments

As outlined in its annual report, the CFTC's Division of Enforcement was busy in 2018 with 83 cases filed (third-highest in CFTC history); $900 million in penalties (fourth-highest); 26 cases alleging manipulation, spoofing or disruptive trading (annual average for 2009 to 2017 was six); and highest number and greatest amount of whistleblower awards (five awards totaling $75 million). Giancarlo has made clear that a vigorous enforcement program to protect market integrity remains a top priority for the CFTC, and the agency's 2018 enforcement record bears that out.

Enforcement Activity in 2018

83
cases filed

$900 million
in penalties

26
cases alleging manipulation, spoofing or disruptive trading

5
whistleblower awards totaling $75 million

But 2019 could be more challenging for both the CFTC and private plaintiffs, based on recent and pending judicial decisions. *CFTC v. DRW* rejected the CFTC's attempt to expand its traditional price manipulation authority to cover instances where a trader merely intended to affect the price, even if there was another purpose for trading (such as hedging). Instead, the court reaffirmed that the CFTC must prove a trader intended to create an artificial price — that is, a price that does not reflect the legitimate forces of supply and demand. Meanwhile, the U.S. Court of Appeals for the Second Circuit recently heard argument in an appeal of a decision that the CFTC claims could restrict the reach of its cross-border power to pursue price manipulation where the alleged misconduct occurs abroad. In *Prime International Trading, Ltd. v. BP Plc*, the district court held that the private plaintiffs' claims impermissibly required extraterritorial application of the CEA. The plaintiffs alleged that a number of companies involved in different sectors of the oil industry engaged in overseas manipulation of a foreign benchmark for the price of Brent crude oil that affected the prices of the plaintiffs' Brent crude oil futures and other derivatives contracts traded on the New York Mercantile Exchange and ICE Futures Europe.

The CFTC also faces challenges to its authority to sanction "manipulative or deceptive" schemes. One district court ruled in a pretrial proceeding that to do so, the CFTC must prove fraud and not just manipulative conduct (*CFTC v. Kraft Foods Group, Inc.*). That case may go to trial in 2019. In dismissing a CFTC action, another district court ruled that the converse is true: The CFTC must prove not just fraud but also manipulation (*CFTC v. Monex Credit Co.*). *Monex* is on appeal to the U.S. Court of Appeals for the Ninth Circuit. These decisions will go a long way toward shaping the scope of the CFTC's post-Dodd-Frank authority.

Lastly, private plaintiffs that seek to use the antitrust laws to bring claims against entities regulated by the CFTC could face a more difficult task. In a first-of-its-kind ruling under the CEA, a court rejected an antitrust claim against a CFTC-registered exchange on implied repeal grounds. That case, too, has been appealed, this time to the U.S. Court of Appeals for the Seventh Circuit.

Conclusion

The coming year promises to be pivotal for the CFTC: a change in leadership amid a significant swaps trading rule-making, EU legislation with serious ramifications for U.S. CCPs, and litigation by the Commission and private plaintiffs that could have a major impact on the CFTC's enforcement program. These developments warrant the attention of market participants.

Click here for a full list of derivatives-related articles authored by Skadden attorneys in the last year.

Key Developments in US Sanctions

Contributing Partners

Jamie L. Boucher / Washington, D.C.

Eytan J. Fisch / Washington, D.C.

Counsel

Khalil N. Maalouf / Washington, D.C.

Associate

Joseph M. Sandman / Washington, D.C.

In 2018, the United States continued to expand its sanctions programs and increase enforcement. While President Donald Trump's decision to re-impose nuclear-related sanctions on Iran has perhaps drawn the most attention, key developments have taken place in other areas as well. Notably, the U.S. imposed sanctions on certain prominent Russian oligarchs, launched new sanctions programs with respect to Nicaragua and interference in U.S. elections, implemented for the first time compliance commitments in the context of a settlement agreement with the Office of Foreign Assets Control (OFAC) and took its first sanctions-related actions in the digital currency space.

The U.S. also has continued vigorous sanctions enforcement and appears increasingly to be targeting individuals for criminal prosecution. We expect that economic sanctions will remain a robust central instrument of U.S. foreign policy in 2019.

Iran Nuclear Sanctions Re-Imposed

Trump's announcement in May 2018 that the U.S. was withdrawing from its participation in the Joint Comprehensive Plan of Action (JCPOA) marked a split with the other P5+1 partners (China, France, Russia, the United Kingdom and Germany), which are still committed to the 2015 agreement with Iran to limit that country's nuclear activities in exchange for sanctions relief. (See our May 14, 2018, August 28, 2018, and November 13, 2018, client alerts.)

Even under the JCPOA, the comprehensive U.S. embargo against Iran remained in place, and with very limited exceptions, U.S. persons remained prohibited from doing business with Iran or its government. As a result, from a primary sanctions perspective (*i.e.*, transactions with a U.S. nexus), the changes were relatively narrow.

The U.S. also re-imposed the sweeping nuclear-related secondary sanctions that previously targeted broad sectors of Iran's economy, including banking, finance and insurance; energy and petrochemicals; shipping, shipbuilding and ports; automotive; semifinished and precious metals; and certain software. Secondary sanctions are a set of measures that principally target foreign individuals and entities for engaging in enumerated activities that may have no U.S. jurisdictional nexus. Unlike a violation of primary sanctions, a non-U.S. party that engages in conduct that is subject to secondary sanctions can itself be subject to various sanctions by the U.S. government. Although OFAC provided 90- and 180-day wind-down periods, those periods have now expired, and the Trump administration has signaled that it will fully enforce the sanctions now in effect.

