April 27, 2016

Q1 2016 U.S. Legal and Regulatory Developments

The following is our summary of significant U.S. legal and regulatory developments during the first quarter of 2016 of interest to Canadian companies and their advisors.

1. Recent Delaware Court of Chancery Decisions:

Delaware Court of Chancery Rejects Another Disclosure-Only Settlement

On January 22, 2016, in *In re Trulia, Inc. Stockholders Litigation*, the Delaware Court of Chancery again rejected a settlement in the M&A context that released a broad range of claims in exchange only for supplemental disclosure in a proxy circular. The Court commented that practitioners should expect approval of such disclosure-only settlements only if the plaintiff obtains supplemental disclosures that are "plainly material" (that is, not a "close call" with respect to materiality) and the release is narrowly tailored to encompass only disclosure and fiduciary duty claims concerning the sale process, rather than a broad release of any and all claims, including unknown claims.

The Court highlighted the problematic features of deal litigation that prompted its decision. The Court explained that its willingness in the past to approve disclosure settlements of marginal value resulted in a litigation landscape where virtually every transaction involving the acquisition of a public corporation became subject to hastily filed class action lawsuits alleging disclosure violations, but that far too often such litigation served no useful purpose for stockholders. Instead, it served only to generate attorneys' fees for certain plaintiffs' attorneys and as a means for defendants to obtain through settlement an extremely broad release of all claims against them in exchange for immaterial disclosures.

For a more detailed discussion of *In re Trulia, Inc. Stockholders Litigation*, see the Paul, Weiss memorandum at:
https://www.paulweiss.com/media/3325930/26jan16ma.pdf.

Delaware Court of Chancery Holds That a Buyer's Fraud Claim Based on Extra-Contractual Representations Will Not Be Barred Unless the Buyer Affirmatively Disclaims Reliance on Such Representations

In *FdG Logistics LLC* v. *A&R Logistics Holding, Inc.*, the Delaware Court of Chancery held that a seller's disclaimer in a merger agreement of extra-contractual representations and warranties was insufficient to bar a buyer's claim for fraud, which was based on extra-contractual representations

© 2016 Paul, Weiss, Rifkind, Wharton & Garrison LLP. In some jurisdictions, this publication may be considered attorney advertising.
Past representations are no guarantee of future outcomes.

allegedly made by the seller during merger negotiations, because the buyer itself did not make an affirmative statement in the merger agreement disclaiming reliance on such extra-contractual representations.

The merger agreement in the transaction included a disclaimer, which stated that the target company was not making any representation or warranty outside of the merger agreement (the "Disclaimer Provision"), and an integration clause, which further stated that the transaction documents contained the entire agreement between the parties and superseded any other understandings, agreements or representations. After the merger closed, the sellers filed a complaint to recover a tax refund under the merger agreement. In response, the buyer asserted counterclaims against the sellers, including a counterclaim for fraud based on alleged misrepresentations and omissions in documents that the target company provided to the buyer before it entered into the merger agreement. The sellers moved to dismiss the fraud counterclaim because it related to alleged misrepresentations outside of the merger agreement, counter to the Disclaimer Provision.

The Court denied the motion to dismiss, holding that the Disclaimer Provision was not an unambiguous disclaimer of reliance by the buyer. In doing so, the Court provided an important reminder of how an enforceable anti-reliance clause must be constructed. Specifically, to be enforced, anti-reliance clauses must contain a clear statement disclaiming reliance. The Court explained that it "will not bar a contracting party from asserting claims for fraud based on representations made outside the four corners of [an] agreement unless that contracting party unambiguously disclaims reliance on such statements." The Court further explained that the identity of the disclaiming party is central to the Court's analysis because the Court must "strike an appropriate balance between holding sophisticated parties to the terms of their contracts and simultaneously protecting against the abuses of fraud." The Court reiterated that because of this "venerable public policy" it will not insulate a party from liability for its counterparty's reliance on fraudulent statements made outside an agreement absent a clear statement by that counterparty disclaiming such reliance.

For a more detailed discussion of *FdG Logistics LLC* v. *A&R Logistics Holding, Inc.*, see the Paul, Weiss memorandum at:
https://www.paulweiss.com/media/3365276/25feb16dem_a.pdf

2. Bill Introduced in U.S. Senate to Reform Section 13(d) Reporting Rules

On March 17, 2016, certain U.S. Senators introduced a bill, "The Brokaw Act," that would increase the oversight and transparency of activist investors and hedge funds. The proposed legislation would direct the Securities and Exchange Commission (the "SEC") to amend the reporting rules under Section 13(d) of the Securities Exchange Act of 1934 (the "Exchange Act").

The major amendments raised by The Brokaw Act include:

- Significantly shortening the period for filing an initial Schedule 13D from ten calendar days to two business days;
- Requiring the disclosure of short positions of over 5%;
- Providing that beneficial ownership include a pecuniary or indirect interest in shares, such as derivative instruments; and
- Expanding the definition of a "person" to include persons acting as a "group, or otherwise coordinating the actions of the persons," specifically targeting the collusion of activist investor "wolf packs."

Should The Brokaw Act, or some variation of it, become law at some point in the future, it could significantly impact the current activist investor landscape.

For the full text of the bill, see: https://www.baldwin.senate.gov/imo/media/doc/3.17.16%20-%20Brokaw%20Act%20Final.pdf.

