GT GreenbergTraurig

GT Insights for Public Companies

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SEC Enforcement and Litigation

SEC Announces Settlement with Issuer Regarding Undisclosed Perks and Improper Use of Non-GAAP Financial Measures

On Jan. 18, 2017, the SEC settled charges alleging that the issuer (i) failed to disclose certain perquisites paid to its then Chairman and CEO and (ii) violated disclosure rules regarding non-GAAP financial measures.

- ***Failure to disclose perquisites***. The issuer failed to disclose approximately $11.3 million of compensation paid to its Chairman and CEO from 2009 through 2014 for a variety of perquisites, including private aircraft usage, cosmetic surgery, yacht- and sports-car-related expenses, jewelry, cash for tips and gratuities, medical expenses for the Chairman and CEO, family members, and others, charitable donations in his name, pet care, vacation and personal travel expenses, and club memberships. After the issuer conducted an internal investigation in response to SEC inquiries, the Chairman and CEO resigned, paid back the amounts he improperly received as perquisites and also returned approximately $10.6 million of annual cash bonuses.
- ***Failure to comply with non-GAAP financial measure disclosure requirements***. The SEC found that the issuer had improperly used certain non-GAAP financial measures in violation of disclosure requirements contained in Regulation G and Item 10(e) of Regulation S-K, despite the fact that the issuer had previously agreed to comply with such requirements in prior correspondence with the SEC. In particular, the issuer (i) failed to afford equal or greater prominence to GAAP measures in its earnings releases containing non-GAAP financial measures and (ii) incorporated an additional reconciling item into its calculation of "organic revenue growth," a non-GAAP financial measure calculated by the issuer, without informing investors of the change, which resulted in higher "organic revenue growth" results.

The issuer agreed to pay a $1.5 million penalty to the SEC in connection with the settlement.

Delaware Chancery Court Strikes Down Supermajority Director Removal Bylaw

On Jan. 24, 2017, the Delaware Chancery Court invalidated a corporate bylaw requiring a supermajority vote of the outstanding shares to remove a director. The court found the bylaw inconsistent with the requirements of Section 141(k) of the Delaware General Corporation Law (DGCL), which states "any director or the entire board of directors may be removed, with or without cause, by the holders of a *majority* of the shares then entitled to vote at an election of directors [emphasis added]." The case comes after the court in late 2015 invalidated charter and bylaw provisions that sought to make directors removable only for "cause," holding that such limitation was only appropriate for companies with classified boards or that allowed for cumulative voting.

http://courts.delaware.gov/Opinions/Download.aspx?id=251800

Delaware Chancery Court Holds Fee-Shifting Bylaw Invalid

On Dec. 27, 2016, the Delaware Chancery Court ruled that a fee-shifting bylaw was invalid. The fee-shifting bylaw provided that a stockholder who brought an internal corporate claim against the company outside of Delaware would be responsible for the company's attorneys' fees and expenses relating to the claim, unless the stockholder obtains a judgment on the merits. The company also adopted a bylaw that required internal claims to be filed in Delaware. The two bylaws together provided that if a stockholder violated the exclusive forum bylaw by bringing an internal action outside of Delaware, the fee-shifting bylaw would apply.

The company adopted these bylaws six months after Delaware enacted legislation prohibiting the use of fee-shifting bylaws. At the same time, Delaware enacted legislation permitting Delaware corporations to adopt bylaws requiring that internal claims must be filed exclusively in Delaware.

The Court held that the plain language of the fee-shifting bylaw violates the language of DGCL Section 109(b), which unambiguously prohibits the inclusion of any bylaw provision that would shift to a stockholder a company's attorneys' fees or expenses incurred in connection with an internal corporate claim, regardless of where the claim is filed. The Court rejected the company's argument that the amendment to the DGCL prohibiting fee-shifting bylaws should be read together with the amendment permitting exclusive forum bylaws to permit fee-shifting when claims are filed outside of Delaware. The Court noted that Section 109(b) makes no distinction between claims filed within or outside of Delaware.

http://courts.delaware.gov/Opinions/Download.aspx?id=250680

SEC

SEC Permits Exclusion of Shareholder Proposals Regarding Virtual-Only Shareholder Meetings and Greenhouse Gas Reductions

The SEC recently issued no-action letters permitting companies to exclude shareholder proposals relating to virtual-only shareholder meetings and greenhouse gas reductions under the "ordinary business operations" exception.

