October 3, 2019

Q3 2019 U.S. Legal & Regulatory Developments

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

1. SEC Extends the "Test-the-Waters" Accommodation to All Issuers

On September 26, 2019, the U.S. Securities and Exchange Commission (the "SEC") announced that it has adopted a new rule under the U.S. Securities Act of 1933 (the "Securities Act") extending a "test-the-waters" accommodation, currently available only to emerging growth companies ("EGCs"), to all issuers. The goal of new Rule 163B is to encourage more issuers to enter the U.S. public equity markets, while continuing to maintain appropriate investor protections, by leveling the playing field among issuers, increasing their flexibility to tailor the size and other terms of an offering, and reducing core costs of going public.

Section 5(c) of the Securities Act prohibits any written or oral offers prior to the filing of a registration statement. In 2012, the U.S. Congress passed the Jumpstart Our Business Startups Act that created, inter alia, a "test-the-waters" accommodation for EGCs (Section 5(d) of the Securities Act). The accommodation permits EGCs, or any persons acting on their behalf, to engage in oral or written communications with potential investors that are, or are reasonably believed to be, qualified institutional buyers ("QIBs") or institutional accredited investors ("IAIs"), either before or after filing of a registration statement, in order to ascertain such investors' interest in a contemplated securities offering.

Under new Rule 163B, all issuers (whether domestic or foreign, reporting or non-reporting, EGCs or non-EGCs, and including well-known seasoned issuers and investment companies) will be allowed to gauge market interest in a possible initial public offering or other registered securities offering through oral or written communications with certain institutional investors prior to, or following, the filing of a registration statement.

The rule will be become effective 60 days after publication in the Federal Register.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978911/1oct19-sec-test-waters.pdf

For the full text of the Final Rule, please see:
https://www.sec.gov/rules/final/2019/33-10699.pdf

2. SEC Issues Guidance on Proxy Voting Responsibilities of Investment Advisers and the Applicability of Proxy Rules to Proxy Voting Advice Dispositions

On August 21, 2019, the SEC approved much anticipated guidance regarding the applicability of proxy rules to proxy voting advice and related guidance regarding proxy voting responsibilities of investment advisers. Over the past several years, the SEC has engaged with the public on the proxy voting process multiple times, starting with a 2010 concept release seeking input on the U.S. proxy system and more recently a 2018 roundtable on the same topics. The SEC has relied on the information gathered through these engagement efforts to issue this guidance, which takes a middle-of-the-road approach between the more stringent regulation that registrants had sought and maintaining the status quo as proxy advisory firms and some investors had urged.

As part of its guidance, the SEC issued two Q&A's relating to the applicability of the U.S. federal proxy rules to proxy voting advice. First, the SEC confirmed that proxy voting advice generally constitutes a solicitation under the U.S. proxy rules. In coming to this determination, the SEC noted, among other things, that proxy advisory firms market packages of commercial services that are designed to influence the client's voting decisions, even if the client ultimately does not follow the proxy advisory firm's recommendations or if the proxy advisory firm makes recommendations based on its application of the client's voting criteria (unless the firm's services are purely administrative or ministerial). The SEC observed that, notwithstanding this conclusion, proxy advisory firms may still take advantage of certain exemptions to the SEC's information and filing requirements under the U.S. federal proxy rules, and that any advice given in response to unsolicited inquiries from clients (*e.g.*, by a broker or a financial advisor to a client in response to an inquiry) is not considered a solicitation. Second, the SEC also confirmed that proxy voting advice provided by proxy advisory firms is subject to the SEC's antifraud provisions under Rule 14a-9 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act").

