2012 Developments in the United States

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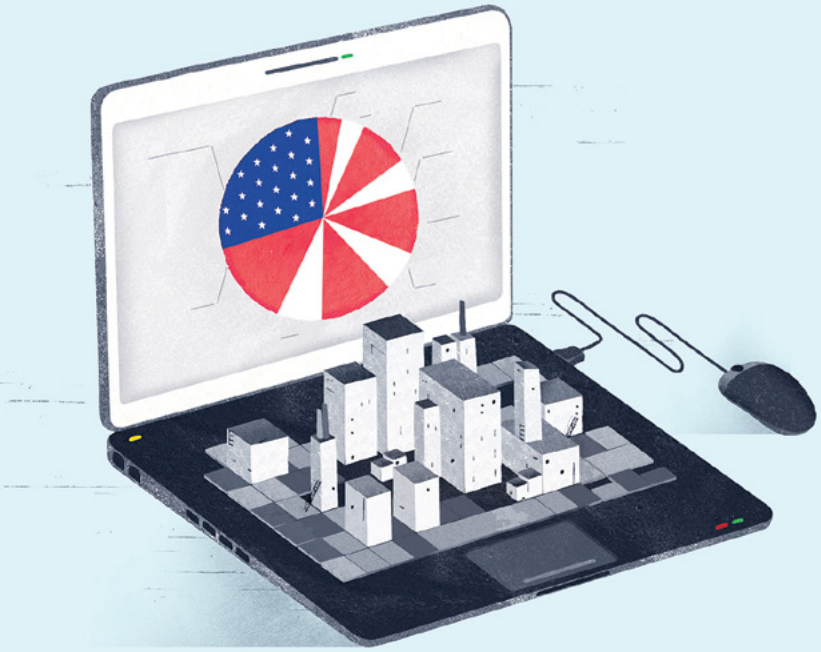
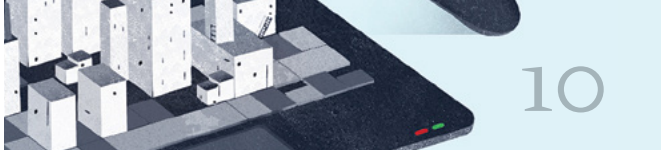
In 2012, the U.S. securities regulatory pendulum changed direction with the enactment of the *Jumpstart Our Business Startups Act* (the JOBS Act). While the JOBS Act relaxes regulatory burdens for certain issuers, various new disclosure obligations and investor protection measures continued to be introduced under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank).





In addition, new disclosure requirements reflecting Congressional efforts to promote foreign policy goals have been imposed under the *Iran Threat Reduction and Syria Human Rights Act of 2012* (the IRT Act). The most notable initiatives of the past year include:

- proposed reforms to eliminate the restrictions on general solicitation and advertising for certain private placements and the easing of compliance and disclosure obligations, particularly for "emerging growth companies" under the JOBS Act;
- the adoption by the Securities and Exchange Commission (SEC) of listing standards for compensation committees pursuant to Dodd-Frank, as well as NASDAQ and NYSE proposals to implement those requirements;
- new disclosure obligations relating to the manufacturing of goods using conflict minerals and payments to governments by resources extraction issuers; and
- the significant expansion of U.S. sanctions against Iran under the IRT Act which, among other things, imposes new disclosure requirements relating to sanctionable activities on U.S. domestic and foreign private issuers required to file reports with the SEC.

In news from the bench, the Supreme Court of Delaware endorsed the reasoning of the Ontario Superior Court of Justice in blocking a $5.3 billion acquisition, transforming restrictions on the use of shared information commonly found in confidentiality agreements into the effective equivalent of a standstill agreement.

The JOBS Act: Jumpstart Our Business Startups

The JOBS Act makes significant changes to U.S. federal securities laws primarily directed at easing regulatory requirements for "emerging growth companies" (EGCs) and other smaller issuers making securities offerings in the United States. Among other things, the JOBS Act:

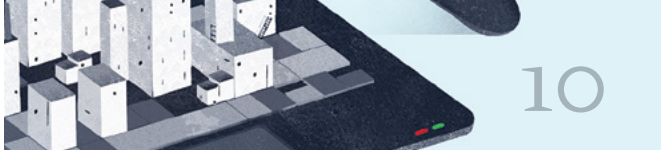
- Provides EGCs with an exemption from, or simplifies compliance with, a number of U.S. securities law requirements, including the periods that must be covered by financial statements, executive compensation reporting and Sarbanes-Oxley auditor attestations. It also allows EGCs to "test the waters" with "qualified institutional buyers" and institutional "accredited investors" prior to filing a registration statement with the SEC and to file that registration statement confidentially. These benefits are already available to U.S. issuers and Canadian and other foreign private issuers that qualify as EGCs.

The JOBS Act is intended to make it easier for small and emerging companies to conduct securities offerings in the United States, and modernize the securities offering process for companies of all sizes by eliminating the prohibition on general solicitation and general advertising in connection with Rule 144A offerings and certain other private placements of securities.

