VI. Finance, Mergers, and Acquisitions

*E.N. Ellis IV and Steven C. Friend**

A. Introduction 79
B. SEC Disclosure Update and Simplification Under the FAST Act 79
C. The Ongoing Demise of LIBOR 84
D. FinCEN Customer Due Diligence Requirements 87
E. SEC Non-GAAP Enforcement Action 89
F. SEC Request for Comment on Periodic Reporting 90

A. Introduction

The second half of 2018 and early 2019 saw revisions to reporting and disclosure policies by various regulatory bodies. The Securities and Exchange Commission (SEC) continued to pursue disclosure reform and simplification initiatives under the Fixing America's Surface Transportation Act (FAST Act). In line with its recent focus on the use of financial disclosures not in accordance with Generally Accepted Accounting Principles (GAAP), the SEC announced an enforcement action focused on certain non-GAAP disclosures. Additionally, companies continued to adapt to the planned phasing out of the London Interbank Offered Rate (LIBOR). Finally, new rules adopted by the Financial Crimes Enforcement Network (FinCEN) within the U.S. Department of the Treasury require financial institutions to identify and verify the identity of beneficial owners who own or control legal entity customers of the financial institutions.

B. SEC Disclosure Update and Simplification Under the FAST Act

On August 17, 2018, the SEC issued a final rule adopting proposed rule changes to simplify and reduce disclosure requirements for public companies, investment advisers, and investment companies.[1] The rule changes are designed to reduce compliance burdens for public companies without reducing the total mix of information available to investors.[2] These amendments implement the Congressional

*E.N. Ellis IV and Steven C. Friend are partners in the New York office of Hunton Andrews Kurth LLP. Mr. Ellis is chair of the Finance, Mergers, and Acquisitions Committee.

1. Securities and Exchange Commission, Disclosure Update and Simplification, Release No. 10532 (Aug. 17, 2018) [83 FR 50148 (Oct. 4, 2018)], *available at* https://www.sec.gov/rules/final/2018/33-10532.pdf [hereinafter Disclosure Update].

2. *Id*. at 9.

mandate under the FAST Act requiring the SEC to eliminate provisions of Regulation S-K that are duplicative, overlapping with other disclosure regimes, or unnecessary.[3] The FAST Act was enacted in December 2015 and directs that the SEC review the disclosure requirements of Regulation S-K and modernize and simplify its requirements.[4] The SEC first issued proposed amendments to Regulation S-K and requested public comment thereon in July 2016.[5] While the amendments affect disclosure requirements under both Regulation S-K and Regulation S-X, below is a summary of key disclosure requirements under Regulation S-K that have been modified or eliminated by the amendments:

Item 101(b)—Segment information. Previously, Item 101(b) required a registrant to disclose certain financial information with respect to its operating segments in the business description section of a prospectus or periodic report.[6] This disclosure was eliminated by the amendments.[7] The SEC noted that the information previously required to be disclosed under Item 101(b) of Regulation S-K was duplicative of information already required to be disclosed in notes to the financial statements and a registrant's Management's Discussion and Analysis (MD&A) section.[8]

Item 101(d)(1), (2) and (3)—Financial information about geographic areas. Item 101(d)(1) mandated that a registrant state the following for each of its last three fiscal years: (A) revenues by the registrant's country of domicile; (B) all foreign countries in total from which the registrant derives revenue; and (C) any individual foreign country, if material to the registrant's business.[9] Item 101(d)(2) permitted issuers to cross-reference between the notes to the financial statements and the description of the issuer's business.[10] Furthermore, Item 101(d)(3) required that a registrant describe any risks attendant to its foreign operations or any dependence on any of its segments on any such foreign operations.[11] The amendments eliminated the aforementioned requirements under Item 101(d) since the SEC reasoned that this disclosure would still be available in the notes to the financial statements and any risks disclosed pursuant to Item 503(c) of Regulation S-K (Risk Factors).[12] However, the SEC amended Item 303(a) of Regulation S-K

3. *Id*. at 10.

4. Fixing America's Surface Transportation Act of 2015. Pub. L. No. 114-94, 129 Stat. 1312, § 72002(2) (2015).

5. Securities and Exchange Commission, Disclosure Update and Simplification, Release No. 33-10110 (July 13, 2016) [81 FR 51607 (Aug. 4, 2016)], *available at* https://www.sec.gov/rules/proposed/2016/33-10110.pdf; s*ee also* Securities and Exchange Commission, Extension of Comment Period for Disclosure Update and Simplification, Release No. 33-10220 (Sept. 23, 2016) [81 FR 66898 (Sept. 29, 2016)], *available at* https://www.sec.gov/rules/proposed/2016/33-10220.pdf.