Russian Oligarchs Sanctioned

On April 6, 2018, OFAC announced Russia-related sanctions against seven oligarchs, 12 companies they owned or controlled, 17 senior government officials, and a state-owned weapons-trading company and its bank subsidiary. (See our April 11, 2018, client alert.) The sanctions were implemented under Ukraine- and Russia-related executive orders and give rise to both primary and secondary sanctions risks.

The oligarchs that OFAC targeted are more integrated into the global economy than many other designated individuals or entities, and OFAC issued general licenses and accompanying guidance to minimize immediate disruptions to U.S. persons, partners and allies as the agency negotiated the terms of delisting with certain sanctioned companies. The general licenses allow some otherwise prohibited transactions and activities necessary to maintain or wind down existing dealings with, or divest interests in, specific sanctioned companies. OFAC has revised and extended some of these authorizations several times.

On December 19, 2018, OFAC notified Congress that it plans to remove three of the sanctioned companies from the List of Specially Designated Nationals and Blocked Persons (SDN List): En+ Group plc, UC Rusal plc and JSC EuroSibEnergo. OFAC explained that it had added the three companies to the SDN List because they were owned or controlled, directly or indirectly, by Oleg Deripaska, who was sanctioned the same day. In its notification to Congress, OFAC announced that it had reached a deal with the companies to reduce Deripaska's direct and indirect ownership stake, along with other commitments. Unless Congress intervenes, OFAC is expected to remove the three companies from the SDN List as soon as January 18, 2019.

New Sanctions Programs Launched

In recent months, the U.S. launched new sanctions programs with respect to both Nicaragua and interference in U.S. elections. These new programs, along with increased sanctions on Venezuela and Cuba (see our November 8, 2018, client alert), are part of what appears to be a broader, albeit uneven, trend of targeting with sanctions individuals and entities that threaten democracy and human rights.

On November 27, 2018, Trump signed Executive Order 13851, which created a list-based Nicaragua sanctions program to address the violent response by the Nicaraguan government to the protests that began on April 18, 2018, as well as the Daniel Ortega regime's dismantling and undermining of democratic institutions and the rule of law, its use of violence and repressive tactics against civilians, and its destabilizing corruption. The president issued the executive order less than a month after National Security Advisor John R. Bolton gave a speech in which he denounced Cuba, Venezuela and Nicaragua as the "Troika of Tyranny" and signaled a renewed U.S. campaign against left-wing authoritarian governments in the Western Hemisphere. As of January 7, 2019, OFAC had sanctioned Nicaragua's first lady and vice president under the new program.

On September 12, 2018, the president signed Executive Order 13848, which created a sanctions program to target individuals and entities that interfere with or undermine public confidence in U.S. elections, including through the unauthorized accessing of election and campaign infrastructure or the covert distribution of propaganda and disinformation. On December 19, 2018, OFAC used several authorities to sanction individuals and entities involved in interfering with political and electoral systems, including the nine Russian intelligence officers under indictment in connection with interference in the 2016 U.S. presidential election.

Compliance Commitments in OFAC Settlement Agreement

On December 20, 2018, OFAC announced a settlement agreement with St. Louis, Missouri-based carbon fiber manufacturer Zoltek Companies and its subsidiaries involving apparent violations of the Belarus Sanctions Regulations. Significantly, the agreement is OFAC's first incorporating compliance commitments; they included those regarding management, risk assessment, internal controls, testing and audit, training, and annual certification. These commitments constitute a substantial and lengthy undertaking, with compliance and reporting required for years into the future. Looking ahead, companies should consider the risk of being asked to accept similar compliance commitments as part of any settlement with OFAC.

Digital Currencies

On November 28, 2018, OFAC for the first time included digital currency addresses as identifying information when it announced cyber sanctions-related designations of two Iranian men who allegedly helped exchange digital currency ransom payments into the Iranian rial on behalf of Iranian malicious cyber actors. In its announcement, OFAC emphasized that regardless of whether a transaction is denominated in a digital currency or traditional fiat currency, OFAC compliance obligations are the same. We expect continued activity in this space, particularly as malicious actors increasingly turn to digital currencies to evade traditional means of detection.

Robust Enforcement Activity

The U.S. has continued robust sanctions enforcement over the past year. Notably, following the OFAC, Department of Justice and Department of Commerce penalties in 2017 against Chinese technology giant ZTE Corporation related to shipments to Iran and North Korea, the Department of Commerce's Bureau of Industry and Security (BIS) activated its suspended denial order against ZTE "in response to ZTE falsely informing the U.S. Government that it would or had disciplined numerous employees responsible for the violations that led to the March 2017 settlement agreement," according to the Department of Commerce. Ultimately, BIS reached a new settlement agreement with ZTE, and the company was required to pay an additional $1.4 billion in fines and submit to monitoring, among other requirements.

Although substantially smaller in scale, OFAC pursued thematically similar enforcement actions against non-U.S. companies that exported or re-exported U.S.-origin goods to countries subject to comprehensive U.S. sanctions. The past year also saw the return of major sanctions enforcement actions against non-U.S. financial institutions, with the November 2018 settlement between various U.S. authorities and Société Générale.

The U.S. also has continued to target individuals for criminal prosecution in sanctions-related cases. Mehmet Hakan Atilla, the deputy general manager for international banking at Halkbank, a Turkish state-owned bank, was convicted in January 2018 of conspiring to violate U.S. sanctions law, and he was sentenced to 32 months in prison in May 2018. Canadian authorities also recently arrested Meng Wanzhou, the chief financial officer of Huawei Technologies Co., Ltd., at the request of the United States, and she likely faces charges in the U.S. relating to business with Iran. These actions may become more common in the years ahead as the U.S. increasingly focuses on individual accountability for sanctions violations. (See "Enhanced US Export Controls and Aggressive Enforcement Likely to Impact China.")

