Pepper Hamilton LLP
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Canadian Update

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message from partner in charge

In this issue, we explore how various financial and investment issues are affecting Canada:

Ivan Knauer, Gregory Nowak and Matthew Silver explore how the proposed Private Fund Investment Advisers Registration Act would subject some non-U.S. advisers to U.S. scrutiny for the first time, and we note that Pepper's Canadian Webinar Series also focuses on how the act can specifically affect Canadian business interests.

Greg and Matt also explain the FTC's Red Flags Rule, and urge foreign entities that deal with U.S. entities to follow the rule, as a matter of customer expectations.

Greg Paw illuminates Canada's new push to punish white-collar crime, noting similarities to current U.S. anti-fraud provisions.

Jaime Daddona Brennan and I also provide updates on cross-border corporate and securities matters, and an article by Jane Luxton and Bill Walsh explores how several ongoing worldwide climate-change initiatives may affect Canadian commerce.

As always, we welcome comments, questions and suggestions.

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in this issue

1 New Bill Would Require Advisers to Many Canadian Hedge And Private Equity Funds to Register as U.S. Investment Advisers
4 Canadian Webinar Series
5 New Identity Theft Program Requirements for Most 'Creditors' and 'Financial Institutions:' One More Extension Granted
7 Canada's New Push to Punish White-Collar Crime
8 The Latest on Climate Change
10 Cross-Border Corporate and Securities Updates

New Bill Would Require Advisers to Many Canadian Hedge and Private Equity Funds To Register as U.S. Investment Advisers

After a couple months of relative quiet, a revised and somewhat less expansive form of the original Private Fund Investment Advisers Registration Act of 2009, now HR 3818, has been approved by the House Financial Services Committee and is on its way to a full House vote. If enacted, HR 3818 would, among other things and for the first time, subject many non-U.S. advisers that have contact with the United States solely by virtue of a few U.S. clients (directly or potentially indirectly) to U.S. registration and scrutiny. The legislative debate is actively taking shape.[1]

HR 3818 would completely delete current Section 203(b)(3) of the Investment Advisers Act of 1940 (the Advisers Act), gutting a standard exemption from registration relied on by investment advisers (foreign or otherwise) operating in the United States who have fewer than 15 clients (currently a fund counts as a single client – something that is also likely to change if HR 3818 is enacted). As a result, after a phase-in period of one year, most parties that meet the U.S. definition of being an "investment adviser"[2] would be required to register with the U.S. Securities and Exchange Commission (SEC), regardless of the number of clients they have. Registration has many implications, including a general prohibition on charging performance-based fees to natural persons who are not "qualified clients"[3] – a standard that, pursuant to HR 3818, would be indexed for inflation. Some exemptions would remain, however, based on such things as total assets under management and the types of entities advised.[4]

"Foreign private fund advisers" will be exempt from SEC registration, whether or not they advise any funds. A foreign private fund adviser is an investment adviser with no place of business in the United States *and* who:

- does not generally hold itself out in the United States as an investment adviser (Web sites may count)
- is not an investment adviser to a U.S.-registered investment company (mutual fund) or business development company, and
- during the preceding 12 months has had: (a) fewer than 15 clients in the United States and (b) assets under management attributable to clients in the United States of less than $25 million (or such higher dollar amount as the SEC may decide).

It should be noted that HR 3818 does not prohibit a foreign private fund adviser from optionally registering with the SEC (for example, a foreign adviser who would otherwise trigger registration filings in multiple U.S. states might decide that a central SEC registration is less onerous) provided it meets any applicable minimum assets under management tests, etc.

