July 29, 2019

Q2 2019 U.S. Legal & Regulatory Developments

The following is our summary of significant U.S. legal and regulatory developments during the second quarter of 2019 of interest to Canadian companies and their advisors.

SEC Proposes to Streamline Disclosures Relating to Acquisitions and Dispositions

On May 3, 2019, the Securities and Exchange Commission ("SEC") proposed rule changes to streamline the information that domestic issuers and foreign private issuers voluntarily reporting on domestic forms (10-K, 10-Q and 8-K) are required to provide to investors in connection with significant acquisitions and dispositions of other businesses. The proposed amendments are intended to facilitate more timely access to capital and reduce complexity and compliance costs of the financial disclosures triggered by significant acquisitions and dispositions.

When registrants acquire a significant business, other than a real estate operation, Rule 3-05 of Regulation S-X (*Financial statements of businesses acquired or to be acquired*) generally requires these registrants to provide separate audited annual and unaudited interim pre-acquisition financial statements of that business. The number of years of financial information that must be provided depends on the relative significance of the acquisition to the registrant. Article 11 of Regulation S-X requires registrants to file unaudited pro forma financial information relating to the acquisition or disposition.

The proposed changes would, among other things:

- **Update the significance tests when evaluating what financial statements are required.** Whether an acquisition is significant pursuant to Rule 3-05 of Regulation S-X is determined by applying the investment, asset and income tests in the "significant subsidiary" definition. The SEC proposes to revise the investment and income tests to improve their application and to assist registrants in making more meaningful significance determinations.

- **Limit the financial statement requirement to a maximum of two years.** In the proposing release, the SEC notes that two years of pre-acquisition financial statements would be sufficient to allow investors to understand the possible effects of an acquired business on the registrant. Accordingly, the SEC proposes eliminating the requirement to file the third year of Rule 3-05 financial statements for an acquisition that exceeds 50% significance.

- **Permit abbreviated financial statements in certain circumstances.** The SEC notes that registrants frequently acquire a component of an entity, such as a product line or a line of business, that does not itself constitute a separate entity and may not have separate financial statements necessary to prepare Rule 3-05 financial statements because the component often represents only a small part of the selling entity. The SEC proposes to permit registrants in these circumstances to provide abbreviated financial statements regarding assets acquired and liabilities assumed if certain conditions are met.

- **Permit the use of International Financial Reporting Standards.** The SEC is proposing limited modifications to Rule 3-05 to permit acquired business financial statements to be prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS") without reconciliation to U.S. generally accepted accounting principles ("GAAP") if the acquired business would qualify to use IFRS if it were a registrant.

- **Amend pro forma financial information requirements to improve its relevance.** Pro forma financial information for a business acquisition currently consists of historical financial statements of the registrant and the acquired business and is adjusted for certain items if specified criteria are met. The proposed rules would amend the pro forma financial information requirements to improve the content and relevance of such information. Under the proposals, Article 11 would be revised by replacing the existing pro forma adjustment criteria with simplified requirements to depict the accounting for the transaction and present the reasonably estimable synergies and other transaction effects that have occurred or are reasonably expected to occur.

- **Revise the significance threshold for the disposition of a business.** The proposed rules would also revise Rule 11-01(b) to raise the significance threshold for the disposition of a business from 10% to 20% to conform it to the threshold at which an acquired business is significant under Rule 3-05, and to conform, to the extent applicable, the tests used to determine the significance of a disposed business to those used to determine the significance of an acquired business.

The proposed rule changes are the result of the SEC's ongoing evaluation of disclosure requirements, including its 2015 *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant*.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978642/13may19-sec-disclosures.pdf

For the full text of the proposed rule, please see:
https://www.sec.gov/rules/proposed/2019/33-10635.pdf

For the full text of the 2015 *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant*, please see:
https://www.sec.gov/rules/other/2015/33-9929.pdf

SEC Proposes to Amend Definitions of "Accelerated Filer" and "Large Accelerated Filer"

On May 9, 2019, the SEC announced a proposal to amend the definitions of "accelerated filer" and "large accelerated filer" under Rule 12b-2 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") in an ongoing effort to reduce costs and reporting requirements for registrants. The proposed rule changes would:

- exclude from "accelerated filer" and "large accelerated filer" status registrants that are eligible to be treated as "smaller reporting companies" and that had annual revenues of less than US$100 million in the most recent fiscal year for which audited financial statements are available;

- increase the transition thresholds for accelerated and large accelerated filers becoming nonaccelerated filers from a public float of US$50 million to US$60 million and for exiting large accelerated filer status from a public float of US$500 million to US$560 million; and

- add an annual revenue test of less than US$100 million (or less than US$80 million if not able to meet US$100 million at first test) to the transition thresholds for exiting both accelerated and large accelerated filer status.

