INSIGHTS

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Highlights from the San Diego Securities Regulation Institute

At a recent conference in Coronado, CA, SEC Chair Mary Jo White, Chief Justice Leo E. Strine Jr. of the Delaware Supreme Court, various senior SEC staff, and numerous practitioners gathered to discuss a wide variety of current issues. The topics ranged from proxy season trends to cybersecurity to developments in mergers and acquisitions and also included a panel discussion with institutional investors regarding shareholder engagement.

By Daniela Stolman, Sean Sullivan, Michael Titera, and Cem Surmeli

The 43rd Annual Securities Regulation Institute (Institute), sponsored by Northwestern Pritzker School of Law, was held January 25-27, 2016, in Coronado, California. The panels at the Institute covered a number of topics, including newly adopted and proposed rules administered by the Securities and Exchange Commission (SEC), proxy season trends and developments, corporate governance and shareholder relations, cybersecurity, SEC enforcement, insider trading developments, key developments in accounting and auditing, and mergers and acquisitions developments. Speakers and panelists at the Institute included SEC Chair Mary Jo White, the Honorable Leo E. Strine Jr., Chief Justice of the Delaware Supreme Court, Andre G. Bouchard, Chancellor of the Delaware Court of Chancery, senior SEC staff, and practitioners.

Keynote Address

SEC Chair Mary Jo Chair White's remarks touched upon a number of topics ranging from disclosure effectiveness to board diversity. Chair White indicated that, in addition to completing rulemaking required under the statutory mandates of the Jumpstart Our Business Startups Act of 2012 (JOBS Act) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the SEC is making headway on efforts to improve disclosure effectiveness. In September 2015, the SEC published a request for comments on the effectiveness of the financial disclosure requirements in Regulation S-K.[1] The SEC plans to publish a concept release regarding possible improvements to Regulation S-K, in particular, the business and financial disclosures required by periodic reports on Forms 10-K and 10-Q. Chair White also mentioned plans to issue a technical release focused on overlapping

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disclosure requirements of U.S. Generally Accepted Accounting Principles (GAAP) and the SEC's disclosure rules, which would have the goal of rationalizing the differences and eliminating duplicative disclosures. In addition, the SEC Staff is working on revisions to two industry guides: Industry Guide 3 (Statistical disclosure by bank holding companies) and Industry Guide 7 (Description of property by issuers engaged or to be engaged in significant mining operations). Chair White indicated that the purpose of the SEC's Disclosure Effectiveness Initiative is not necessarily to reduce the amount of required disclosures, but to improve disclosure and make it more effective, which could mean adding disclosure requirements in certain areas.

Many market participants are looking at ways to provide secondary market liquidity.

When discussing recent developments in the area of exemptions from registration and the rules regarding general solicitation, Chair White noted that while these are positive developments in many respects, the SEC must be careful that its rules are properly calibrated to protect the interests of investors. She discussed the formation of interdivisional working groups at the SEC tasked with monitoring these developments for potential abuses as new markets emerge. In particular, Chair White noted that there is a working group tasked with looking at whether "reasonable" steps are being taken by issuers engaged in Rule 506(c) private offerings to verify that the purchasers are "accredited investors," as required by the rule.

Chair White also referenced the recently released report from the SEC Staff on its review of the definition of "accredited investor."[2] She explained her belief that the current definition's use of net worth and income thresholds does not effectively fulfill the goal of protecting investors who cannot fend for themselves.[3] She expressed her belief that the definition needs to change and welcomed any comments on ways to improve it.

Chair White went on to discuss the fact that many market participants are looking at ways to provide secondary market liquidity. She thinks that the marketplace has yet to find an optimal solution for providing secondary liquidity. She indicated that the SEC is trying to modernize its rules and does not want to be an impediment to responsibly providing secondary liquidity. Chair White noted that if practitioners feel that the SEC's rules are getting in the way of finding an optimal solution for providing secondary liquidity, this should be raised to the SEC.

Turning to the rulemaking required by Dodd-Frank, Chair White noted that with the adoption of new revenue recognition principles and the potential increase in restatements as a result of the implementation of these new principles, there is a potential for the SEC's forthcoming final clawback rule to have a significant impact.[4] She noted that the SEC Staff is looking at all of the issues raised by commenters, but explained that the statutory mandate contained in Dodd-Frank does not give the SEC much flexibility. Without giving a specific timeline, Chair White noted that the final clawback rule is a priority for 2016.

