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Q1 2017 U.S. Legal and Regulatory Developments

The following is our summary of significant U.S. legal and regulatory developments during the first quarter of 2017 of interest to Canadian companies and their advisors.

1. Recent SEC Disclosure Developments

On March 1, 2017, the U.S. Securities and Exchange Commission ("SEC") issued a notice and request for comment, together with proposed and final rules intended to update certain disclosure requirements as follows:

- **XBRL Reporting Requirements for IFRS Users**. The SEC issued a notice that the IFRS Taxonomy has been published and is available for foreign private issuers to submit their financial statements in eXtensible Business Reporting Language ("XBRL"). Canadian foreign private issuers that prepare their financial statements in accordance with IFRS will be required to submit financial data in XBRL with their first annual report on Form 20-F or Form 40-F for a fiscal period ending on or after December 15, 2017.

- **Hyperlinks to Exhibits in SEC Filings**. The SEC adopted a final rule requiring issuers to include a hyperlink to each exhibit listed in the exhibit index of a registration statement or filing that is required to include exhibits under Item 601 of Regulation S-K for domestic issuers, or under Form F-10 or Form 20-F for foreign private issuers. The rule, originally proposed in August 2016, becomes effective September 1, 2017, or September 1, 2018 for smaller reporting companies and companies that are neither large accelerated filers nor accelerated filers. At this time, the SEC has not extended the hyperlinking requirement to Form 6-K or to other Forms under the multi-jurisdictional disclosure system used by certain Canadian issuers.

For the full text of this article, please see: https://www.paulweiss.com/media/3976979/3mar17sec.pdf

2. Second Circuit Holds That Trust Indenture Act 316(b) Prohibits Only Non-Consensual Amendments to Core Payment Terms of Bond Indentures

On January 17, 2017, the U.S. Court of Appeals for the Second Circuit issued its long-anticipated opinion in *Marblegate Asset Management, LLC* v. *Education Management Finance Corp.*, ruling that Section 316(b) of the Trust Indenture Act of 1939 (the "TIA") prohibits only non-consensual amendments to core payment terms of bond indentures. The 2-1 ruling vacated and remanded the decision of the district court, which determined that the defendants (two affiliated note issuers and their corporate parent) violated Section 316(b) by engaging in a series of transactions that, while they did not amend the governing indentures, were designed to restructure the defendants' debt in a manner that deprived non-consenting noteholders of their practical ability to collect payment on the notes. The Second Circuit opinion clarifies an issue that had caused substantial doubt and debate in the U.S. debt markets and provides companies that issue debt in the United States with broader ability under the TIA to restructure that debt outside of bankruptcy court.

For the full text of this article, please see:
https://www.paulweiss.com/media/3890505/18jan17marblegate.pdf

3. President Signs Executive Order on Core Principles for Regulating the U.S. Financial System

On February 3, 2017, President Donald J. Trump signed an executive order setting forth "Core Principles" intended to guide the regulation of the U.S. financial system. Although not specifically mentioned in the executive order, revisions to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") will likely be a focus of scrutiny based on comments made by the President and his staff during the campaign and by the President at the time of the order's signing.

We will continue to monitor and report on both executive and legislative developments in financial system regulation.

For the full text of this article, please see: https://www.paulweiss.com/media/3945910/9feb17eov3.pdf

4. President and Congress Eliminate SEC Resource Extraction Rule

On February 14, 2017, President Trump signed a joint resolution of Congress passed under the Congressional Review Act ("CRA"), which eliminated an SEC rule requiring resource extraction issuers to disclose payments made to the U.S. federal government or foreign governments for the commercial development of oil, natural gas or minerals.

Section 1504 of the Dodd-Frank Act directed the SEC to issue rules requiring resource extraction issuers to include in an annual report information relating to any payment made by the issuer or its affiliates to the U.S. federal government or a foreign government for the purpose of the commercial development of oil, natural gas or minerals. The original resource extraction rule was adopted by the SEC in August 2012. Following a challenge by industry groups in 2013, the rule was vacated by the U.S. District Court for the District of Columbia.

