January 14, 2013

2012 U.S. Legal and Regulatory Developments

The following is a summary of significant U.S. legal and regulatory developments during 2012 of interest to Canadian companies and their advisors.

1. Implementation of the Jumpstart Our Business Startups (JOBS) Act

a. **JOBS Act Facilitates IPOs and Eases Restrictions on Private Capital Formation in the United States.** On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act"), implementing sweeping changes to the rules governing IPOs and private capital formation in the United States by domestic and foreign issuers. The JOBS Act substantially reduces the regulatory burdens on "emerging growth companies" (companies with less than $1 billion in annual revenues) ("EGCs") during and following an IPO, and also substantially relaxes restrictions on communications with potential investors in the context of both public and private offerings. Many provisions of the JOBS Act, including the new relaxed standards for EGCs, were immediately effective and do not require further SEC rulemaking, though the SEC Staff has issued guidance in the form of one announcement and a series of "FAQs". Certain other provisions will not become effective until the SEC adopts implementing rules.

   For more information, see the Paul, Weiss memorandum at http://www.paulweiss.com/files/upload/19Apr12JOBS.pdf.

b. **SEC Issues Proposed Rules Under the JOBS Act Eliminating the Prohibition on General Solicitation and General Advertising for Private Offerings.** On August 29, 2012, the SEC released proposed rules to eliminate the ban on general solicitation and general advertising in connection with private offerings made pursuant to Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933. Under the proposed rules, issuers would be able to use general solicitation or general advertising in connection with Regulation D offerings, as long as the issuer takes reasonable steps to verify that the eventual purchasers of the securities are all accredited investors or to give the issuer reasonable belief they are all accredited investors. The SEC declined to establish specific requirements that would constitute reasonable steps. Instead, the SEC said that issuers should consider the various objective facts and circumstances of each transaction, including the representations of a potential investor, the amount and type of information that the issuer has about each potential investor, the approach used to solicit investors and the terms of the offering, such as a minimum investment amount. Issuers wishing to make private offerings without engaging in general solicitation or general advertising would still be able to do so and would not be subject to the requirement to take reasonable steps to verify accredited investor status. For Rule 144A offerings, the proposed rules would eliminate the requirement that offers only be made to qualified institutional buyers ("QIBs") and would require that securities be sold only to QIBs or to purchasers the seller reasonably believes are QIBs.

For more information, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1166517/10sep12jobs.pdf.

2. **Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act**

a. **SEC Adopts Rules Under Dodd-Frank Requiring the Disclosure of Payments Made to Governments by Resource Extraction Issuers.** On August 22, 2012, the SEC adopted final rules to implement Section 1504 of the Dodd-Frank Act. Entities that are "resource extraction issuers" will be required, as of September 30, 2013, to disclose the details of payments in excess of US$100,000 made by the issuer to non-U.S. governments or the U.S. federal government for the purpose of the commercial development of oil, natural gas or minerals. These disclosures will be filed annually with the SEC on a new form, Form SD. "Resource extraction issuers" include all companies required to file annual reports with the SEC under the Exchange Act that are engaged in the commercial development of oil, natural gas or minerals, including domestic U.S. companies, foreign private issuers and Canadian companies filing under MJDS. The rules define commercial development of oil, natural gas or minerals to include the exploration, extraction, processing and export of oil, natural gas or minerals or the acquisition of a license for any such activity. However, the rules do not cover entities involved in ancillary activities, such as manufacturing products like drill bits used by resource extractors. The SEC has further clarified that "processing" does not include refining or smelting, but does include field processing activities, such as the removal of impurities from hydrocarbons. Disclosures on Form SD must provide the information in XBRL format and must include (1) the total amount of each payment, (2) the currency in which each payment was made, (3) the financial period in which each payment was made, (4) the entity and business segment of the issuer that made the payment, (5) the country and governmental entity that received the payment, (6) the project to which the payment relates and (7) the type of payment (e.g., royalties, taxes, fees). Importantly, these rules make no exception for situations where confidentiality clauses or non-U.S. legal provisions would prohibit disclosure. Form SD will be required to be filed no later than 150 days after the company's fiscal year end. A group of trade associations has petitioned the Court of Appeals for the District of Columbia to modify or set aside the rules. The outcome of this litigation could alter the provisions of the SEC's rules, the timeline for implementation, or both.

