GT GreenbergTraurig

# GT Insights for Public Companies

October 31, 2016 A Bi-Weekly Update

## SEC Regulation

### New Guidance on Determining the Median Employee For CEO Pay Ratio Disclosure

On Oct. 18, 2016, the SEC Division of Corporation Finance issued several new compliance and disclosure interpretations, or CDIs, regarding CEO pay ratio disclosure that will be required for 2017 compensation. The new CEO pay ratio rules require companies to disclose the ratio between the annual total compensation of the CEO and the annual total compensation of the median employee. The new CDIs provide companies guidance on how they should select and apply a consistently applied compensation measure, or CACM, in identifying the median employee. Specifically, the SEC confirmed the following.

- Any measure that reasonably reflects the annual compensation of employees may serve as a CACM, depending on a company's particular facts and circumstances. It is not expected that CACM would necessarily identify the same median employee as if the company were to use annual total compensation.
- Hourly or annual pay rates used alone generally are not considered an appropriate CACM, but may be used as a component in determining an employee's overall compensation.
- The time period used in applying CACM to identify the median employee does not have to be a full annual period nor include the date on which the employee population is determined.
- Annual total compensation from the prior fiscal year may be used as the CACM if there has not been a change in either employee population or compensation arrangements that would result in a significant change of the company's workforce pay distribution.
- Companies should include all workers whose compensation is determined by the company or one of its consolidated subsidiaries in determining the median employee, regardless of whether the worker would be considered an "employee" for tax, employment law, or other purposes.
- A company will not be considered to be determining the compensation of workers employed by an unaffiliated third party, if the company merely specifies that those workers receive a minimum level of compensation.
- An individual who is an independent contractor may be the "unaffiliated third party" who determines his or her own compensation, and thus may be excluded from the employee population from which the median employee is identified.
- Companies must determine if a furloughed employee is an "employee" on the date of determination and, if so, whether the employee is a permanent employee on unpaid leave or a temporary or seasonal employee, based on their specific facts and circumstances. The amount of compensation included in the CACM would then be consistent with such category.

https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#128c.01

## SEC Proposes Amendments Limiting Use of "Withhold" Option on Proxy Cards for all Director Elections

On Oct. 26, 2017, the SEC proposed proxy rule amendment aimed at ensuring that proxy cards specify all applicable shareholder voting options in all director elections. The proposed amendments will impact all solicitations for director elections that are subject to the proxy rules.

Under the proposed amendments, proxy cards would be required to include an "against" voting option for the election of directors where there is a legal effect of doing so. No option to "withhold" votes would be permitted where an "against" vote has legal effect. The proposed amendments would also require issuers to provide shareholders the ability to "abstain" in a director election governed by a majority voting standard.

In addition, the proposed amendments would require disclosure about the effect of a withhold vote in an election of directors.

Comments on the proposed amendments must be submitted to the SEC on or before 60 days after the publication of the proposals in the Federal Register.

https://www.sec.gov/rules/proposed/2016/34-79164.pdf

## SEC Proposal Would Require Use of Universal Proxy Card in Contested Director Elections

On Oct. 26, 2016, the SEC proposed amendments to the proxy rules that will require parties in a contested director election to use universal proxy cards that include the names of all Board nominees. Under current Rule 14a-4(d), one party may not include the other party's nominees on its proxy card unless the other party's nominees consent to be named in its proxy statement. Since such consent is rarely provided, shareholders are limited to voting on the slates of nominees chosen by the soliciting parties.

The proposal would give shareholders the ability to vote by proxy for their preferred combination of board candidates nominated by management and dissident shareholders similar to a vote in person. Universal proxy cards would be required in all non-exempt solicitations in contested elections other than those involving foreign private issuers, registered investment companies, and business development companies.

Specifically, the proposed rules would require management and each other proxy contestant to provide each other party with notice of the names of their director nominees:

> with respect to the dissident nominees, no later than 60 calendar days prior to the anniversary of the previous year's annual meeting date, and

> with respect to the company nominees, no later than 50 calendar days prior to the anniversary of the previous year's annual meeting date.

Proxy contestants would be required to refer shareholders to the other party's proxy statement for information about that party's nominees and explain that shareholders can access the other party's proxy statement for free on the SEC's website. In order to use the universal ballot, dissidents would be required to:

> solicit shareholders representing at least a majority of the voting shares entitled to vote on the election of directors, and

> file their definitive proxy statement with the SEC by the later of 25 calendar days prior to the meeting date or five calendar days after the company files its definitive proxy statement.

Universal proxy cards would be subject to presentation and formatting requirements to help ensure that universal proxy cards clearly and fairly present information.