6. *See* Disclosure Update, *supra* note 1, at 69–70.

7. *Id*. at 70.

8. *Id*. at 69–70.

9. *Id*. at 71.

10. *Id*.

11. *Id*.

12. *Id*. at 72.

(MD&A) to add an explicit reference to "geographic areas" in order to stress the continued importance of this disclosure to investors.[13]

Item 201(a)(1)—Market price of registrant's common equity. The amendments eliminated the requirements under Item 201(a)(1) to disclose the high and low prices of a registrant's common stock for each quarter within a registrant's last two fiscal years, so long as a registrant's common equity is traded on an established public market.[14] The SEC stated that this amendment was proposed and accepted due to the regular availability of the information for free on many different websites, including the exchanges' or quotation systems' websites.[15] Despite this amendment to Item 201(a)(1), a registrant will continue to be required to disclose its trading symbol for its traded common equity, or other instruments, in its prospectuses and annual reports.[16]

Instruction 5 to Item 303(b)—Discussion regarding seasonal aspects of business in Interim Reports. Consistent with the rationale of the other amendments adopted under Release No. 33-10532, the requirement of Instruction 5 to Item 303(b) to include a discussion of the seasonality of a registrant's business in the MD&A sections of its interim reports was deemed redundant (with the requirements of US GAAP in combination with the remainder of Item 303) and eliminated by the amendments.[17] The SEC made it clear in the amendments that the remainder of Item 303 requires reasonably similar disclosure as Instruction 5 to Item 303(b), and therefore such requirement could be eliminated.[18] However, the amendments retained the seasonality disclosure requirements in annual reports required by Item 101(c)(1)(v), which provide such disclosure, to the extent such information is material to a registrant's business segments and business as a whole.[19]

Items 503(d) and 601(b)(12)—Ratio of earnings to fixed charges and/or preferred stock dividends. Issuers that registered debt securities and/or preferred stock were previously required to disclose the historical (and in certain cases, pro forma) ratio of earnings to fixed charges and/or preferred stock dividends in a prospectus when issuing securities.[20] Regulation S-K additionally required the registrant to file as an exhibit to registration statements and periodic reports the computation of any ratio of earnings to fixed charges.[21] The current amendments eliminate these requirements under Regulation S-K.[22]

When contemplating the elimination of the requirements contained in Items 503(d) and 601(b)(12), the SEC considered several rationales. The SEC reasoned that there currently exists a number of analytical tools, including ratios derived

---

13. *Id*.
14. *Id*. at 103.
15. *Id*. at 102.
16. *Id*. at 102–03.
17. *Id*. at 75.
18. *Id*.
19. *Id*.
20. *Id*. at 55.
21. *Id*.
22. *Id*. at 58.

from information readily available in a registrant's financial statements, that may accomplish the stated disclosure objective of the ratio of earnings to fixed charges.[23] Additionally, debt investors typically negotiate contractual agreements with issuers to obtain specific financial information, including fixed charge coverage covenants, and a registrant would still be required to disclose material impacts of debt covenants to the extent they are reasonably likely to be breached or limit the registrant's ability to obtain additional financings in the future.[24] Finally, the SEC noted that with respect to the disclosure of pro forma ratios, Item 504 of Regulation S-K (Use of Proceeds) would still require disclosure of information about an offering's effect on a registrant's fixed charges, including interest rate, maturities, and the amount of the proceeds used to discharge indebtedness.[25]

The amendments became effective on November 5, 2018.[26]

On October 11, 2017, the SEC proposed additional changes to Regulation S-K.[27] These additional amendments further implement the mandate under the FAST Act.[28] The SEC adopted the amendments on March 20, 2019.[29]

A few of the key amendments are:

Item 102—Description of physical property. Previously, Item 102 required a company to disclose "the location and general character of [its] principal plants, mines and other materially important physical properties."[30] In response to concerns of immaterial disclosures, the SEC amended Item 102 to require a company's description of its physical property only if the properties are considered material to the company.[31]

