October 30, 2020

Q3 2020 U.S. Legal & Regulatory Developments

The following is our summary of significant U.S. legal and regulatory developments during the third quarter of 2020 of interest to Canadian companies and their advisors.

1. SEC Adopts Final Rules on Proxy Voting Advice and Related Guidance on Investment Adviser Voting Responsibilities

On July 22, 2020, the U.S Securities and Exchange Commission (the "SEC") voted 3-1 to adopt final rule changes and related guidance on proxy voting advice. In a move welcomed by companies, but strongly opposed by proxy advisory firms and their investor clients, the final rules take a "principles-based" approach to the regulation of proxy voting advice.

The amendments, among other things:

- codify the SEC's longstanding view that proxy voting advice generally constitutes a solicitation for purposes of the proxy rules;
- but provide that a proxy advisory firm may avail itself of exemptions from certain information and filing requirements of the proxy rules if it:
  - provides specified conflicts of interest disclosure in its proxy voting advice or in an electronic medium used to deliver the advice (failure to disclose such conflicts and the methodologies and sources of information used could be considered materially misleading in violation of Rule 14a-9's antifraud provisions); and
  - adopts and publicly discloses written policies and procedures reasonably designed to ensure that (i) companies that are the subject of proxy voting advice have access to the advice prior to or at the time the advice is disseminated to the proxy advisory firm's clients and (ii) its clients have a mechanism by which they can reasonably expect to become aware of any written statements regarding the proxy voting advice from companies that are the subject of such advice, in a timely manner before the applicable shareholder meeting.

Proxy advisory firms have until December 21, 2021 to implement these new procedures.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3980386/22july20-sec-proxy-voting.pdf

For the SEC press release on these rule amendments, please see:

- https://www.sec.gov/news/press-release/2020-161

2. SEC Amends Disclosure Requirements for Business Sections, Legal Proceedings and Risk Factors

On August 26, 2020, the SEC adopted amendments to Regulation S-K that update disclosure requirements in Item 101(a) (description of the general development of the business), Item 101(c) (narrative description of the business), Item 103 (legal proceedings) and Item 105 (risk factors). The SEC believes that the changes will result in a more principles-based, registrant-specific and cost-efficient approach to disclosure that will facilitate an understanding of the performance of a registrant's business, its financial position and prospects through the eyes of its management and board of directors.

The amendments to Items 101 and 103 apply only to domestic registrants and foreign private issuers that have elected to file on domestic forms because Regulation S-K does not apply to foreign private issuers unless a form reserved for foreign private issuers (*e.g.*, Form F-1, F-3, or F-4) specifically refers to Regulation S-K. The amendments to Item 105 apply to both domestic and foreign private issuers.

The amendments become effective November 9, 2020.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3980453/sec_amends_disclosure_requirements_for_business_sections_legal_proceedings_and_risk_factors.pdf

For the SEC adopting release, please see:

- https://www.sec.gov/rules/final/2020/33-10825.pdf

3. SEC Settles Charges against BMW AG for Failure to Provide Accurate Disclosure in Rule 144A Bond Offerings

On September 24, 2020, the SEC announced settled charges against BMW AG and two of its U.S. subsidiaries for inaccurate and misleading disclosures included in offering memoranda for Rule 144A offerings of bonds in the United States. The enforcement action arose out of improper reporting of retail

sales of BMW vehicles. The enforcement action was based on violations of Section 17(a)(2) and (a)(3) of the U.S. Securities Act of 1933 (the "Securities Act").

This enforcement action is notable in that it is highly unusual for the SEC to pursue disclosure claims against a foreign issuer (that is not an SEC registrant) undertaking an offering of securities in the United States on a private basis. In 2003, the SEC brought an action against Parmalat Finanziara S.p.A. for violations of Section 17(a) in connection with debt offerings in the United States; the claims arose out of the financial scandal involving Parmalat and certain of its senior managers and directors.

According to the SEC order, between 2015 and 2019, BMW of North America LLC ("BMW NA"), a U.S. subsidiary of BMW AG and its national sales company in the United States, engaged in three separate practices that resulted in inaccurate reporting of its retail vehicle sales volume. During the periods in question, BMW AG, through a finance subsidiary, undertook seven bond offerings in the United States in reliance on Rule 144A, raising $18 billion.