For more information, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1157426/24aug12-sec.pdf.

b. **SEC Adopts Rules Under Dodd-Frank Requiring Disclosures Regarding the Use of Conflict Minerals.** On August 22, 2012, the SEC adopted final rules to implement Section 1502 of the Dodd-Frank Act concerning conflict minerals, namely, coltan (the metal ore from which tantalum is extracted), cassiterite (the metal ore from which tin is extracted), gold, wolframite (the metal ore from which tungsten is extracted), their derivatives, or any other mineral determined by the Secretary of State to be financing conflict in the Democratic Republic of Congo or an adjoining country. The rules apply to each company that files annual reports with the SEC for which conflict minerals are *necessary* to the functionality or production of a product it manufactures or contracts to have manufactured, including domestic U.S. companies, foreign private issuers and Canadian issuers filing under MJDS. The rules do not apply to entities that only mine for these minerals. The SEC has provided guidance on the factors relevant to determining whether a conflict mineral should be considered *necessary*: (1) whether the mineral is intentionally used in the manufacture of the product; (2) whether the mineral is itself included in the actual product; (3) whether the mineral plays a role in the product's function; (4) whether the mineral is necessary to produce the product; and (5) whether, for primarily ornamental products, the mineral is incorporated for ornamental purposes. Once an issuer has determined conflict minerals are necessary to the functionality or production of one of its products, it must conduct a good faith inquiry to determine if it sources conflict minerals from the Democratic Republic of Congo or an adjoining country. If the issuer determines it has no reason to believe it sources conflict minerals from this region, it must disclose this determination on Form SD, along with a description of the inquiry that led it to this conclusion. If the issuer determines it has reason to know or knows it sources conflict minerals from this region, the issuer will be required to file a Conflict Minerals Report describing the measures the issuer has taken to due diligence the source and chain of custody of the conflict minerals. The Conflict Minerals Report must be audited by an independent auditor. The conflict minerals disclosure and/or Conflict Minerals Report included in Form SD must cover the calendar year from January 1 to December 31, regardless of an issuer's fiscal year end. The first Form SD will cover calendar year 2013. The final rule requires that an issuer's first Form SD, including its Conflict Minerals Report, if applicable, be filed with the SEC no later than May 31, 2014. An issuer must provide its required conflict minerals information for the calendar year in which it completes the manufacture of a product that contains conflict minerals or in which the issuer's contract manufacturer completes the manufacture of a product that contains any conflict minerals. As with the rules implementing Section 1504 of the Dodd-Frank Act, a group of trade associations has petitioned the Court of Appeals for the District of Columbia to modify or set aside these rules as well. The outcome of this litigation could alter the provisions of the SEC's rule, the timeline for implementation, or both.

For more information, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1153118/27-aug-12_sec.pdf.

c. **Phase-in of Swap-related Rules.** The Dodd-Frank Act required the CFTC and the SEC to create a new regulatory regime for swaps and security-based swaps. On October 12, 2012, obligations under the CFTC and SEC's new rules went into effect for swap dealers and major swap participants, which include duties regarding (1) information disclosures to counter-parties, (2) recordkeeping, (3) reporting, (4) clearing, (5) margin requirements and (6) position limits. A non-financial entity may elect to except from these clearing requirements any swap entered into for the purpose of hedging or mitigating commercial risk.

For more information, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1162351/31aug12_df.pdf.

d. **NYSE and Nasdaq Propose Compensation Committee Rule Amendments.** As required by the Dodd-Frank Act and related SEC rules, both the NYSE and Nasdaq have issued their proposed rule amendments related to compensation committee independence and responsibilities. The NYSE's proposed standards are based on the SEC's rules and make substantial use of the discretion that the SEC gave to the exchanges in implementing its rules. Most notably, the NYSE is not proposing any additional mandatory independence conditions for compensation committee members beyond those already in place. Instead, the NYSE has chosen to add factors that boards must consider in determining compensation committee independence. Nasdaq's proposed new listing standards differ in significant ways from the NYSE's proposal. For example, Nasdaq proposes to add a new mandatory prohibition against compensation committee members accepting directly or indirectly any compensation from the company or its subsidiaries (other than directors' fees or certain fixed retirement payments).

