



GT Insights for Public Companies

October 17, 2016

A Bi-Weekly Update

SEC Regulation

End of Tandy Representations

On Oct. 5, 2016, the Division of Corporation Finance announced that, effective immediately, they will no longer require issuers to include “Tandy” representations in responses to SEC comment letters. Tandy representations, which have been required in all such response letters since 2004, are acknowledgments that:

- > the issuer is responsible for the adequacy and accuracy of disclosures made in a filing that is subject to the SEC comment and review process,
- > comments by the SEC staff, changes to disclosure in response to comments by the SEC staff, or the declaration of effectiveness of a filing do not foreclose the SEC from taking any action with respect to the filing, and
- > the issuer will not assert the SEC staff’s comments or the declaration of effectiveness of a filing as a defense in any legal proceeding initiated by the SEC or under federal securities laws.

In the mid-1970s, the staff began to include requests for Tandy representations (named for the first issuer that received such a request) in comment letters when the staff had an open enforcement inquiry related to a particular issuer. However, in 2004, when most SEC comment letters and responses became publicly available on EDGAR, the staff

announced that they would request that issuers include Tandy representations in all responses to comment letters.

In lieu of a request for Tandy representations, the staff intends to include the following statement in comment letters:

“We remind you that the company and its management are responsible for the accuracy and adequacy of their disclosures, notwithstanding any review, comments, action or absence of action by the staff.”

<https://www.sec.gov/corpfin/announcement/cf-announcement--no-more-tandy-language.html>

Recent SEC Comment Letter Provides Insight to SEC’s Current Views on Non-GAAP Measures

A recently released SEC comment letter provides issuers additional insight into the views of the staff of the Division of Corporation Finance on the use of certain non-GAAP financial measures. The comment letter, issued in July 2016, questioned whether certain of the issuer’s non-GAAP financial measures included in its Form 10-K complied with the relevant rules and recent guidance.

- > *Recurring Nature of Adjustment.* Noting that the company excluded certain non-recurring items in calculating Adjusted EBITDA, the staff requested information on the nature of those items and the basis for excluding them. The staff noted that

Item 10(e) of Regulation S-K does not permit issuers to adjust a non-GAAP performance measure to eliminate or smooth items identified as non-recurring or unusual when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. In its response, the issuer explained that while some of the non-recurring items had occurred in the prior two years, it did not believe that such items were reasonably likely to recur within the next two years and, as such, such items should be treated as non-recurring.

- > *Characterization of Performance v Liquidity Metric.* In a second comment, the staff asked whether the non-GAAP financial measure “Cash Available for Distribution” was a liquidity measure, in which case Item 10(e) would prohibit exclusion of cash settled charges or liabilities. In its response, the issuer stated that it used the measure “Cash Available for Distribution” as a performance measure, not a liquidity measure, and it was therefore not subject to the prohibition against excluding charges or liabilities that require cash settlement.

The issuer successfully addressed the SEC’s comments without having to change its disclosures.

<https://www.sec.gov/Archives/edgar/data/1635581/000119312516673644/filename1.htm>

Corporate Governance

SEC Update on Proxy Access

On Sept. 27, 2016, the staff of the Division of Corporation Finance issued three no-action letters in response to requests to exclude shareholder proxy access proposals on the basis that the companies had already “substantially implemented” the proposals.

Pursuant to Rule 14a-8(i)(10) under the Securities Exchange Act of 1934, a company may exclude a shareholder proposal from its proxy statement if the company has substantially implemented the proposal. The staff has clarified that a company need not implement the shareholder proposal exactly as requested, but rather it must satisfy the “essential objective” of the proposal.

