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GT Insights for Public Companies

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Governance

ISS Releases 2017 Voting Policy Updates

On Nov. 21, 2016, Institutional Shareholder Services, or ISS, released its voting policy updates for the 2017 proxy season. This release followed ISS' review of the results of its policy survey, which was summarized in the Oct. 31, 2016 edition of GT Insights. The following is a brief summary of the policy updates:

> ***Overboarding of Executive Chairs***. ISS will generally recommend against a director that sits on more than five (formerly six) public company boards or, if the director is also the CEO of the public company, more than two public company boards besides their own.

> ***IPO Company Dual Class Structures and other Provisions***. ISS will generally recommend against directors of the board of newly public companies that, in connection with an IPO, adopted capital structures with multiple classes of stock that have different voting rights or adopted charter or bylaw provisions materially adverse to the rights of shareholders. A commitment to put the provisions to shareholder vote within three years will no longer be sufficient, and a sunset provision on the unequal voting rights would be necessary to avoid a negative recommendation.

ISS will consider the following factors in making its recommendation: (1) the level of impairment of shareholders' rights; (2) the disclosed rationale; (3) the ability to change the governance structure (*e.g.*, limitations on shareholders' right to amend, or supermajority vote requirements to amend, the bylaws or charter); (4) the ability of shareholders to hold directors accountable (*i.e.*, is the board classified or are there annual elections); (5) any reasonable sunset provision; and (6) other relevant factors.

> ***Company-Imposed Restrictions on Binding Shareholder Proposals***. ISS will recommend against the members of the governance committee if the company's governing documents impose undue restrictions on shareholders' ability to amend the company's bylaws, such as prohibiting the submission of binding shareholder proposals or imposing share ownership or holding periods in excess of that required under Rule 14a-8. These recommendations would continue until the restrictive provisions were eliminated.

> ***Stock Distributions: Splits and Dividends***. ISS will generally recommend in favor of a management proposal to increase the company's authorized common shares for stock splits or stock dividends, provided the "effective" increase (formerly just "increase") in authorized shares is within the allowable increase calculated in accordance with ISS' Common Stock Authorization policy.

> ***Equity and Other Compensation Plans***. ISS will add dividends payable prior to vesting as a plan feature in connection with its evaluation of a company's Equity Plan Scorecard (EPSC). A company will earn full EPSC points if the plan expressly prohibits, for all award types, the payment of dividends before the vesting of the

underlying award, but will earn no EPSC points if the plan is silent or does not include the prohibition, even if the company in practice does not pay dividends until vesting. In addition, a minimum vesting period of one year for all award types must be specified under the plan in order to receive full EPSC points for this factor, but no points will be earned if the plan allows for individual award agreements that reduce or eliminate the one-year vesting requirement.

> ***Proposals for Shareholder Ratification of Director Compensation.*** ISS will evaluate, on a case-by-case basis, management proposals seeking advisory shareholder ratification of non-employee director compensation, based on the following factors: (1) if the equity plan under which non-employee director grants are made is on the ballot, whether it warrants support; (2) the relative magnitude of director compensation as compared to similar companies; (3) the presence of problematic director compensation pay practices; (4) director stock ownership guidelines and holding requirements; (5) vesting schedules; (6) the mix of cash and equity-based compensation; (7) meaningful limits on director compensation; (8) the availability of retirement benefits or perquisites; and (9) the quality of director compensation disclosure.

> ***Non-Employee Director Equity Plans.*** ISS will broaden the factors considered when assessing non-employee director equity plans. Under its revised policy, ISS will evaluate these plans on a case-by-case basis based on: (1) the total estimated cost of the company's equity plans relative to industry/market cap peers. This will be measured by the company's estimated Shareholder Value Transfer (SVT) based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; (2) the company's three-year burn rate relative to its industry/market cap peers; and (3) the presence of any egregious plan features (such as an option repricing provision or liberal change in control vesting risk). Where the plans exceed the plan cost or burn rate benchmarks when combined with employee/executive stock plans, ISS will also consider the same qualitative factors considered in evaluating management proposals seeking advisory shareholder ratification of non-employee director compensation (as described above).

> ***Amendments to Cash and Equity Plans.*** ISS has more clearly defined its framework for evaluating proposals to amend plans, such as its approach to those presented only for 162(m) purposes, as compared to those involving multiple amendments for other purposes. ISS will generally recommend in favor of proposals that seek to address administrative features and those seeking approval only for 162(m) purposes (but only if the administering committee consists entirely of independent outsiders as defined by ISS). ISS will evaluate on a case-by-case basis amendments to cash incentive plans (including initial post-IPO proposals) and other bundled material amendments.