Item 303—Management's discussion and analysis. Item 303(a) mandates registrants to discuss their "financial condition, changes in financial condition, and results of operations" so as to "enhance a reader's understanding of [the registrant's] financial condition, changes in financial condition, and results of operations."[32] The discussion generally focuses on a period-to-period comparison from the company's three most recent fiscal years.[33] The amendment to Item 303 grants flexibility when discussing historical periods to reduce the period-to-period

---

23. *Id*. at 56.
24. *Id*. at 57.
25. *Id*. at 58.
26. *Id*. at 1.
27. Securities and Exchange Commission, FAST Act Modernization and Simplification of Regulation S-K, Release No. 33-10425 (Oct. 11, 2017) [82 FR 50988 (Nov. 2, 2017)], *available at* https://www.sec.gov/rules/proposed/2017/33-10425.pdf.
28. *See* Fixing America's Surface Transportation Act of 2015. Pub. L. No. 114-94, 129 Stat. 1312, § 72002(2) (2015).
29. Securities and Exchange Commission, FAST Act Modernization and Simplification of Regulation S-K, Release No. 33-10618 (Mar. 20, 2019) [84 FR 12674 (Apr. 2, 2019)], *available at* https://www.sec.gov/rules/final/2019/33-10618.pdf.
30. *Id*. at 33.
31. *Id*. at 37.
32. *Id*. at 10–11.
33. *Id*.

comparison to the two most recent fiscal years.[34] Registrants are allowed to eliminate the comparison involving the earliest year in situations where

> (i) that discussion was not material to an understanding of the registrant's financial condition, changes in financial condition, and results of operations, and (ii) the registrant had filed its prior year Form 10-K on EDGAR and that Form 10-K included in its [MD&A] a discussion of the earliest of the three years included in the financial statements of the current filing.[35]

Item 405—Section 16 compliance. The SEC eliminated the requirement for directors, officers, and ten percent shareholders to furnish duplicate copies of reports mandated by Section 16(a) of the Securities Exchange Act of 1934, as amended (1934 Act) to their companies.[36] Previously under this section, directors, officers, and ten percent shareholders were required to provide duplicate copies to the registrant of beneficial ownership reports filed under Section 16.[37] Given the availability of these reports on EDGAR, the SEC believed physical delivery is no longer necessary.[38] Previously, Item 405(a)(1) required a registrant to include the disclosure heading "Section 16(a) Beneficial Ownership Reporting Compliance." The SEC changed the heading to "Delinquent Section 16(a) Reports" and eliminated the requirement for both the revised heading and accompanying disclosure if the company has no delinquencies to report.[39] In addition, the amendments delete the check box on the cover of the Form 10-K that relates to Item 405 disclosures.[40]

Item 601(b)—Exhibit requirements. The amendments related to Item 601 permit registrants to omit confidential information from material contract exhibits without submitting a confidential treatment request if such information is (i) not material and (ii) would likely cause competitive harm if publicly disclosed.[41] This is a change to the current process that requires a registrant to give the SEC an unredacted copy of each exhibit and request confidentiality. The SEC staff will continue to assess the appropriateness of redactions, which will be subject to review and comment at the staff's discretion.[42] Registrants will still need to mark the exhibit index specifying which sections of the exhibit have been omitted and include a statement that indicates that information from the marked exhibit has been omitted.[43] Registrants will also need to indicate by brackets where the information is omitted from the exhibit.[44]

---

34. *Id*. at 16.
35. *Id*. at 11.
36. *Id*. at 41–42.
37. *Id*. at 40.
38. *Id*. at 42.
39. *Id*. at 41.
40. *Id*. at 41–42.
41. *Id*. at 21, 25.
42. *Id*. at 25–26.
43. *Id*. at 26–27.
44. *Id*.

Hyperlinks. The amendments require an active hyperlink to information on EDGAR if it has been incorporated by reference into a registration statement or prospectus.[45] According to the SEC, "[T]hese amendments will improve the readability and navigability of disclosure documents and discourage repetition, consistent with [the] FAST Act mandate."[46] Registrants are not required to file an amendment to a document solely to correct an inaccurate hyperlink, unless that hyperlink was included in a pre-effective registration statement. This requirement is similar to the existing requirements for exhibit hyperlinking.[47]

With limited exceptions described in the final release, the amendments became effective on May 2, 2019.[48]

C. The Ongoing Demise of LIBOR

In July 2017, Andrew Bailey, head of the U.K. Financial Conduct Authority (FCA), announced that the FCA would begin phasing out the LIBOR interest rate benchmark by the end of 2021, the benchmark rate which underpins, among other things, mortgages, corporate debt securities, and interest rate derivatives contracts.[49]