Chair White finished by discussing her views on the importance of diversity in the boardroom. She referred to the numerous studies showing that diversity tends to add value and make a board function better. Chair White noted that despite these widely available findings, the actual statistics regarding board diversity show limited improvement. She explained that the issue is not a lack of supply, but a failure of nominating committees to search for candidates in new and different channels rather than using the same networks as they have used in the past. Chair White noted that the SEC has faced criticism over whether its disclosure rules relating to diversity go far enough. In particular, critics have pointed out that the SEC's rules do not include a definition of the term "diversity" and do not reference gender, racial, ethnic or other specific types of diversity.[5] Chair White stated her view that many of these concerns are well founded and that the SEC Staff currently is studying the existing rules to see if additional guidance or rulemaking is warranted.

A Conversation with Chief Justice Strine

In the context of a discussion regarding director duties in M&A transactions, Chief Justice Strine, expressed his view that the best way for directors to reduce their litigation risk is to act as they do in their day jobs. He cautioned directors against thinking in terms of whether they are in *Revlon* mode and instead recommended that they always try to do the right thing for the companies they represent and their shareholders. As a fiduciary, he explained, a director should always try to seek the most favorable result for the shareholders.

Disclosures of ownership interests should be required more promptly than they are under current rules.

Chief Justice Strine also expressed his view that the United States' approach to disclosure of ownership interests under Exchange Act Section 13(d) is embarrassingly out of date. He noted that extensive information is required to be disclosed regarding management and questioned why the United States does not have "all-in" disclosure of both long and short positions held by activists. Chief Justice Strine further asserted that disclosures of ownership interests should be required more promptly than they are under current rules. He attributed these shortcomings in the rules, at least in part, to the political pressures exerted on the SEC, and observed that if our model of transparent markets is going to work properly, the public needs to know the true economic interests of everyone involved.

Cybersecurity

David M. Lynn of Morrison & Foerster LLP, Joseph A. Grundfest, Professor at Stanford Law School, Alexa King, the Senior Vice President, General Counsel and Secretary of FireEye, Inc. and Benjamin A. Powell of Wilmer Hale LLP discussed some of the challenges public companies face with respect to cybersecurity.

The panel went over some of the recent cyberattacks in the news, how companies should prepare for and react to such attacks and the board's role in managing this process. One panelist recommended, and other panelists concurred, that companies should retain cyber-advisers to bridge their gaps in knowledge and awareness regarding cybersecurity. An outside cyber-adviser can assess the strengths and vulnerabilities of the cybersecurity measures implemented by a company's internal team. Panelists noted that having the same team that designed a company's cybersecurity measures assess the vulnerabilities of such measures results in a conflict of interest that may prevent a company from being aware of weaknesses and necessary improvements with respect to cybersecurity. The panel then discussed the viability of certain proactive counter-measures to deal with cyber threats, such as populating a company's servers with "fake" proprietary information that can confound attackers about which information is real or even hiding malware in a company's servers that can harm an attacker's operation when downloaded during the course of a breach.

Hot Topics in Corporate Governance and Shareholder Relations

Keir D. Gumbs of Covington & Burling LLP and Elizabeth A. Ising of Gibson, Dunn & Crutcher LLP chaired a corporate governance and shareholder relations panel consisting of Mary A. Francis, Corporate Secretary and Chief Governance Officer of the Chevron Corporation and Abe M. Friedman, Managing Partner of CamberView Partners LLC.

The panel opened with an assessment of trends in proxy access proposals. Approximately 120 proxy access proposals were submitted in 2015, which were often similar to the SEC's vacated proxy access rule, which set the minimum access requirement for shareholders at a 3 percent aggregate ownership level for 3 years, and allowed for nominations for up to 25 percent of board seats. Of the 88 shareholder proposals on proxy access that were put to a vote, 55 received majority approval, and 3 of 7 management proposals on the topic were approved. Investor support of proxy access proposals has grown year-over-year by more than 20 percent, with average investor support of such proposals standing at 54.4 percent. While proxy access bylaws have become a hot topic during the shareholder proposal season, thus far proxy access bylaws have been adopted by about 120 companies, with approximately 5 percent of S&P 500 companies having adopted or committed to adopt proxy access. Accordingly, panelists noted, proxy access is likely to be a prominent area for shareholder proposals in the years to come. The panel also discussed the likelihood that shareholders and shareholder groups will submit proxy access "2.0" proposals in 2016 and the intensified focus on universal proxies in contested director elections.

