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GT Insights for Public Companies

September 19, 2016 A Bi-Weekly Update

Securities and Exchange Commission

Companies Receive Correspondence from SEC Division of Enforcement Alleging Violations of Non-GAAP Rules

Recently, the SEC's Division of Enforcement appears to have taken a particular interest in companies' compliance with Regulation G and Item 10(e) of Regulation S-K, which govern the use of non-GAAP financial measures. Typically, the SEC has addressed any alleged non-compliance with these rules through comment letters issued by the Division of Corporation Finance. However, in recent weeks, multiple companies have reported receiving correspondence from the Division of Enforcement, alleging violations based upon earnings releases containing non-GAAP financial measures in headlines and summary bullet points without there being an equal or greater prominence presentation of the most directly comparable GAAP financial measures.

Item 10(e) of Regulation S-K, adopted in 2002, requires that companies presenting a non-GAAP financial measure in either (1) an SEC filing or (2) an earnings release furnished to the SEC must include a presentation, "*with equal or greater prominence*," of the most directly comparable financial measure presented in accordance with GAAP. Until recently, the SEC's Compliance and Disclosure Interpretations, or CDIs, regarding non-GAAP financial measures did not specifically address what disclosure would, or would not, comply with the prominence requirement. However, in May 2016, the SEC updated its guidance to include a non-exclusive list of examples of non-GAAP disclosure that the SEC's staff would consider to be in violation of the prominence rule. Among the examples provided: omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures (see Question 102.10, available at https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm).

Given the SEC's focus, all companies should carefully review their use of non-GAAP financial measures in their filings and earnings releases and ensure that their use conforms to the SEC's rules and most recent guidance.

SEC Proposes Amendments Requiring Hyperlinks to Exhibits in Filings

On Aug. 31, 2016, the SEC proposed amendments that would require companies to include a hyperlink to each exhibit identified in the exhibit index of registration statements and periodic and current reports. To enable the use of hyperlinks, companies must submit these filings in HyperTextMarkup Language, or HTML, format.

The proposed amendments are part of the SEC's "Disclosure Effectiveness Initiative," a comprehensive evaluation of the SEC's disclosure requirements aimed at improving the disclosure regime for the benefit of both companies and investors. Under the current system, someone seeking to access an exhibit that has been incorporated by reference must review the exhibit index to determine the filing in which the exhibit is included, and then must search through the company's filings to locate the relevant filing to review for the particular exhibit. The proposed amendments are designed to facilitate easier access to these exhibits.

Nearly all of the forms that are required to include exhibits under Item 601 of Regulation S-K will be impacted by the proposed amendments.

For registration statements, active hyperlinks to each exhibit would be required only in the version of the registration statement that becomes effective. For periodic and current reports, the active hyperlinks to each exhibit would be required when the report is filed.

Comments are due to the SEC on or before Oct. 27, 2016.

https://www.sec.gov/rules/proposed/2016/33-10201.pdf.

SEC Issues New Fee Advisory Rate

On Aug. 31, 2016, the SEC announced its yearly adjustment to the fee rate paid under the securities laws. Starting in fiscal year 2017, companies must pay $115.90 per million dollars to register securities, an increase from the previous rate of $100.70 per million dollars. The new rate increases the applicable rates under the Securities Act for the registration of securities and under the Exchange Act for the repurchase of securities, as well as for proxy solicitations and statements in corporate control transactions. The adjustment also increases rates for securities sold pursuant to Rule 24f-2 of the Investment Company Act of 1940. The new rate will go into effect Oct. 1, 2016.

https://www.sec.gov/rules/other/2016/33-10200.pdf

Corporate Governance

ISS Issues 2017 Policy Survey

In Aug. 2016, Institutional Shareholder Services, or ISS, issued its policy survey for the 2017 proxy season. Typically, the survey is a lead indicator of key issues being considered by ISS. The following is a brief overview of the main questions included in this year's survey.

- **Board Refreshment and Tenure.** The survey asks for input as to whether director tenure raises issues concerning a board's refreshment and nominating process. It asks whether certain factors, including the average tenure of the board, the proportion of the board having long tenures, and the absence of new independent directors, might have an impact on that process.
- **Overboarding of Executive Chairs.** Overboarding refers to instances when a director or executive sits on an excessive number of public company boards of directors. Currently, the overboarding policy differentiates between a non-executive director, who is considered overboarded if he sits on more than 5 boards, and a CEO, who is considered overboarded if he sits on more than 3 boards. The survey asks whether non-CEO executive chairs should be subject to the non-executive director standard, or the more restrictive CEO standard.
- **IPO Dual Class Structures.** The survey asks whether ISS should recommend voting against directors that, in connection with an IPO or in post-bankruptcy, adopt structures with multiple classes of stock that have different voting rights.
- **Metrics to Evaluate Executive Compensation.** While ISS currently uses total shareholder return to analyze the relationship between CEO pay and company performance, the

survey asks whether other metrics should also be considered, including revenue, earnings, returns, and cash flow.

> **Say-on-Frequency.** The survey asks whether "say-on-pay" votes shall be held every one, two, or three years, and whether certain factors, such as company size, financial performance, and prior shareholder support for say-on-pay, should play a part in this frequency analysis.

> **Cross-border Executive Pay.** The survey asks how ISS should evaluate situations where international companies conduct multiple say-on-pay votes due to the applicable legal requirements of different jurisdictions. More specifically, it asks whether it is acceptable to have opposing vote recommendations based on different countries' policies.