HR 3818 concentrates on "private funds," defined as funds relying on Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940[5] for an exemption from registration. Investment advisers of "private funds" (*whether or not the private fund or the adviser is based in the United States*), that have assets under management (on a cumulative basis) above the SEC's regulatory threshold[6] would be subject to U.S. SEC registration, *unless*:

- each of their advised private funds has "assets under management in the United States of less than $150,000,000" (presumably meaning assets of U.S. parties in any one fund), or
- the fund(s) advised are "venture capital funds" – HR 3818 would allow the SEC to define the term "venture capital fund" as it sees fit, or
- the investment adviser to the private fund qualifies as a "foreign private fund adviser" (see above), or
- the investment adviser solely advises small business investment companies licensed under the Small Business Investment Act of 1958 (or certain entities applying for SBA licenses).

The minimum of $150 million in fund assets effectively exempts most start-up funds and managers from SEC regulation until assets under management reach these levels. HR 3818 would also grant the SEC specific authority to require all registered advisers (including the ones forced to register under HR 3818) to maintain detailed reports. Report maintenance requirements, which the SEC could vary by private fund type or size, would include at least the following for each private fund:

- amount of assets under management
- use of leverage (including off-balance sheet leverage)
- counterparty credit risk exposures
- trading and investment positions
- trading practices, and
- such *other information* as the SEC, in consultation with the Board of Governors of the U.S. Federal Reserve, determines is necessary or appropriate.

Pepper Point: Although U.S. and foreign advisers to "venture capital funds" and/or private funds of under $150 million would not be required to register under the Advisers Act (unless otherwise required, i.e., due to the nature of their other clients), HR 3818 does authorize the SEC to require that advisers to such funds maintain whatever records and file whatever reports with the SEC as the SEC deems necessary or appropriate. The SEC may use these record-keeping and reporting requirements in situations in which an adviser is not only generally exempt from registration, but qualifies as a "foreign private fund adviser" with minimal contact with the United States.

Because the records and reports of a private fund advised by a registered adviser would be deemed records of the investment adviser, such records would also be subject to examination by the SEC and its staff. Although HR 3818 states that the SEC will not be required to disclose such reports or records, the SEC is specifically prohibited from withholding the information from the U.S. Congress and provides that the SEC may supply the information to any "federal agency or any self-regulatory organization requesting the report or information for purposes within the scope of its jurisdiction" or to other parties pursuant to an order from a U.S. court.

Pepper Point: If enacted as proposed, HR 3818, each private fund and its general partner and/or investment manager will need to review closely its record-keeping and retention policies to make sure that they comply with U.S. standards (which are generally more onerous than those in Canada and most non-U.S. jurisdictions).

Pepper Point: Any foreign-registered investment adviser that runs a "private fund" and does not meet a registration exemption could be required to register under the U.S. Investment Advisers Act and to supply detailed informa-

The SEC may use these record-keeping and reporting requirements in situations in which an adviser is not only generally exempt from registration, but qualifies as a 'foreign private fund adviser' with minimal contact with the United States.

tion and reports about itself, its funds and perhaps even its underlying foreign clients to U.S. regulators. If HR 3818 passes intact, the SEC presumably would also have the ability to turn over information to even foreign "self-regulatory organization[s] requesting the report for purposes within the scope of its jurisdiction." All private funds should start looking at their policies and procedures now to prepare for the possibility of this upcoming event.[7]

Pepper Point: The proposed venture capital fund exclusion leaves several key points unclear. If enacted, the definition may or may not include many conventional private equity funds and what are now commonly understood to be venture capital funds.

Pepper Point: It is unclear if an adviser advises private clients (say one or two executives with a few hundred thousand dollars each) and SBA funds, venture capital funds or private funds of under $150 million, whether having total cumulative assets-under-management of more than $25 million[8] would trigger an SEC registration requirement, or if assts of any of the SBA funds, venture capital funds or private funds of under $150 million would be excluded from the calculation. On the other hand, it is certainly *not* unclear that if HR 3818 passes with an exemption for advisers in cases in which all of the advisers' private funds have less than $150 million in assets under management, there will be a strong temptation to split up existing funds into nearly-but-not-quite-identical smaller funds that are each under the threshold.