Conclusion

U.S. sanctions expanded considerably over the past year. With respect to Iran and Russia, U.S. sanctions now target a broader range of individuals and entities, including through secondary sanctions. OFAC simultaneously launched new sanctions programs to target new categories of malign actors, and it brought compliance commitments into its settlement process for the first time and emphasized that its existing sanctions programs and authorities extend even to novel areas, such as cryptocurrency. We expect that the Trump administration will continue to favor sanctions as a tool to implement U.S. foreign policy and that enforcement activity will increase in the year ahead.

Click here for a full list of anti-money laundering and economic sanctions-related articles authored by Skadden attorneys in the last year.

Index of Skadden-Authored Articles From 2018

To view any of the articles listed in this index,
please visit skadden.com/insights.

Skadden-Published Client Memos

Corporate

December

SEC Requests Public Comment on Earnings Releases and Quarterly Reports / December 20, 2018

SEC Adopts Final Rules to Allow Exchange Act Reporting Companies to Use Regulation A / December 20, 2018

HKEx Announces Stock Connect Program to Open to WVR Companies / December 17, 2018

2019 SEC Filing Deadlines for Calendar Year End Companies / December 3, 2018

November

Matters to Consider for the 2019 Annual Meeting and Reporting Season / November 30, 2018

Delaware Enacts Amendments to LLC Act and Delaware General Corporation Law – Insights: The Delaware Edition / November 29, 2018

Economic Growth, Regulatory Relief, and Consumer Protection Act: Impacts on Investment Companies / November 1, 2018

October

SEC Staff Issues Shareholder Proposal Guidance / October 24, 2018

Planning for Merger Reviews and Antitrust Inquiries in Case of a 'No-Deal' Brexit / October 17, 2018

How Can Boards of Directors Make Sense of the Current ESG Landscape? / October 2, 2018

California to Require Inclusion of Female Directors at Public Corporations Based in the State / October 1, 2018

September

European Private Equity Thrives With Record Fundraising / September 25, 2018

Bax Limits Standing to Pursue Derivative Claims in Bankruptcy / September 25, 2018

Reminders of Recent Updates for Upcoming SEC Filings / September 21, 2018

August

SEC Proposes to Ease Disclosures Required by Rules 3-10 and 3-16 of Regulation S-X in Certain Registered Debt Offerings / August 8, 2018

Delaware Enacts Amendments to LLC Act and Delaware General Corporation Law / August 2, 2018

SEC Solicits Comment on Modernizing the Rules and Forms for Stock-Based Compensation / August 2, 2018

July

Financial Reporting Council Publishes Revised UK Corporate Governance Code / July 25, 2018

The JOBS Act 3.0: Regulatory Reforms Pass House of Representatives / July 23, 2018

SEC Eases Disclosure Threshold Under Rule 701 / July 19, 2018

Southeast Asian Competition Regulators Ramp Up Merger Control Enforcement / July 16, 2018

SEC Expands 'Smaller Reporting Company' Definition / July 9, 2018

June

Impact of SEC Staff Guidance on Shareholder Proposals in the 2018 Proxy Season: Dead-End Street or Road Under Construction? / June 20, 2018

May

Public Market Advocacy Groups Release Guidance / May 10, 2018

April

Hong Kong Publishes Groundbreaking New Rules for Dual-Class Shares, Emerging and Innovative Sectors / April 26, 2018

Bankruptcy Code's Safe Harbor Defense Eliminated by Supreme Court; Variant Defense May Survive / April 26, 2018

Delaware Amendments Would Apply 'Market Out' Exception to Section 251(h) Back-End Mergers, Clarify Ratification Procedures / April 25, 2018

Delaware Amendments Would Permit Divisions of LLCs, Formation of Registered Series and Statutory Public Benefit LLCs / April 24, 2018

Russia Adopts Rules for Governmental Preliminary Review of Transactions Involving Foreign Investors / April 20, 2018

New Legislation Will Benefit Business Development Companies While Closed-End Funds Remain in Limbo / April 9, 2018

March

Reminders for Annual Meeting Proxy Materials / March 9, 2018

February

Hong Kong Announces Groundbreaking New Rules for Dual-Class Share, High-Tech and Biotech Company Listings / February 26, 2018

White House Infrastructure Plan – Perspectives for the P3 Market / February 16, 2018

SEC Approves NYSE Rules to Facilitate Direct Listings / February 8, 2018

January

The Board's Three 'C's' of Corporate Governance: Composition, Communication and Connection / January 23, 2018

Infrastructure Policy Developments in Year One of the Trump Administration / January 23, 2018

Asset-Based Lending: A Powerful Tool With Increasing Flexibility / January 23, 2018

US Capital Markets Expected to Remain Robust in 2018 / January 23, 2018

Positive Outlook for European Capital Markets / January 23, 2018

Brexit: Much Discussed, Little Understood / January 23, 2018

Priorities Begin to Emerge for Trump's SEC / January 23, 2018

As President Xi's Power Grows, So Does China's Presence on World Stage / January 23, 2018

Strategic Imperatives, Market Confidence Drive US M&A / January 23, 2018

Europe Insights / January 23, 2018

State of the Financial Restructuring Market / January 23, 2018

Novel Theories Emerge in Merger Enforcement / January 23, 2018

Litigation / Controversy

December

Delaware Court of Chancery Invalidates Forum Selection Provisions Regulating Claims Under the Securities Act of 1933 / December 21, 2018