For proposals to amend equity incentive plans, ISS will vote on a case-by-case basis. If the proposal requests additional shares and/or the amendments may potentially increase the transfer of shareholder value to employees, the recommendation will be based on the EPSC evaluation as well as an analysis of the overall impact of the amendments. If the plan is being presented for vote for the first time post-IPO, the recommendation will be based on the EPSC evaluation as well as an analysis of the overall impact of any amendments (whether or not additional shares are being requested). If, however, there is no request for additional shares and the amendments are not deemed to potentially increase the transfer of shareholder value to employees, then the recommendation will be based entirely on an analysis of the overall impact of the amendments.

https://www.issgovernance.com/file/policy/2017-americas-iss-policy-updates.pdf

Glass Lewis Releases its 2017 Proxy Voting Guidelines

On Nov. 18, 2016, Glass Lewis released updates to its proxy voting policy guidelines for the 2017 proxy season. The changes to the 2017 U.S. policy guidelines are summarized below:

> ***Director Overboarding***. Beginning in 2017, Glass Lewis will generally recommend voting against a director who serves: (i) on more than five public company boards or (ii) as an executive officer of any public company while serving on more than two public company boards. Glass Lewis will generally not recommend a vote against an overboarded director at the company where he or she serves as an executive.

  Glass Lewis may consider relevant factors in determining whether to refrain from recommending a vote against an overboarded director and may also refrain from such a recommendation if the company provides "sufficient rationale" for that director's continued board service.

> ***Board Evaluation and Refreshment***. Glass Lewis clarified its approach to board evaluation, succession planning, and refreshment. The proxy advisor believes that "a robust board evaluation process" that focuses on assessing and aligning director skills with company strategy is more effective than solely relying on age or tenure limits.

> ***Governance Following an IPO or Spin-Off***. With respect to newly-public companies, Glass Lewis indicated that it will review the terms of the company's governing documents to determine whether they severely restrict shareholder rights from the outset. If Glass Lewis believes the governing documents significantly restrict shareholders' ability to effect change, it will consider recommending a vote against the members of the governance committee or the directors that served at the time of the governing documents' adoption. The specific areas of governance that Glass Lewis may review include anti-takeover mechanisms, supermajority vote requirements, and general shareholder rights.

> ***Issuer Data Report***. Glass Lewis also announced "open enrollment" in its "Issuer Data Report" (IDR) service which allows participating public companies to obtain a data-only version of their Glass Lewis Proxy report prior to Glass Lewis completing its analysis and voting recommendations in connection with annual meetings. Glass Lewis provides this IDR service free-of-charge to a limited number of public companies on a first-come, first served basis. Enrollment for the IDR service ends on January 6, 2017 or when the annual limit is reached.

2017 Guidelines: http://www.glasslewis.com/wp-content/uploads/2016/11/2017_Guideline_US.pdf

Enrollment for the IDR service: https://meetyl.com/issuer_data_report

Company Rejects First Proxy Access Nomination

As summarized in the Nov. 14, 2016, edition of GT Insights, on Nov. 10, 2016, a shareholder proponent filed the first ever Schedule 14N announcing that it used a company's proxy access bylaw to nominate a director for election at the company's 2017 annual meeting. The company subsequently rejected the nominee stating that the shareholder could not properly make the representation required under the bylaw that it did not possess intent to change or influence control of the company when it acquired its shares. The company pointed to prior statements made by the shareholder that the company should spin off one or more of its businesses and a proposal submitted by the shareholder to the company to do so. On Nov. 28, 2016, the shareholder filed an amended Schedule 13D with the SEC stating that it was withdrawing its nominee and would not pursue proxy access.

https://www.sec.gov/Archives/edgar/data/70145/000119312516776709/d296488dex99.htm

https://www.sec.gov/Archives/edgar/data/70145/000080724916000490/nfg_10.htm

SEC Regulation

Division of Corporation Finance Provides Guidance on Tender Offers

On Nov. 18, 2016, the SEC Division of Corporation Finance for the first time issued Compliance and Disclosure Interpretations, or CDIs, relating to the tender offer rules under Regulation 14D and 14E.