Virtual-Only Shareholder Meetings. The SEC permitted the exclusion of shareholder proposals seeking to require that two companies adopt a corporate governance policy to initiate or restore in-person annual meetings, and to publicize the policy to investors. Each company has been holding its annual meetings solely online, an increasingly common practice in recent years (sometimes referred to as virtual-only annual meetings). Each company argued that the proposal was excludable under Exchange Act Rule 14-8(i)(7), as a proposal dealing with a matter relating to the company's ordinary business operations. The SEC has previously noted that the underlying policy of the "ordinary business" exception is to confine the resolution of ordinary business problems to management and the board of directors, because certain tasks are fundamental to management's ability to run a company's day-to-day operations, and that shareholders should not be able to micromanage a company. The companies noted that the SEC has in prior years granted no-action relief allowing exclusion of proposals that sought to prohibit a company from holding its annual meeting in a particular city. In each case, the SEC permitted the exclusion of the proposals as relating to the company's ordinary business operations.

Greenhouse Gas Reductions. The SEC also recently permitted the exclusion of shareholder proposals seeking to require that the board of directors issue a report to shareholders assessing the feasibility of, and setting forth policy options for the company to reach, a net-zero greenhouse gas emissions status by the year 2030. Again, in each case the company argued that the proposal was excludable from its proxy materials because it deals with ordinary business operations. In each case, the SEC concurred with the company's request to omit the proposal as relating to the company's ordinary business operations. The SEC stated in each no-action letter that it viewed the proposal as seeking to micromanage the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment.

Audit Analytics Reports on Top Issues in 2016 SEC Comment Letters

Audit Analytics recently released its "big picture" review of SEC comment letter activity for the first six months of 2016. The SEC issued 2,491 comment letters to 808 reporting companies in the first six months of 2016, a considerable decline compared to 3,166 and 4,348 letters filed in the first six months of 2015 and 2014, respectively.

Non-GAAP measures have become the new top area of concern, with 16.4 percent of all letters containing at least one non-GAAP comment, as compared to 8.9 percent in the first six months of 2015. This increase was expected, as the SEC released guidance on non-GAAP reporting in its May 2016 Compliance & Disclosure Interpretations and has indicated in recent speeches that it is paying close attention to the excessive or misleading use of custom metrics.

Additionally, a large number of comments involved the review of earnings transcripts, presentation materials or corporate websites, rather than focusing mainly on SEC filings. Comments relating to fair value measurement, the valuation of long-lived assets and goodwill, tax-related topics, and revenue recognition were also at the top of the list.

http://www.auditanalytics.com/blog/sec-comment-letters-a-look-at-top-issues-in-2016/

In addition to its review of SEC comment letters, Audit Analytics reviewed the first batch of SEC comment letters received following the SEC's May 2016 release of its non-GAAP reporting guidance.

The analysis covered the 1,426 comment letters issued to 479 companies between July 1 and Oct. 31, 2016. Over 40 percent of the companies received letters with at least one non-GAAP comment, most of which were related to filings from the first half of 2016. Almost half of the non-GAAP comments related to the following four issues:

> undue prominence of non-GAAP measurements in earnings reports;

> net of tax presentation;

> exclusion of normal, recurring or cash operating expenses; and

> individually tailored recognition and measurement methods.

http://www.auditanalytics.com/blog/sec-comment-letters-review-of-first-batch/

Governance

CII Releases New FAQs on Director Voting

On Jan. 5, 2017, the Council of Institutional Investors (CII) issued FAQs on majority voting for directors. CII advocates the use of consequential majority voting, which removes board discretion if a director does not receive majority approval. CII noted that while almost 90 percent of S&P 500 companies use majority voting, only 29 percent of Russell 2000 companies use majority voting in uncontested elections. Most mid-cap and small-cap companies elect directors by plurality vote.

