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Quorum

A Newsletter for Corporate Board Members

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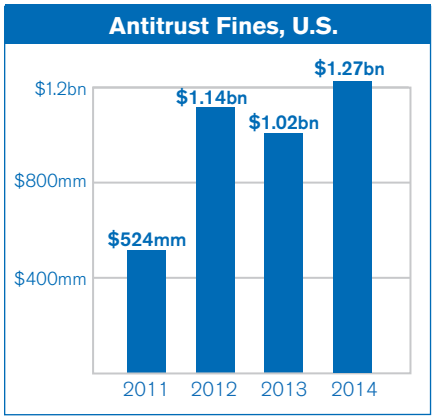
Corporations and the New World of Antitrust Enforcement

National and regional authorities are, more than ever, wielding their antitrust and other regulatory powers to shape their economies and influence their competitive positions. Cadwalader partners Charles (Rick) Rule, Alec Burnside and Joseph Bial discuss the current trends in global antitrust and the impact of regulatory intervention.

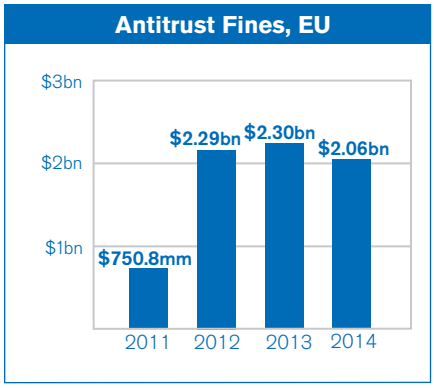
Q: WHAT DOES THE PROLIFERATION OF ANTITRUST REGIMES MEAN FOR GLOBAL CORPORATIONS?

Rick: It means there's no place to hide. When I was Assistant Attorney General for the DOJ Antitrust Division, from 1986 to 1989, there were barely a handful of active antitrust regulators around the world. Today there are some 120 competition agencies from over 90 different countries. They all meet and liaise through the International Competition Network and talk to each other, particularly in cartel and merger investigations. Corporations really need a holistic strategy to deal consistently with agencies worldwide.

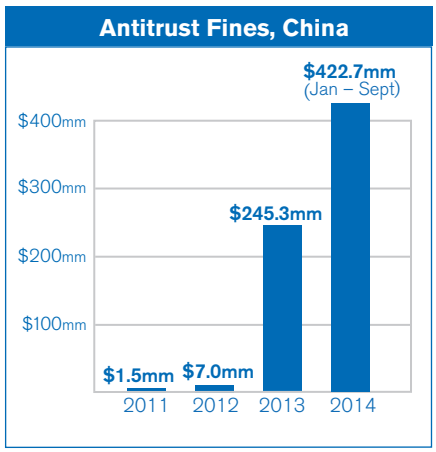
Joe: Regulators throughout Asia also have shown an increasing appetite for enforcement activity. Antitrust authorities in China, Japan, Korea, Taiwan, and elsewhere are actively pursuing cases — indeed, in some instances where U.S. and European regulators have balked at enforcement, it's sometimes been the case that regulators in Asia have stepped in with investigations or more aggressive remedies.



Source: U.S. Department of Justice; DOJ fiscal year ends September 30.



Source: ec.europa.eu (European Commission Communication Department); 2014 through December 10.



Source: The US-China Business Council, "Competition Policy and Enforcement in China"; Law360.

Alec: Since it started reviewing mergers in 1990, Europe has become a key hurdle, as some American corporations — for example, Boeing, General Electric and Oracle — have come to learn. China's MOFCOM is now starting to punch at a weight to match the country's economic importance, making a trio of key regulators in many deals: U.S., EU and China. And the EU has recently legislated to encourage the type of follow-on damages litigation that has marked the U.S. antitrust landscape for years. This is the start of a whole new chapter, with a host of legal and tactical considerations in the defense and pursuit of compensation claims.

Q: HOW ARE U.S. AND EU REGULATORS AND CORPORATIONS RESPONDING TO CHINA'S INCREASING USE OF ANTI-MONOPOLY LAWS AND PRICE COMPETITION RULES?

Joe: Since adopting its Anti-Monopoly Law in 2008, China has increased the breadth and depth of its antitrust capabilities and, not surprisingly, of its enforcement activities. Chinese regulators have been increasingly active in mergers, monopolization, and even cartel matters. Companies targeting the markets in China have to factor in the likelihood of antitrust enforcement there, as do U.S. and European regulators.

