GT Insights for Public Companies

April 17, 2018

In this Issue:

Corporate Governance | SEC Enforcement | Litigation

Corporate Governance

ISS Updates Voting Policies

On March 29, 2018, and again on April 9, 2018, well into proxy season, Institutional Shareholder Services, or ISS, published updates to its U.S. Proxy Voting Research Procedures & Policies. The updates provide helpful guidance on administrative topics, board attendance, majority-supported shareholder proposals, poison pill provisions, charter/bylaw provisions and governance failures. The following are summaries of certain updated topics.

Procedural:

What happens if the proxy report contains a factual error?

- Report a factual error to the ISS Help Center as soon as possible. If ISS agrees that a correction is required, it will issue a proxy alert to clients.

How and when will ISS change a vote recommendation in a proxy alert?

- If a company decides to make changes or provide additional information to shareholders after an ISS proxy report has been published, the information must be publicly disclosed so that ISS can

© 2018 Greenberg Traurig, LLP

respond (preferably via a regulator's website).

- If the information is determined to be significant and warrants change, ISS will issue a proxy alert.
- New information provided by the company must be available at least five business days ahead of the meeting.

Board Attendance Policy:

What exceptions to the requirement that board members attend at least 75 percent of board and committee meetings apply in the case of a newly-appointed director?

- Newly-appointed directors are generally exempted from the board attendance policy if they attended fewer than 75 percent of the board and committee meetings for the period for which they served.

Proxy Access Proposals:

How will ISS evaluate a Board's implementation of proxy access in response to a majority-supported shareholder proposal?

- ISS may issue an adverse recommendation if a proxy access policy contains material restrictions that are more stringent than those included in a majority-supported proxy access shareholder proposal with respect to, at a minimum, ownership thresholds above 3 percent, ownership duration longer than 3 years, aggregation limits below 20 shareholders and cap on nominees below 20 percent on the board.

Poison Pills:

How will ISS apply the new 2018 policy to recommend against director nominees at companies holding non-shareholder approved pills to previously-grandfathered poison pills that will be expiring shortly?

- Generally, if the pill is in effect as of the date of the shareholder meeting, ISS will recommend against the nominees.

How do companies terminate poison pills prior to the expiration date?

- Most companies should be able to accelerate the pill's expiration date, without involving the cost of redemption.

Does ISS still consider deadhand or slowhand provisions problematic?

- Yes. For 2018, ISS will recommend against the board nominees of any company holding a long-term poison pill that has not been ratified by its public shareholders.

What if a company adopts a poison pill before the company goes public?

- If the pill is not put to a binding shareholder vote at the first shareholder meeting, ISS will recommend a withhold or against vote on all nominees.

© 2018 Greenberg Traurig, LLP

<u>Classified Boards:</u>

- ISS recommends against board nominees who do not opt out of classified boards.

<u>Unilateral By-Laws/Charter Amendments:</u>

Which types of charter/bylaw adoptions are likely to result in continued adverse voting recommendations?

- For public companies, adoption of multiclass structure; classified board, and/or supermajority vote requirements; and
- For all public companies, fee-shifting provisions.

Other administrative updates relating to timing of reports, request for documents and engagements, and asking questions on U.S. voting policies can be found in the updated Policies & Procedures.

Human Capital Management Becomes a Top 2018 Investor Concern

BlackRock, the world's largest investment firm, has identified human capital management, or HCM, as one of its 2018 priorities when engaging with companies in which it invests. The increase in interest for information on HCM is shared by other institutional investors. For example, the EY Center for Board Matters identified HCM as one of investors' top five priorities in its compilation of investors' top priorities for companies for 2018 (involving interviews with over 60 institutional investors with an aggregate of $32 trillion under management).

HCM refers to a company's practices and policies related to employee development, diversity, equal employment, health, safety, labor relations and supply chain labor standards. Specific issues include addressing the changing definition of work for millennials, technology-driven displacement of workers, worker training and broader company efforts to address projected skills shortages.

BlackRock views HCM as the responsibility of both a company's board and management team and expects a public company's board to be engaged in the oversight of the company's strategy and defining a company's purpose to better ensure that the company's HCM practices are properly aligned. While disclosure of information on HCM is evolving, BlackRock encourages companies to be more transparent in its HCM disclosure so that investors can better identify companies that are focused on more effectively managing this critical aspect of a company's business and success. According to BlackRock, companies should consider the following questions in particular, when implementing policies and preparing public disclosures on HCM:

- What role does the company play in the community?
- Does the company have a diverse workforce?
- Is the company adapting to technological change?
- Is the company providing the retraining and opportunities that its employees and its business will need to adjust to an increasingly automated world?
- What is our process for ensuring employee health and safety and complying with occupational health and safety policies?
- What systems are in place to oversee matters related to the supply chain?

© 2018 Greenberg Traurig, LLP

- Is there a link between HCM and executive compensation?