Separately, the SEC issued six Q&A's relating to proxy voting responsibilities of investment advisers, addressing matters that include: investment advisers' ability to agree with clients as to the scope of the adviser's authority and responsibilities to vote proxies on the client's behalf; steps that should be taken by an investment adviser to ensure its voting decisions are in a client's best interests; investment advisers' obligations to consider the capacity and competency of a proxy advisory firm with respect to certain matters when determining whether to retain the firm; the design of the investment adviser's policies and procedures, including those aimed at periodically evaluating the services of its selected proxy advisory firm; and whether an investment adviser is required to exercise every opportunity to vote a proxy for a client.

These clarifications will likely impact the policies and procedures, as well as practices, of investment advisers and proxy advisory firms, in particular if there is a greater likelihood of registrants challenging practices under the antifraud provisions under Exchange Act Rule 14a-9. Further changes may still be forthcoming, as the SEC continues to consider, among other things, rule amendments to address proxy advisory firms' reliance on proxy solicitation exemptions in Exchange Act Rule 14a-2(b) – which exempts such firms from complying with SEC proxy information and filing requirements – and other proxy voting issues. SEC guidance, unlike rulemaking, is not subject to a comment process and, therefore, has immediate effect following publication in the Federal Register, although the real impact is unlikely to be evident before the 2020 proxy season, at the earliest.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978857/28aug19-sec-proxy-voting.pdf

For the full text of the SEC's guidance, please see:
https://www.sec.gov/rules/interp/2019/34-86721.pdf

3. SEC Proposes to Modernize Descriptions of Business and Legal Proceedings, and Risk Factor Disclosures, Under Regulation S-K

On August 8, 2019, the SEC proposed amendments to Regulation S-K under the Exchange Act that aim to modernize the current descriptions of business and legal proceedings and risk factor disclosure requirements. The proposed amendments are designed to improve the readability of disclosure documents, as well as discourage repetition and disclosure of non-material information. The proposed amendments would revise disclosure requirements for registrants under Items 101(a) (description of the general development of the business), 101(c) (narrative description of the business), 103 (legal proceedings) and 105 (risk factors) of Regulation S-K. The SEC proposal reflects a desire for more principles-based disclosure requirements whereby disclosure objectives are set and management can exercise judgment as to how to satisfy those objectives.

Once implemented, these changes will impact disclosures made by Canadian and U.S. issuers who report on U.S. domestic issuer forms, including Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q.

The proposed amendments principally impact four disclosure areas:

- **Item 101(a), General Development of Business**: The proposed amendments would eliminate the five-year disclosure timeframe for the registrant's description of general business development, instead focusing disclosure on the information material to understanding the development of a registrant's business irrespective of a specific timeframe. The SEC also proposed to eliminate the prescriptive list of disclosure items in Item 101(a) and instead shift to a principles-based approach, allowing registrants to satisfy their obligation by providing material information on the general development of their business. The proposed amendments would also require registrants to provide updated disclosure only for material developments in filings made after an initial registration statement;

- **Item 101(c), Narrative Development of Business**: The proposed amendments would reaffirm the existing principles-based approach of Item 101(c) and clarify that a registrant has to discuss the enumerated items for a segment only when material to its business;

- **Item 103, Legal Proceedings**: The proposed amendments would permit registrants to provide some or all of the information already required under Item 103 by using cross-references to disclosure elsewhere in the document (including the financial statements and MD&A), thereby avoiding duplicative disclosure of information; and

- **Item 105, Risk Factors**: The proposed amendments would require registrants to provide summary risk factor disclosure if the risk factor section exceeds 15 pages and would change the disclosure standard from the "most significant" factors to the "material" factors which make an investment speculative or risky. Registrants would also be required to organize risk factors under relevant headings and to place generic risk factors generally applicable to companies at the end of the risk factors section under a separate heading entitled "General Risk Factors."