Under Dodd-Frank, stricter rules have been implemented to regulate the independence of public companies' compensation committees, and to impose disclosure and reporting obligations related to the use of conflict minerals and payments to governments by resource extraction issuers.

The IRT Act creates new disclosure obligations for all U.S., Canadian and other foreign private issuers required to file reports with the SEC regarding dealings with Iran, terrorist organizations and proliferators of weapons of mass destruction (WMDs). Most companies will be required to comply with these new disclosure requirements for the first time in their next annual report on Form 10-K, Form 20-F or Form 40-F filed with the SEC.

The *Martin Marietta* decision confirms that under Delaware as well as Ontario law the restrictions on the use of information in a confidentiality agreement could block a subsequent hostile bid or proxy contest, even absent an explicit standstill provision.



- Liberalizes communications among research analysts, investment bankers and company officers, and relaxes certain restrictions on the publication of research reports in connection with equity offerings by EGCs.
- Requires the SEC to adopt rules to eliminate prohibitions on general solicitation and general advertising in connection with Rule 144A offerings and certain offerings under Rule 506 of Regulation D.
- Will create, upon adoption of SEC implementing rules, a new registration exemption being referred to as Regulation A+ for public offerings where the aggregate amount of securities sold in the prior year in reliance on the exemption does not exceed US$50 million. The securities sold under this new exemption will not be subject to resale restrictions.
- Relaxes the requirements that trigger the need for a company to register equity securities under the *Securities Exchange Act of 1934*, as amended (Exchange Act) so that a company (other than a bank or bank holding company) will be able to have up to 1,999 shareholders of record (so long as fewer than 500 are non-accredited investors) before the obligations to register and file public disclosure are triggered.
- Will create a registration exemption for "crowdfunding" transactions.

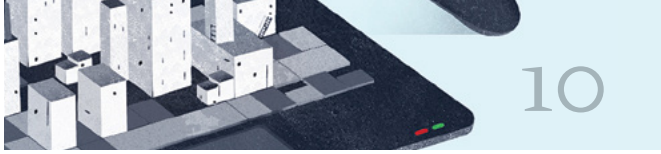
Rulemaking Under the *Dodd-Frank Wall Street Reform and Consumer Protection Act*

Listing Standards for Compensation Committees

The SEC adopted Exchange Act Rule 10C-1 directing U.S. national securities exchanges to implement listing standards by June 30, 2013 regarding the independence of compensation committee members and the retention of compensation advisors, as well as amending proxy disclosure rules requiring additional disclosure on compensation consultants' conflicts of interest.

The NYSE and the NASDAQ filed proposed amendments to their listing rules to implement the SEC requirements. Existing "bright line" prohibitions for determining "independence" will continue to apply under the proposed listing standards, augmented by the Rule 10C-1's independence requirements which require consideration of the source of a director's compensation and the existence of any affiliation between a director and issuer or its subsidiary.

The NASDAQ proposal goes further by establishing a "bright line" prohibition that the director not receive, directly or indirectly, any consulting, advisory or other compensatory fees from the issuer, other than fees received as a member of the compensation committee, the board of directors or other board committee or the receipt of fixed amounts under a retirement plan. NASDAQ listed companies will also have to have a separate compensation committee composed of at least two independent directors to determine compensation of the CEO and all other executive officers.



Both proposals require compensation committees to assess the independence of compensation advisers (consultants, legal counsel and other advisers), including examination of the six independence factors specified in Rule 10C-1, before retaining such advisers, other than in-house legal counsel, though retention of an independent adviser is not required under either proposal.

Canadian and other foreign private issuers with listed equity securities will still be able to take advantage of NYSE and NASDAQ exemptions from corporate governance related listing standards; however, under the NASDAQ proposal, foreign private issuers will be required to disclose the reasons why they do not have an independent compensation committee.

New proxy statement requirements require disclosure of whether the work of a compensation consultant, whether retained by management, the compensation committee or any other board committee, has, after consideration of the six independence factors set forth in Rule 10C-1, raised any conflict of interest and, if so, the nature of the conflict and how it is being addressed.

Conflict Minerals

The SEC adopted a rule to implement the Dodd-Frank disclosure obligations for the use of conflict minerals originating in the Democratic Republic of Congo and adjoining countries (Covered Countries). Conflict minerals are defined as: columbite-tantalite (commonly used in electronics), wolframite (used to produce tungsten which is commonly used in metal wire), cassiterite (tin), and gold.

The rule requires any issuer that uses conflict minerals as a necessary part of the functionality or production of a product manufactured or contracted to be manufactured by the issuer to disclose to the SEC on a new disclosure form (Form SD) whether those conflict minerals originated from a Covered Country. If there is reason to believe the conflict minerals originated from a Covered Country, the issuer is required to file a separate "Conflict Minerals Report" on Form SD that includes, among other things, a description of the due diligence performed on the supply chain, a description of products that are not "DRC conflict free" and a certification of an independent private audit of its Conflict Minerals Report. The first Form SD filing must be made no later than May 31, 2014 covering the 2013 calendar year. The rule also establishes a transition period for products deemed "DRC conflict undeterminable" and implements a separate reporting standard for recycled and scrap conflict materials.