Rick: On the regulatory side, U.S. and European authorities understand the need for cooperation with their Chinese counterparts by, for example, separately entering into Memoranda of Understanding, or MOUs, that facilitate cooperation and dialogue among these regulators. U.S. and European authorities also have provided technical cooperation to help train Chinese regulators so as to foster a sound antitrust enforcement policy.

Alec: Western companies have found themselves ever more exposed to Chinese antitrust regulators. For example, China's MOFCOM blocked the formation of the P3 container shipping alliance which U.S. and EU regulators had cleared. China cleared the Glencore/Xstrata deal, both Swiss-based companies, on condition that they divest a mine in Peru. The approved buyer was Chinese…. and in a couple cases involving intellectual property, China has pursued more expansive licensing obligations than either the U.S. or Europe had sought. There is a constant suspicion — among regulators and business alike — that industrial policy considerations are at play just beneath the surface of Chinese antitrust decisions.

Q: ARE THE MORE MATURE – U.S. AND EU – REGIMES OVERSTEPPING THEIR BOUNDS / BEING TOO REACTIONARY?

Alec: There's a historical irony in that the European Commission is now even more ambitious than the U.S. in its extra-territorial reach. Europe used to criticize the U.S. for its "long-arm" jurisdiction, but now takes an expansive view of its

own ability to require evidence from abroad and to investigate indirect effects in Europe. The EU courts haven't fully validated its right to do so, but firms have tended to buckle in the face of its enforcement intent.

Rick: U.S. authorities continue to defend vigorously their prerogative to investigate conduct that occurred in other countries but indirectly affected American consumers. For example, in *Motorola Mobility v. AU Optronics Corp.*, the DOJ took the highly unusual step of asking the Seventh Circuit to vacate its own decision in order to clarify that nothing in the decision would stop the DOJ from continuing to prosecute non-U.S. manufacturers from engaging in cartel activity outside the U.S. so long as that activity results in "direct, substantial, and foreseeable" sales in the U.S.

Joe: As a result of this aggressiveness, we are starting to see a reaction from other regulators around the world, particularly in Asia. For example, in the *Motorola* case that Rick mentioned, regulators in Taiwan, Korea, and Japan formally provided submissions to the U.S. courts opposing the DOJ's position on its broader assertion of extraterritorial jurisdiction. In this case, the Seventh Circuit sided with the DOJ, but the extent of the DOJ's reach still remains unclear.

Rick: The cooperation among regulators is a fact of life. It can work to the advantage of business in smoothing coordinated outcomes, but it is also a trap for the unwary. They are joined up — just as we need to be.

OUR VIEW

In light of increasing activity and global coordination among antitrust regimes, boards should consider:

- Developing a holistic, global strategy to antitrust issues to ensure a consistent approach to regulators around the globe
- Paying close attention to China, where the competition authorities are becoming increasingly active
- Identifying business priorities to guide legal strategies, particularly where there are parallel investigations by authorities in different jurisdictions

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Charles (Rick) Rule *is the head of Cadwalader's Antitrust Group, Co-Chair of its Litigation Department and Managing Partner of the Washington office. He focuses his practice on providing U.S. and international antitrust advice to major corporations in connection with "bet your company" matters, particularly high-profile mergers, acquisitions, and joint ventures.*

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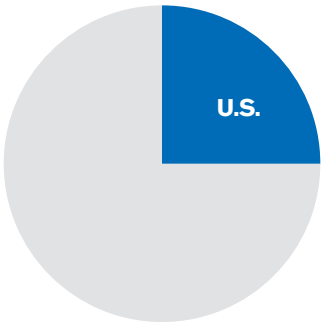
Directors Ignore Cybersecurity Risks at Their Peril

By Peter Isajiw and John Vazquez

Cybercrime costs the world economy an estimated $400 billion annually, with U.S. companies' losses accounting for more than 25 percent



Source: The Economic Impacts of Cybercrime and Cyber Espionage, The Center for Strategic and International Studies, July 2013.

Percent drop in Target's quarterly net profit following its 2013 data breach

-46%

Source: "Target Earnings Slide 46% After Data Breach," The Wall Street Journal, February 26, 2014.

The recent barrage of high-profile corporate cyberattacks demonstrates that cybersecurity weaknesses pose a serious corporate threat that can inflict tremendous costs on businesses.

Cybercrime costs the world economy an estimated $400 billion each year, and losses to U.S. companies account for more than 25 percent of this global total, according to a report by the Center for Strategic and International Studies.