Delaware Supreme Court Affirms *Akorn* / December 21, 2018

Failure to Report Adverse Events Results in Criminal Misbranding Settlement and Individual Liability / December 14, 2018

DOJ Announces Revisions to Yates Memorandum Policy / December 10, 2018

Understanding the CLOUD Act's Expansive Reach / December 10, 2018

Inside the Courts – December 2018 / December 6, 2018

November

DOJ Announces 'China Initiative' to Investigate and Prosecute Chinese Companies / November 29, 2018

Delaware Litigation Developments Impacting Financial Advisors – Insights: The Delaware Edition / November 29, 2018

From the Get-Go: Interpreting *MFW*'s *Ab Initio* Requirement – Insights: The Delaware Edition / November 29, 2018

'Partial and Elliptical Disclosures' May Preclude *Corwin* Doctrine – Insights: The Delaware Edition / November 29, 2018

Can It Be Fixed? Further Judicial Guidance Concerning Sections 204 and 205 – Insights: The Delaware Edition / November 29, 2018

Dieckman and *Mesirov* Highlight That Differences in Limited Partnership Agreements Impact Aiding-and-Abetting Claims – Insights: The Delaware Edition / November 29, 2018

Preparing for Democratic Oversight Investigations / November 7, 2018

New York's Authorization of Fantasy Sports Ruled Unconstitutional / November 1, 2018

'Reasonable Efforts' Clauses in Delaware: One Size Fits All, Unless… / November 1, 2018

October

Analyzing *Akorn*: Delaware's First M&A Termination Under Material Adverse Effect / October 19, 2018

Spotlight on No-Poach Agreements Continues, Expands to New Industries / October 17, 2018

The Class Action Chronicle Midyear Update: 2018 / October 11, 2018

EU General Court Dismisses Parallel Trade Group's Dual-Pricing Complaint Against GSK / October 4, 2018

The United States-Mexico-Canada Agreement Significantly Curtails Foreign Investment Protection / October 2, 2018

September

Inside the Courts – September 2018 / September 28, 2018

New York's Commercial Division Continues Its Efforts to Increase Efficiencies / September 25, 2018

Cryptocurrency Litigation Update: Court Allows Government's Criminal Case Against REcoin Founder to Proceed / September 20, 2018

Ninth Circuit Addresses Use of Doctrines of Judicial Notice and Incorporation by Reference at Pleading Stage in Securities Cases / September 6, 2018

Second Circuit Curtails Use of Conspiracy and Complicity Statutes in FCPA Actions / September 4, 2018

August

Cross-Border Investigations Update – August 2018 / August 29, 2018

July

Federal Circuit Denies PTO Attorneys' Fees / July 31, 2018

EU Fines Google €4.34 Billion for Alleged Abuse of Dominant Position of Android Mobile System and Apps / July 30, 2018

EC Fines Consumer Electronics Manufacturers for RPM / July 25, 2018

Latin America Dispute Resolution Update – The Latest Developments in Cross-Border Disputes Involving the US and Latin America / July 12, 2018

Inside the Courts – June 2018 / July 2, 2018

The E-Discovery Digest – June 2018 / July 2, 2018

June

Supreme Court to Clarify What Constitutes a 'Registration' Under the Copyright Act / June 29, 2018

Supreme Court Holds American Express Rule Is Not an Antitrust Violation / June 27, 2018

China's Antitrust Regime: Retooled, Retrenched and (Potentially) Ready for Battle / June 20, 2018

Supreme Court Rules That Pending Class Actions Do Not Toll Limitations Period for Subsequent Class Actions / June 11, 2018

The Distributed Ledger: Blockchain, Digital Assets and Smart Contracts / October 16, 2018

CFIUS Pilot Program Expands Jurisdiction to Certain Noncontrolling Investments, Requires Mandatory Declarations for Some Critical Technology Investments / October 11, 2018

CFTC Chairman Giancarlo Reaffirms Commitment to Aggressive Enforcement Efforts / October 11, 2018

Recent Court Decisions Shine Spotlight on Scope of CFTC's Dodd-Frank Anti-Fraud and Anti-Manipulation Enforcement Authority / October 1, 2018

Privacy & Cybersecurity Update – September 2018 / October 1, 2018

September

Employment Flash – September 2018 / September 26, 2018

The Emergence of Utility-Owned Renewable Energy Under Build-Transfer Agreements / September 25, 2018

Data Protection in Japan to Align With GDPR / September 25, 2018

Tightened Restrictions on Technology Transfer Under the Export Control Reform Act / September 11, 2018

US Imposes New Sanctions in Response to the Skripal Assassination Attempt / September 10, 2018

Privacy & Cybersecurity Update – August 2018 / September 5, 2018

August

UK Plans to Maintain State Aid Regime Post-Brexit / August 30, 2018

US Implements First Round of Iran Sanctions 'Snap Back' / August 28, 2018

Recent Political Law Developments in Missouri and Maine / August 28, 2018

IRS Issues Anticipated Guidance on Covered Employees and Grandfathering Rules Under Code Section 162(m) / August 23, 2018

Proposed Bonus Depreciation Regulations Clarify Impact on Certain Transactions / August 20, 2018

MSRB Notes Compliance Risks of Issuer-Solicited Charitable Donations / August 8, 2018

US Finalizes CFIUS Reform: What It Means for Dealmakers and Foreign Investment / August 6, 2018

Opportunity Zone Funds Offer New Tax Incentive for Long-Term Investment in Low-Income Communities / August 1, 2018