Pepper Point: Competing language to HR 3818 exists in the Senate in the form of Chris Dodd's 1,136-page Senate discussion draft bill, the "Restoring American Financial Stability Act of 2009," available at http://banking.senate.gov/public/_files/AYO09D44_xml.pdf. A portion of the discussion draft bill contains Dodd's version of the Private Fund Investment Advisers Registration Act of 2009. While largely similar to HR 3838, there are certain key differences, chiefly:

- The Dodd draft includes an exception from registration and reporting requirements with respect to "the provision of investment advice related to a private equity fund." It is left to the SEC to define the term "private equity fund."
- The Dodd draft would adjust Section 202A(a)(1)(A) of the Investment Advisers Act so that, in general, all advisers with assets under management of under $100 million would be under the authority of applicable states and not the SEC.
- Rather than inflation indexing the definition of "qualified client," the Dodd draft inflation indexes the natural person standards for "accredited investors."
- The Dodd draft does not contain the small business investment company exceptions found in HR 3818.

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Endnotes

1 On November 10, 2009, Chris Dodd introduced a Senate discussion draft bill proposing many of the same modifications to the law as HR 3818, but with certain key differences. At the October 2009 National Association of Compliance Professionals National Meeting in Philadelphia, PA, members of the U.S. Securities and Exchange Commission (SEC) staff opined publicly that there was a better than even chance that some form of hedge fund/private equity fund registration legislation (either registering advisers or the funds themselves) would be enacted in 2010.

2 As defined in Section 202(a)(11) of the Advisers Act - text available at http://www.law.uc.edu/CCL/InvAdvAct/sec202.html.

3 The current U.S. "qualified client" standards are available at http://www.law.uc.edu/CCL/InvAdvRls/rule205-3.html.

4 In general, any person or entity operating in the United States or directing business into the United States, or potentially simply having U.S. clients, who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities and does not (a) have less than $25 million (or, a higher number in the SEC's discretion) of assets under management, (b) falls under an exemption under Section 202(a)(11) (such as by being a U.S. registered bank), (c) meets the new "foreign private fund adviser" definition, or (d) only advises "venture capital funds" or SBA funds or "private funds" below a $150 million threshold, may be required to register with the SEC as an investment adviser.

5 These are, by far, the most commonly applicable U.S. exemptions from the Investment Company Act for hedge funds, fund of funds and private equity funds. They require that the fund have a limited number of investors who can meet appropriate asset, income or sophistication related tests.

6 The threshold will not be less than $25 million but at the SEC's discretion, may be higher (currently, registration is generally optional at $25 million and generally mandatory at $30 million).

7 HR 3818 would overturn legislatively the *Goldstein* decision (http://pacer.cadc.uscourts.gov/docs/common/opinions/200606/04-1434a.pdf) that had invalidated earlier SEC attempts to require the advisers of private funds to register. HR 3818 would amend Section 211 of the Advisers Act to allow the SEC to define the term "client" in multiple ways and "to prescribe different regulations for different classes of persons or matters within its jurisdiction." This change would facilitate the SEC "looking through" funds (and perhaps multiple layers of funds) to find the dollar and client number/percentage thresholds that would require registration. HR 3818 also deletes Section 210(c) of the Advisers Act that prohibits the SEC from requiring the disclosure of an investment adviser's clients (thus allowing the SEC to require investment advisers to disclose their client lists and, effectively private funds to disclose the identity of their investors).

8 Or a higher amount, in the SEC's discretion – *see* footnote 6.

Canadian Webinar Series

Private Fund Investment Advisers Registration Act of 2009 Set to Impact Many Canadian Hedge and Private Equity Funds
December 16, 2009 | 12:00 – 1:00 P.M. EASTERN

The Private Fund Investment Advisers Registration Act of 2009 (HR 3818) has been approved by the House Financial Services Committee and is on its way to a full House vote. While not quite as expansive as the original proposal made by the Obama Administration last July, if enacted, HR 3818 would, among other things and for the first time, subject many advisers, both in the United States as well as Canadian advisers that have contact with the United States solely by virtue of a few U.S. clients (direct or potentially indirect), to U.S. registration and scrutiny.