In December 2015, the SEC re-proposed the resource extraction disclosure rule, in part to address the concerns that led to the original rule being vacated. The rule was adopted substantially as re-proposed in June 2016, and would have required that resource extraction issuers comply with the disclosure requirements starting with their fiscal year ending on or after September 30, 2018.

Given that Canada has adopted a disclosure initiative similar to the SEC's original rules, the elimination of this rule will not have a significant impact on companies subject to the Canadian disclosure regime.

The elimination of the disclosure requirements for resources extraction issuers marks the first action by Congress to roll back regulations implementing parts of the Dodd-Frank Act.

For the full text of this article, please see:
https://www.paulweiss.com/media/3954480/15feb17_sec.pdf

5. A Flurry of FCPA Enforcement Actions Marks the End of the Obama Administration

Following on the heels of a record-breaking enforcement year, the Department of Justice (the "DOJ") and the SEC continued their FCPA enforcement activities at a breakneck pace in December 2016 and January 2017. In the final weeks of the Obama Administration, the DOJ resolved matters with six companies, which collectively paid U.S. $513.3 million in criminal fines. The SEC also brought enforcement actions against six companies, which paid a total of U.S. $328 million in civil penalties, disgorgement and prejudgment interest. In addition, in January 2017 alone, the DOJ criminally charged five individuals, and the SEC civilly charged two, for alleged violations of the FCPA.

The flurry of enforcement activity likely had more to do with Obama Administration officials' efforts to clear the decks before the arrival of the Trump Administration, rather than signaling any new enforcement trends. Nonetheless, some enforcement themes emerge from a close reading of these cases. For example, two of the actions – *Zimmer Biomet* and *Orthofix* – shed light on how the DOJ and the SEC treat repeat offenders who were subject to prior FCPA enforcement actions. Others, such as *Teva*, reinforce the DOJ's new focus on disgorgement.

For the full text of this article, please see:
https://www.paulweiss.com/media/3957908/17feb17_fcpa.pdf

6. Trump Administration Makes Active Use of Economic Sanctions and Imposes Record-Setting Sanctions Penalty

Despite its generally deregulatory stance, the Trump Administration has made active use of economic sanctions as a tool of foreign policy and has taken a rigorous approach to sanctions enforcement. On March 7, 2017, three federal agencies – the DOJ, the Department of Commerce, and the Department of the Treasury's Office of Foreign Assets Control ("OFAC") – reached a U.S. $1.19 billion resolution with a Chinese company, Zhongxing Telecommunications Equipment Corporation ("ZTE"), for sanctions and export violations involving trade with Iran. This represents the largest U.S. sanctions/export controls penalty against a non-financial company. The Trump Administration also continues to impose new sanctions, announcing new designations targeting Iran only two weeks after President Trump's inauguration, as well as recent designations related to North Korea, Venezuela, and counter-terrorism.

Canadian companies doing business internationally must continue to be vigilant regarding U.S. sanctions risks, particularly if they are using U.S. dollars or involving U.S. financial institutions or other U.S. persons.

For our article discussing recent U.S. sanctions, anti-money laundering, and cybersecurity developments, please see: https://www.paulweiss.com/media/3967232/22feb17aml.pdf

7. SEC Adopts T+2 Settlement Cycle for Securities Transactions

On March 22, 2017, the SEC adopted, as proposed, an amendment to Rule 15c6-1(a) under the Securities Exchange Act of 1934 to shorten by one business day the standard settlement cycle for most broker-dealer securities transactions. Currently, the standard settlement cycle for these transactions is three business days, known as T+3. The amended rule shortens the settlement cycle to two business days, or T+2, unless otherwise expressly agreed to by the parties at the time of the transaction. Transactions that already settle on a shorter settlement cycle will not be affected by the amendment.