Comments on the proposed amendments must be submitted to the SEC on or before 60 days after the publication of the proposals in the Federal Register.

https://www.sec.gov/rules/proposed/2016/34-79164.pdf

## New Rule 701 Guidance on Options Assumed in a Merger and Date of Sale for RSUs

The SEC Division of Corporation Finance recently issued two CDIs addressing Rule 701, which exempts offers and sales of private company securities pursuant to compensatory benefit plans or arrangements. The CDIs clarify that:

- Public companies that acquire privately held companies and assume outstanding options that were issued in compliance with Rule 701 *do not* need to register the offer and sale of the shares now issuable (i.e. the acquiring company's shares) upon the exercise of the assumed options. Further, the acquiror's Exchange Act reports will satisfy any disclosure requirements under Rule 701(e).

- Restricted Stock Units, or RSUs, that settle based on conditions related to company performance and/or length of service without the payment of additional consideration by the employee are deemed to be sold for purposes of Rule 701(e) on the date of grant. As a result, if the issuer "sells" over $5 million in securities (including RSUs) during a consecutive 12-month period, the company must provide the required risk factors, financial and other information a reasonable time before the date the RSU is granted.

  The staff noted that although RSUs are derivative securities, they are not exercised or converted. Thus Rule 701(e)(6), which provides that information must be provided a reasonable time before derivative securities are exercised or converted, does not apply to RSUs.

https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#271.04

https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#271.24

## SEC Revises CDI on Rule 144(d) Holding Period for Securities Issued Pursuant to Employment Agreements

On Oct. 19, 2016, the SEC Division of Corporation Finance issued a revised CDI addressing the holding period for Rule 144(d). The CDI revised the staff's position to state that the holding period for restricted securities issued pursuant to individually negotiated employment agreements commences when investment risk for the securities passes to the employee (i.e. the date that the employee is deemed to have paid for the security), rather than, as provided by the prior CDI, the date the securities vested.

The revised CDI clarifies that an individual will be deemed to have paid for the security as follows:

- For awards where vesting is conditioned solely on (1) continued employment and/or satisfaction of performance conditions that are not tied to the employee's individual performance and (2) do not require the employee to pay any additional consideration, the holding period would commence on the date of the agreement; and

- For awards that require additional payment upon exercise, conversion, or settlement – the holding period would commence on the date on which such payment is made.

The revised CDI brings the staff's position in line with Question 23 of Securities Act Release No. 6099 (Aug. 2, 1979) regarding Resales of Restricted and Other Securities and is consistent with the holding period determination provisions of Rule 144 itself.

https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm

## SEC Amendments to Facilitate Intrastate Offering Rule

On Oct. 26, 2016, the SEC adopted final rules intended to facilitate intrastate securities offerings, including amendments to existing Rule 147 under the Securities Act, and creation of a new Rule 147A. Rule 147, which was originally adopted in 1974, provides a safe harbor under the Securities Act for offers and sales of securities made only to residents of the state in which the issuing company is incorporated, has its principal office and is doing business. Given the limited scope of the exemption, it has historically been used infrequently.

New Rule 147A is substantially similar to Rule 147, but will allow offers (but not sales) to out-of-state residents, and will apply to companies that are incorporated in a different state. As a result, issuing companies may engage in general solicitations over the Internet or by other means that are accessible outside of the applicable state, so long as sales are limited to residents of the state. In addition, the company need not be incorporated in the state in which the offering occurs, as long as it has its principal place of business in the state (and otherwise meets the "doing business" test).

The amendments to Rule 147 adopted by the SEC do not change the fundamental requirements of the Rule, which will still be limited to offers and sales to residents within the company's state of incorporation.

Both amended Rule 147 and new Rule 147A will include the following provisions:

- A requirement that the issuer has its "principal place of business" in-state and satisfies at least one "doing business" requirement that would demonstrate the in-state nature of the issuer's business,
- A new "reasonable belief" standard for issuers to rely on in determining the residence of the purchaser at the time of the sale of securities,
- A requirement that issuers obtain a written representation from each purchaser as to residency,
- A limit on resales to persons residing within the state or territory of the offering for a period of six months from the date of the sale by the issuer to the purchaser,
- An integration safe harbor that would include any prior offers or sales of securities by the issuer made under another provision, as well as certain subsequent offers or sales of securities by the issuer occurring after the completion of the offering, and
- Legend requirements to offerees and purchasers about the limits on resales.