The proposed amendments are subject to a 60-day public comment period ending on October 22, 2019.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978834/21aug19-sec-regulation-s-k.pdf

For the full text of the SEC's proposed amendments, please see:
https://www.sec.gov/rules/proposed/2019/33-10668.pdf

4. New York Governor Signs Data Security Law

On July 25, 2019, New York Governor Andrew M. Cuomo signed into law a new data security law, the Stop Hacks and Improve Electronic Data Security ("SHIELD") Act. The SHIELD Act expands New York's existing data breach notification law by broadening its scope and imposing more stringent notification and procedural requirements on businesses in the aftermath of a data breach. The SHIELD Act also requires companies to implement "reasonable safeguards" to protect consumer data.

Amongst other changes, the SHIELD Act expands the definition of what constitutes a data breach, requiring companies to notify any resident of New York state when their private information is accessed—not just when it is acquired—by unauthorized third parties. If unauthorized third parties viewed, "communicated with," used, or altered such information, the new law treats these as indications that unauthorized access took place. The SHIELD Act also purports to expand the geographic application of New York's data breach notification law to include any person or entity that "owns or licenses computerized data which includes private information" of a New York resident. This is a significant change from prior legislation, which applied only to persons or entities that conducted business in New York state.

The SHIELD Act is representative of the trend towards heightened requirements regarding data handling and data breaches throughout the United States and internationally. With the steady increase in the number of data breaches, lawmakers and regulators are increasingly focused on ensuring that companies provide transparency to affected consumers (and imposing fines for companies unable or unwilling to comply). In light of the SHIELD Act, companies wherever located should determine whether they hold data pertaining to New York residents and therefore whether the SHIELD Act's terms apply to them. Companies may need to update their data security policies and controls and their incident response plans to comply with the new requirements.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978800/31jul19-ny-data-laws.pdf

For the full text of the SHIELD Act, please see:
https://legislation.nysenate.gov/pdf/bills/2019/S5575B

5. SEC Issues Statement Highlighting Risks Regarding LIBOR Transition

On July 12, 2019, the SEC staff issued a statement (the "LIBOR Statement") urging market participants to prepare for the transition away from the London Interbank Offered Rate ("LIBOR") reference rate. The LIBOR Statement represents the views of the SEC's Divisions of Corporation Finance, Investment Management and Trading and Markets, as well as the Office of the Chief Accountant. This announcement echoes those made by other regulators and financial industry participants that the transition from LIBOR to alternative reference rates must be a focus well before LIBOR ceases publication, which is expected to occur in 2021. The SEC staff described the transition from LIBOR as "taking on urgency," and market participants should take steps now to account for LIBOR's expected discontinuation.

Amongst other things, the LIBOR Statement encourages market participants to: commence the process of identifying contracts that extend beyond 2021 to determine their exposure to LIBOR; consider, when entering into new contracts that would normally reference LIBOR, whether to instead reference an alternative reference rate such as the Secured Overnight Financing Rate, or if the decision is made to reference LIBOR, whether to include effective fallback language to account for the cessation of LIBOR's publication; and assess the impacts, if any, that the discontinuation of LIBOR will have on existing and new contracts, and to implement mitigation efforts accordingly. Additionally, each of the SEC's Divisions of Corporation Finance, Investment Management and Trading and Markets and the Office of the Chief Accountant provided specific guidance to registrants and other market participants likely to be impacted by the discontinuation of LIBOR, tailored to the different constituencies regulated by the SEC, each of which will face potentially different challenges.

Many aspects of the transition away from LIBOR will cause operational, business, and legal difficulties, and several of the questions posed by the SEC for consideration with regard to existing contracts highlight particular challenges faced by market participants as they prepare for LIBOR cessation. Market participants should continue to stay apprised of these issues through ongoing discussions with regulators, monitoring regulatory developments from their regulators and working groups, and consultations with outside counsel on industry-wide efforts to address these, and other, challenging questions.

For the full text of our memorandum, please see:
https://www.paulweiss.com/media/3978778/18jul19-sec-libor-transition.pdf

For the full text of the LIBOR statement, please see:
https://www.sec.gov/news/public-statement/libor-transition

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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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