The panel also focused on broader shareholder proposal trends, noting that approximately 1,030 shareholder proposals were received by companies in 2015. Of those proposals, 18 percent were withdrawn and 14 percent were excluded pursuant to no-action requests granted by the SEC. No-action relief requests were up in 2015 over 2014 (318 vs. 295), while favorable SEC action with respect to no-action relief requests was down year-over-year (61 percent vs. 71 percent). According to data from Institutional Shareholder Services (ISS), the top areas of focus for shareholders submitting proposals related to corporate governance matters (43 percent of proposals), environmental or social matters (45 percent of proposals) and executive compensation matters (12 percent of proposals).

Obligations of Directors of Public Companies

Former SEC Commissioner Cynthia A. Glassman, director of Discover Financial Services and Navigant Consulting, Inc., former SEC Chairman Harvey L. Pitt, founder, CEO and managing director of Kalorama Partners LLC, David A. Katz of Wachtell, Lipton, Rosen & Katz LLP and Simon M. Lorne, Vice Chairman and Chief Legal Officer at Millennium Management LLC, discussed issues facing directors with respect to executive compensation, succession planning and overseeing risk management.

Directors should endeavor to do what is in the best interest of shareholders rather than trying to appease proxy advisors.

With respect to succession planning, the panelists acknowledged that this is often a difficult area for boards to maneuver. The CEO may not be interested in engaging in succession planning, a process which contemplates his or her departure. Likewise, the selection of a successor, if made public, could alienate others in the organization who felt they should have been selected. A public succession plan could even cause departures by disaffected executives and drain a company of its human capital. The panel discussed whether a company would be required to disclose its succession planning. One panelist noted that there is no specific requirement to disclose a preferred candidate to succeed the CEO but posed a hypothetical scenario in which a company provides additional compensation to the selected successor to retain them until the CEO retires. In such a case, the company could be obligated to disclose why it gave the potential successor additional compensation.

The panel then discussed the issue of executive compensation. Some panelists lamented that innovative approaches to executive compensation are being inhibited by proxy advisors who would prefer uniformity across public companies. However, one panelist noted that he was not aware of any situations in which a compensation committee wanted to use a creative approach to compensation but felt inhibited from doing so by external groups. Another panelist stated that directors should endeavor to do what is in the best interest of shareholders rather than trying to appease proxy advisors. The panelist also suggested that restrictions on over-boarding limit the cross-pollination of good ideas on executive compensation across public companies. The panel then discussed the role that outside counsel and compensation consultants can play to fill in that gap and inform compensation committees of best practices.

Finally, the panel discussed how boards should approach risk management. One panelist stated that boards too often focus on compliance rather than strategic decision making. Another panelist agreed that boards should focus more on oversight rather than the details of risk management. These panelists expressed disagreement with the cybersecurity panel's assertion that boards should necessarily have a cybersecurity advisor and explained their view that directors' time is better spent on overall corporate strategy. One panelist also added that the board's responsibility is not to hire specialists to mitigate risk in every area, but rather to hire a CEO who will make the necessary hires and manage this process.

Key Issues in Capital Formation

A panel consisting of David R. Fredrickson, Chief Counsel and Associate Director of the Division of Corporation Finance, Annemarie Tierney, VP, Head of Strategy and New Markets at NASDAQ Private Market, Gordon K. Davidson of Fenwick & West LLP, Nicole Irvin of Andreesen Horowitz, Charles S. Kim of Cooley LLP and Sarah K. Solum of Davis Polk & Wardwell LLP discussed recent developments in capital formation.

Mr. Frederickson explained that the Staff takes a different approach to reviewing Regulation A+ filings depending on whether the offering is made under Tier 1 or Tier 2. Because Tier 1 offerings are subject to review by state regulators and are relatively small, the SEC typically just looks at eligibility criteria and verifies that the offering materials contain everything that is required. For Tier 2 offerings, there is no review by state regulators and the offering sizes are somewhat larger, so the SEC applies a more extensive review strategy.