In two of the three letters, the staff stated that it would not recommend enforcement action if the company excluded the shareholder proposal which requested that the company adopt a proxy access bylaw, on the basis that the company’s recently adopted proxy access bylaw addressed the shareholder proposal’s essential objective. In both cases, the company’s bylaws provided that a shareholder or group of shareholders who have held 3 percent of the company’s stock for 3 years is permitted to nominate up to 20 percent of the board. However, the staff granted no-action relief even though the company bylaws deviated from the terms of the proposal and omitted certain terms identified in the proposal as “essential elements for substantial implementation.” Specifically:

- > the company bylaws restricted the number of shareholders who could form a group to 20, whereas the proposal sought an unlimited group;
- > the company bylaws limited the number of board seats to 20 percent of the board, while the proposal would have provided access to 25 percent of the board; and
- > one of the company’s bylaws imposed a two-year restriction on the ability to re-nominate a candidate who fails to garner a certain percentage of the vote, whereas the proposal would not have imposed such restriction.

By comparison, in the third letter, the staff denied the company’s request to exclude a shareholder

proposal to *amend* the company's proxy access bylaw. The staff stated that it was unable to conclude that the company's proxy access bylaw "compare[d] favorably with the guidelines of the proposal." The proposal sought to amend certain terms of the company's existing proxy access bylaw, which included the same key terms which were found to have addressed the essential objectives in the proposals that were the subject of the other two letters.

These three letters seem to imply that the SEC's position with respect to the ability to exclude a shareholder proposal will differ based on whether the proposal requests that the company "adopt" a proxy access bylaw as opposed to "amend" its existing proxy access bylaw. This would seem to be the case, even if the proposal includes "essential" terms different from those included in the company's current bylaw.

<https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchiecisco092716-14a8.pdf>

<https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchie092716-14a8.pdf>

<https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/jamesmcritchiewd40092716-14a8.pdf>

SEC Enforcement and Litigation

Delaware Chancery Court Clarifies that Disclosure Claims Should Be Brought Pre-Closing

In an opinion issued Sept. 28, 2016, the Court of Chancery of Delaware clarified its position that claims challenging the sufficiency of proxy solicitation disclosures should be brought during the pre-closing period of a merger transaction in order to insure a fully informed vote of the stockholders.

Following the closing of the merger transaction, the plaintiff sought damages for two purported disclosure violations:

- > a claim that the Court had previously rejected at the preliminary injunction phase, and
- > a second claim which had been initially included in the complaint, but which had not been pursued pre-closing.

The plaintiff stated that such claims should not be considered waived in the post-close context, arguing in part that recent decisions by the Court have suggested that a plaintiff can elect to bring disclosure claims pre- or post-close.

In finding against the plaintiff's argument, the Court clarified that "...where a plaintiff has a claim, pre-close, that a disclosure is either misleading or incomplete in a way that is material to stockholders, that claim should be brought pre-close, not post-close." The Court stated that while damages for a disclosure violation claim may be remedied post-close, the right of the stockholders to a fully informed vote is irrevocably lost following a stockholder vote. Therefore, the Court added that "[t]he preferred method for vindicating truly material disclosure claims is to bring them pre-close, at a time when the Court can insure an informed vote. Because of this interest, a salutary incentive could be provided by considering claims based on disclosure, pled but not pursued pre-close, to be waived."

<http://www.leagle.com/decision/In%20DECO%2020160928067/NGUYEN%20v.%20BARRETT>

SEC Sanctions Three Issuers for Failing to Timely Disclose Equity Issuances

In the last week of September, the SEC Enforcement division brought three separate enforcement actions against companies for failure to timely report issuances of unregistered equity securities on Form 8-

K and Form 10-Q. The actions are similar to the 10 enforcement actions brought by the SEC in late 2014 against companies who failed to timely make the required disclosures about financing deals and other unregistered sales that diluted their stock.

The SEC did not allege fraud in any of the recent three enforcement actions, only that each of the three companies had failed to report on Form 8-K an Item 3.02 Issuance of Unregistered Securities within four days of entering into a binding agreement pursuant to which the company committed to issuing shares of its common stock in an unregistered transaction. In two of the cases, the SEC also alleged that the companies had issued convertible notes on multiple dates and:

- > failed to file a Form 8-K under Item 3.02 reporting the issuance of unregistered securities within four days of the issuance of each of the notes, and
- > failed to furnish the information required by Item 701 of Regulation S-K regarding unregistered equity securities under Item 2 of Form 10-Q.

