October 12, 2017

Q3 2017 U.S. Legal and Regulatory Developments

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

1. Trump Administration and Republican Congressional Leaders Release Framework for Tax Cuts

On September 27, 2017, the Trump administration, the House Committee on Ways and Means and the Senate Committee on Finance released a nine-page tax reform proposal entitled: "Unified Framework For Fixing Our Broken Tax Code" (the "Framework"). The Framework sets out specific targets for lower business and individual tax rates. The Framework would reduce the corporate tax rate from 35% to 20%, establish a new 25% tax rate for certain pass-through business income and create a territorial tax system and a one-time mandatory repatriation tax. The Framework would also replace the current seven individual tax brackets with three brackets with rates set at 12%, 25% and 35%, while leaving open the possibility of providing a fourth higher tax bracket. The Framework proposes to roughly double the standard deduction, increase the current $1,000 child tax credit and repeal the individual alternative minimum tax and the estate tax. While the plan would repeal "most itemized deductions," tax incentives for mortgage interest and charitable donations generally would remain. The Framework calls for the House and Senate tax committees to provide specific details of tax reform legislation and resolve other open issues.

For the Framework, please see:
https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf

2. U.S. Department of Commerce Preliminarily Determines 220% Subsidies with respect to Bombardier C Series Jets

On September 26, 2017, in response to a complaint from the Boeing Company, the U.S. Department of Commerce ("Commerce") announced an affirmative preliminary determination in the countervailing duty investigation of 100- to 150-seat large civil aircraft from Canada's Bombardier Inc., finding that Bombardier's C-Series jets received countervailable subsidies of 219.63%. Commerce is scheduled to announce its final determination on or about December 19, 2017. The International Trade Commission is scheduled to make its final injury determination approximately 45 days after Commerce issues its final determination, if affirmative.

For Commerce's announcement, please see:
https://www.commerce.gov/news/press-releases/2017/09/us-department-commerce-issues-affirmative-preliminary-countervailing-1

3. Divided Second Circuit Panel Overrules Prior *Newman* Insider Trading Decision

On August 23, 2017, in *United States* v. *Martoma*, the United States Court of Appeals for the Second Circuit overruled its own 2014 decision in *United States* v. *Newman* and altered the standard for determining whether the personal benefit element of insider trading has been satisfied. The decision had been eagerly anticipated as a key test for how courts would interpret the U.S. Supreme Court's 2016 decision in *Salman* v. *United States*.

For more than 30 years, since the Supreme Court's seminal decision in *Dirks* v. *SEC,* the dividing line between lawful trading on material, nonpublic information and unlawful insider trading has been whether the tipper breached a duty in exchange for a "personal benefit." In most cases, courts have had little difficulty defining the boundaries of that requirement because either the tipper received a financial benefit, or the tippee was a close friend or relative with whom the insider had no legitimate, business reason to be sharing confidential corporate information. In those circumstances, courts have generally permitted an inference of a personal benefit.

In *Newman*, however, the Second Circuit was faced with a corporate insider (an investor relations employee) who shared information with an analyst at an institutional investor. In order to enforce the dividing line created by the *Dirks* Court, and avoid chilling legitimate communications between market professionals and company insiders, the Second Circuit in *Newman* held that, in the absence of an explicit *quid pro quo*, a gift of confidential information from a tipper to a tippee could only amount to a "personal benefit" when the tipper had a "meaningfully close personal relationship" with the tippee.

On August 23, 2017, the Second Circuit panel majority in *Martoma* overruled that test and created a new standard for defining the boundaries of the "personal benefit" requirement: a "personal benefit" to the tipper may exist "whenever the information was disclosed with the expectation that the recipient would trade on it and the disclosure resembles trading by the insider followed by a gift of the profits to the recipient." One judge dissented from the panel's decision.