As a result of the proposed rule changes, certain low-revenue registrants would not be required to have their assessment of the effectiveness of internal control over financial reporting ("ICFR") attested to, and reported on, by an independent auditor, although management would continue to be required to make such assessments and to establish and maintain the effectiveness of their ICFR.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978669/23may19-accelerated-filer.pdf

For the full text of SEC's proposed rule, please see:
https://www.sec.gov/rules/proposed/2019/34-85814.pdf

Delaware Supreme Court Rejects Reliance on Trading Price in Appraisal Action; Orders Award of Deal Price Minus Synergies

In *Verition Partners Master Fund Ltd.* v. *Aruba Networks, Inc.*, the Delaware Supreme Court reversed the Court of Chancery's exclusive reliance on a pre-announcement stock trading price to determine "fair value" in a statutory appraisal action, reasoning the valuation methodology was inappropriate on the record presented. Instead, the Delaware Supreme Court directed the Court of Chancery to enter a judgment reflecting the deal price minus the synergy value shared with Aruba's stockholders, resulting in an increase to the appraisal award originally ordered by the Court of Chancery by approximately US$2 per share. Despite this increase, the award remained approximately 20% less than the negotiated deal price. The

Delaware Supreme Court's ruling continues the emerging line of Delaware cases utilizing deal-price-minus-synergies as the best measure of fair value for public company mergers subjected to open, arm's length negotiations.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978601/19apr19-aruba-del.pdf

For the full text of the decision, please see:
http://www.potteranderson.com/media/experience/861_Verition%20v%20Aruba.pdf

Supreme Court Passes–For Now–on Rejecting an Implied Private Right of Action for Tender Offer Claims

On April 23, 2019, the Supreme Court issued a one-line *per curiam* order in *Emulex* v. *Varjabedian*: "The writ of *certiorari* is dismissed as improvidently granted." The dismissal came just one week after contentious oral arguments that focused on the fundamental question of whether shareholders can bring private suits under Section 14(e) of the Exchange Act for misstatements or omissions made in connection with tender offers. The Supreme Court's dismissal of the appeal leaves two fundamental questions unresolved: first, does a private right of action exist under Section 14(e)? And, second, does a claim based on false statements or omissions under Section 14(e)—whether by private plaintiffs or by the SEC—require proof only of negligence, as the Ninth Circuit has held, or of scienter, as other circuits have held?

The Supreme Court's dismissal of *Emulex* means that, at least for now, the Ninth Circuit's opinion stands. The private right of action may not be around for much longer, however. Based on the tenor of oral argument in *Emulex*, a majority of the Justices seem prepared to close the door on any implied private right of action under Section 14(e). Notably, Section 14(e) applies only to "tender offers," not to mergers or other transactions where no tender is made. It remains to be seen whether the Supreme Court has any interest in reconsidering the private right of action under Section 14(a), the provision governing proxies, which was at issue in the *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) decision repeatedly invoked at argument.

For now, it is important for all defendants being sued under Section 14(e) to make, and preserve, all arguments that no implied private right of action exists under Section 14(e), both to present a desirable vehicle for the Supreme Court to reconsider the question, and to make it easier for these defendants to benefit from a favorable decision on this question if the Supreme Court rejects a private right of action in the future.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978614/25apr19-emulex.pdf

OFAC Issues Guidance on Sanctions Compliance Programs and Flags "Root Causes" Underlying Prior Enforcement Actions

On May 2, 2019, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") issued guidance entitled "A Framework for OFAC Compliance Commitments" (the "Framework") that strongly encourages companies to "develop, implement, and routinely update" risk-based sanctions compliance programs. OFAC made clear that the guidance was intended for U.S. companies as well as non-U.S. companies that conduct business in or with the United States, with U.S. persons, or using U.S. origin goods or services. The guidance describes five "essential components" of an effective sanctions compliance program: (i) management commitment, (ii) risk assessment, (iii) internal controls, (iv) testing and audit, and (v) training.

