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Q3 2016 U.S. Legal and Regulatory Developments

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

SEC Crackdown on Use of Non-GAAP Financial Measures

On September 8, 2016, as part of a general sweep aimed at non-GAAP financial measures being conducted by the Securities and Exchange Commission (the "SEC") Division of Enforcement, the SEC announced charges against former executives of a publicly traded company for allegedly overstating its financial performance by intentionally manipulating calculations of its adjusted funds from operations, a non-GAAP measure.

The charges are part of a broader effort by the SEC directed to the presentation of non-GAAP measures and the investing public's ability to understand and rely on such measures in connection with a company's financial statements. Following the cue of a March, 2016 speech by SEC Chair Mary Jo White which warned that the SEC would be narrowing in on the use of non-GAAP measures, in May 2016, the SEC's Division of Corporation Finance updated its Compliance and Disclosure Interpretation ("C&DIs") relating to the use of non-GAAP measures. The update presented further interpretation of the prohibitions found in Regulation G and Item 10(e) of Regulation S-K, violations of which are now more likely to attract the scrutiny of the SEC. The updated interpretation suggests that the SEC will be especially vigilant with regards to failing to present a GAAP measure with equal or greater prominence to that of its non-GAAP comparable.

Moving forward, companies should expect heightened scrutiny from the SEC surrounding the disclosure of any non-GAAP measures. Companies should review the updated C&DI as well as Regulation G and Item 10(e) of Regulation S-K, and ensure that the use of non-GAAP measures in disclosures is both justifiable and does not have the potential to confuse or mislead readers. When non-GAAP measures are used, companies should be sure to disclose the comparable GAAP financial measure in an equal or more prominent fashion.

For a more detailed summary of the C&DI, please see the Paul, Weiss memorandum available at: https://www.paulweiss.com/media/3571705/3june16_sec_updates.pdf.

SEC Approves Requirement to Disclose Third-Party Director Compensation for Nasdaq Companies

On July 1, 2016, the SEC approved a new Nasdaq rule to require a listed company to disclose the material terms of any third-party compensation or payments made to any nominee for director, or sitting director, in connection with his or her candidacy or service on the company's board of directors. The New York Stock Exchange has not yet proposed a similar rule for its listed companies, so only Nasdaq-listed companies are subject to this requirement for the time being. Foreign private issuers may elect to follow home country practices instead of complying with the rule, provided that the issuer discloses on its website or in its annual report that it has elected not to comply with the rule.

Nasdaq's new Rule 5250(b)(3) requires listed companies to disclose the material terms of all agreements and arrangements between any director or nominee for director and any third party relating to compensation or other payment in connection with such person's candidacy or service as a director. This disclosure must be made on an annual basis until the earlier of the resignation of the director or one year after the termination of the compensation arrangement, either on the company's website or in the definitive proxy or information statement for the shareholders' meeting at which directors are to be elected (or in the Form 10-K or 20-F, if the company does not file proxy or information statements). If a company makes the disclosure on its website, the disclosure must be available no later than the date of filing of the definitive proxy or information statements in connection with the applicable shareholder meeting (or the Form 10-K or Form 20-F, if the company does not file proxy or information statements) and must be continuously accessible.

For a more detailed discussion of the new rule, see the Paul, Weiss memorandum at: https://www.paulweiss.com/media/3635184/13jul16securities.pdf.

For the full text of the final rule see:
http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2016/SR-NASDAQ-2016-013_Amendment_2.pdf.

SEC Proposes Updates to Rationalize Disclosure Requirements

On July 13, 2016, the SEC proposed amendments to certain of its disclosure requirements that may have become redundant, duplicative, overlapping, outdated or superseded, in light of other SEC disclosure requirements, U.S. Generally Accepted Accounting Principles ("GAAP"), International Financial Reporting Standards ("IFRS") or changes in the information environment. The SEC also solicited comment on certain disclosure requirements that overlap with, but require information incremental to, U.S. GAAP to determine whether to retain, modify, eliminate or refer them to the Financial Accounting Standards Board ("FASB") for potential incorporation into U.S. GAAP.