If the Second Circuit's new test for determining "personal benefit" survives a potential *en banc* review, it will remain to be seen how lower courts implement that test, particularly in the context of communications between a corporate insider and a market professional.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3977260/25aug17-martoma.pdf

4. Delaware Courts Continue to Address Appraisal Issues in the Third Quarter of 2017

This quarter, the Delaware courts issued two opinions that related to appraisal valuations. In one, *DFC Global Corporation* v. *Muirfield Value Partners, L.P.*, the Delaware Supreme Court continued to stress reliance on deal price in determining fair value in appraisal actions absent a problematic sale process. In the opinion by Chief Justice Strine, the Supreme Court reversed and remanded the Court of Chancery's determination of the fair value of DFC Global Corporation, which had been found to be $10.30 per share (approximately 8% more than the merger price). Although the Supreme Court declined to create a presumption that deal price is the best evidence of fair value in arm's-length mergers, it nevertheless found that the Court of Chancery erred in not giving greater weight to the deal price as the most reliable indication of fair value, given the robust sale process. The Supreme Court also rejected the Court of Chancery's seeming recognition of a "private equity carve out," in which the deal price in a private equity transaction is viewed as an unreliable indication of fair value due to the firm's goal of achieving a specified rate of return.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3977231/7aug17-dfc.pdf

In the other decision, *ACP Master, Ltd.* v. *Sprint Corporation* and *ACP Master, Ltd.* v. *Clearwire Corporation*, Vice Chancellor Laster of the Delaware Court of Chancery appraised the fair value of Clearwire at approximately 57% less than the deal price in the merger between the company and majority stockholder, Sprint, largely because synergies generated by the transaction must be excluded from the appraisal valuation by law. The court also dismissed related fiduciary duty claims, finding that the merger was entirely fair to Clearwire minority stockholders.

For the decision, please see: http://courts.delaware.gov/Opinions/Download.aspx?id=259730

5. OFAC Breaks New Ground by Penalizing Non-U.S. Companies for Making U.S. Dollar Payments Involving a Sanctioned Country

On July 27, 2017, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") announced a $12 million settlement with CSE Global Limited and its subsidiary, CSE TransTel Pte. Ltd. ("TransTel"), which are both based in Singapore.

TransTel entered into contracts to install telecommunications equipment for several Iranian energy projects. According to the settlement, TransTel apparently violated U.S. sanctions by using its U.S. dollar account at a Singapore-based bank to make over $11 million in payments to various third-party vendors—including several Iranian companies—that were providing goods and services in connection with the Iranian contracts. These payments (which did not indicate their relation to Iran) were processed through the U.S. financial system and caused multiple financial institutions to violate U.S. sanctions by engaging in the prohibited exportation of financial services (i.e., processing U.S. dollar payments) from the United States to Iran or for the benefit of Iran.

This action is significant because it appears to be the first time OFAC has penalized a non-U.S., nonfinancial company for "causing" sanctions violations by initiating U.S. dollar payments involving a sanctioned country. Historically, OFAC has focused its enforcement resources on penalizing non-U.S. banks that processed such U.S. dollar transactions involving sanctioned countries, especially where the banks were alleged to have knowingly removed (or helped their customers to remove) information indicating a link to the sanctioned country; OFAC has chosen not to pursue the banks' customers that initiated these transactions. While this particular case involves Iran sanctions—and could reflect the Trump administration's policy of more aggressively confronting Iran—it likely signals a broader enforcement trend that applies across the range of U.S. sanctions programs.

In light of this action, Canadian and other non-U.S. companies that do business with OFAC-sanctioned jurisdictions or persons should be aware of the significant risks of using U.S. dollar payments.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3977213/28jul17-transtel.pdf

For OFAC's announcement of its enforcement actions, please see:
https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170727_transtel.pdf

6. President Trump Signs Sanctions Legislation Targeting Russia, North Korea and Iran, Creating New Compliance Risks for U.S. and Non-U.S. Companies

On August 2, 2017, President Trump signed the Countering America's Adversaries Through Sanctions Act ("CAATSA") into law. CAATSA—which was passed overwhelmingly by the Senate and House of Representatives on a broad bipartisan basis—significantly expands certain U.S. sanctions targeting Russia. The law also restricts President Trump's ability to lift certain sanctions unilaterally, by including a congressional review mechanism that will allow Congress to potentially block the president from relaxing measures targeting Russia. CAATSA also adds sanctions targeting North Korea, largely incorporating an earlier House bill, the "Korean Interdictions and Modernization of Sanctions Act." Finally, CAATSA codifies certain non-nuclear sanctions in place against Iran. Many of the law's sanctions are secondary sanctions, meaning that non-U.S. entities that engage in certain activities—even if such activities do not involve U.S. persons or the United States—may themselves be sanctioned by the United States.