Foreign private issuers that follow their home country practice will be exempt from both the NYSE and Nasdaq compensation committee independence requirements but, if applicable, will be required to disclose the reasons why they do not meet the NSYE or Nasdaq, as applicable, independence requirement. A Canadian issuer that files an annual report on Form 40-F with the SEC may include such disclosure in its Form 40-F or on its website.

For a more detailed summary of the NYSE's proposals, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1203603/1-oct-12_nyse.pdf, and for a more detailed summary of Nasdaq's proposals, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1203628/1-oct-12nas.pdf.

e. **SEC Receives More Than 3,000 Whistleblower Tips.** Under the Dodd-Frank Act, the SEC can pay financial awards to whistleblowers who provide high-quality, original information about a possible securities law violation that leads to a successful SEC enforcement action with more than $1 million in monetary sanctions. The SEC is authorized to pay the whistleblower 10 to 30 percent of the sanctions collected. In the first full year of the program, the SEC received 3,001 tips, complaints and referrals from whistleblowers from individuals in all 50 states, the District of Columbia, and the U.S. territory of Puerto Rico, as well as 49 countries outside of the United States, including 46 tips from Canada. The most common complaints related to corporate disclosures and financial statements (18.2 percent), offering fraud (15.5 percent), and manipulation (15.2 percent).

3. **New Disclosure Required by Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2102 ("ITRSHRA").** Under Section 219 of ITRSHRA, which created Section 13(r) of the Exchange Act, U.S. domestic issuers and foreign private issuers alike are required to disclose, among other things, investments in or transactions with parties that could have the effect of furthering the Iranian petroleum or petrochemical sectors, assisting Iran to develop weapons of mass destruction or other military capabilities or assisting the Government of Iran to commit serious human rights abuses against the people of Iran. If an issuer or an affiliate of an issuer has engaged in any activity specified by Section 13(r), the issuer must provide a detailed description of each such activity that occurred during the period covered by the report, including the nature and extent of the activity, the gross revenues and net profits, if any, attributable to the activity, and whether the issuer or the affiliate of the issuer (as the case may be) intends to continue the activity. The issuer is also required to separately file with the SEC a notice that the disclosure of that activity has been included in the issuer's report. The SEC is, in turn, required to forward all such disclosures to the White House and the President is then obligated to commence an investigation into the reporting issuer to determine if such issuer is subject to sanctions under the Iran Sanctions Act of 1996 or other applicable federal law. On December 4, 2012, the staff of the SEC published guidance clarifying, among other things, that the new disclosure requirements apply to any periodic report, including annual reports on Form 40-F and Form 20-F, with a due date after February 6, 2013. Disclosure is not required if neither the issuer nor its affiliates engaged in the specified activities.

For the full text of the ITRSHRA see http://www.gpo.gov/fdsys/pkg/BILLS-112hr1905enr/pdf/BILLS-112hr1905enr.pdf, and for the SEC's guidance see http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm.

4. **SEC and Justice Department Release FCPA Guide.** On November 14, 2012, the Department of Justice ("DOJ") and SEC jointly released a 120-page publication titled " FCPA: A Resource Guide to the U.S. Foreign Corrupt Practices Act" (the "Guide"). This "unprecedented undertaking" offers guidance on many aspects of the FCPA including the national and international anti-corruption enforcement landscape, the FCPA's applicability to different types of businesses and individuals, the principles guiding DOJ and SEC enforcement and charging decisions and the hallmarks of an effective anti-corruption compliance program. The Guide draws on DOJ opinion releases previously issued to individual companies, numerous examples from prior DOJ and SEC enforcement actions, decisions issued by federal trial and appellate courts, and some FCPA "lore." Significantly, the DOJ reports that in the past two years alone, it has declined to prosecute "several dozen cases against companies where potential FCPA violations were alleged." The DOJ and the SEC provide six anonymized examples of matters they declined to pursue, along with some of the relevant factors considered in reaching their determinations.