While the companies had reported the issuance of the convertible notes in the notes to the unaudited financial statements for the relevant period, they had not specifically provided the disclosure required by Item 701 of Regulation S-K in Part II, Item 2 of the Form 10-Q.

Each of the companies, without admitting or denying the allegations, agreed to the entry of a cease and desist order and the payment of a penalty ranging from \$25,000 to \$50,000.

<https://www.sec.gov/litigation/admin/2016/34-78934.pdf>
<https://www.sec.gov/litigation/admin/2016/34-79011.pdf>
<https://www.sec.gov/litigation/admin/2016/34-78955.pdf>

SEC Sanctions Company for Misrepresentation of Performance Metrics

On Oct. 5, 2016, the SEC announced that a large financial institution agreed to pay a \$90 million penalty and admit wrongdoing to settle charges that it misrepresented how it determined a key performance metric of its wealth management business. In addition, the former chief operating officer also agreed, on a neither admit nor deny basis, to settle charges that he was a cause of the company's violations and pay an \$80,000 penalty.

The SEC found that this institution deviated from its publicly disclosed methodology for determining net new assets, or NNA, a metric used by investors to measure a financial institution's success in attracting new business. This company had disclosed that it determined NNA based on individual assessments of each client's intentions and objectives. However, the SEC determined that the company sometimes used an undisclosed, results-driven approach to determine NNA in order to meet senior management's targets. Andrew J. Ceresney, Director of the SEC's Enforcement Division stated that the institution's "failure to disclose this results-driven approach deprived investors of the opportunity to fairly judge the firm's success in attracting new money."

Notably, this financial institution was not required by rule or regulation to disclose NNA and the methodology for its calculation. By doing so, however, the company effectively determined that NNA is important to investors and material to assessing the company's performance. Consequently, by failing to disclose a change in the company's methodology for determining NNA, the SEC found the company's disclosure misleading.

For any company that discloses a performance metric relevant to an investor's assessment of the company's business, this SEC enforcement action makes clear that any change to the calculation of that

metric must be disclosed in order to avoid being misleading.

Company Agrees to Pay \$500,000 Penalty in SEC Whistleblower Retaliation Case

In its second whistleblower retaliation case (and first ever stand-alone retaliation case) since Dodd-Frank, the SEC found that a company employee was removed from significant work assignments within weeks of reporting to senior management, the company's internal hotline, and to the SEC, that the company's financial statements might be in violation of the whistleblower employment anti-retaliation provisions of Section 21F(h) of the Securities Exchange Act of 1934. Section 21F(h) prohibits an employer from discharging, demoting, suspending, threatening, harassing, directly or indirectly, or in any other manner discriminating against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower in providing information regarding potential violations of the securities laws to the SEC.

The employee/whistleblower, who allegedly had received positive performance reviews for several years and had been ranked as a "high-potential" employee, was terminated approximately three months after he raised his concerns.

According to the SEC's Order, the company conducted an internal investigation into allegations made by the whistleblower, who did not oversee the company's accounting functions, and determined its reported financial statements contained no misstatements given that the company had a process to reconcile the costs in question.

Without admitting or denying the SEC's findings, the company agreed to pay a \$500,000 penalty and to cease and desist from committing or causing any further violations of Section 21F(h).

www.sec.gov/litigation/admin/2016/34-78991.pdf

Public Company Accounting

Recently Issued Accounting Standards – The SEC's View on Disclosure

The SEC staff recently addressed best practices for financial statement disclosure in periods leading up to the adoption of recently issued accounting standard updates, or ASUs. In particular, the SEC staff commented on the application of Staff Accounting Bulletin (SAB) Topic 11.M "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period," to three significant ASUs to be implemented over the next few years:

- > ASU 2014-0, Revenue from Contracts with Customers,
- > ASU 2016-2, Leases (Topic 842), and
- > ASU 2016-13, Measurement of Credit Losses on Financial Instruments.