While a number of the sanctions included in CAATSA are referred to as "mandatory," it remains to be seen how certain provisions are enforced by the Trump administration. As an initial matter, many of these provisions require the president to sanction individuals or entities only after he determines that they have engaged in certain activities, thus allowing the president to theoretically refrain from enforcing these sanctions by withholding certain determinations. Additionally, in signing the Act, President Trump released two signing statements, in which he noted his "concerns to Congress about the many ways [the bill] improperly encroaches on Executive power, disadvantages American companies, and hurts the interests of our European allies," and his view that the "bill remains seriously flawed," because it "encroaches on the executive branch's authority to negotiate" and because "the Congress included a number of clearly unconstitutional provisions." President Trump stated that he would implement the statute's restrictions "in a manner consistent with the President's constitutional authority to conduct foreign relations."

While the Iran-related measures should not require major compliance attention beyond existing efforts by financial institutions or other companies subject to Iran-related sanctions risk, the same is not true for the new Russia and North Korea measures. Instead, CAATSA presents significant new compliance risks for both U.S. and non-U.S. companies conducting business with Russia. The law does the same for non-U.S. companies that may be doing business with North Korea.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3977222/3aug17-caatsa.pdf

For the CAATSA, please see: https://www.congress.gov/115/bills/hr3364/BILLS-115hr3364enr.pdf

7. President Trump Signs Executive Order Authorizing Sweeping Secondary Sanctions on Entities Involved In North Korean Trade

On September 20, 2017, President Trump signed Executive Order 13810, "Imposing Additional Sanctions with Respect to North Korea" (the "EO"), which broadly authorizes the Department of the Treasury to impose sanctions against individuals and entities, including non-U.S. financial institutions, for conducting or facilitating trade with North Korea. The EO marks the Trump administration's decision to employ a strategy of threatening secondary sanctions—sanctions that target conduct with no nexus to the United States—to pressure companies around the world to sever business involving North Korea. When announcing the EO, President Trump stated, "Foreign banks will face a clear choice: Do business with the United States, or facilitate trade with the lawless regime in North Korea." The EO builds on recent U.N. Security Council Resolutions and CAATSA and signals Congress's embrace of broad secondary sanctions against North Korea.

Although the ultimate effect of the new EO will largely turn on its implementation, the EO reflects the continued commitment of the Trump administration to sever North Korea's access to international trade and financial markets. Under this new threat of secondary sanctions, Canadian companies and other non-U.S. entities should seriously consider the risks associated with forming or maintaining trade, financial, or other business relationships, directly or indirectly, with North Korea. While most financial institutions were already conducting enhanced diligence related to North Korea, the new EO serves as another warning of the importance of these compliance measures.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3977308/26sep17-sanctions.pdf

For the EO, please see:
https://www.treasury.gov/resource-center/sanctions/Programs/Documents/13810.pdf

8. SEC Issues Pay Ratio Guidance

On September 21, 2017, the Securities and Exchange Commission ("SEC") and its Division of Corporation Finance issued interpretative guidance on the calculation of CEO pay ratio disclosure for public companies. The pay ratio rules require the disclosure of the ratio of the annual total compensation of a registrant's median employee to the annual total compensation of its principal executive officer and take effect with respect to compensation paid by companies in their first full fiscal year beginning on or after January 1, 2017. This will require proxy disclosure in 2018 for most companies. The rule does not apply to Canadian companies that are foreign private issuers. The guidance provides companies with significant flexibility in using estimates and statistical sampling to identify the median employee and calculate his or her total compensation, with the core message being that any one or combination of methods is acceptable so long as it is "reasonable."

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3977404/27sep17-sec.pdf

For the SEC's interpretive release, please see: https://www.sec.gov/rules/interp/2017/33-10415.pdf

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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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