Privacy & Cybersecurity Update – July 2018 / August 1, 2018

July

Final Phases of Initial Margin Requirements for Uncleared Swaps Expected to Spark Additional Margin Compliance Efforts / July 26, 2018

California Enacts Sweeping New Privacy Law / July 11, 2018

New Proposed Regulations Remove Obstacles to Partnership Formation, Debt Capitalization Transactions / July 9, 2018

CFTC and SEC Approve Revised Memorandum of Understanding on Information Sharing / July 9, 2018

Expanding the Scope of National Security-Focused Foreign Investment Reviews in Europe / July 2, 2018

June

Privacy & Cybersecurity Update – June 2018 / June 29, 2018

President Trump Tentatively Looks to FIRRMA to Expand US Foreign Investment Reviews / June 28, 2018

IBOR Global Benchmark Transition Report Finds Gap Between Awareness and Action / June 27, 2018

Employment Flash – June 2018 / June 27, 2018

South Dakota v. Wayfair, Inc.: Supreme Court Overturns Physical Presence Test for Online Retailers / June 22, 2018

The Ever-Evolving Cryptocurrency Legal Landscape / June 20, 2018

US Tax Reform Update: Early Impact and Trends / June 20, 2018

FDA Strives to Adapt Regulatory Approach to Rapidly Evolving Digital Health Space / June 20, 2018

Impact of US Tax Reform on Cross-Border Estate Planning / June 20, 2018

Russia Amends Foreign Investment Rules / June 12, 2018

Russia Responds to Recent Foreign Sanctions With New Law / June 4, 2018

Privacy & Cybersecurity Update – May 2018 / June 1, 2018

US Steps Up Sanctions on Venezuela and Extends Limited Russia Sanctions Wind-Down Relief / June 1, 2018

May

IRS Issues Notice on Payments Made in Exchange for State and Local Tax Credits / May 29, 2018

DOJ Antitrust Division Names New Criminal Deputy Assistant Attorney General / May 18, 2018

Tackling the Challenges of Complying With FinCEN's New Customer Due Diligence Rule / May 15, 2018

US Withdrawal From Iran Nuclear Deal Poses Challenges for Companies / May 14, 2018

OFAC Updates Two General Licenses, Issues Additional Guidance Related to Recent Russia Sanctions / May 7, 2018

Privacy & Cybersecurity Update – April 2018 / May 1, 2018

April

Employment Flash – April 2018 / April 30, 2018

Increase in SIFI Threshold Should Spur More Bank M&A Activity / April 26, 2018

OFAC Issues New General Licenses, Guidance Related to Recent Russia Sanctions / April 24, 2018

US Imposes New Russia Sanctions Targeting Oligarchs, Senior Government Officials and Entities / April 11, 2018

New York State Responds to Federal Tax Reform / April 9, 2018

Privacy & Cybersecurity Update – March 2018 / April 2, 2018

March

Federal Reserve Gears Up to Publish LIBOR Alternative / March 28, 2018

Health Care Investigation Trends: Corporate Integrity Agreements No Longer a Given / March 26, 2018

European Commission Presents 'Fair Taxation of the Digital Economy' Package / March 26, 2018

House Committee Holds Hearing on Export Control Reform Bill / March 21, 2018

Analysis of Executive Order Prohibiting Broadcom's Acquisition of Qualcomm / March 20, 2018

Privacy & Cybersecurity Update – February 2018 / March 1, 2018

February

Reminder: New Jersey Pay-to-Play Form BE Due March 30, 2018 / February 28, 2018

LDA Filers Using Method C Must Now Disclose Local Direct Legislative Lobbying Expenses / February 26, 2018

SEC Issues Interpretive Guidance on Cybersecurity Disclosures / February 23, 2018

Impact of US Tax Reform on Insurance Companies / February 20, 2018

Political Contribution Disclosure Rules in Illinois, Maryland, New Jersey, Pennsylvania and Rhode Island / February 15, 2018

CFTC and DOJ File a Flurry of Spoofing Actions / February 6, 2018

Privacy & Cybersecurity Update – January 2018 / February 1, 2018

January

Employment Flash – January 2018 / January 30, 2018

Revised HSR Thresholds Announced / January 29, 2018

Fintech Deal Landscape to Remain Active in 2018 / January 23, 2018

Rise of Blockchain and ICOs Brings Regulatory Scrutiny / January 23, 2018

Standards of Conduct for Investment Advisers, Broker-Dealers Under SEC Review / January 23, 2018

Reform Proposes Sweeping Changes to CFIUS Reviews / January 23, 2018

Trump Administration Rolls Back Climate Change Initiatives / January 23, 2018

Consumer Financial Protection Bureau Update / January 23, 2018

Addressing Workplace Sexual Harassment in the #MeToo Era / January 23, 2018

Key Considerations to Protect Against Insider Threats in Cybersecurity / January 23, 2018

Trade Barrier on Solar Cells and Modules to Significantly Impact US Solar Industry / January 23, 2018

International Taxation in the Digital Era: The Rapidly Evolving European Perspective / January 23, 2018

US Tax Reform Enacts the Most Comprehensive Changes in Three Decades / January 23, 2018

New York Cybersecurity Regulations Could Affect Foreign Banks / January 23, 2018

Impact of New US Tax Law on High Net Worth Individuals, Trusts and Family Offices / January 23, 2018

CFTC Updates on Virtual Currency Regulation, Alternatives to Libor and Fallout From Brexit / January 23, 2018

As Congress Struggles With ACA Repeal, Trump Administration Moves Forward With Regulatory Reform / January 23, 2018