   For more information, see the Paul, Weiss memorandum at: http://www.paulweiss.com/media/1332404/16-nov-12fcpa.pdf.

5. **SEC Approves PCAOB Auditing Standard No. 16, Communications with Audit Committees**. On December 17, 2012, the SEC approved Auditing Standard No. 16, *Communications with Audit Committees*, which was adopted by The Public Company Accounting Oversight Board on August 15, 2012. The Standard is effective for public company audits of fiscal periods beginning on or after Dec. 15, 2012. Auditing Standard No. 16 is focused on improving communications between the auditor and the audit committee. Among other things, it requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee, to record the terms of the engagement in an engagement letter, to have the engagement letter executed by the appropriate party or parties on behalf of the company and to determine that the audit committee has acknowledged and agreed to the terms. The Standard does apply to audits of emerging growth companies under the JOBS Act.

   For the full text PCAOB Auditing Standard No. 16, see http://pcaobus.org/Standards/Auditing/Pages/Auditing_Standard_16.aspx.

6. **Significant U.S. Case Law Developments**

   a. **Second Circuit Rules on Legal Standard Required to Establish a "Domestic Transaction" in Securities under *Morrison***. In its 2010 decision in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010), the Supreme Court addressed whether Section 10(b) of the Securities Exchange Act of 1934, as amended, applies to a securities transaction involving foreign investors, foreign issuers and/or securities traded on foreign exchanges. The *Morrison* decision curtailed the extraterritorial application of the federal securities laws by holding that Section 10(b) applies only to (a) transactions in securities listed on domestic exchanges or (b) domestic transactions in other securities. In March 2012, in *Absolute Activist Value Master Fund Ltd. v. Ficeto, et al.*, Docket No. 11-0221-cv (2d Cir. Mar. 1, 2012), the Second Circuit addressed for the first time what constitutes a "domestic transaction" in securities not listed on a U.S. exchange. The court held that, to establish a domestic transaction in securities not listed on a U.S. exchange, plaintiffs must allege facts plausibly showing either that irrevocable liability was incurred or that title was transferred within the United States.

For more information on *Absolute Activist Value Master,* see the Paul, Weiss memorandum at http://www.paulweiss.com/media/103257/5Mar12Memo.pdf.

b. **Delaware Supreme Court Affirms $2 Billion Southern Peru Copper Damages Award.** In *Americas Mining Corporation v. Theriault Southern Copper Corp.,* on August 27, 2012, the Delaware Supreme Court affirmed the Court of Chancery's decision in the Southern Peru Copper litigation in which the Court of Chancery awarded damages of $2 billion and $300 million in attorneys' fees. The Court held that Southern Peru's controlling shareholder and its directors breached their fiduciary duty of loyalty by causing Southern Peru to acquire the controlling shareholder's interest in a Mexican mining company at an unreasonably high price. While the damage and fee levels were unprecedented, the Delaware Supreme Court found that the Court of Chancery exercised its discretion appropriately in awarding such amounts after the plaintiffs had prevailed in showing that Southern Peru Copper had overpaid. The Delaware Supreme Court also clarified that in a transaction where a majority stockholder stands on both sides, the enhanced entire fairness will apply instead of the standard business judgment rule.

For more information on *Americas Mining Corporation*, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1160927/28-aug-12-dcc.pdf.