Payments to Governments by Resource Extraction Issuers

The SEC adopted a rule to implement the Dodd-Frank annual reporting obligations on resource extraction issuers for payments to the U.S. federal government or any non-U.S. government (including Canadian federal, provincial or local governments, or any company that is majority owned by a non-U.S. government) relating to the commercial development of oil, natural gas or minerals. Companies must commence reporting applicable payments on Form SD for fiscal years ending after September 30, 2013.

The rule encompasses projects that directly relate to commercial development activities including exploration, extraction, processing, export or the acquisition of a license for any such activity. Ancillary activities, such as transportation, are excluded.

The rule establishes an exemption for payments (or series of related payments) of less than US$100,000 during the most recent fiscal year, but does not provide any confidentiality exception (i.e., disclosure is required even if a host country's laws or any existing or future contract prohibit the disclosure of such information).

Resource extraction issuers should consider whether any information systems need to be modified to gather the type of data necessary to comply with this disclosure obligation.

New Disclosure Requirements under the *Iran Threat Reduction and Syria Human Rights Act of 2012*

The IRT Act significantly expands U.S. sanctions against Iran by, among other things, (i) adding new activities to the list of trigger events mandating sanctions; (ii) making U.S. companies subject to significant civil penalties if their foreign subsidiaries engage in transactions with Iran; and (iii) imposing new disclosure requirements relating to knowing engagement in sanctionable activities by domestic and foreign private issuers required to file reports with the SEC pursuant to Section 13(a) under the Exchange Act. The new disclosure provisions will apply to periodic and annual reports required to be filed with the SEC on or after February 6, 2013. For reporting companies with calendar year ends, the disclosure obligations will first apply to their Annual Report on Form 10-K, 20-F or 40-F for the fiscal year ending December 31, 2012.

The IRT Act requires an issuer who files annual or quarterly reports with the SEC to make specific disclosures in such reports if, during the period covered by the report, the issuer or any of its affiliates knowingly engaged in certain activities prohibited by the *Iran Sanctions Act of 1996* or the *Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010*, or knowingly engaged in dealings with terrorist organizations, proliferators of weapons of mass destruction or the Government of Iran or its instrumentalities or controlled entities.

If an issuer or one of its affiliates engaged in any of these activities during the relevant reporting period, the issuer must provide a detailed description of such activity, including the nature and extent of the activity, the gross revenues and net profits, if any, attributable to the activity, and a statement whether or not the issuer or its affiliate intends to continue the activity.

The same information must be concurrently submitted to the SEC in a separate notice to be posted on its website, and is reported by the SEC to the President of the United States for investigation of possible sanctions.

Confidentiality Agreements

The Delaware courts, citing a 2009 decision of the Ontario Superior Court of Justice, transformed a typical restriction governing use of information under a confidentiality agreement into the effective equivalent of a standstill provision.

Martin Marietta Materials, Inc. (Martin Marietta) and Vulcan Materials Company (Vulcan) entered into a confidentiality agreement in the spring of 2010 to facilitate negotiations of a potential merger of equals. Vulcan's enthusiasm for the merger eventually waned and talks stalled. Although the confidentiality agreement permitted the use of confidential information only in the context of evaluation of a transaction "between" the parties, Martin Marietta utilized such information in evaluating and commencing a hostile exchange offer for Vulcan.

In considering whether Martin Marietta's use of the information to formulate a hostile bid was permitted under the terms of the confidentiality agreement, the court focused largely on the parties' use of the word "between" and the circumstances in which the parties had negotiated the confidentiality agreement. The court concluded that the agreement to permit the sharing of information to evaluate a possible transaction "between" the parties evidenced an intention that shared information not be used in an unsolicited bid and temporarily enjoined Martin Marietta's offer.

In light of this decision, potential acquirors should consider the following points when negotiating confidentiality agreements, especially where it is important to preserve an effective hostile option:

The term of the agreement and its confidentiality and use restrictions.
Now that confidentiality and use restrictions may be interpreted as de facto standstill provisions, acquirors should consider negotiating for effective terms that are shorter than the market standard one-to-three years to preserve the flexibility to make a hostile offer.

Sequestering a "clean team".
Where members of the principal deal team may be "tainted" by access to confidential information subject to the use restrictions in a confidentiality agreement, acquirors should consider whether it is feasible to sequester a "clean team" of internal personnel, directors and advisors from exposure to confidential information for use on a subsequent "Plan B" unsolicited option. Consideration should also be given to when and whether to expose key executives to confidential information, given that doing so may preclude them from evaluating or participating in a later hostile approach.

Limit Information Reviewed.
Acquirors should assess whether to limit their scope of diligence to non-public information that is likely to be disclosed by the target in the near term, e.g., recent financial results or recently incurred liabilities.

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