LIBOR, which first appeared in the 1980s, is calculated daily by surveying banks on their estimated borrowing costs from one another in five currencies across seven time periods.[50] It was previously overseen by the British Bankers' Association until a rate-rigging scandal uncovered in 2012 led to the ICE Benchmark Administration (ICE), a subsidiary of the Intercontinental Exchange Inc.,[51] taking control over the administration of the benchmark in 2014. With ICE as administrator, LIBOR underwent a series of reforms meant to more closely tie submissions and rates to actual transactions in order to ensure that the rate represents market conditions.[52]

The decision to abandon the benchmark rate has prompted discussion among a variety of market participants regarding viable replacements for LIBOR and how to interpret existing documentation based on LIBOR that does not provide for other alternatives.[53] A transition to alternative benchmarks has a significant impact on existing documentation for floating rate debt securities, interest rate swaps, and credit agreements.[54] It remains uncertain how existing contracts using LIBOR will be amended and which benchmark will replace LIBOR.

45. *Id.* at 76.
46. *Id.*
47. *Id.* at 79.
48. *Id.* at 1–2.
49. Max Colchester, *Scandal-Hit Libor to Be Phased Out*, Wall St. J. (July 27, 2017), https://www.wsj.com/articles/u-k-calls-time-on-scandal-hit-libor-1501148216.
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.*

In the derivatives market, the International Swaps and Derivatives Association has prepared certain amendments to its standard documentation to implement fallback rates for certain existing interbank offered rates.[55] These fallback rates would apply upon the permanent discontinuation of the interbank offered rates.[56]

In the public debt capital markets, there has been a good deal of consistency in the formulation for setting a rate once LIBOR is gone. In August 2018, NextEra Energy Capital Holdings, Inc. (NextEra) priced $716 million of floating rate debentures due 2020 and $350 million of floating rate debentures due 2021.[57] Similar to past transactions, the floating LIBOR rate going forward is a reference to a particular Bloomberg or Reuters page. To the extent that the information is no longer provided on such pages, the calculation agent must seek LIBOR quotes from the London offices of four major banks. However, if the issuer determines that LIBOR has been permanently discontinued, the calculation agent will use an "alternative reference rate selected by a central bank, reserve bank, monetary authority or any similar institution" (including any committee or working group thereof) that is consistent with accepted market practice (the "Alternative Rate").[58]

One surprising aspect of this (possible) move to an "Alternative Rate" is the discretion given to the calculation agent thereby. As part of such substitution, the calculation agent will "as directed by [the issuer], make such adjustments ("Adjustments") to the Alternative Rate or the spread thereon, as well as the business day convention, interest determination dates and related provisions and definitions, in each case that are consistent with accepted market practice for the use of such Alternative Rate for debt obligations."[59] Not only are holders of the floating rate instruments, at the outset, agreeing that an alternative rate may replace the LIBOR rate on their debt securities, they are further agreeing that the calculation agent can alter that new rate with "adjustments" consistent with market practice. The final fallback under the NextEra papers, if an Alternative Rate cannot be obtained, is the last rate available on the relevant Bloomberg or Reuters page.[60]

Another recent example of this approach was AT&T Inc.'s (AT&T) $3.75 billion floating rate global notes due 2024, which closed on August 22, 2018.[61] Similar to NextEra, in the case where LIBOR had been discontinued, the AT&T transaction allowed the calculation agent to use an "alternative rate" and to make "adjustments" that are "consistent with accepted market practice for the use of such [a]lternative [r]ate."[62]

---

55. Press Release, International Swaps and Derivatives Association, ISDA Publishes Consultation on Benchmark Fallbacks (July 12, 2018), *available at* https://www.isda.org/2018/07/12/isda-publishes-consultation-on-benchmark-fallbacks.

56. *Id.*

57. NextEra Energy Capital Holdings, Inc., Form 424(b)(2) (Aug. 21, 2018), *available at* https://www.sec.gov/Archives/edgar/data/753308/000114420418045959/tv501450-424b2.htm.

58. *Id.* at S-21 to S-22.

59. *Id.* at S-22.

60. *Id.*

61. AT&T Inc., Form 424(b)(2) (Aug. 16, 2018), *available at* https://www.sec.gov/Archives/edgar/data/732717/000119312518253029/d585064d424b2.htm.