No business with a digital presence is immune to cybersecurity risks, which include:

- Reputational damage and loss of goodwill
- Penalties for non-compliance with data privacy regulations
- Litigation risks, including consumer class actions and shareholder derivative litigation, among others
- Lack of appropriate insurance coverage for cybersecurity incidents

The recent attack on Sony Pictures and the devastating impact it has had on Sony's operations provide a frightening example of the risk facing all businesses, even those that might believe themselves to be unlikely targets. As SEC Commissioner Luis A. Aguilar recently noted: "boards that choose to ignore, or minimize, the importance of cybersecurity oversight responsibility, do so at their own peril."

OUR VIEW

It would be unreasonable to expect all corporate directors to be adept at the highly-technical aspects of information security. At the same time, directors' fiduciary duties to oversee the company's affairs and monitor risk extend to cybersecurity. The following steps should provide a framework to ease this tension.

1. DESIGNATE CYBERSECURITY POINT PEOPLE AND OBTAIN ADEQUATE EXPERT SUPPORT

Boards should appoint a set of directors responsible for cybersecurity, and seek expert guidance. In some corporations it may be possible to appoint directors with particular cybersecurity expertise. Other companies may need to rely on outside experts to train the board, or to delegate cybersecurity issues to a dedicated committee. There is no one-size solution, and boards will need to consider their particular resources to ensure they possess the expertise required to effectively oversee the company.

2. PROACTIVELY ASSES CYBERSECURITY WEAKNESSES

Companies should routinely perform risk assessments, utilizing experts where needed. This should include assessment of data system vulnerabilities, as well as physical and cryptographic security measures. It should also include consideration of what information companies collect, how it is used, and whether companies are creating

unnecessary risk by over-collecting data or storing stale data beyond its useful life.

3. DEVELOP AND PRACTICE A DATA BREACH RESPONSE PLAN

When responding to a cyberattack, time is of the essence. Having a well-orchestrated response plan is critical to mitigating the legal and economic fallout from a data breach. A delayed response can increase the risks of reputational damage, loss of consumer confidence and financial losses. More importantly, federal and state regulators are aggressively seeking to penalize companies that do not promptly react to cybersecurity incidents.

4. ESTABLISH A CLEAR CHAIN OF COMMAND

In the wake of a cyberattack or data breach, there will likely be competing objectives and concerns amongst corporate stakeholders. For example, brand management or public relations concerns may conflict with disclosure requirements. Establishing an internal cybersecurity response team with input from critical business units and a clear allocation of decision-making authority will minimize internal disagreement, confusion and delay in the event of a cybersecurity incident.

5. REEVALUATE INSURANCE COVERAGE

Losses from cyberattacks and data breaches may not be covered by customary commercial insurance policies. Director & Officer insurance policies may offer better coverage for such losses in certain contexts, but this shouldn't be assumed. To avoid potentially expensive coverage exclusions, boards should reevaluate: (1) current insurance policies to determine whether cyberattacks and the cost of remedial efforts that follow are excluded, and (2) whether additional cybersecurity-specific insurance coverage is warranted.

6. CONTINUOUSLY MONITOR BUSINESS PRACTICES AND RISKS

Criminals, hackers, and even foreign governments are constantly adapting to cybersecurity protections and adopting sophisticated techniques to circumvent the most advanced security measures. Corporations need to be similarly nimble in adapting to the ever-changing nature of the threat. Boards, or their delegates, should establish regular and systemic risk review procedures to stay ahead of the threat.

The scope of cybersecurity-related ramifications to corporations and their boards is still unfolding. Customer, shareholder, and regulator responses to cyberattacks are evolving as incidents continue to increase in severity. Although there is no silver bullet, a board that is active in implementing controls to prevent, detect, and remediate cyberattacks is well-situated to defend a variety of future claims.

63,000+

Confirmed cybersecurity incidents in 2013, of which more than 1,300 resulted in data breaches

Source: Verizon, 2014 Data Breach Investigations Report (http://www.verizonenterprise.com/DBIR/).

SEC Suggests Broadening Director and Officer Liability for Securities Fraud: What Directors Need to Know

By Bradley J. Bondi

Directors should employ the following safeguards in light of the SEC's expanded use of section 20(b):

1. Review corporate disclosures to identify any apparent misstatements based on their knowledge—but, by the same token, avoid the urge to micromanage disclosures such that they may be deemed to have assisted in making them.
2. Avoid interjecting themselves into issues that are the purview of officers, such as how to handle analyst questions and how to convey important corporate news.
3. Insist that counsel be present during any board discussions concerning disclosures to protect those conversations as attorney-client privileged.