A Regulatory Reform Agenda for FERC / January 23, 2018

Impact of US Tax Reform on Mergers and Acquisitions: New Opportunities and Pitfalls / January 18, 2018

An In-Depth Look at the Impact of US Tax Reform on Mergers and Acquisitions / January 18, 2018

Tax Cuts and Jobs Act: Impact on Tax-Exempt Organizations / January 17, 2018

Section 162(m) After the Tax Cuts and Jobs Act: What to Do Now / January 4, 2018

Privacy & Cybersecurity Update – December 2017 / January 2, 2018

Externally Published Thought Leadership

Corporate

December

Corporate Governance: Activist Funds Attack Italy / *TopLegal* / December 13, 2018

Building Blocks: Precedent in Bankruptcy Cases / *ABI Journal* / December 1, 2018

Non-Negotiated Provisions, Standard Form Contracts and Provisions Deemed to Be Abusive: Unclear Consequences of the French Contract Law Reform for Company Law Practitioners (translation) / *Fusions & Acquisitions* / December 1, 2018

Regulatory Developments in Foreign Investment Control and their Impact on Cross Border M&A Transactions (translation) / *Option Droit & Affaires Magazine* / December 1, 2018

November

'Reasonable Efforts' Clauses in Delaware: One Size Fits All, Unless… / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / November 22, 2018

The SEC's New Shareholder Proposal Guidance / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / November 12, 2018

DOJ's Revamped Merger Review Process: A Little Bit of Give and Take / *New York Law Journal* / November 9, 2018

SEC Guides on Tackling Shareholder Proposals / *IR Magazine* / November 2, 2018

SEC Guides on Tackling Shareholder Proposals / *Corporate Secretary* / November 1, 2018

October

Making Sense of the Current ESG Landscape / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / October 18, 2018

The California Board Diversity Requirement / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / October 16, 2018

The Rise in ESG Investing — And What Boards Can Do / *Law360* / October 11, 2018

September

The Fight Against Fraud and Other Breaches of Probity in Companies and the Challenges That Companies Are Currently Facing (translation; subscription required) / *La Semaine Juridique Édition Entreprise Et Affaires* / September 27, 2018

The Current Reform of French Foreign Investment Control / *LesEchos* / September 17, 2018

The Proposed Extension of the French Minister of Economy's Powers to Apply Sanctions and Remedies Under French Foreign Investment Rules / *La Semaine Juridique Édition Entreprise Et Affaires* / September 6, 2018

Latin America: Mixed M&A Outlook / *Latinvex* / September 5, 2018

Looking Ahead / *Latin Lawyer* / September 4, 2018

Proposed Bonus Depreciation Regulations Clarify Impact on Certain Transactions / *The M&A Lawyer* / September 1, 2018

Deposit-Guarantee Schemes in French Law and in European Law (translation) / *Osservatorio Del Diritto Civile E Commerciale* / September 1, 2018

August

How Delaware Refreshed Its LLC Act and General Corp. Law / *Law360* / August 6, 2018

July

Capacity of Corporate Entities: Legal Security Is Back! (translation) / *L'Agefi* / July 19, 2018

Impact of SEC Guidance on Shareholder Proposals in the 2018 Proxy Season / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / July 4, 2018

A Dilemma From America (translation) / *Frankfurter Allgemeine Zeitung* / July 3, 2018

The Trustee as a Shareholder (translation) / *Revue Des Sociétés* / July 1, 2018

Mid-Year 2018 Update – Part II / *Turnarounds & Workouts* / July 1, 2018

June

The Prohibition for a Bondholder to Exercise Its Right to Vote (translation) / *Revue Des Sociétés* / June 8, 2018

Mid-Year 2018 Update / *Turnarounds & Workouts* / June 1, 2018

May

Conflicts of Interest: Corporate Law Premium (translation) / Capital Finance / May 14, 2018

Upcoming Uptick in Bank M&A Activity? / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / May 14, 2018

Governance and Financial Regulation / July 2, 2018

Cooperation and the Risk of Privilege Waiver in Government Investigations / *Financier Worldwide* / July 1, 2018

1st Circ.'s Uber Ruling Imposes Burdens on App Design / *Law360* / July 1, 2018

The Role of Contemporaneous Documents in EC Competition Law / *Financier Worldwide* / July 1, 2018

June

Limits on Indemnification and Advancement For Delaware Corporations / *The D&O Diary* / June 21, 2018

Market Trends and Climate / *Lexology* / June 19, 2018

'Sole Discretion' Provisions and the Implied Covenant of Good Faith and Fair Dealing / *New York Law Journal* / June 19, 2018

China Agritech May Have Limited Practical Effect / *Law360* / June 15, 2018

No-Poaches and Non-Competes: Democrats' Proposed Legislation Places Employment Practices in Antitrust Crosshairs / *New York Law Journal* / June 11, 2018

Why Widespread Use of Live Video Testimony Is Not Justified / *Law360* / June 4, 2018

Identifying and Preventing Insider Threats / *Financier Worldwide* / June 1, 2018

May

An Introduction to Smart Contracts and Their Potential and Inherent Limitations / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / May 26, 2018

Criminal Antitrust Enforcement Has a New Leader / *Law360* / May 21, 2018

SCOTUS Hears Arguments on Vitamin C Conspiracy / *New York Law Journal* / May 7, 2018

April

Show Us the Money / *The Daily Journal* / April 16, 2018

AT&T/Time Warner: How Judge Leon's Experience in 'Comcast/NBCU' May Shape the Trial / *New York Law Journal* / April 9, 2018