The SEC also amended Rule 504 under Regulation D to increase the amount of securities that can be offered and sold within a 12-month period from $1 million to $5 million, and to disqualify certain bad actors from participating in Rule 504 offerings (substantially similar as existing provisions in Rule 506 under Regulation D). As a result of these changes, the SEC repealed existing Rule 505, a separate exemption under Regulation D for private offerings of securities with an aggregate purchase price of $5 million within a 12-month period.

The amendments to Rule 147 and the adoption of new Rule 147A will become effective 150 days after publication in the Federal Register. The amendments to Rule 504 will become effective 60 days after publication in the Federal Register, and the repeal of Rule 505 will be effective 180 days after publication in the Federal Register.

https://www.sec.gov/rules/final/2016/33-10238.pdf

## Governance

### ISS Issues Draft Voting Policy Changes for 2017

On Oct. 27, 2016, ISS released for public comment its draft voting policy changes for 2017. Comments on the draft policies must be provided by Nov. 10, 2016. Final policies will be released the week of November 14, 2016. The draft U.S. policy includes the following proposed key changes:

***Election of Directors/Committee Members***

- ISS would recommend a vote against, or withhold from, members of the governance committee where companies have placed "undue" restrictions (e.g. outright prohibition or share ownership or time holding requirements in excess of SEC Rule 14a-8) on shareholders' ability to amend the company's bylaws.
- ISS would issue adverse director vote recommendations when a company completes its IPO with a multi-class capital structure with unequal voting rights among classes. ISS would no longer consider the results of shareholder votes on adverse governance features when issuing a vote recommendation. Instead, ISS would consider the inclusion of a reasonable sunset provision on the adverse capital structure or governance provisions.

***U.S-Listed Companies Incorporated Abroad***

- ISS would recommend a vote in favor of general share issuance authorities (i.e., those without a specified purpose) up to 20 percent of currently issued capital, if the duration of the authority is clearly disclosed and reasonable.
- ISS would consider on a case-by-case assessment, under U.S. policy, all compensation proposals on a ballot (whether included per U.S. or foreign requirements) pertaining to the same executive pay program, including aligned voting recommendations on all such proposals. If there is no applicable U.S. policy, then the policy of the country that requires it to be on the ballot would apply. As a result, most markets' say-on-pay proposals would be evaluated under the U.S. Management Say-on-Pay voting policy.

https://www.issgovernance.com/policy-gateway/2017-benchmark-policy-consultation/

## SEC Enforcement and Litigation

### SEC Continues Focus on Audit Firms As Gatekeepers

On Oct. 18, 2016, the SEC announced an $11.8 million settlement with an auditing firm and two of its partners related to failed audits of a public company. The SEC had previously charged the company with accounting fraud related to deceptive income tax accounting and imposed a $140 million penalty on the company.

The SEC found that, despite having designated the company as a high-risk client, the auditor repeatedly failed to detect the fraud until it had been ongoing for more than four years. The SEC's Order noted that the auditor relied on unsubstantiated explanations from the company instead of performing required audit procedures related to the company's post-closing adjustments to lower its year-end provision for income taxes each year.

This announcement followed the Sept. 19, 2016 announcement regarding the first enforcement actions on auditor independence failures due to close personal relationships, which was described in the Oct. 17, 2016 edition of GT Insights and a subsequent speech by Andrew J. Ceresney, Director of the SEC's Division of Enforcement, on the SEC's enforcement work in the area of auditing.

In his Sept. 22, 2016 speech, Ceresney reiterated the SEC's position that auditors play an important role in the financial reporting process and are critical gatekeepers, stating that the SEC was going to expect auditors to:

- ensure they have sufficient capacity and competence to audit the client before agreeing to be engaged by the client,
- properly plan and execute audits, with significant risks identified through adequate audit procedures,
- "exercise appropriate professional skepticism," properly document their work and gather sufficient audit evidence, and when "red flags" are present and require more evidence from the client than unsubstantiated representations from management,
- use their internal resources and knowledge when troublesome issues arise, and
- have "robust" monitoring processes and training on independence issues.

In light of the recent enforcement actions and Mr. Ceresney's speech, companies should likely expect auditors to "step up" their audit processes and seek additional evidence from clients with respect to significant risks identified in the audit.

https://www.sec.gov/news/pressrelease/2016-219.html

https://www.sec.gov/news/speech/ceresney-enforcement-focus-on-auditors-and-auditing.html

## Public Company Accounting

### Form S-3s Filed After Adoption of New Revenue Recognition Standard Will Require Retrospective Revision of Financial Statements

In a recent meeting with the Center for Audit Quality SEC Regulations Committee (the CAQ Committee), the SEC staff addressed the impact of new revenue recognition standard, Accounting Standards Codification Topic 606 (ASC 606) on registration statements on Form S-3 filed after the adoption of the new standard. According to Item 11(b)(ii) of Form S-3, at the time the Form S-3 becomes effective, registrants must retrospectively revise audited financial statements that are incorporated by reference into the Form S-3 to reflect a subsequent change in accounting principle in order to reflect the impact of the new principle on such prior comparable period. The staff has historically viewed discontinued operations and changes in segment presentation as changes that would require such retrospective revision. At the meeting with the CAQ Committee, the staff indicated that the adoption of ASC 606 would be a change that would require full retrospective revision of financial statements incorporated by reference into a Form S-3.