- Schedule 14D-9:
  - If an issuer engages a financial advisor to provide advice that will be discussed in the Schedule 14D-9, it must disclose a summary of all "material terms" of the compensation arrangement *even if* the advisor expressly states that it is not soliciting or making recommendations to the shareholders.
  - An issuer, when attempting to meet the "material term" disclosure obligation stated above, may not do so through generic references to "customary compensation," as such ambiguity does not help shareholders properly assess the objectivity of the advisor's analysis.
- Interpretations on the Abbreviated Tender Offer No Action Letter
  - When a foreign private issuer announces an abbreviated offering, it may do so by furnishing a press release on a Form 6-K rather than a Form 8-K.
  - Abbreviated tender offers can have minimum tender conditions.
  - In the event of an abbreviated tender offer, the amount of cash consideration offered concurrently to persons other than Qualified Institutional Buyers (QIBs) and non-U.S persons can be calculated with reference to a fixed spread to a benchmark, provided the calculation is the same as that used in determining the amount of Qualified Debt Securities.
  - Offerors can issue Qualified Debt Securities under Section 3(a) (9) of the 1933 Act to QIBs and/or non-U.S. persons and can still conduct an abbreviated offer. They need not rely on Section 4(a)(2) or Rule 144A.
  - Regarding the no-action letter's conditions for an abbreviated offer, offerors may announce the abbreviated offer at any time, however should not commence the abbreviated offer prior to 5:01 p.m. on the 10th business day after the first public announcement of a purchase, sale or transfer of a material business or amount of assets described in the no-action letter. If commenced after 5:01 p.m. on a particular business day, the first day of the business day period would be the next business day.

https://www.sec.gov/divisions/corpfin/guidance/cdi-tender-offers-and-schedules.htm

https://www.sec.gov/divisions/corpfin/cf-noaction/2015/abbreviated-offers-debt-securities012315-sec14.pdf

Division of Corporation Finance Provides Guidance on Regulation D and Regulation A

- On Nov. 17, 2016, the SEC Division of Corporation Finance issued a new Compliance and Disclosure Interpretations (CDI) regarding the integration of successive offerings under Regulation D. The new CDI provides that a private offering conducted pursuant to Rule 506(b) will not be integrated with an offering subsequently conducted using general solicitation pursuant to

Rule 506(c) within six months of the Rule 506(b) offering, as long as the issuer satisfies the requirements of the applicable rule for each offering.

> Rule 502(a) has historically provided a safe harbor from integration for two Regulation D offerings if the first offering is completed more than six months before the start of the second Regulation D offering. The rule also provides factors to be considered in determining whether the offerings should be integrated if the six month safe harbor is not met.

> The new CDI provides that the Rule 502(a) integration factors are not the sole means by which an issuer may determine whether the two offerings should be integrated. The staff looked to Rule 152, which provides that transactions by an issuer not involving a public offering will remain exempt from registration notwithstanding that the issuer subsequently makes a public offering and/or files a registration statement, to support the position that the two offerings would not be integrated.

> The Division also issued three new CDIs relating to Regulation A:

> When qualifying an additional class of securities by post-qualification amendment to a previously qualified offering statement on Form 1-A, the issuer need only include information related to the additional class of securities. Issuers must also disclose any unregistered securities issued or sold within the past year, including any unregistered securities that were issued or sold pursuant to Regulation A.

> When calculating whether a change in price in a Regulation A offering exceeds 20 percent of the maximum aggregate offering price to determine whether a post-qualification amendment to revise pricing information is necessary, the 20 percent change may be measured from either the high end (in the case of an increase in the offering price) or the low end (in the case of a decrease in the offering price) of that range. Further, that provision may not be used to make an offering in excess of the limits set forth in Rule 251(a) or which would result in a Tier 1 offering becoming a Tier 2 offering.

> Consistent with the treatment of "emerging growth companies" under the FAST Act, an issuer relying on Regulation A may omit financial information for historical periods if it reasonably believes that those financial statements will not be required at the time of qualification of the Form 1-A. The issuer must amend the offering statement before qualification to include all required financial information and redistribute any solicitation materials at the time that any previously omitted financial information has been included in an amended offering statement.

https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#182.12
https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#182.13
https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#182.14
https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#256.34

SEC Enforcement and Litigation

SEC Enforcement Actions Against Public Companies Continued to Increase in 2016

According to a recent report issued by the NYU Pollack Center for Law & Business and Cornerstone Research, SEC enforcement actions against public companies or their subsidiaries have outpaced the overall growth in all enforcement actions over the last four fiscal years, increasing 130 percent from 2013 (compared to 61 percent for all independent enforcement actions). The report analyzes data on all SEC enforcement actions filed and specifically those filed against public company defendants. It also includes information on cooperation by public company defendants in settlement negotiations.

In 2016 alone, the SEC brought 92 actions against public companies or their subsidiaries, the highest in any year of available data, and an increase from 84 actions in 2015. The most common allegations in the actions were related to issuer reporting and disclosure, followed by actions against investment advisors and investment companies and FCPA violations. The overwhelming majority of defendants (97 percent) settled with the SEC concurrently with the filing of the enforcement action. The SEC made note of the defendants' cooperation in 55 percent of these settlements.

It remains to be seen what 2017 will bring, given the coming change in administration and Chairman White's departure. However, if historical trends are any indication, we can expect the SEC will continue its current pace of enforcement actions.

https://www.cornerstone.com/Publications/Reports/SEC-Enforcement-Activity-Against-Public-Company-Defendants-2016

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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