Non-U.S. issuers accessing the U.S. capital markets should be mindful that the SEC monitors disclosure directed at investors in those markets, whether retail investors in the public markets or sophisticated institutional investors in the Rule 144A or other private offering markets, and it does not distinguish between equity offerings and debt offerings in terms of disclosure standards.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3980495/sec_settles_charges_against_bmw_ag_for_failure_to_provide_accurate_disclosure_in_rule_144a_bond_offerings.pdf

For the SEC press release, please see:

- https://www.sec.gov/news/press-release/2020-223

4. SEC Published Nasdaq's Proposal for Direct Listing with a Capital Raise

On September 15, 2020, the SEC published proposed listing rule changes filed by Nasdaq on September 4 that would permit companies undertaking a direct listing on Nasdaq to raise capital. Under the revised rules, companies would be permitted to undertake an initial public offering and concurrent Nasdaq listing without the use of underwriters to market the shares.

Nasdaq's proposal follows the recent New York Stock Exchange ("NYSE") rule change, described below, permitting primary direct floor listings, *i.e.*, direct listings with a primary capital raise. The NYSE rule was approved on August 26, 2020, but has yet to take effect.

Proposed Listing Rule IM-5313-2, an amendment of Nasdaq's current Listing Rule IM-5313-1, would allow a company to simultaneously list on the Nasdaq Global Select Market and sell on its own behalf its previously unregistered common equity shares upon the effectiveness of a Securities Act registration statement in the opening auction on the first day of trading on the exchange.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3980479/sec_publishes_nasdaqs_proposal_for_direct_listings_with_a_capital_raise.pdf

For the SEC's publication of the proposed listing rule change, please see:

- https://www.sec.gov/rules/sro/nasdaq/2020/34-89878.pdf

5. SEC Approves NYSE Rule Change Permitting Primary Direct Floor Listings

On August 26, 2020, the SEC approved a proposed rule change filed by the NYSE that modifies provisions relating to direct listings to permit companies undertaking a direct listing on the exchange to raise capital. In effect, this rule change would allow companies to undertake an initial public offering and concurrent NYSE listing without the use of underwriters to market the shares. The rule change allows for primary direct listings to occur alone or together with a secondary direct listing.

On August 31, 2020, the SEC stayed the effectiveness of the rule change following a notice by the Council of Institutional Investors that it intends to challenge the rule change.

The August 26 rule change provides companies with the option to sell, concurrently with a direct listing, newly issued shares, without the involvement of underwriters. The NYSE has introduced two new terms to differentiate between a direct listing previously permitted by the NYSE, in which only a company's existing shareholders are selling shares (a "Selling Shareholder Direct Floor Listing"), and a direct listing in which the company itself is selling shares in the opening auction or one in which both the company and its selling shareholders are selling shares in the opening auction (a "Primary Direct Floor Listing").

A company can qualify for a Primary Direct Floor Listing in two ways:

- by selling at least $100 million in market value of shares in the opening auction on the first day of trading on the NYSE; or

- if the aggregate market value of the shares that the company sells in the opening auction on the first day of trading and of the shares that are publicly held immediately prior to listing totals at least $250 million, with the market value calculated using a price per share equal to the lowest price in the price range set by the company in the Securities Act registration statement.

In either case, the company must have at least 400 security holders holding round lots and 1.1 million publicly held securities outstanding as of the time of listing, and the price per share must be at least $4.00. Stabilization activities by insiders would have to comply with all federal securities laws, including Regulation M and other anti-manipulation rules.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3980466/sec_approves_nyse_rule_change_permitting_primary_direct_floor_listings.pdf

For the SEC order, please see:

- https://www.sec.gov/rules/sro/nyse/2020/34-89684.pdf

6. CFIUS Releases Final Regulations Changing Mandatory Filing Requirements

On May 20, 2020, the Treasury Department issued proposed regulations to fundamentally change the requirements for Committee on Foreign Investment in the United States ("CFIUS") filings implemented under the Foreign Investment Risk Review Modernization Act of 2008 ("FIRRMA"). On September 11, 2020, the Treasury Department released final versions of these regulatory changes, which became effective on October 15, 2020. However, the previous rules will apply to any transaction where the parties have signed a binding agreement prior to October 15.