62. *Id.* at S-7 to S-8.

Unlike NextEra and AT&T, certain other recent floating rate transactions also contemplate, under certain circumstances, the appointment of an independent financial advisor. On September 10, 2018, General Motors Company closed an offering of $450 million senior notes due 2021,[63] which provided that:

> if we determine there is no clear market consensus as to whether any rate has replaced three-month LIBOR in customary market usage, we may appoint in our sole discretion an independent financial advisor (the "IFA") to determine an appropriate Alternative Rate, and any Adjustments, and the determinations of the IFA will be binding on us, the trustee, the calculation agent, if any, and the holders of the Floating Rate Notes.[64]

For similar language which contemplates an independent financial advisor, see Pfizer Inc.'s $300 million offering of floating rate notes, which closed on September 7, 2018.[65]

In a speech on December 6, 2018,[66] SEC Chairman Jay Clayton highlighted specific market risks which the SEC is monitoring, including the transition away from LIBOR.

Of particular note in Chairman Clayton's discussion of LIBOR was his discussion of the Secured Overnight Financing Rate (SOFR):

> The Alternative Reference Rate Committee [(ARRC)]—a committee convened by the Federal Reserve that includes major market participants, and on which the SEC staff and other regulators participate—has proposed an alternative rate to replace U.S. Dollar LIBOR—the Secured Overnight Financing Rate, or "SOFR." The [ARRC] has identified benefits to using SOFR as an alternative to LIBOR. For example, SOFR is based on direct observable transactions. SOFR is based on a market with very deep liquidity, reflecting overnight Treasury repurchase agreement transactions with daily volumes regulatory in excess of $700 billion.[67]

The ARRC, which first met in December of 2014, was convened to identify an alternative reference rate for use primarily in derivatives contracts.[68] As noted by Chairman Clayton, on June 22, 2017, the ARRC identified SOFR as its recommended alternative to US Dollar LIBOR.[69] The ARRC considered a comprehensive list of potential alternatives, including other term unsecured rates, overnight unsecured rates such as the Effective Federal Funds Rate (EFFR) and

63. General Motors Company, Form 424(b)(2) (Sept. 5, 2018), *available at* https://www.sec.gov/Archives/edgar/data/1467858/000119312518268865/d618880d424b2.htm.

64. *Id*. at S-14.

65. Pfizer Inc., Form 424(b)(5) (Sept. 4, 2018), *available at* https://www.sec.gov/Archives/edgar/data/78003/000119312518268294/d617367d424b5.htm.

66. The full text of the speech is available at https://www.sec.gov/news/speech/speech-clayton-120618.

67. *Id*.

68. Frequently Asked Questions, Alternative Reference Rates Committee 1 (Jan. 31, 2019), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf.

69. *Id*. at 3.

the Overnight Bank Funding Rate, other secured "repo" rates, Treasury bill and bond rates, and overnight index swap rates linked to EFFR.[70]

SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities.[71] SOFR is published by the Federal Reserve Bank of New York and is determined based on transactions composed of (i) triparty repurchase agreements (repo), (ii) general collateral finance repo, and (iii) bilateral Treasury repo transactions cleared through Fixed Income Clearing Corporation.[72] One issue that must be analyzed in a transition from LIBOR to SOFR is that SOFR is an overnight rate with no term rate equivalent to LIBOR's term rates structure.[73]

The Federal National Mortgage Association (Fannie Mae) issued the market's first-ever SOFR securities.[74] The three-tranche $6 billion SOFR debt transaction settled on July 30, 2018.[75] Credit Suisse became the first bank to issue debt tied to SOFR, selling a $100 million six-month certificate of deposit on August 20, 2018.[76]

D. FinCEN Customer Due Diligence Requirements

On May 11, 2018, new rules[77] adopted by FinCEN require financial institutions to identify and verify the identity of beneficial owners who own or control legal entity customers of the financial institutions and to obtain a certification from the legal entity customers as to their beneficial owners. The new rules are intended to assist law enforcement in investigating terrorist financing, money laundering, and other financial crimes that may be perpetrated through the use of legal entities.

FinCEN's beneficial ownership definition includes two parts:

(a) the control prong, covering a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer, a senior manager or any other individual who regularly performs similar functions; and

(b) the ownership prong, covering each individual (if any) who directly or indirectly owns 25% or more of the equity interests of a legal entity customer.