3. OFAC Issues Guidance Regarding the Changes to the Iran Sanctions Regime

On January 16, 2016, international inspectors verified that Iran had complied with the initial nuclear requirements of the Joint Comprehensive Plan of Action ("JCPOA"), and the Secretary of State confirmed that verification. This milestone marked January 16 as "Implementation Day," the day on which U.S. and European sanctions relief under the JCPOA took effect. On that day, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") issued new guidance, FAQs, and general licenses to give effect to these changes.

The U.S. sanctions relief that took effect on January 16 left primary sanctions largely intact, but resulted in a substantial reduction in secondary sanctions which threaten non-U.S. persons with negative consequences if they do business in certain Iranian sectors or with particular Iranian individuals and entities, even where such transactions have no U.S. nexus. The changes to Iran sanctions present U.S. companies and, to a greater extent, non-U.S. companies, new opportunities to enter a previously isolated marketplace, which opportunities are accompanied by important legal, reputational and practical risks.

For a detailed summary of the changes in OFAC guidance, see the Paul, Weiss memorandum at: https://www.paulweiss.com/media/3322106/20jan16alert.pdf.

For the OFAC guidance and other documents related to the JCPOA "Implementation Day," see: https://www.treasury.gov/resource-center/sanctions/Programs/pages/iran.aspx.

4. U.S. House of Representatives Passes Bill that Proposes Changes to the Definition of "Accredited Investor"

On February 1, 2016, the U.S. House of Representatives passed a bill that proposes changes to the definition of "accredited investor" under U.S. federal securities laws. Known as "The Fair Investment Opportunities for Professional Experts Act," the bill directs the SEC to broaden its definition of "accredited investor" for natural persons found in Section 2(a)(15) of the U.S. Securities Act of 1933. Firstly, the bill would codify the net worth and income tests largely in their current forms under Section 501(a)(5) and (6) of Regulation D. Secondly, the bill proposes adding two additional classes of persons to the definition of "accredited investor," regardless of the level of that person's income.

The additional classes of "accredited investors" would include:

1. **Licensed brokers or advisors.** Natural persons currently licensed or registered as a broker or investment adviser by the SEC, the Financial Industry Regulatory Authority ("FINRA"), or an equivalent self-regulatory organization (as defined in section 3(a)(26) of the Exchange Act) ("SRO"), or the securities division of a state or the equivalent state division responsible for licensing or registration of individuals in connection with securities activities.

2. **Persons with certain professional knowledge.** Natural persons the SEC determines, by regulation, to have demonstrable education or job experience to qualify such person as having professional knowledge of a subject related to a particular investment, and whose education or job experience is verified by FINRA or an equivalent SRO.

The first additional class is straightforward, but the potential breadth of the second additional class is not determinable at this point in time. However, it is clear that adding these new classes of "accredited investors" would expose a currently untapped source of capital for private placements.

For the full text of the bill, see: https://www.gpo.gov/fdsys/pkg/BILLS-114hr2187eh/pdf/BILLS-114hr2187eh.pdf.

5. FTC Announces New Hart-Scott-Rodino and Clayton Act Section 8 Thresholds

The Federal Trade Commission (the "FTC") has revised the jurisdictional and filing fee thresholds of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") and the Premerger Notification

Rules. The new thresholds took effect on February 25, 2016 and apply to transactions that close on or after that date.

Under the HSR Act, notification and report forms must be submitted by parties intending to merge or acquire assets, voting securities or certain non-corporate interests if both the (1) size of transaction and (2) size of parties thresholds are met, unless an exemption from filing applies.

1. **Size of Transaction:** The minimum size of transaction threshold is US$78.2 million, increased from the 2015 threshold of US$76.3 million.

2. **Size of Parties:** The size of parties threshold is inapplicable if the value of the transaction exceeds US$312.6 million (US$305.1 million in 2015). For transactions with a value between US$78.2 million and US$312.6 million, the size of parties threshold must be met and will be satisfied in one of the following three ways.

	I	II	III
Acquiring Person:	US$156.3 million annual net sales or total assets	US$156.3 million annual net sales or total assets	US$15.6 million annual net sales or total assets
	and	*and*	*and*
Acquired Person:	US$15.6 million total assets	a manufacturer with US$15.6 million annual net sales or total assets	US$156.3 million annual net sales or total assets

The FTC also increased the thresholds that prohibit, with certain exceptions, competitor companies from having interlocking relationships among their directors or officers under Section 8 of the Clayton Act.

For a more detailed summary of new HSR Act and Clayton Act thresholds, see the Paul, Weiss memorandum at: https://www.paulweiss.com/media/3324869/26jan16ftc.pdf.

*   *   *

For a discussion of certain other developments not highlighted above, please see our memoranda available at: http://www.paulweiss.com/practices/region/canada.aspx.

*   *   *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Matthew W. Abbott 212-373-3402 mabbott@paulweiss.com	Christopher J. Cummings 416-504-0522 ccummings@paulweiss.com	Andrew J. Foley 212-373-3078 afoley@paulweiss.com
Adam M. Givertz 416-504-0525 agivertz@paulweiss.com	Edwin S. Maynard 212-373-3024 emaynard@paulweiss.com	Stephen C. Centa 416-504-0527 scenta@paulweiss.com

Associates Rebecca Vasluianu and Aaron J. Abramson contributed to this client alert.