Senior leadership at the Securities and Exchange Commission (SEC) has vowed to use section 20(b), an obscure section of the Securities Exchange Act of 1934, to charge individuals who may have had some role in a corporate disclosure but were not the requisite "makers" of the statement. The ramifications are significant for directors, including members of the audit committee, and officers who may have reviewed or assisted in the preparation of corporate disclosures. SEC Chair White and Enforcement Director Ceresney both indicated that the SEC will pursue gatekeepers, including directors, and the SEC recently charged the chair of an audit committee for allegedly failing to act promptly enough to investigate red flags.

BACKGROUND

For decades, the SEC has used section 20(a) to pursue individuals for *secondary* liability, but section 20(a) requires the SEC to establish that someone else committed an underlying violation and that the individuals controlled the primary actor — both of which are high hurdles. In 2011, the Supreme Court in *Janus Capital Group, Inc. v. First Derivative Traders* held that only the "maker" of a statement may be liable for securities fraud and that the maker is the person or entity with "ultimate authority" over that statement. The Court explained that other persons who contributed to the creation of a statement (or corporate disclosure) may avoid liability if they lacked the requisite "ultimate authority." The Court did hint, however, that section 20(b) of the Exchange Act may address individuals who assisted in creating the statement but lacked "ultimate authority." Joseph Brenner, the Chief Counsel in the SEC's Division of Enforcement, has stated that he is "fairly confident and hopeful" that the SEC soon would use section 20(b) to pursue *primary* liability against an individual, such as a director, because that individual had some role in the false or misleading statement, including merely reviewing the statement in the context of an audit committee meeting or similar meeting of the board of directors.

OUR VIEW

The SEC's position is unsettled. However, we believe existing case law suggests that the SEC will have difficulty in court if it decides to use section 20(b) in such an aggressive manner. In light of the significance to directors of the aggressive SEC stance, we think it would be prudent for boards to employ safeguards (*see sidebar).*

Quorum Update: Shareholder-Director Exchange Reaches Out to Public Company Boards and Hosts Inaugural Symposium

By Gregory P. Patti, Jr.

Several months ago, investor representatives of the Shareholder-Director Exchange (SDX) working group sent a letter to lead directors and corporate secretaries of every Russell 1000 company, urging public company boards to consider adopting and clearly articulating a policy for shareholder-director engagement, whether through adoption of the SDX Protocol or otherwise. The letter stated:

> "Engagement between public company directors and their company's shareholders is an idea whose time has come. We believe that U.S. public companies, in consultation with management, should consider formally adopting a policy providing for shareholder-director engagement, whether through adoption or endorsement of the SDX Protocol or otherwise. Several prominent U.S. companies are already following this path of engagement and disclosing their engagement efforts – we believe other public companies should follow their lead."

SDX also announced the addition of four new working group members:

- Mayree Clark, Managing Partner of Eachwin Capital and Director, Ally Financial Services
- Gail Deegan, Director, EMC Corp. and iRobot Corp.
- Rakhi Kumar, Head of Corporate Governance, State Street Global Advisors
- Anne Sheehan, Director of Corporate Governance, California State Teachers' Retirement System (CalSTRS)

In November, the SDX working group and founders – Cadwalader, Teneo and Tapestry Networks – hosted the inaugural SDX Symposium at the Harvard Club in New York City. The event convened a distinguished group of CEOs, directors and representatives from institutional investors to engage in a candid discussion on the importance of shareholder-director engagement in corporate governance.

The majority of the SDX Working Group, comprised of leading independent directors and representatives from some of the largest and most influential long-term institutional investors, attended the Symposium to lead the discussion along with special guests like Ivan Seidenberg, former Chairman and CEO of Verizon Communications, and William McCracken, former CEO of CA Technologies, Inc. These individuals participated in interactive panels focused on overcoming key challenges to engagement, sharing personal case studies about the future of engagement.

In addition to the panel discussions, the Symposium featured a conversation hosted by CNBC's Chief International Correspondent Michelle Caruso-Cabrera with The Home Depot's Chairman Frank Blake about his perspectives on engagement based on his experiences.