Previously, a mandatory CFIUS filing was required whenever (i) a foreign person acquired control over, or made a covered investment in, a U.S. business involved with critical technologies in certain industry sectors and (ii) whenever a covered control transaction or covered investment resulted in the acquisition of a substantial interest in a U.S. business that involves critical technology, critical infrastructure, or the maintenance or collection of sensitive personal data of U.S. citizens (a "TID U.S. business") by a foreign person in which a foreign government has a substantial interest. The mandatory filing requirements were discussed in depth in our February 27, 2020 client alert, hyperlinked below.

Under the recent regulatory changes, the focus is no longer on the industry sector to which the TID U.S. business' critical technology is linked, but rather on whether the foreign person acquiring control over, or making the covered investment in, the TID U.S. business (i) has its principal place of business in a country to which a transfer of the U.S. business's critical technology would require a U.S. export control license or (ii) has 25% or more of its voting interest controlled by another foreign person or group of foreign persons whose principal place of business (in the case of entities) or nationality (in the case of individuals) is linked to a country to which a transfer of the U.S. business's critical technology would require a U.S. export control license.

The result of this important change is to make an export control assessment critical in determining whether a mandatory CFIUS filing is triggered by a particular acquisition of control over, or a covered investment in, a TID U.S. business.

Another important consequence of this recent change is to place a heavier filing burden on countries that are the target of more stringent U.S. export controls, while investors from U.S. allies (including, *e.g.*, Canada) will be significantly less likely to trigger a mandatory filing requirement.

An additional change with respect to the mandatory filing requirement for foreign government-linked acquisitions and covered investments is more minor in nature. The FIRRMA implementing regulations provided that, in the case of a foreign person that has a general partner, managing member or the equivalent, the national or subnational governments of a single foreign state will be considered to have a substantial interest in that foreign person only where those governments hold 49 percent or more of the interest in the general partner, managing member or the equivalent. In the recent regulations, this provision was changed so that it would only apply to partnerships and similar entities whose activities are directed, controlled or coordinated by or on behalf of the general partner, managing member or the equivalent.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3980482/cfius_releases_final_regulations_changing_mandatory_filing_requirements.pdf

For our June 4, 2020 memorandum on CFIUS changes, please see:

- https://www.paulweiss.com/media/3980262/4jun20-cfius-filing-requirements.pdf

For our February 27, 2020 memorandum on the final regulations implementing FIRRMA, please see:

- https://www.paulweiss.com/media/3979361/27feb20-firrma.pdf

7. SEC Amends Definitions of Accredited Investor and Qualified Institutional Buyer

On August 26, 2020, the SEC adopted final amendments to the definitions of "accredited investor" ("AI") and "qualified institutional buyer" ("QIB") to include new AI categories of natural persons and entities and an expanded list of eligible entities that qualify as QIBs. The AI definition is used principally to determine to whom securities can be sold in private placements under Rules 506(b) and 506(c) of Regulation D, and the QIB definition is used principally to determine to whom securities can be resold under Rule 144A.

Subscription agreements used for offerings of interests in private funds, as well as investor letters and other documents distributed in connection with private placements, tend to set out in full the definitions of AI and QIB, and these documents as well as indentures, offering memorandums and securities law legends

typically make specific reference to "accredited investors within the meaning of sub-paragraphs (1), (2), (3) or (7) of Rule 501(a)" when intending to cover institutional accredited investors as there is no technical definition of "institutional accredited investor." Practitioners should consider modifying subscription agreements and other documents to reflect the changes to the AI and QIB definitions.

The amendments to the AI and QIB definitions, although modest in scope, are a welcome step towards the modernization of the two concepts that play a key role in determining investors' eligibility to participate in private securities offerings. The definitions have remained largely unchanged for over 35 years.

The amendments become effective December 8, 2020.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3980449/sec_amends_definitions_of_accredited_investor_and_qualified_institutional_buyer.pdf

For the SEC adopting release, please see:

- https://www.sec.gov/rules/final/2020/33-10824.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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