CII described the following voting methods:

> ***Strict Plurality Voting***: Nominees who receive the most "for" votes are elected until all board seats are filled. CII states this method is the best approach for contested elections and is appropriate for those companies with cumulative voting. However, CII states that plurality voting is

not appropriate for uncontested elections with no cumulative voting. In an uncontested election, every nominee is elected upon receiving just one "for" vote, thus effectively serving as a rubber stamp on the board's nominations.

- ***"Plurality Plus" Voting***: Similar to strict plurality voting, except that a majority-opposed director must tender his resignation. Despite this requirement, the director is still legally elected to serve another term, and the board retains full control in determining whether to accept the director's resignation. Due to the strong tendency of boards to reject such resignations, CII encourages plurality companies to skip "plurality plus" and adopt consequential majority voting.
- ***Majority Voting (with board-rejectable resignation)***: Under majority voting, a nominee in an uncontested election must receive more "for" than "against" votes to be legally elected. However, most companies pair this method with a resignation requirement that preserves the board's ultimate control in deciding whether a defeated director stays or goes. This is the form of majority voting found at most S&P 500 companies. Thus, CII recognizes that this method poses problems similar to those presented in "Plurality plus" voting. Nonetheless, CII currently accepts this form of majority voting if already in place, and if the board has a good-faith commitment to replace unelected directors within a reasonable period of time.
- ***Consequential Majority Voting***: CII's preferred voting standard for uncontested elections, this method requires an uncontested nominee to receive more "for" than "against" votes, and requires the director to submit an irrevocable resignation upon appointment to the board. Resignation is triggered automatically if the director does not receive the required vote.

CII notes that any majority standard (whether majority or consequential majority) must be coupled with some form of "holdover" provision to ensure a smooth transition in the event of a director's defeat. Holdover provisions typically allow 90 days for the transition, and CII believes a window of up to 180 days is reasonable in certain circumstances.

http://www.cii.org/files/issues_and_advocacy/board_accountability/majority_voting_directors/CII%20Majority%20Voting%20FAQ%201-4-17.pdf

Accounting

Center for Audit Quality Publishes Tool to Assist Audit Committees' Oversight of New Revenue Recognition Standard

The Center for Audit Quality (CAQ) recently released a new publication, *Preparing for the New Revenue Recognition Standard, A Tool for Audit Committees,* designed to help audit committee members fulfill their oversight responsibilities. This publication comes on the heels of the SEC Staff's heightened encouragement to companies and their audit committees to address the impending effectiveness in 2018 of the new revenue recognition standard, ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606).

Many companies will need to determine the impact based on 2016 financial information and all companies are required to provide meaningful transition disclosure. Audit committees will play a key role in overseeing the potentially significant implementation efforts of the new revenue recognition standard. In recognition of this, and based on key messages from regulators, the CAQ has developed and published its tool for audit committees.

The publication provides important questions for audit committees to ask of management related to the company's implementation efforts:

- ***Understanding the New Revenue Recognition Standard — What Is It?*** This section provides a brief overview of the standard's core principles. To assist in their understanding of these core principles, audit committee members should ask management to explain the standard and how it affects, or does not affect, the company.

> ***Evaluating the Company's Impact Assessment — How Will Revenue Recognition Change?*** This section provides a list of specific questions and general advice to help the audit committee discuss management's impact assessment of the new standard in light of the company's business.

> ***Evaluating the Implementation Project Plan — How Do We Need to Prepare?*** This section provides a list of questions designed to assist audit committees in understanding and evaluating management's implementation project plan. Included among the list are questions regarding plan milestones, progress updates, views of external auditors and third-party vendors on management's implementation plan, experience level of the accounting team, accounting judgments, systems and controls and tone at the top.

> ***Other Implementation Considerations — What Else Do We Need to Consider?*** This section provides helpful questions audit committees may ask in overseeing various other considerations, such as new disclosure requirements, transition methods, as well as key policy decisions to make in advance of adopting the new standard.

The tool also provides a list of helpful resources on revenue recognition developed by CAQ member firms and the American Institute of CPAs.

http://www.thecaq.org/preparing-new-revenue-recognition-standard-tool-audit-committees

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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