The panelists noted that on August 6, 2015, the Division of Corporation Finance issued new compliance and disclosure interpretations (Questions 256.23 through 256.33) regarding the meaning of "general solicitation" and "general advertising" for purposes of an unregistered securities offering made in reliance on Regulation D under the Securities Act of 1933.[6] Mr. Frederickson reviewed the key points of the guidance, highlighting its acknowledgment that where groups of experienced, sophisticated investors, such as "angel investors," share information about private offerings through their networks, members who have a relationship with a particular issuer may introduce that issuer to other members without having the shared informed deemed a general solicitation.[7] Mr. Frederickson reiterated that, in such situations, whether there has been a general solicitation is a fact-specific determination.

Mr. Frederickson went on to explain that on the same day the Staff issued its guidance regarding general solicitation, it also issued a no-action letter to an Internet-based venture capital firm, Citizen VC, Inc., concurring with the firm's conclusion that the procedures described in its request letter would create a substantive, pre-existing relationship and thus would not constitute general solicitation or general advertising within the meaning of Rule 502(c) of Regulation D.[8] The policies and procedures described in the request letter were designed to evaluate the prospective investor's sophistication, financial circumstances and ability to understand the nature and risks of the securities to be offered. In its response the Staff noted that there is no specific duration of time or particular short form accreditation questionnaire that can be relied upon solely to create such a pre-existing relationship. Mr. Frederickson explained that the SEC's no-action position rests, in part, on the fact that a prospective member of the platform is not presented with any investment opportunity when being qualified to join the platform. In other words, any investment opportunity would only be presented after the prospective investor becomes a member of the platform.

The RAISE Act creates a new statutory exemption from SEC registration for the resale of private companies securities.

Ms. Tierney discussed the recently adopted Reforming Access for Investments in Startup Enterprises (RAISE) Act, which was signed into law on December 4, 2015 as part of the Fixing America's Surface Transportation (FAST) Act. The RAISE Act creates a new statutory exemption from SEC registration (and pre-empts state law) for the resale of private companies securities if certain conditions are met. Ms. Tierney explained that new Securities Act Section 4(a)(7) basically codifies the legal construct known as the "Section 4(1½) exemption." She explained that she expects this to be used frequently in situations where employees have vested equity and would like to sell some of that equity to cover the cost of taxes. Ms. Tierney indicated the NASDAQ intends to publish a set of FAQs on the legislation in February 2016.

The panelists also discussed other changes in the securities laws brought about by the FAST Act. For example, the time before an IPO road show can begin was shortened from 21 days to 15 days after the first public filing of the registration statement. The legislation also permits emerging growth companies (EGCs) to keep EGC status for up to one year if they otherwise lose it during the IPO review process. It also allows EGCs to exclude from their IPO filings earlier financial statements that would not otherwise be required by the time of the offering.[9]

Getting Practical on Accounting and Auditing

John W. White of Cravath, Swaine & Moore LLP chaired a panel focused on accounting and auditing issues consisting of Wesley R. Bricker, Deputy Chief Accountant, SEC Office of the Chief Accountant, Jeanette M. Franzel, Board Member of the Public Company Accounting Oversight Board (PCAOB), Michael J. Gallagher, Managing Partner, Assurance Quality, PricewaterhouseCoopers LLP, and Michele J. Hooper, President and CEO of The Directors' Council and Vice Chair of the Center for Audit Quality. The panel stressed the importance for companies (despite the one year delay in effectiveness) to start focusing immediately on implementation of the new revenue recognition standard (FASB ASU No. 2014-09).[10] Panelists emphasized the active role that the audit committee should play in the process, including by putting pressure on management to identify key hurdles of adoption and required system changes and to formulate a timeframe for implementation. The panel also discussed disclosure requirements in connection with the new standard. Mr. Bricker emphasized the importance of public disclosure regarding the transition and noted that the Staff anticipates that registrants will include in their public filings information regarding the status of implementation as well as any material changes in internal controls in connection with the implementation of the new standard.