In the adopting release, the SEC noted its belief that the shortened standard settlement cycle will reduce certain risks inherent in the clearance and settlement process for all clearing agencies, such as a central counterparty's credit, market and liquidity risk exposure to its members, because there will be fewer unsettled trades and a reduced time period of exposure to such trades. The SEC also noted that shortening the standard settlement cycle will benefit investors through quicker access to funds and securities following trade execution and will more closely align and harmonize the U.S. standard settlement cycle with those foreign markets that have already moved to a shorter settlement cycle.

The T+2 requirement would not apply to certain specified categories of securities and would not affect the settlement cycle for firm commitment underwritings.

The compliance date for the amendment to Rule 15c6-1(a) is September 5, 2017. The SEC has undertaken to submit a report within three years of that date evaluating possible movement to a T+1 or shorter settlement cycle.

The final rule is available at: https://www.sec.gov/rules/final/2017/34-80295.pdf

For the full text of this article, please see:
https://www.paulweiss.com/media/3977005/23mar17sec.pdf

8. Delaware Supreme Court Affirms Decision Permitting Merger Termination Based on Failure to Satisfy Tax Opinion Covenant

In a 4-1 split decision in *The Williams Cos., Inc.* v. *Energy Transfer Equity, L.P., et al.*, the Delaware Supreme Court affirmed the Court of Chancery's decision permitting termination of a merger agreement by the acquirer based on the failure of the acquirer to obtain a tax opinion from its counsel, the receipt of which was a condition precedent to the closing of the merger. The Supreme Court held that, even though the Court of Chancery did not properly analyze whether the acquirer met its covenants to use "commercially reasonable efforts" to obtain the tax opinion and "reasonable best efforts" to consummate the transaction, the acquirer had met its burden of proving that any alleged breach did not materially contribute to the failure to obtain the tax opinion.

For the full text of this article, please see:
https://www.paulweiss.com/media/3977011/27mar17williams.pdf

9. Supreme Court to Examine Key Question of Securities Fraud Liability Based Solely on Omissions

On March 27, 2017, the U.S. Supreme Court granted certiorari in a potentially significant securities case addressing the scope of claims under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, based solely on alleged omissions of material information. *Leidos, Inc. Indiana Public Retirement System, Supreme Court No. 16-581.* The Supreme Court will resolve a split between the Second and Ninth Circuits caused by the Second Circuit's holding that issuers may be liable for federal securities fraud by omitting information required to be disclosed by SEC regulations, even if those omissions do not render affirmative disclosures misleading.

Traditionally, to prevail under Section 10(b) and Rule 10b-5(b), a plaintiff must prove either a false statement or an omission of facts that renders a company's affirmative statements misleading. The Second Circuit in *Leidos* held that a case can also be predicated on an alleged failure to disclose information required to be disclosed under Item 303 of SEC Regulation S-K ("Item 303"), such as "known trends or uncertainties . . . that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."

Argument is expected to be scheduled in the fall, and the decision will likely be released sometime during the Supreme Court's 2017–2018 term.

For the full text of this article, please see:
https://www.paulweiss.com/media/3977015/30mar17leidos.pdf

10. SEC Issues Statements Following Recent Conflict Minerals Decision

On April 7, 2017, the SEC's Division of Corporation Finance stated that it has determined that it will not recommend enforcement action to the Commission, if companies, including those that are subject to paragraph (c) of Item 1.01 of Form SD, only file disclosure under the provisions of paragraphs (a) and (b) of Item 1.01 of Form SD.

In a separate statement issued on the same date, Michael Piwowar, Acting Chairman of the SEC, addressed the recent final judgment of the District Court for the District of Columbia in *National Association of Manufacturers* v. *SEC*. In the final judgment, issued on April 4, 2017, the court held that Section 1502 of the Dodd-Frank Act and the SEC's conflict minerals rule, Rule 13p-1 and Form SD thereunder, violate the First Amendment to the extent that the rule requires companies to report to the SEC and state on their websites that any of their products "have not been found to be 'DRC conflict free.'" The court held the rule unlawful and set it aside, but only to the extent it requires companies to state that any of their products "have not been found to be 'DRC conflict free.'"