---

70. *Id.*

71. *Id.*

72. *Id.*

73. *See* Pfizer Inc., Form 424(b)(5), *supra* note 65.

74. Press Release, Federal National Mortgage Association, Fannie Mae Pioneers Market's First-Ever Secured Overnight Financing Rate (SOFR) Securities (July 26, 2018), *available at* http://www.fanniemae.com/portal/media/financial-news/2018/fannie-mae-pioneers-sofr-securities-6736.html.

75. *Id.*

76. Joe Rennison, *Credit Suisse Becomes First Bank to Issue Debt Tied to Sofr*, Fin. Times (Aug. 20, 2018), https://www.ft.com/content/a7f5b21c-a4cd-11e8-8ecf-a7ae1beff35b.

77. 31 C.F.R. 1010.230.

On July 19, 2016, FinCEN issued guidance[78] summarizing the new requirements and responding to certain frequently asked questions. FinCEN's 2016 guidance summarizes the types of entities excluded from the beneficial ownership requirement (both the control prong and the ownership prong), which include:

- a financial institution regulated by a federal functional regulator or a bank regulated by a state bank regulator;
- a department or agency of the United States, of any state, or of any political subdivision of a state;
- an entity established under the laws of the United States, or any state, or of any political subdivision of any state, or under an interstate compact, that exercises governmental authority;
- an entity (other than a bank) whose common stock or analogous equity interests are listed on the New York, American, or NASDAQ stock exchange;
- a subsidiary, other than a bank, of an entity described in the immediately preceding bullet that is organized under the laws of the United States or of any state and at least 51% of whose common stock or analogous equity interests are held by the listed entity;
- an issuer of securities registered under Section 12 of the 1934 Act or that is required to file reports under Section 15(d) of the 1934 Act;
- an investment company, as defined in Section 3 of the Investment Company Act of 1940, registered with the SEC;
- an SEC-registered investment adviser, as defined in Section 202(a)(11) of the Investment Advisers Act of 1940;
- an exchange, a clearing agency, or any other entity registered with the SEC under the 1934 Act;
- a registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, defined in Section 1a of the Commodity Exchange Act, registered with the Commodity Futures Trading Commission;
- a public accounting firm registered under Section 102 of the Sarbanes-Oxley Act;
- a bank holding company, as defined in Section 2 of the Bank Holding Company Act of 1956 (12 USC 1841), or a savings and loan holding company, as defined in Section 10(n) of the Home Owners' Loan Act (12 USC 1467a(n)); and
- a pooled investment vehicle operated or advised by a financial institution excluded from the beneficial ownership requirement.

78. Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions (July 19, 2016), *available at* https://www.fincen.gov/sites/default/files/2016-09/FAQs_for_CDD_Final_Rule_%287_15_16%29.pdf.

FinCEN issued additional frequently asked questions on April 3, 2018.[79]

In the context of an underwritten sale of securities, the lead underwriter is often tasked with obtaining the certification of beneficial ownership and copies of identifying documents. In many transactions, as described in the July 2016 guidance, the issuer will have an exemption from both the control prong and the ownership prong. In those instances, a lead underwriter, in some cases, will obtain from the issuer the certification of the exemption upon which the issuer is relying. Current practice on this subject varies among major investment banks.

E. SEC Non-GAAP Enforcement Action

On December 26, 2018, the SEC announced it had settled charges against ADT Inc. (ADT).[80] The SEC had found that ADT, in two earnings releases, gave undue emphasis to the non-GAAP measurement of adjusted earnings before interest, tax, depreciation and amortization (EBITDA).[81] ADT agreed to an administrative settlement finding violations of Section 13(a) of the 1934 Act and Rule 13a-11 thereunder.[82] In connection therewith, the SEC imposed a $100,000 civil penalty and ordered ADT to cease and desist from further violations.[83]

On May 17, 2016, the SEC released twelve new or updated Compliance and Disclosure Interpretations (C&DIs) regarding the use of non-GAAP financial measures.[84] This guidance followed public statements by then SEC Chair Mary Jo White and other SEC officials on the increased use and potentially misleading nature of such measures.[85]

The guidance noted the following four examples of non-GAAP measures that are potentially misleading under Regulation G:[86]

1. Certain adjustments that are not explicitly prohibited but could be misleading;[87]
2. Non-GAAP measures that are not consistently presented between periods;[88]

---

79. Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions (Apr. 3, 2018), *available at* https://www.fincen.gov/sites/default/files/2018-04/FinCEN_Guidance_CDD_FAQ_FINAL_508_2.pdf.