The panel also discussed the different standards regarding going concern determinations in the accounting and auditing literature as a result of the adoption by the Financial Accounting Standards Board (FASB) of the new going concern standard in August 2014, which takes effect for all entities for the first annual period ending after December 15, 2016, and interim periods thereafter. FASB's Accounting Standards Update No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, requires management to issue a going concern warning when conditions give rise to "substantial doubt." "Substantial doubt" is deemed to exist when it is probable that the company will be unable to meet its obligations within one year from the financial statement issuance date. While auditing standards use the same trigger of "substantial doubt," the term has been interpreted in audit practice to mean "significant possibility." Many accounting and audit professionals believe "probable" is a higher threshold than the "significant possibility" standard historically used by auditors, creating the possibility that auditors and management may reach different conclusions as to whether going concern disclosure is required. Ms. Franzel noted that the PCAOB Staff expects to release a consultation paper on this in the second half of 2016.

Other hot topics identified and discussed by the panel included: (1) non-GAAP disclosure; (2) internal controls; (3) related-party transactions; and (4) segment disclosure. With respect to non-GAAP disclosure, the panel noted that there has been a renewed focus on such measures by the SEC, PCAOB, FASB and in the press. The panel noted that the Division of Corporation Finance appears particularly focused on this topic as it is the only category for which comments increased for the first half of 2015 as compared to the comparable prior year period and is the third most frequent comment issued by the Staff (trailing only behind comments related to MD&A (#1) and fair value (#2)).

Discussion with Institutional Investors

Meredith B. Cross of Wilmer Hale LLP, former Director of the Division of Corporation Finance, led a panel discussion comprised of Anne T. Chapman, Senior Manager, Governance and Proxy, The Capital Group Companies, Inc. (Capital), Bess Joffe, Managing Director, Corporate Governance, TIAA-CREF, and Anne Sheehan, Director of Corporate Governance, California State Teachers' Retirement System (CalSTRS).

The panelists addressed how their respective organizations view the voting policies and reports issued by proxy advisory firms, specifically ISS and Glass, Lewis & Co. (Glass Lewis). CalSTRS uses its own policies to make voting decisions, but subscribes to both ISS and Glass Lewis and views both as providing helpful research and voting platforms. TIAA-CREF looks at the policies and reports of both ISS and Glass Lewis, but Glass Lewis is its primary provider of advisory services and the provider of its voting platform. Capital has its own research function, but uses reports issued by ISS and Glass Lewis to fact-check its own research.

The best time for companies to engage with investors is in the off-season.

Next, the panelists expressed their views on outreach and engagement by companies. The panelists agreed that the best time for companies to engage with investors is in the off-season. They also noted that in certain situations it is helpful if board members participate in the engagement. For example, it is helpful for investors to be able to speak to a member of the compensation committee when executive compensation is an issue. In other situations, investors noted that it is more beneficial to engage with executive officers who have more familiarity with company operations. One panelist emphasized the need for companies to listen to the investors' concerns when problems arise as opposed to merely making presentations about why the investors should not worry about the problems. The panelists also noted that because the information companies provide typically relates to governance matters, Regulation FD is not usually a concern.

The panelists went on to discuss the importance of making disclosures easy to read and inviting. They noted that it is helpful when a proxy statement calls out year-over-year changes to governance policies, practices and structures or other changes that investors may find useful. The panelists agreed that consolidating the most important information in a well-crafted summary is important. One panelist also indicated that having information readily accessible on a company's website is particularly helpful for institutional investors.

The panelists discussed board quality and refreshment and the panelists' views on proscriptive rules regarding tenure and mandatory retirement ages for directors. Multiple panelists stressed the importance of clear disclosures regarding how a board views board quality and evaluates the skills, qualifications and qualities of its individual board members and the board as a whole. One panelist noted that proscriptive tenure and retirement rules are blunt instruments that boards sometimes use to achieve what should be the goal of the nominating process undertaken by the nominating committee.

The panel concluded with a brief discussion of proxy access. One panelist recommended that companies talk to their largest shareholders before drafting proxy access provisions to see what those shareholders believe to be most important. Another cautioned companies against being "too cute" when drafting the specifics of their proxy access provisions. Most large shareholders have long-term stakes in companies and will be asking about these provisions down the road and, where appropriate, pushing companies to remove objectionable provisions.