Challenges When Enforcing Arbitral Awards / *Corporate Disputes Magazine* / April 1, 2018

Multijurisdictional Product Liability Claims / *Corporate Disputes Magazine* / April 1, 2018

Shareholder Disputes / *Corporate Disputes Magazine* / April 1, 2018

Guest Post: Supreme Court Weighs Whether to Extend American Pipe Tolling / *The D&O Diary* / April 1, 2018

March

Agencies Indicate Efficient, Targeted Enforcement Priorities That Rely on Self-Disclosure / *Wolters Kluwer Securities Regulation Daily* / March 20, 2018

New Law in Cartel Damage Claims Changes Rules (translation) / *Börsen-Zeitung* / March 17, 2018

Recent Developments in State Action Immunity / *New York Law Journal* / March 12, 2018

Commercial Arbitration '2018 Annual Review' / *Financier Worldwide* / March 1, 2018

Risk Management and Compliance (translation) / *Magazine des Affaires* / March 1, 2018

Understanding Continuing Trends in M&A Disclosure Litigation / *Transaction Advisors* / March 1, 2018

February

Ruling Provides Guidance on Demand Futility / *The Daily Journal* / February 27, 2018

Skadden Discusses Pros and Cons of 'Home Country' Arbitration Clauses / *The CLS Blue Sky Blog* / February 26, 2018

Beyond the Form: Using Jury Instructions to Your Advantage / *The Daily Journal* / February 21, 2018

Effective Use of Deposition Video Clips at Trial / *The Daily Journal* / February 21, 2018

Major Recent FCPA Developments and Their Implications / *Global Investigations Review* / February 16, 2018

Securities Class Action Filings Reach Record High / *Westlaw Practitioner Insights for Securities Enforcement & Litigation* / February 16, 2018

Conditions Ripe for Increased Trade Secret Litigation; Skadden IP Attorneys Explain Why / *Wolters Kluwer Intellectual Property Law Daily* / February 16, 2018

The Supreme Court Takes On Two-Sided Markets / *New York Law Journal* / February 9, 2018

January

Is It The End of Deal Litigation as We Know It? / *The Daily Journal* / January 23, 2018

Holiday Season Gifts Practitioners With Slew of Notable Opinions From Delaware Courts / *Delaware Business Court Insider* / January 10, 2018

Guest Post: Dell Strongly Reinforces Importance of Merger Price / *The D&O Diary* / January 9, 2018

Inside France's 1st Deferred Prosecution Agreement / *Law360* / January 4, 2018

Dell Strongly Reinforces Importance of Merger Price / *Law360* / January 3, 2018

Court of Chancery Addresses the Effect of Corwin and Garner in the Section 220 Context / *Transaction Advisors* / January 1, 2018

Court of Chancery Confirms MFW Applies to Controlled-Company Sale With Disparate Consideration / *Transaction Advisors* / January 1, 2018

Delaware Courts Continue to Define Appropriate Valuation Methodologies for Statutory Appraisal / *Transaction Advisors* / January 1, 2018

What's Law Got to Do With It? The Role of Governing Law in International Commercial Arbitration / *Wolters Kluwer's Arbitration* / January 1, 2018

Regulatory

December

Immigration in Flux / *New York Law Journal* / December 6, 2018

Annual Review 2018: Data Protection & Privacy Laws / *Financier Worldwide* / December 1, 2018

Skadden on the Evolving Regulatory Landscape / *Lawdragon* / December 1, 2018

Market Manipulation on Forward Contracts (translation) / *Bulletin Joly Bourse* / December 1, 2018

The Responsible Corporate Officer Doctrine: Protections Are Needed Despite DOJ's Cautious Approach / *Update Magazine* / December 1, 2018

A New Frontier for Solar: Utility Build-Transfer Agreements / *North American Clean Energy* / December 1, 2018

November

Does a Civil Penalty Time Bar Apply in the Tax Context? / *Law360* / November 27, 2018

Section 162(m) Limit on Compensation / *Thomson Reuters Practical Law* / November 20, 2018

Skadden Discusses Merger Reviews and Antitrust Inquiries in Case of 'No-Deal' Brexit / The *CLS Blue Sky Blog* / November 1, 2018

October

Utilities' Build-Transfer Deals Spur Renewable Projects / *Law360* / October 24, 2018

The Fight Against No-Poach Agreements Is Expanding / *Law360* / October 23, 2018

OPINION: Italy Has Set the Wrong Tone on Excessive Drug Pricing / *Politico Pro* / October 16, 2018

Brexit and Cross-Border Reorganizations: German Tax Risks / *Tax Notes* / October 15, 2018

Midterm Congressional Legislative Wrap-Up: Major Issues and Emerging Priorities / *New York Law Journal* / October 5, 2018

Supreme Court Review: Agency Fees and Retiree Health Benefits / *New York Law Journal* / October 4, 2018

Venezuela-Related Sanctions: U.S. and EU Developments and Compliance Challenges (translation) / *La Revue Trimestrielle De Droit Financier* / October 1, 2018

Tightened Restrictions on Technology Transfer Under the Export Control Reform Act / *WorldECR* / October 1, 2018

September

State Attorneys General and Their Influence on Merger Enforcement / *New York Law Journal* / September 12, 2018

A Summary of Executive Compensation and Benefits Issues for Start-Ups and Emerging Companies / *Bloomberg Law's Compensation Planning Journal* / September 7, 2018

Expert Q&A on Section 162(m) After Tax Reform / *Practical Law* / September 1, 2018

August

Are Governmental Entity Non-Shareholder Contributions Income After the 2017 Tax Act? / *Bloomberg BNA's Tax Management Memorandum* / August 14, 2018