As an appendix to the Framework, OFAC also describes some of the common "root causes" of the apparent violations that were the subject of its prior enforcement actions. This appendix is meant to assist companies in "designing, updating and amending" their sanctions compliance programs.

The Framework, and the related "compliance commitments" in recent OFAC settlements, represent a new effort by OFAC to more clearly and comprehensively communicate its expectations about appropriate sanctions compliance practices. U.S. and non-U.S. companies would be well advised to study the Framework and the compliance commitments carefully.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978645/14may19-ofac-compliance.pdf

For the full text of the Framework, please see:
https://www.treasury.gov/resource-center/sanctions/Documents/framework_ofac_cc.pdf

Foreign Corrupt Practices Act ("FCPA") Developments

SEC Fines Telefônica Brasil S.A. US$4.125 Million Relating to World Cup Tickets Given to Government Officials

On May 9, 2019, the SEC imposed a US$4.125 million civil penalty on Telefônica Brasil S.A. to resolve allegations that the company's internal accounting controls failed to protect sufficiently against the risk that things of value, like World Cup tickets and related hospitality, would be given improperly to government officials, and that the company inaccurately recorded such expenses in its books and records, all in violation of the accounting provisions of the FCPA. Telefônica Brasil has agreed to settle the allegations without admitting or denying the SEC's findings.

Specifically, the SEC alleges that Telefônica Brasil, a subsidiary of Telefônica S.A., a Spanish multinational broadband and telecommunications provider, failed to devise and maintain sufficient internal accounting controls over a hospitality program that the company hosted in connection with the 2014 World Cup and the 2013 Confederations Cup. Telefônica Brasil, a foreign issuer whose ADRs trade on the New York Stock Exchange, allegedly offered and provided tickets and hospitality to government officials who were directly involved with, or in a position to influence, government actions affecting the company's business. In total, Telefônica Brasil allegedly provided World Cup and Confederations Cup tickets and related hospitality with a combined total value of nearly US$740,000 to approximately 127 government officials between 2012 and 2014.

According to the SEC, although Telefônica Brasil had in place a general code of ethics that prohibited these gifts to public officials, it was not followed due to a lack of internal accounting controls, a compliance breakdown, and a deficient internal audit function. Additionally, the SEC alleges that, because the company recorded the ticket purchases and hospitality as being for general advertising and publicity purposes, when in fact the tickets and related hospitality were given to government officials, Telefônica Brasil's books and records did not, in reasonable detail, accurately and fairly reflect the disposition of the company's assets.

The settlement further demonstrates that the SEC will enforce the internal accounting controls provisions of the FCPA, even where it is unable to establish, or chooses not to charge, violations of the FCPA's anti-bribery provisions, and that lavish gift, travel and hospitality programs and expenses are a significant risk area for companies, including those outside of the United States.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978643/13may19-telefonica-brasil.pdf

TechnipFMC Agrees to Pay US$296 Million to DOJ and Brazilian Authorities to Resolve Criminal FCPA Charges; SEC Civil Charges Pending

On June 25, 2019, the Department of Justice announced a resolution with Technip FMC PLC ("TFMC"), a London-headquartered, global provider of oil and gas technology and services that is listed on the New York Stock Exchange, for conspiracy to violate the anti-bribery provisions of the FCPA. TFMC is a result of the 2017 merger of Paris-based Technip S.A. and Houston-based FMC Technologies, Inc. TFMC entered into a three-year deferred prosecution agreement with the DOJ and agreed to pay a combined total criminal fine of more than US$296 million to resolve the charges with the DOJ and with the Advogado-Geral da União, the Controladoria-Geral da União and the Ministério Público Federal in Brazil. TFMC will pay approximately US$82 million in fines to the DOJ, which will credit the US$214 million that TFMC pays to the Brazilian authorities. Additionally, TFMC has reached an agreement in principle with the SEC, subject to final SEC approval.