Mergers and Acquisitions: Trends and Developments

Chancellor Bouchard and a panel of M&A practitioners consisting of Richard E. Climan of Weil, Gotshal & Manges LLP, Alison Ressler of Sullivan & Cromwell LLP and Robert E. Spatt of Simpson Thacher & Bartlett LLP opened the mergers and acquisitions discussion with observations on the health of the M&A market. 2015 was described as a "blockbuster year," in which M&A activity for the first time eclipsed the pre-recession highs of 2007. Both domestic and global M&A activity increased over 2014 levels (which was a particularly strong year in its own right), and the trend of more strategic purchases and fewer deals led by private equity buyers continued, with panelists musing that the "mega management buyouts" of the last M&A boom may be a thing of the past. The panelists noted that the hot equity markets of 2015 allowed public companies to use their own stock as a highly valued currency, which may account, in part, for the substantial strategic deal volume. Looking forward, the panelists generally agreed that "no one expects 2016 [M&A] activity" to be as robust as 2015.

The panel discussed recent Delaware corporate law case decisions, including the Delaware Court of Chancery's August 2015 decision, *In re Dole Foods Co., Inc. Stockholders Litigation.*[11] The stockholder litigation in that case focused on the circumstances surrounding the 2013 single-step take-private merger of Dole Foods Co., Inc. by its Chief Executive Officer and 40 percent stockholder. The decision, in which the Chief Executive Officer (David Murdock) and the General Counsel (Michael Carter) were both found liable to investors for $148 million in fraud damages relating to information concealed from the company's special committee in connection with the take-private transaction, provides a number of important take-aways for practitioners. Panelists stressed the importance of an independent and thorough process, and, in particular, that management remain neutral and respond to special committee requests. Moreover, the court will examine closely the independence of each member of the special committee in the case of a controlling party transaction because of the heightened risk of lack of independence. Additionally, the mere presence of a special committee will not preclude a finding of a breach of the duty of loyalty by a director or officer. Finally, the panelists noted that majority-of-the minority stockholder votes, like the stockholder vote in the Dole transaction, do not cleanse a transaction in which controller influence is present.

The mere presence of a special committee will not preclude a finding of a breach of the duty of loyalty by a director or officer.

The panelists also discussed the December 2015 affirmation by the Delaware Supreme Court of *RBC Capital Markets v. Jervis*,[12] in which the lower court found the financial advisor to the seller liable for $76 million for aiding and abetting the seller's board of director's breaches of fiduciary duty. The affirmation continues a line of cases holding that undisclosed conflicts of interest (in the *RBC Capital Markets* and related *Rural/Metro*[13] cases, on the part of the financial advisor to the seller) adversely affect a sale process. However, panelists noted, the Supreme Court emphasized that the narrow ruling in *Rural/Metro* "effects no shifts in the *Revlon* landscape, let alone tectonic ones." As a general matter, while being aware and sensitive to board member and financial advisor conflicts of interest is critical in a sale process, the *Rural/Metro* decision can be understood to indicate that claims of aiding and abetting a breach of fiduciary duty by a financial advisor will be challenging to substantiate absent conscious wrongdoing.

Updates from SEC Senior Staff—Division of Corporate Finance

Senior SEC Staff from the Division of Corporation Finance discussed a variety of topics, including recent rulemaking and guidance, shareholder proposal issues and filing reviews. The panel consisted of Keith F. Higgins, Director of the Division of Corporation Finance, David R. Fredrickson, Chief Counsel and Associate Director of the Division of Corporation Finance, and Tamara Brightwell, Senior Special Counsel to the Director of the Division of Corporation Finance.

Mr. Fredrickson discussed the SEC's recent guidance regarding shareholder proposals in Staff Legal Bulletin No. 14H (SLB 14H).[14] He emphasized that the Staff has changed its position on how it evaluates requests for exclusion of shareholder proposals on Rule 14a-8(i)(9) grounds. Under the previous test, a shareholder proposal was excludable if including it, along with an allegedly conflicting management proposal, could present "alternative and conflicting decisions for the shareholders" and create the potential for "inconsistent and ambiguous results." SLB 14H replaced that test with the rule that a direct conflict only exists if a reasonable shareholder could not logically vote in favor of both proposals (i.e., a vote for one proposal is tantamount to a vote against the other proposal). Mr. Frederickson noted that this new guidance regarding Rule 14a-8(i)(9) was prompted by no-action requests relating to proxy access proposals. He acknowledged that one of the Staff's main challenges during the 2016 proxy season will be to decide how it will evaluate Rule 14a-8(i)(10) substantial implementation arguments, particularly in the context of proxy access proposals. The Staff already has received a number of no-action requests from companies seeking to exclude shareholder proposals regarding proxy access on the grounds that the proxy access provisions adopted by the companies substantially implement the shareholder proposals, despite the fact that the companies' proxy access provisions use different thresholds and terms than those sought by the various shareholder proposals. The SEC has not issued any no-action letters on these facts yet this year.