By way of background, in 2014, the SEC issued guidance on the conflict minerals rule following an earlier Court of Appeals decision, which had found that the rule "violate[s] the First Amendment to the extent the statute and rule require regulated entities to report to the Commission and to state on their website that any of their products have 'not been found to be "DRC conflict free."'" In response to the court's decision, the 2014 SEC guidance stated that no company would be required to describe its products as "DRC conflict free," as having "not been found to be 'DRC conflict free,'" or as being "DRC conflict undeterminable," and that no audit of the issuer's Conflict Minerals Report would be required unless that issuer voluntarily elected to describe a product as "DRC conflict free."

In the April 7, 2017 public statement, Acting Chairman Piwowar announced that, following the recent final judgment of the district court, he has instructed the staff of the SEC to begin work on a recommendation for future action to address the Court of Appeals decision – including whether Congress's intent in Section 13(p)(1) can be achieved through a descriptor that avoids the constitutional defect identified by the court – and how that determination affects overall implementation of the conflict minerals rule.

Significantly, Acting Chairman Piwowar also acknowledged that the primary function of the extensive requirements for due diligence on the source and chain of custody of conflict minerals set forth in paragraph (c) of Item 1.01 of Form SD (including the Conflict Minerals Report audit requirement) is to enable companies to make the "DRC conflict free" disclosure. As this disclosure has now been found to be unconstitutional, Acting Chairman Piwowar acknowledged "it is difficult to conceive of a circumstance that would counsel in favor of enforcing Item 1.01(c) of Form SD." We will continue to monitor developments with regard to the conflict minerals rule.

For guidance on the conflict minerals rule, please see:
https://www.paulweiss.com/practices/transactional/capital-markets-securities/publications/sec-provides-guidance-following-court-of-appeals-ruling-in-conflict-minerals-case?id=17908

For the SEC's public statements, please see:
https://www.sec.gov/news/public-statement/piwowar-statement-court-decision-conflict-minerals-rule

https://www.sec.gov/news/public-statement/corpfin-updated-statement-court-decision-conflict-minerals-rule

For the full text of this article, please see: https://www.paulweiss.com/media/3977052/10apr17sec.pdf

11. Allergan Pays U.S. $15 Million Fine for Failure to Disclose Merger Negotiations

The SEC recently announced a settlement with Allergan, Inc., pursuant to which Allergan agreed to pay a U.S. $15 million penalty and admitted to violating requirements to update prior disclosure to reflect M&A negotiations in which the company was involved. This action arose in the context of Allergan's pitched battle against Valeant's hostile takeover attempt. Shortly after Valeant's offer launched in April 2014, Allergan filed a Schedule 14D-9, as required by SEC rules, in which it recommended against the offer as inadequate, and further stated that it was not "undertaking or engaged in any negotiations in response to the [o]ffer that relate to or could result in . . . any extraordinary transaction" involving Allergan or any of its subsidiaries. Although Schedule 14D-9 requires that such disclosure be promptly updated for any material changes, Allergan did not disclose that it was considering alternative transactions or engaging in negotiations – including possibly acquiring an unnamed target and being acquired by Actavis plc – until months later in some instances and only after the strong urging of SEC staff.

While this settlement does not create or imply any new obligations on the part of potential merger parties to disclose preliminary negotiations, it serves as a helpful reminder that once a party speaks about the existence or non-existence of such negotiations, it then has the obligation not to provide misleading information and to promptly update any prior disclosure as material changes occur. This is especially the case where disclosure has been made pursuant to an SEC filing that imposes antifraud and updating requirements, such as a Schedule 14D-9 or Schedule 13D. The Allergan action is just the latest in a series of SEC enforcement procedures against undue reliance on "boilerplate" disclosure in such filings.

For the SEC order, see: https://www.sec.gov/news/pressrelease/2017-16.html

For the full text of this article, please see:
https://www.paulweiss.com/media/3896303/19jan17allergan.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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