Survey results are typically published near the end of September, and final policy updates are normally released in November. All final policies will be implemented on Feb. 1, 2017.

https://www.issgovernance.com/iss-releases-annual-policy-survey/

Litigation

Recent 9th Circuit Decision Interprets Scope of SOX Certification and Disgorgement Provisions

On Aug. 31, 2016, the United States Court of Appeals for the Ninth Circuit reversed a district court decision with respect to liability of a CEO and CFO in connection with their certifications to the Form 10-Q and Form 10-K. Specifically the Court found the following.

> Rule 13e-14 of the Exchange Act, which sets forth the requirement of CEOs and CFOs to certify as to the accuracy of the financial statements contained in Form 10-Ks and Form 10-Qs, has an implicit truthfulness requirement. This requirement obligates the signing officer to attest to the accuracy of the statements made in the certifications. As a result, the Court reversed the district court's ruling that Rule 13e-14 does not provide the SEC with a cause of action for making false certifications.

> Section 304, which requires the CEO and CFO to reimburse a company for certain incentive- or equity-based compensation if the company's financial statements are restated due to the company's material noncompliance with financial reporting requirements due to misconduct, only requires misconduct by the company, not the CEO or CFO. Consequently, the Court reversed the district court's ruling that the defendants did not violate Section 304 of SOX because the company's financial restatement was not due to misconduct by the former executives.

https://cdn.ca9.uscourts.gov/datastore/opinions/2016/08/31/14-55221.pdf

Recent SEC Actions Signal Expansion of the SEC's Scrutiny of Agreements for Compliance with Whistleblowing Rules under Dodd-Frank

In Aug. 2011, as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank, Congress authorized the SEC to provide monetary awards to whistleblowers who come forward with high-quality original information that leads to an SEC enforcement action in which over $1,000,000 in sanctions is ordered. Whistleblowers can be awarded between 10% and 30% of the money collected. Rule 21F-17 provides that "[n]o person may take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement."

Initial actions by the SEC to enforce compliance with Rule 21F-17 focused on companies' confidentiality agreements, but recent SEC actions signal an expansion of the SEC's scrutiny to also include severance agreements. The SEC has recently issued fines against companies relating to provisions in severance agreements requiring that employees:

- waive their right to any monetary awards they could receive from filing a complaint or a charge with an administrative agency
- notify the company prior to such disclosure.

For more information on recent SEC actions relating to a company's use of severance agreements that contain confidentiality, covenant-not-to-sue or release provisions that allegedly violated SEC whistleblower rules, see the Greenberg Traurig Alert, "SEC Scrutinizes Severance Agreements for Compliance With Dodd-Frank." http://www.gtlaw.com/News-Events/Publications/Alerts/197622/SEC-Scrutinizes-Severance-Agreements-for-Compliance-With-Dodd-Frank

Exchanges

Nasdaq Proposes Rule Amendments to Implement T+2 Settlement Cycle

Nasdaq has proposed rule changes to implement the pending reduction in the settlement cycle for U.S. equities, corporate and municipal bonds, and unit investment trusts from the current three business day settlement cycle (T+3) to the proposed two business day settlement cycle (T+2). The current industry target date for the move from a T+3 to T+2 settlement cycle is Sept. 5, 2017.

According to the U.S. T+2 Industry Steering Committee, shortening the settlement cycle for U.S. equity, corporate and municipal bond and unit investment trust trades will reduce operational, systemic and counterparty risk, lower liquidity needs and limit procyclicality, while aligning the U.S. with other T+2 settlement markets across the globe.

Among the proposed rule changes is a modification to Nasdaq Rule 11140(b)(1) to provide that the "ex-dividend date," which is the date on which a security is traded without the right to receive a dividend or distribution that has been declared by the company, generally will be the first business day before the record date, as opposed to the current second business day before the record date.

Nasdaq anticipates filing rule amendments to implement the new T+2 settlement cycle later in 2016. Comments on the proposed rule amendments may be submitted to Nasdaq MarketWatch prior to Sept. 30, 2016.

http://nasdaq.cchwallstreet.com/nasdaq/pdf/nasdaq-issalerts/2016/2016-002.pdf

Accounting

FASB Clarifies the Classification of Contingent Consideration Payments Made after a Business Combination in the Statement of Cash Flows

In Aug. 2016, the FASB issued Accounting Standards Update, or ASU, 2016-15 to provide guidance on certain cash flow classification issues, including whether the payment of contingent consideration after a business combination should be categorized as operating, investing or financing in the statement of cash flows.

The ASU provides that:

- Cash payments made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability be classified as cash outflows for investing activities. While the ASU does not define the term "soon after," the Basis for Conclusions in the ASU indicates that the payment must be made within a relatively short period of time after the acquisition date (for example, three months or less)

- Cash payments not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability should be separated and classified as follows:
- Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date should be classified as financing activities
- Cash payments in excess of the amount of the contingent consideration liability recognized at the acquisition date should be classified as operating activities

The amendments are effective for public companies for fiscal years beginning after Dec. 17, 2017 and interim periods within those fiscal years.

http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168389912&acceptedDisclaimer=true

Upcoming Webinar

Wednesdays 9/28 or 10/5 or Thursday 10/6

Feds Step Up Scrutiny of Severance and Confidentiality Agreements: How Will Your Agreements Fare?

Given recent legal challenges and enforcement actions by the SEC, EEOC and other government agencies, it is time for all companies, but especially public companies, to review and update their employee confidentiality and severance agreements. Join us for a timely webinar presentation on what employers need to consider to make sure their agreements are compliant with the law, while still protecting confidential business information and precluding separating employees from receiving double recoveries.

For more information - http://gtlawinfo.com/cv/cb4047cde7cc1ec7510ca48c1579aaf464f6f538

Questions about topics covered in this newsletter should be directed to the GT attorney with whom you regularly contact or to the Executive Editor:

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GT Insights

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