As a result, unless a registrant can show that the retrospective application of ASC 606 to all prior year periods is "impracticable" (as further discussed in ASC 250-10-45-9), a registrant must retrospectively revise prior year financial statements prior to going effective on a Form S-3 (or any other registration statement) filed after its first Form 10-Q incorporating the new standard. The staff indicated that they are available to consult with registrants that find retrospective revision of prior year comparable periods to be impracticable. The staff did not, however, offer any additional guidance on what circumstances might be deemed "impracticable," and therefore the guidance set forth in ASC 250-10-45-9 remains the guidepost for this determination.

Because the updating requirements of Item 11(b)(ii) of Form S-3 do not apply to "takedown offerings" from an existing effective Form S-3 shelf registration statement, the consideration of whether to retrospectively revise financial statements in connection with such offerings hinges on whether the adoption of ASC 606 constitutes a "fundamental change," thereby triggering the registrant's undertaking to update its prospectus for such change.

http://www.thecaq.org/sec-regulations-committee-highlights-june-14-2016

https://www.sec.gov/news/speech/speech-bricker-05-05-16.html

GT GreenbergTraurig

# GT Insights

**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 | marsicoa@gtlaw.com
> Jean Harris | harrisj@gtlaw.com
> Kara MacCullough | maccolloughk@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

GT GreenbergTraurig

# GT Insights

| | | | |
|---|---|---|---|
| **Albany**<br>+1 518.689.1400 | **Delaware**<br>+1 302.661.7000 | **New York**<br>+1 212.801.9200 | **Silicon Valley**<br>+1 650.328.8500 |
| **Amsterdam**<br>+ 31 20 301 7300 | **Denver**<br>+1 303.572.6500 | **Northern Virginia**<br>+1 703.749.1300 | **Tallahassee**<br>+1 850.222.6891 |
| **Atlanta**<br>+1 678.553.2100 | **Fort Lauderdale**<br>+1 954.765.0500 | **Orange County**<br>+1 949.732.6500 | **Tampa**<br>+1 813.318.5700 |
| **Austin**<br>+1 512.320.7200 | **Houston**<br>+1 713.374.3500 | **Orlando**<br>+1 407.420.1000 | **Tel Aviv^**<br>+972 (0) 3.636.6000 |
| **Berlin¬**<br>+49 (0) 30 700 171 100 | **Las Vegas**<br>+1 702.792.3773 | **Philadelphia**<br>+1 215.988.7800 | **Tokyo¤**<br>+81 (0)3 4510 2200 |
| **Berlin-GT Restructuring¯**<br>+49 (0) 30 700 171 100 | **London***<br>+44 (0)203 349 8700 | **Phoenix**<br>+1 602.445.8000 | **Warsaw~**<br>+48 22 690 6100 |
| **Boca Raton**<br>+1 561.955.7600 | **Los Angeles**<br>+1 310.586.7700 | **Sacramento**<br>+1 916.442.1111 | **Washington, D.C.**<br>+1 202.331.3100 |
| **Boston**<br>+1 617.310.6000 | **Mexico City+**<br>+52 55 5029.0000 | **San Francisco**<br>+1 415.655.1300 | **Westchester County**<br>+1 914.286.2900 |
| **Chicago**<br>+1 312.456.8400 | **Miami**<br>+1 305.579.0500 | **Seoul∞**<br>+82 (0) 2.369.1000 | **West Palm Beach**<br>+1 561.650.7900 |
| **Dallas**<br>+1 214.665.3600 | **New Jersey**<br>+1 973.360.7900 | **Shanghai**<br>+86 (0) 21.6391.6633 | |

*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. ¯ Berlin - GT Restructuring is operated by Köhler-Ma Geiser Partnerschaft Rechtsanwälte, Insolvenzverwalter. *Operates as Greenberg Traurig Maher LLP. **Greenberg Traurig is not responsible for any legal or other services rendered by attorneys employed by the strategic alliance firms. +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. ©2016 Greenberg Traurig, LLP. All rights reserved.*