c. **Delaware Court of Chancery Enjoins Unsolicited Offer For Violation of Confidentiality Agreement**. In *Martin Marietta Materials, Inc. v. Vulcan Materials Company*, the Delaware Court of Chancery enjoined Martin Marietta from continuing its unsolicited exchange offer for, and proxy contest against, Vulcan for four months because Martin Marietta violated its confidentiality agreement with Vulcan. The confidentiality agreement was entered into at a time when the two parties were focused on a potential friendly merger. When discussions failed, however, and Martin Marietta decided to make a public, unsolicited exchange offer for Vulcan, the confidential information obtained pursuant to the confidentiality agreement, including the amount of anticipated synergies, was central to Martin Marietta's campaign. The key provision at issue in the confidentiality agreement required that the parties would use confidential information solely for the purpose of evaluating a transaction "between" Martin Marietta and Vulcan. The court found that this sentence was ambiguous but ultimately, citing a 2009 Ontario Superior Court of Justice decision, *Certicom Corp. v. Research in Motion Ltd.*, agreed with Vulcan's interpretation. As such, Chancellor Strine held that Martin Marietta could not use the confidential information for its bid. The decision, which was recently affirmed by the Delaware Supreme Court, underscores the subtle ways that confidentiality agreements can impose standstill obligations even absent express standstill provisions.

For more information on *Martin Marietta*, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1070279/7-may-12.pdf.

d. **Delaware Court of Chancery Issues Pronouncement on Deal Protections.** In bench rulings on November 9, 2012 and November 27, 2012 in *In re Complete Genomics, Inc. S'holder Litig.*, the Delaware Court of Chancery temporarily enjoined a merger between Complete Genomics, Inc. ("Genomics") and BGI-Shenzhen ("BGI") pending corrective disclosure regarding, among other things, BGI's willingness to employ Genomics' current CEO and let him operate Genomics as an independent entity under BGI ownership. The Court further enjoined Genomics from enforcing a confidentiality agreement with a third-party bidder that contained a "Don't Ask, Don't Waive" standstill provision. Notably, the Court also addressed a series of deal protections that were put in place such as a 4.8% break-up fee and change-of-recommendation limitations. Although the Court held that the break-up fee was permissible, the Court found the provision restricting the Board's ability to change its recommendation troubling, but premature to adjudicate.

   For more information on *In re Complete Genomics, Inc.*, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1357759/4-dec-12.pdf.

e. **Delaware Court of Chancery Holds that "Don't Ask, Don't Waive" Provisions Are Permissible Under Certain Circumstances.** In *In re Ancestry.com Inc. S'holder Litig.*, a December 17, 2012, bench ruling, the Delaware Court of Chancery again addressed "Don't Ask, Don't Waive" standstill provisions, holding that there is no per se rule prohibiting such provisions. The Court explained that in certain circumstances a board of directors may be able to use such provisions to maximize stockholder value. However, the Court noted that if a board of directors does not understand how such a provision operates, or that such a provision was in place, it might be evidence of a violation of its duty of care. When viewed together with the Court of Chancery's November 2012 bench rulings *in In re Complete Genomics, Inc. S'holder Litig.*, this decision indicates that while "Don't Ask, Don't Waive" provisions are permissible under Delaware law, such provisions should be employed only in circumstances where a board of directors has affirmatively judged their use to be appropriate.

For more information on *In re Ancestry.com Inc. S'holder Litig.*, see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1388216/4-jan-13_del.pdf.

f. **Supreme Court Upholds Landmark Federal Health Care Legislation.** In a high-profile test of the Supreme Court's approach to constitutional limits on Congressional power, on June 28, 2012, the Court upheld the Patient Protection and Affordable Care Act of 2010 (the "Act"), the sweeping federal overhaul of the nation's health insurance system. A majority of the justices found that the Act's "individual mandate," which requires citizens to purchase health insurance, was constitutional under Congress's power to tax, although a different majority of the Court—with the Chief Justice as the swing vote—held that the individual mandate violated the Commerce Clause. A majority of the justices also upheld the Act's expansion of the Medicaid program—but only so long as States may opt out of the expanded provisions without losing their pre-existing federal funding for Medicaid.

As significant as the decision is for health care, it is arguably even more significant for the Court's federalism jurisprudence. Five justices have stated a willingness to deem federal legislation beyond Congress's Commerce Clause powers. A majority of justices has also indicated a willingness to strike down the conditioning of federal spending on the States' acquiescence to what the Court regards as coercive policy requirements.

For more information on this landmark decision, please see the Paul, Weiss memorandum at http://www.paulweiss.com/media/1005593/2jul12scotus.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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