Mr. Higgins discussed petitions the SEC received last year from the United Brotherhood of Carpenters and Joiners of America (Carpenters Union) and the Council of Institutional Investors (CII) regarding proxy statement disclosure of director voting standards. The Carpenters Union was concerned that, for companies that have not adopted majority voting, there was not enough understanding of the effect of a "withhold" vote. The Carpenters Union would like the Commission to eliminate the "withhold" vote option and move to a "for" and "abstain" voting regime. Similarly, CII requested that the Staff provide guidance regarding the rules for disclosure of voting requirements in proxy statements. CII's petition sought to compel the SEC to require companies to provide more easily understandable, plain English disclosures. Mr. Higgins noted that the Staff currently is reviewing these issues and requested that, in the meantime, companies make an effort to carefully review their disclosures regarding voting standards to ensure their accuracy.

On a related note, Ms. Brightwell explained that the Staff also received requests that the SEC require companies that retain directors who do not receive a majority vote (unelected directors) to disclose the reasons for the such decisions. Given the relevance of this information to investors, Ms. Brightwell believes companies should include disclosure regarding the board's rationale for retaining unelected directors.

Companies should include disclosure regarding the board's rationale for retaining unelected directors.

Mr. Higgins noted that the issues the Division of Corporation Finance is currently addressing in its reviews include: (1) the lack of adequate disclosures regarding the impact of the drop in oil prices (for energy companies and other companies that may be impacted by this change); (2) the lack of adequate disclosures regarding the impact of changes in foreign currency rates (specifically with respect to known trends); and (3) the lack of adequate disclosures regarding non-GAAP financial measures.

The panel ended with Mr. Higgins discussing non-GAAP metrics. He recounted that last year a company was reporting adjusted earnings figures based on a normalized commodity price (using an average of the last three years). The Staff thought this was going a bit too far because the current price of a commodity is what the company is actually dealing with in a particular quarter. On the other hand, Mr. Higgins reported that the Staff recently has decided that "system-wide sales" (inclusive of both company-owned and franchised stores/restaurants) is not inherently misleading, and as such the Staff is no longer objecting to the metric as an inappropriate non-GAAP financial measure.

Recurring Disclosure Challenges

Mr. Higgins also participated in a panel consisting of Christoph A. Pereira, Chief Corporate, Securities & Finance Counsel at General Electric Company, Thomas J. Kim of Sidley Austin LLP, Alexander F. Cohen of Latham & Watkins LLP and Catherine T. Dixon of Weil, Gotshal & Manges LLP that discussed disclosure challenges commonly encountered by public companies in the context of some hypothetical fact patterns.

The panel first discussed how companies should approach disclosure under Item 403(c) of Regulation S-K[15] when the CEO of a public company that also owns the majority of its shares engages in estate planning. The panel went over how factors such as the age of the CEO and the likelihood of the imminent implementation of such planning could impact the analysis of whether the estate planning constitutes an "arrangement." One panelist pointed out that the Item 403(c) of Regulation S-K lacks a materiality qualifier and discussed how an internal counsel could attempt to read a materiality qualifier into the rule to reach a common sense result. Mr. Higgins noted that it is not certain whether investors would be interested in such estate planning information where the CEO is relatively young and implementation of the planning appears to be remote. Another panelist then noted that many companies did not make this type of disclosure in their proxy statements, suggesting that personal privacy issues may ultimately trump other disclosure considerations, but also highlighted situations such as Sumner Redstone at Viacom, Inc. and Steve Jobs at Apple Inc. as prime examples of when the need for disclosure may supersede personal privacy considerations.