Founded in February 2014 by Cadwalader, Teneo and Tapestry Networks, SDX brings together the collective best thinking of leading independent directors and representatives from some of the largest and most influential long-term institutional investors to explore why, how, and when boards and institutional investors should engage directly with each other. The 10-point SDX Protocol provides guidance to public company boards and shareholders on how to make these engagements more effective and beneficial to both parties.

"It is clear that there is a changing dynamic in shareholder-director relations in the U.S. that SDX has tapped into and amplified."

- Anne Sheehan, Director of Corporate Governance, California State Teachers' Retirement System (CalSTRS) and new member of the SDX working group

SDX in the News

"Proxy Season 2015: Meeting the Challenge"
IR Magazine, 11/17/14

"Shareholders Demand Pow-Wows with Boards"
CFO.com, 7/25/14

"Investors to Directors, 'Can We Talk?'"
The New York Times DealBook, 7/21/14

"Activists Crash Deal Makers' Party"
The New York Times DealBook, 3/25/14

"Executives Take Note: Activists are Sometimes Right"
Financial Times, 3/23/14

Contributors to this issue:

Corporations and the New World of Antitrust Enforcement

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Directors Ignore Cybersecurity Risks at Their Peril

Peter Isajiw *concentrates his practice on complex commercial and securities litigation, in addition to regulatory investigations. He represents corporations, financial institutions, directors, officers, and individuals in a variety of state and federal court matters. Peter has represented clients in matters involving business disputes, securities laws and regulations, RICO, fraud, breach of contract, breach of fiduciary duty, and corporate governance, among others.*

John Vázquez *concentrates his practice on complex commercial litigation, with a particular focus on securities, corporate governance, and shareholder derivative matters. John received a B.A. in Economics from the University of Colorado and earned his J.D. from New York University School of Law, where he was an Editor of the Journal of Legislation and Public Policy. He is admitted to practice in the State of New York.*

SEC Suggests Broadening Director and Officer Liability for Securities Fraud: What Directors Need to Know

Bradley J. Bondi *leads the Securities Enforcement and Investigations Group and is a partner in the White Collar Defense and Investigations and Securities Litigation practices, residing in the Washington, D.C. and New York offices. He focuses on a wide range of complex civil and criminal matters involving securities and financial laws, corporate governance, and business laws.*

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Gregory P. Patti, Jr. *has substantial experience in mergers and acquisitions and securities law, including strategic acquisitions and divestitures, private equity transactions, representation of portfolio companies, general corporate counseling, and '34 Act reporting. He is an advisor to the SDX Protocol, a new approach to shareholder-director engagement.*

In previous issues of *Quorum:*

October 2013

The Challenge for Boards | James C. Woolery

Boards Should Minimize the Role of Proxy Advisors | Louis J. Bevilacqua

Adopt Forum Selection Bylaws to Reduce Litigation Tax | William P. Mills III

Directors Must Act Now on Cybersecurity | Kenneth L. Wainstein, Keith M. Gerver

Are Directors on the Hook When Internal FCPA Controls Fail? | Bradley J. Bondi, Peter B. Clark

Borrow Now or Pay Later | David S. Miller, Linda Z. Swartz

"Say on Pay" Turns Three—and Directors Should Not Fear Arbitrary Rejections | Shane J. Stroud

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Mary Jo White and the New SEC: Implications for Boards | James C. Woolery, Bradley J. Bondi

SEC Renews Its Enforcement Focus—with Vigor—on Accounting Issues | Bradley J. Bondi, David F. Williams, Katy Preston

CFIUS Scrutiny of Foreign Acquisitions of U.S. Businesses Intensifies | Dale Chakarian Turza, A. Joseph Jay III, Keith M. Gerver

New Urgency for Corporate Inversion Transactions | David S. Miller, Linda Z. Swartz

Significant Uptick in Royalty and Patent Stream Monetizations | Ira J. Schacter, Aly El Hamamsy

Quorum Update: The Shareholder-Director Exchange Provides New Tools for Boards | Gregory P. Patti, Jr.

These articles are available at www.cadwalader.com/quorum/newsletter/.

Quorum Editorial Board

About Quorum

Quorum is a resource designed for directors of publicly traded corporations: an executive summary that flags the key challenges and trends in the boardroom. Our editorial team — comprising attorneys who have long-standing relationships with premier financial institutions, *Fortune* 1000 companies and government entities — evaluates new regulations, interprets economic developments, and identifies potential director liability issues that affect how corporate board members plan and execute their long-term strategies.

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