In the Sept. 22 meeting of the FASB's Emerging Issues Task Force, or EITF, the SEC staff announced that, if a company is unable to reasonably estimate the impact of adopting such ASUs, the company should consider additional qualitative financial statement disclosures to assist readers in determining the significance of the effect that the ASU will have on its financial statements when adopted.

In the staff's view, such disclosure should include:

- > a description of the effect of the accounting policies that the company expects to apply, if determined,

- > a comparison with current accounting policies, and
- > the company's progress in implementing the new standards and any significant implementation matters that it still needs to address.

The recent announcement supplements existing guidance in SAB Topic 11.M that a company should evaluate each new accounting standard to determine appropriate disclosure. The disclosure should inform the reader that a new accounting standard has been issued which the company will be required to adopt in the future, and should assist the reader in assessing the significance of the impact that the standard will have on the company's financial statements when adopted.

The SEC staff stated that the objective in making the announcement in September was to give companies

sufficient time to consider the announcement before their year-end financial reporting, and that companies are encouraged but not expected to include these disclosures in financial statements for earlier periods. The SEC staff announcement will be available in the EITF meeting minutes once they are published.

<https://www.sec.gov/interps/account/sabcodet11.htm#M>

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

[Laurie L. Green](#) | +1 954.768.8232 | greenl@gtlaw.com

The following attorneys serve on the Editorial Board of GT Insights for Public Companies.

- > [Elizabeth Fraser](#) | frasere@gtlaw.com
- > [Flora Perez](#) | perezf@gtlaw.com
- > [William Wong](#) | wongw@gtlaw.com
- > [Josh Samek](#) | samekj@gtlaw.com
- > [Anthony Marsico](#) | Marsico@gtlaw.com
- > [Jean Harris](#) | harrisj@gtlaw.com
- > [Kara MacCullough](#) | macculloughk@gtlaw.com
- > [Norman Miller](#) | millern@gtlaw.com
- > [Drew Altman](#) | altmand@gtlaw.com
- > [Victor Semah](#) | semahv@gtlaw.com
- > [Jason Simon](#) | simonj@gtlaw.com
- > [Elaine Greenberg](#) | greenberge@gtlaw.com

Albany +1 518.689.1400	Delaware +1 302.661.7000	New York +1 212.801.9200	Silicon Valley +1 650.328.8500
Amsterdam + 31 20 301 7300	Denver +1 303.572.6500	Northern Virginia +1 703.749.1300	Tallahassee +1 850.222.6891
Atlanta +1 678.553.2100	Fort Lauderdale +1 954.765.0500	Orange County +1 949.732.6500	Tampa +1 813.318.5700
Austin +1 512.320.7200	Houston +1 713.374.3500	Orlando +1 407.420.1000	Tel Aviv[^] +972 (0) 3.636.6000
Berlin⁻ +49 (0) 30 700 171 100	Las Vegas +1 702.792.3773	Philadelphia +1 215.988.7800	Tokyo[⌘] +81 (0)3 4510 2200
Berlin-GT Restructuring[~] +49 (0) 30 700 171 100	London[*] +44 (0)203 349 8700	Phoenix +1 602.445.8000	Warsaw[~] +48 22 690 6100
Boca Raton +1 561.955.7600	Los Angeles +1 310.586.7700	Sacramento +1 916.442.1111	Washington, D.C. +1 202.331.3100
Boston +1 617.310.6000	Mexico City⁺ +52 55 5029.0000	San Francisco +1 415.655.1300	Westchester County +1 914.286.2900
Chicago +1 312.456.8400	Miami +1 305.579.0500	Seoul[∞] +82 (0) 2.369.1000	West Palm Beach +1 561.650.7900
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