Panelist also considered how a company that is set to release its earnings on a Form 8-K should approach the disclosure of a notification that the company would receive a subpoena requesting documents relevant to a Foreign Corrupt Practices Act (FCPA) investigation involving the company. The panel generally agreed that the disclosure of an impending subpoena on a Form 8-K was not necessary as it did not amount to a material legal proceeding required to be disclosed under Item 103 of Regulation S-K. However, the panelists, and Mr. Higgins in particular, suggested that the company should pay careful attention to its risk factors in its next 10-Q and confirm that they remain accurate in light of the FCPA investigation. A panelist then noted that many companies disclose investigations before any proceedings are commenced because preemptive disclosure fosters better relationships with investors.

The panel also discussed a fact pattern involving a company on the cusp of making its initial public offering and how to handle an incident in which the prominent CEO of the company is arrested at a New York City hotel on charges of domestic violence. Mr. Higgins noted that any proceedings involving the CEO would need to be disclosed in the company's prospectus. The panelist then discussed whether charges would amount to proceedings requiring disclosure. However, most concurred that practical concerns would trump legal requirements in this scenario. The company likely would be judged harshly in the court of public opinion ahead of its IPO unless it got in front of the news. One panelist stated that given the IPO context and the fact that the CEO in the scenario is a prominent figure, it would be rather difficult to conclude that this incident should not be disclosed in the prospectus. Another panelist suggested that the company should discuss the issue with the bankers assisting with the IPO considering the sensitivity of the timing.

Notes

1. SEC Release No. 33-9929, "Request for Comment on the Effectiveness of Financial Disclosures about Entities Other Than the Registrant," September 25, 2015, available at *https://www.sec.gov/rules/other/2015/33-9929.pdf*.
2. Report on the Review of the Definition of "Accredited Investor," SEC, December 18, 2015, available at *https://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf.*
3. The "accredited investor" definition is a central component of Regulation D and is "intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary." Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987) [52 FR 3015].
4. Under the proposed new Rule 10D-1, listed companies would be required to develop and enforce recovery policies that in the event of an accounting restatement, "clawback" from current and former executive officers incentive-based compensation they would not have received based on the restatement. Recovery would be required without regard to fault. The proposed rules would also require disclosure of listed companies' recovery policies, and their actions under those policies. *See* SEC Release No. 33-9861, "Listing Standards for Recovery of Erroneously Awarded Compensation," July 1, 2015, available at *https://www.sec.gov/rules/proposed/2015/33-9861.pdf.*
5. *See* Item 407(c)(2)(vi) of Regulation S-K ("Describe ... whether, and if so how, the nominating committee (or the board) considers diversity in identifying nominees for director. If the nominating committee (or the board) has a policy with regard to the consideration of diversity in identifying director nominees, describe how this policy is implemented, as well as how the nominating committee (or the board) assesses the effectiveness of its policy.").
6. *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules (Interpretation # 256.23 - # 256.33) (August 6, 2015), available at *http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.*
7. *Id.* at Interpretation # 256.27.

8. *See SEC No-Action Letter, Citizen VC, Inc.* (avail. August 6, 2015).

9. On December 10, 2015 the SEC published Compliance and Disclosure Interpretations related to the FAST Act, which it updated on December 21, 2015. *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, FAST Act (December 21, 2015), available at *https://www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm.*

10. Unless early adoption is elected, public and nonpublic entities reporting under U.S. GAAP are required to implement the provisions of the new revenue standard for annual reporting periods beginning after December 15, 2017, and December 15, 2018, respectively.

11. *In re Dole Food Co., Inc. Stockholders Litigation*, C.A. No. 8703-VCL (Del. Ch. August 27, 2015).

12. *RBC Capital Markets v. Jervis* (Del. S. Ct. November 30, 2015).

13. *In re Rural Metro Corp. Shareholders Litigation*, 88 A.3d 54 (Del. Ch. 2014); *In re Rural/Metro Corp. Shareholders Litigation*, 102 A.3d 205 (Del. Ch. 2014).

14. Staff Legal Bulleting No. 14H (Corporation Finance), October 22, 2015, available at *https://www.sec.gov/interps/legal/cfslb14h.htm.*

15. Item 403(c) requires issuers to "describe any arrangements, known to the registrant […] the operation of which may at a subsequent date result in a change in control of the registrant" in their proxy statements.

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