SEC Enforcement

SEC Charges Company and one of its Former Executives in a Fraudulent Revenue Recognition Scheme

On March 27, 2018, the SEC charged an energy storage and power delivery product manufacturer, Maxwell Technologies, Inc., and one of its former sales executives, Van Andrews, in a fraudulent revenue recognition scheme designed to inflate Maxwell's reported financial results to better meet analysts' expectations. According to the SEC's order, from December 2011 through January 2013, Maxwell improperly recognized over $19 million in revenue from future quarters in violation of U.S. GAAP. The SEC alleged that Maxwell prematurely recognized revenue from the sale of ultracapacitors, which are essentially small energy storage and power delivery products. Maxwell's ultracapacitor revenue growth was material to analysts and investors and was highlighted in all press releases and earnings calls.

Maxwell, through Andrews, a former Senior Vice President of Sales, prematurely recorded ultracapacitor revenue and used several improper tactics, including:

- customer side deals with contingent payment terms and full right of return;
- channel stuffing;
- extending payment terms to certain distributors;
- falsifying purchase orders and third-party confirmations; and
- instructing certain distributors to order unwanted products at quarter-end.

The SEC's Order alleged that Maxwell's financial and accounting department, including its controller repeatedly overrode and ignored automated controls that should have alerted them to the material revenue recognition departures. According to the SEC's order, then-CEO David Schramm "knew that the sales took place the last days of each quarter, that certain sales were beyond approved credit limits and contained extended payment terms for up to 180 days, and that certain prior sales receivables were significantly past due." Schramm also overrode automated credit limit controls.

Both Maxwell and Andrews consented to the SEC's order, without admitting or denying the allegations and agreed to pay $2.8 million and $50,000, respectively, in penalties. Andrews agreed to be barred from serving as an officer or director of a public company for five years. Schramm and Maxwell's controller also each agreed to pay a penalty without admitting or denying the SEC's findings.

SEC Announces Largest Whistleblower Awards

The Dodd-Frank Act significantly expanded the SEC's whistleblower program. Specifically, under Dodd-Frank, the SEC is authorized to pay monetary awards—subject to certain limitations, exclusions, and conditions—to individuals who voluntarily provide the SEC with original information about a violation of the securities laws that leads to a successful SEC judicial or administrative action in which the monetary

© 2018 Greenberg Traurig, LLP

sanctions exceed $1 million. The total award amounts that can be paid range from 10 percent to 30 percent of the monetary sanctions collected.

On March 19th, the SEC announced its largest-ever Dodd-Frank whistleblower awards, with one whistleblower receiving a $33 million award and two others splitting a $50 million award. In addition, on April 5th, the SEC announced a whistleblower award of more than $2.2 million to a whistleblower who first reported the information to another federal agency and later provided the same information to the SEC. This was the first award paid under the Exchange Act safe harbor, which provides that if a whistleblower submits information to another federal agency and submits the same information to the SEC within 120 days, then the SEC will treat the information as though it had been submitted to the SEC at the same time that it was submitted to the other agency. This case may be of significant interest because it offers government agencies that do not have whistleblower programs in place an opportunity to entice cooperating disclosures by referring people who approach them to the SEC. Furthermore, on April 12th, the SEC announced yet another whistleblower award or more than $2.1 million to a former company insider whose information led to multiple enforcement actions.

These significant payouts continue a trend of high SEC whistleblower awards, with the SEC emphasizing its hope that the awards will incentivize others to step forward with specific, high-quality information about securities laws violations. The SEC has awarded more than $266 million to 55 whistleblowers since issuing its first award in 2012.

By law, the SEC protects the confidentiality of whistleblowers and does not disclose information that might directly or indirectly reveal a whistleblower's identity.

SEC Guidance Clarifies Scope of Non-GAAP Exemption for M&A Forecasts and Disclosures

On April 4, 2018, the Division of Corporation Finance issued two Compliance & Disclosure Interpretations (C&DIs) 101.02 and 101.03 regarding the applicability of Regulation G and Section 10(e) of Regulation S-K to financial measures included in forecasts and disclosed in connection with business combination transactions. The new C&DIs were aimed at clarifying the scope of C&DI 101.01, which provides that financial measures included in forecasts given to a financial advisor and used in connection with a business combination are not non-GAAP financial measures if:

- the measures are included in forecasts provided to a financial advisor for the purpose of rendering a fairness or other opinion materially related to the transaction; and
- the forecasts are disclosed to comply with Regulation M-A or other state or foreign law regarding disclosure of such advisor's analyses or work.

C&DI 101.02 confirms that this exemption is available where the forecasts provided to the financial advisor also are provided to a company's board of directors or a board committee. In addition, under C&DI 101.03, if a company determines that the forecasts provided to bidders in the transaction are material and are therefore being disclosed to comply with the federal securities laws, including the antifraud and other liability provisions, then the financial information included in those forecasts will not be considered non-GAAP financial information. As a result, the financial measures included in the forecasts would not be subject to the requirement to reconcile the measure to GAAP and the other requirements imposed by Item 10(e) of Regulation S-K and Regulation G.