The charges arose from two bribery schemes: one by TFMC's pre-merger predecessor company, Technip S.A., to pay bribes to Brazilian officials, and one by its other pre-merger predecessor, FMC Technologies, Inc., to pay bribes to Iraqi officials. Although the settlements with the DOJ and with the Brazilian authorities resolve allegations relating to conduct that occurred more than ten years ago, TFMC continues to struggle with liabilities incurred by its pre-merger predecessors. The resolutions with the DOJ and authorities in Brazil, as well as the company's pending resolutions with the SEC, highlight the potential significance of successor liability when engaging in merger activity with a company that has engaged in FCPA violations, and the importance of conducting corruption-related due diligence and remediation. Taking steps to understand the risk of successor liability and conducting post-acquisition reviews soon after closing are especially important in light of the DOJ's revised FCPA Corporate Enforcement Policy, announced in 2018, pursuant to which the Department may credit successor entities in mergers and acquisitions that promptly report wrongdoing.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978757/2july19-technipfmc.pdf

For the full text of the revised FCPA Corporate Enforcement Policy, please see:
https://www.justice.gov/jm/jm-9-47000-foreign-corrupt-practices-act-1977

Walmart Pays US$282 Million for Failing to Maintain a Sufficient Anti-Corruption Compliance Program

On June 20, 2019, the Department of Justice and the SEC announced long-awaited resolutions with Walmart, Inc. for violations of the books and records and internal accounting provisions of the FCPA. In addition to entering into a three-year non-prosecution agreement, and agreeing to the imposition of a compliance monitor for two years, Walmart agreed to pay US$137 million to settle the DOJ's criminal charges and a further US$144 million to resolve parallel civil charges brought by the SEC. Additionally, Walmart consented to the SEC's finding that it violated the books and records and internal accounting provisions of the FCPA. Relatedly, WMT Brasilia, S.a.r.l. ("WMT"), Walmart's wholly owned Brazilian subsidiary, pleaded guilty in connection with the resolution.

The settlements with Walmart are further examples of the DOJ and the SEC using the FCPA's accounting provisions in cases in which they believe an issuer's compliance program creates the potential for bribery. Notwithstanding the numerous allegations of improper payments to foreign officials, of knowledge, across multiple subsidiaries and to some degree at the parent company, of deficient controls and awareness that Walmart was expanding internationally at an expedited rate, neither the DOJ nor the SEC concluded there was actual knowledge or even willful blindness of actual bribery, and thus they did not bring any anti-bribery charges.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978734/25jun19-walmart.pdf

SEC Adopts New Standard of Conduct for Broker-Dealers

On June 5, 2019, by a vote of 3-1, the SEC adopted a package of rulemakings and interpretations addressing investors' relationships with broker-dealers and investment advisers. Under Regulation Best Interest (new Rule 15l-1 under the Exchange Act), a broker-dealer and a natural person who is an associated person of a broker-dealer will be required, when making a recommendation regarding any securities transaction or any investment strategy involving securities, to act in the best interest of a retail customer without placing their respective financial interests ahead of the customer. The SEC also approved a rule establishing a new short-form disclosure document (Form CRS) that will provide retail investors with information about the nature of their relationship with their investment professionals. Lastly, the SEC issued interpretations (i) to reaffirm and, in some cases, clarify the SEC's views on the fiduciary duty that investment advisers owe to their clients and (ii) to reaffirm and, in some cases, clarify the SEC's views on the broker-dealer exclusion under the Investment Advisers Act of 1940. The new requirements will come into effect June 30, 2020.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978733/25june19-sec-new-standard.pdf

For the full text of Regulation Best Interest, please see:
https://www.sec.gov/rules/final/2019/34-86031.pdf

For the full text of the rule establishing Form CRS, please see:
https://www.sec.gov/rules/final/2019/34-86032.pdf

For the full text of the SEC interpretation clarifying the SEC's views on the fiduciary duty that investment advisers owe to their clients, please see:
https://www.sec.gov/rules/interp/2019/ia-5248.pdf

For the full text of the SEC interpretation clarifying the SEC's views on the broker-dealer exclusion under the Investment Advisers Act of 1940, please see:
https://www.sec.gov/rules/interp/2019/ia-5249.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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