The proposed amendments are an attempt to streamline the SEC's disclosure requirements and do not significantly alter the total mix of information currently provided to investors or otherwise implement the substantive revisions to Regulation S-K discussed in the SEC's April 2016 concept release, "Report on Review of Disclosure Requirements in Regulation S-K." These proposals are a result of the SEC's Disclosure Effectiveness Initiative, a comprehensive evaluation of the SEC's disclosure requirements with the objective of improving the disclosure regime for both investors and companies. The proposed amendments also implement a requirement under the Fixing America's Surface Transportation Act (the "FAST Act") that the SEC eliminate provisions of Regulation S-K that are duplicative, overlapping, outdated, or unnecessary.

In the proposed release, the SEC notes that, in several cases, the streamlining of disclosure requirements would result in the relocation of disclosures within a filing-often from the non-financial portion of the filing to the financial statements-potentially changing the prominence or context of both the relocated disclosures and the remaining disclosures. The SEC also notes that certain proposed amendments would replace certain existing rules that have bright line disclosure thresholds with rules that do not, potentially changing the disclosure provided to investors.

Significantly, disclosure moved into the financial statements would be subject to an annual audit or interim review by the issuer's auditors, and to internal control over financial reporting. Such a move would also result in such disclosure no longer benefiting from the protections of the Private Securities Litigation Reform Act for forward-looking statements, which may cause issuers to be less likely to voluntarily supplement those disclosures with forward-looking information as compared to disclosures made outside the audited financial statements.

For a more detailed summary of the final rules, see the Paul, Weiss memorandum at:
https://www.paulweiss.com/media/3645661/21jul16_sec.pdf.

For the full text of the proposed rules see:
https://www.sec.gov/rules/proposed/2016/33-10110.pdf.

Delaware Court of Chancery Dismissed Post-Closing Merger Challenge Due to Fully Informed Stockholder Approval

On August 25, 2016, the Delaware Court of Chancery, in its decision in *Larkin* v. *Shah*, dismissed a stockholder challenge to a merger due to the cleansing effect of fully informed stockholder approval, applying the Delaware Supreme Court's *Corwin* v. *KKR Financial Holdings LLC* decision issued in October 2015.

The *Larkin* opinion confirms that, pursuant to *Corwin*, unless a controlling stockholder (or group) stands on both sides of a transaction or receives a non-ratable benefit as to which the entire fairness standard applies *ab initio*, proper stockholder approval insulates transactions from fiduciary challenge on all grounds other than waste, and a plaintiff cannot avoid dismissal merely by alleging that a majority of the board harbored a conflict of interest or failed to exercise due care. Further, *Larkin* states that the business judgment rule is irrebuttably invoked.

In addition, relying on *In re Volcano Corp. Stockholder Litigation*, a significant case decided June 30, 2016, *Larkin* confirms that the tenders by a stockholder majority into a front-end offer under Section 251(h) of the General Corporation Law of the State of Delaware constituted stockholder approval sufficient to invoke the *Corwin* standard. In *In re Volcano Corp. Stockholder Litigation*, the Court found no basis to distinguish the first-step tender offer in a two-step merger under Section 251(h) from a statutorily required stockholder vote. It explained that the target board's role in negotiating a two-step merger subject to a first-step tender offer under Section 251(h) is substantially similar to its role in a merger subject to a stockholder vote under Section 251(c). Moreover, it found that the requirements of Section 251(h) alleviate "the coercion that stockholders might otherwise be subject to in a tender offer."

For a more detailed summary of the *Larkin* v. *Shah* decision, see the Paul, Weiss memorandum at: https://www.paulweiss.com/media/3689089/1sept16larkin.pdf.

For a more detailed summary of the *In re Volcano Corp. Stockholder Litigation* decision, see the Paul, Weiss memorandum at: https://www.paulweiss.com/media/3614605/5jul16volc.pdf.

SEC Proposes Rule Amendment to Shorten Settlement Cycle for Broker-Dealer Securities Transactions from Three Days to Two

On September 28, 2016, the SEC voted to propose amending SEC Rule 15c6-1(a) which would shorten the standard settlement cycle for most broker-dealer security transactions from three business days after the trade date to two business days after the trade date.

Should the amendment pass, the general prohibition on broker-dealers from contracting for the purchase or sale of a security that provides for payment of funds and delivery of the security would last for only two days after the trade date, unless an alternative timeframe is expressly agreed to by the parties at the time of the transaction.

For the proposed rule amendment in its entirety, see https://www.sec.gov/rules/proposed/2016/34-78962.pdf.

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

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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:

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