© 2018 Greenberg Traurig, LLP

Litigation

'Equity Is Not a License to Make Stuff Up' – Court Enters $1 Nominal Damage Awards After Plaintiff Fails to Prove Actual Damages Stemming from Self-Dealing Transaction

The Delaware Court of Chancery recently confirmed that proving a breach of duty does not obviate the need to prove actual damages resulting from that breach.

In this case, a father and his sons constituted the entire board and voted to approve their own compensation, including the granting of generous stock options to themselves (as company officers). They did not use a compensation consultant and the Court found that their documentation of the process and analysis supporting the transaction was "thin." Ultimately, several of the options exercised were paid with promissory notes that were later forgiven.

Following a trial on the merits, the Court found that the challenged self-interested compensation decisions were subject to entire fairness review and that the board failed the test and breached its fiduciary duty of loyalty. The plaintiff, however, was unable to prove that actual damages or rescission was warranted under the circumstances.

The Court therefore awarded only nominal damages of $1 against each defendant, cautioning future litigants as follows:

> "[T]here is [an] important lesson to be learned from this case. While this court endeavors always to remedy breaches of fiduciary duty, especially breaches of the duty of loyalty, and has broad discretion in fashioning such remedies, it cannot create what does not exist in the evidentiary record, and cannot reach beyond that record when it finds the evidence lacking. Equity is not a license to make stuff up."

© 2018 Greenberg Traurig, LLP

Editorial Board

Questions about topics covered in this newsletter should be directed to the Editorial Board of GT Insights for Public Companies:

- Drew M. Altman
  altmand@gtlaw.com
  +1 305.579.0589
- Elizabeth W. Fraser
  frasere@gtlaw.com
  +1 617.310.6237
- Laurie L. Green
  greenl@gtlaw.com
  +1 954.768.8232
- Elaine C. Greenberg
  greenberge@gtlaw.com
  +1 202.331.3106
- Kara L. MacCullough
  maccullough@gtlaw.com
  +1 954.768.8255
- Flora R. Perez
  perezf@gtlaw.com
  +1 954.768.8210
- Marc M. Rossell
  rossellm@gtlaw.com
  +1 212.801.6416
- Joshua M. Samek
  samekj@gtlaw.com
  +1 305.579.0856
- Jason T. Simon
  simonj@gtlaw.com
  +1 703.749.1386
- William Wong
  wongw@gtlaw.com
  +1 310.586.7858

Questions about the Delaware-specific law and litigation topics covered in this newsletter should be directed to:

- Steven T. Margolin
  margolins@gtlaw.com
  +1 302.661.7376
- Kelly A. Terribile
  terribilek@gtlaw.com
  +1 302.661.7393

Albany. Amsterdam. Atlanta. Austin. Boca Raton. Boston. Chicago. Dallas. Delaware. Denver. Fort Lauderdale. Germany.¬ Houston. Las Vegas. London.* Los Angeles. Mexico City.+ Miami. New Jersey. New York. Northern Virginia. Orange County. Orlando. Philadelphia. Phoenix. Sacramento. San Francisco. Seoul.∞ Shanghai. Silicon Valley. Tallahassee. Tampa. Tel Aviv.^ Tokyo.¤ Warsaw.~ Washington, D.C.. West Palm Beach. Westchester County.

This Greenberg Traurig Newsletter is issued for informational purposes only and is not intended to be construed or used as general legal advice nor as a solicitation of any type. Please contact the author(s) or your Greenberg Traurig contact if you have questions regarding the currency of this information. The hiring of a lawyer is an important decision. Before you decide, ask for written information about the lawyer's legal qualifications and experience. Greenberg Traurig is a service mark and trade name of Greenberg Traurig, LLP and Greenberg Traurig, P.A. ¬Greenberg Traurig's Berlin office is operated by Greenberg Traurig Germany, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. *Operates as a separate UK registered legal entity. +Greenberg Traurig's Mexico City office is operated by Greenberg Traurig, S.C., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ∞Operates as Greenberg Traurig LLP Foreign Legal Consultant Office. ^Greenberg Traurig's Tel Aviv office is a branch of Greenberg Traurig, P.A., Florida, USA. ¤Greenberg Traurig Tokyo Law Offices are operated by GT Tokyo Horitsu Jimusho, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ~Greenberg Traurig's Warsaw office is operated by Greenberg Traurig Grzesiak sp.k., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. Certain partners in Greenberg Traurig Grzesiak sp.k. are also shareholders in Greenberg Traurig, P.A. Images in this advertisement do not depict Greenberg Traurig attorneys, clients, staff or facilities. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. ©2018 Greenberg Traurig, LLP. All rights reserved.