A Focus on Price: Antitrust in the Kavanaugh Era / *New Haven Register* / August 13, 2018

How Taxpayers Are Taking to Tax Reform So Far / *Law360* / August 9, 2018

Opportunity Zones Abound but Investors, Tread Carefully / *Law360* / August 7, 2018

Supreme Court Review: Class Action Waivers, Whistleblower Protections / *New York Law Journal* / August 2, 2018

July

New Antitrust Regulators and New Markets / *New York Law Journal* / July 9, 2018

Skadden Discusses Latest Legislation to Expand Foreign Investment Review / *The CLS Blue Sky Blog* / July 9, 2018

June

What to Consider When Developing or Refining Your Cyber Incident Response Plan / *Legal Tech News* / June 25, 2018

Energy Storage: Are We There Yet? / *Law360* / June 22, 2018

The Futures Industry and Cybersecurity / *The Review of Securities & Commodities Regulation* / June 20, 2018

10 Steps to Modernizing Corporate Integrity Agreements / *Law360* / June 20, 2018

A Look at US and EU Fintech Regulatory Frameworks (translation) / *La Semaine Juridique Édition Entreprise Et Affaires* / June 14, 2018

The EU, U.S. Russia and Ukraine Sanctions Programs: Comparisons and Perspectives / *Chronique: Revue Trimestrielle de Droit Financier* / June 1, 2018

May

New York Employers Face New Sexual Harassment Legislation / *New York Law Journal* / May 31, 2018

Antitrust Concerns About Big Data May Be Overblown / *Law360* / May 3, 2018

2018 Distinguished Service Award Recipient: Susan P. Serota / *ABA Tax Times* / May 1, 2018

April

New Advance Payments Statute Raises Questions / *Tax Notes* / April 30, 2018

Efficient Capital Raises by NOL Corporations / *Tax Notes* / April 23, 2018

Reversals of NLRB Precedent Have Significant Implications for Employers / *New York Law Journal* / April 6, 2018

The Potential of Negotiated Tax Penalties (translation; subscription required) / *La Revue De Droit Fiscal* / April 5, 2018

Treat Mass Shootings the Way We Treated Terrorism / *The Washington Post* / April 5, 2018

3 New Settlements Highlight DOJ Scrutiny of Device Makers / *Law360* / April 4, 2018

Broadcom's Blocked Acquisition of Qualcomm / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / April 3, 2018

Recent Trends in Foreign Investment Control (translation) / *La Semaine Juridique – Edition Generale* / April 2, 2018

Selected Tax Issues Involving Blank Check Companies / *Tax Notes* / April 2, 2018

Transfer Pricing / *Financier Worldwide* / April 1, 2018

Tax-Efficient Supply Chain in Shadow of Tax Reform / *Tax Executive* / April 1, 2018

National Security, Export Controls, and the Space Economy / *World ECR* / April 1, 2018

March

A Sea Change in Climate Change Disclosure? / *The Daily Journal* / March 21, 2018

The Rise of Blockchains and Regulatory Scrutiny / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / March 9, 2018

Skadden Discusses Novel Theories Emerging in Merger Enforcement / *The CLS Blue Sky Blog* / March 6, 2018

Merger Review Maintains Its Trajectory / *International Financial Law Review* / March 5, 2018

Antitrust Compliance Tools for In House Lawyers / *ACC Docket* / March 1, 2018

FORUM: Managing Financial Crime Risk and AML Processes With Technology / *Financier Worldwide* / March 1, 2018

Project Finance in the United States / *Getting The Deal Through* / March 1, 2018

February

Rise of Blockchain and ICOs Brings Regulatory Scrutiny / *Wolters Kluwer Banking and Finance Law Daily* / February 23, 2018

Legislation Proposes Sweeping Changes to CFIUS Reviews / *Wolters Kluwer Antitrust Law Daily* / February 22, 2018

Insights to the Trade Barrier on Solar Cells and Modules / *North American Clean Energy* / February 16, 2018

A Look at US and EU Fintech Regulatory Frameworks / *Law360* / February 16, 2018

FERC Statutes and Regulations Newsletters, 595, FERC Statutes and Regulations Newsletters / *Wolters Kluwer's Federal Energy Regulatory Commission Reporter* / February 15, 2018

Impact of Compensation-Related Litigation on Public Companies / *Wolters Kluwer Securities Regulation Daily* / February 14, 2018

Strategic Perspectives – Skadden Attorneys Point Out New York Cybersecurity Regulations Could Affect Foreign Banks / *Wolters Kluwer Banking and Finance Law Daily* / February 8, 2018

Strategic Perspectives: As Congress Struggles With ACA Repeal, Trump Administration Moves Forward With Regulatory Reform / *Wolters Kluwer's Antitrust Law Daily Wrap Up* / February 7, 2018

Impact of US Tax Reform on Mergers and Acquisitions: New Opportunities and Pitfalls / *Wolters Kluwer Securities Regulation Daily* / February 2, 2018

Intern or Employee? The New Federal Test / *New York Law Journal* / February 1, 2018

January

We Can't Keep This Crucial Foreign Investment Panel in the Dark / *The Hill* / January 25, 2018

Market Trends: Say on Pay, Frequency, and Golden Parachute Payments / *Lexis Practice Advisor* / January 23, 2018

Will Life Sciences Companies Face More Scrutiny in 2018? / *Law360* / January 9, 2018

Ineffective Stockholder Approval for Director Equity Awards / *Harvard Law School Forum on Corporate Governance and Financial Regulation* / January 7, 2018