80. In the Matter of ADT INC., Release No. 84956, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (Dec. 26, 2018), *available at* https://www.sec.gov/litigation/admin/2018/34-84956.pdf.

81. *Id.*

82. *Id.*

83. *Id.*

84. For a copy of the C&DIs, see https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm.

85. David Michaels & Michael Rapoport, *SEC Signals It Could Curb Use of Adjusted Earnings Figures*, Wall St. J., (Mar. 16, 2016), https://www.wsj.com/articles/sec-scrutinizing-use-of-non-gaap-measures-by-public-companies-1458139473.

86. 17 C.F.R pt. 244.

87. *See supra* note 84, at CD&I, Question 100.01 (May 17, 2016).

88. *Id.* at CD&I, Question 100.02.

3. Non-GAAP measures that are adjusted only for non-recurring charges when there were also non-recurring gains during the same period;[89] and
4. Non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for a GAAP measure.[90]

The guidance also mandated equal or greater prominence for GAAP measurements under Item 10(e)(1)(i) of Regulation S-K, setting forth the staff's view that GAAP measures must be presented first and described narratively in a manner similar to that of the comparable non-GAAP measures.[91]

In the case of ADT, the SEC found that on two occasions ADT had announced non-GAAP financial measurements without giving "equal or greater prominence" to the "most directly comparable" GAAP measures.[92] Specifically, in the headline of its fiscal 2017 earnings release, ADT announced that adjusted EBITDA was up 8%, without also mentioning net income or loss in the same headline.[93] In its Q1 2018 earnings release, ADT presented adjusted EBITDA figures in the headline and noted that adjusted EBITDA was up 7% as well.[94] Only later in the release did ADT report its net loss under GAAP.[95]

F. SEC Request for Comment on Periodic Reporting

On December 18, 2018, the SEC issued a Request for Comment on how it can enhance the investor protections provided by periodic disclosures while reducing administrative and other burdens on reporting companies associated with quarterly reporting.[96] According to the SEC, the purpose of the Request for Comment is to solicit public input on the nature, timing, format and frequency of periodic reporting, as well as the relationship between the periodic reports that issuers must provide under the 1934 Act and the earnings releases that many issuers furnish on Form 8-K.[97]

Among the topics on which the SEC is requesting comments are the following: (1) the nature and timing of disclosures that public companies must provide in their quarterly reports on Form 10-Q, including the extent to which the Form 10-Q disclosure requirements overlap with the disclosures such companies voluntarily provide in earnings releases; (2) how the SEC can promote efficiency in periodic reporting by reducing unnecessary duplication in the information that

89. *Id*. at CD&I, Question 100.03.
90. *Id*. at CD&I, Question 100.04.
91. *Id*. at CD&I, Question 102.10.
92. *See supra* note 79.
93. *Id*.
94. *Id*.
95. *Id*.
96. Securities and Exchange Commission, Request for Comment on Earnings Releases and Quarterly Reports, Release No. 10588 (Dec. 18, 2018) [83 FR 65601 (Dec. 21, 2018)], *available at* https://www.sec.gov/rules/other/2018/33-10588.pdf.
97. *Id*. at 11.

public companies disclose and how any such changes could affect capital formation, while, at the same time, enhancing, or at least maintaining, appropriate investor protection; (3) whether SEC rules should allow all or certain categories of public companies flexibility as to the frequency of their periodic reporting; and (4) how the current periodic reporting system, earnings releases and earnings guidance (either alone or in combination with other factors) may affect corporate decision-making, including whether the current system fosters an inefficient outlook among public companies and market participants by focusing on short-term results.[98] The Request for Comment included forty-six groups of questions.

Comments were due on March 21, 2019.[99]

This article presents the views of the authors, which do not necessarily reflect those of Hunton Andrews Kurth LLP or its clients. The information presented is for general information and education purposes. No legal advice is intended to be conveyed; readers should consult with legal counsel with respect to any legal advice they require related to the subject matter of the article. Receipt of this article does not constitute an attorney-client relationship. Prior results do not guarantee a similar outcome. Attorney advertising.

98. *Id.* at 11–13.
99. *Id.* at 2.

©2019. Published in Recent Developments in Infrastructure, Vol. 59, No. 1, Fall 2019, by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion there of may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association or the copyright holder.