Pepper attorneys Ivan B. Knauer, Gregory J. Nowak and Matthew R. Silver will discuss the effect this legislation will have on Canadian hedge funds and private equity funds as the legislative debate is actively taking shape.

Moderator
Susan J. Krembs, Partner, Pepper Hamilton LLP
Speakers
Ivan B. Knauer, Partner
Gregory J. Nowak, Partner
Matthew R. Silver, Associate

Register for this complimentary online webinar at http://www.regonline.com/Checkin.asp?EventId=791123.

National Security and Other U.S. Government Regulatory Requirements for U.S.-Canada Inbound or Outbound Sales, Joint Ventures, Mergers and Acquisitions
January 14, 2010 | 12:00 – 1:00 P.M. EASTERN

Protecting Your IP Cross-Border: Legal Issues and Hot Topics
February 23, 2010 | 12:00 – 1:00 P.M. EASTERN

Please register by e-mailing Brian Dolan at dolanb@pepperlaw.com.

New Identity Theft Program Requirements for Most 'Creditors' and 'Financial Institutions:' One More Extension Granted

After several delays, the Federal Trade Commission (FTC) intends to start enforcing the new Identity Theft Red Flags Rule on June 1, 2010.[1] Financial entities such as banks that are subject to regulation by U.S. regulators other than the FTC are already subject to the Red Flags Rule.

Those caught within the reach of the Red Flags Rule, "financial institutions" and "creditors" that are subject to oversight by an appropriate U.S. regulator (such as the FTC), will be required to have a written identity theft program (Program) in place.[2]

Entities operating exclusively outside the United States but who meet the definition of 'creditor' or that of 'financial institution' and who have 'covered accounts' with more than a few U.S. parties, should strongly consider adopting a U.S. Complaint Program, if for no other reason than customer expectations.

Who Is Required to Have an Identity Theft Program in Place?

Step One: Are you a defined 'financial institution' or 'creditor?'

A financial institution such as a state or national bank, a state or federal savings and loan association, a mutual savings bank, a state or federal credit union, or any other entity that holds a "transaction account" belonging to a consumer is subject to the Red Flags Rule. A transaction account is a deposit account or other account from which the owner makes payments or transfers, including checking accounts, negotiable order of withdrawal accounts, savings deposits subject to automatic transfers, and share draft accounts.

Under the Red Flags Rule, a "creditor" is any entity that regularly extends, renews, or continues credit; any entity that regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who is involved in the decision to extend, renew, or continue credit.[3] The definition of a creditor is broad and includes businesses or organizations that regularly defer payment for goods or services or provide goods or services and bill customers later.[4] For example, a professional service provider that allows a client to pay a bill in installments would be a creditor under the Red Flags Rule. In cases in which non-profit and government entities defer payment for goods or services, they, too, are to be considered creditors.

Step Two: If you are a 'financial institution' or a 'creditor,' do you maintain 'covered accounts?'

A covered account is (1) an account primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, or (2) *any other account for which there is a reasonably foreseeable risk to customers or the safety and soundness of the financial institution or creditor from identity theft.*

"Any other account for which there is a reasonably foreseeable risk" includes small business accounts, sole proprietorship accounts, or single transaction consumer accounts that may be vulnerable to identity theft. The business entity must conduct a risk assessment. The assessment must consider any actual incidents of identity theft a business has experienced.

If your business is a "financial institution" or a "creditor" and maintains "covered accounts" and is subject to the jurisdiction of the FTC or another appropriate U.S. regulator, a Program is required.

What Is a Compliant Identity Theft Program?

Programs must include reasonable policies and procedures for detecting, preventing, and mitigating identity theft and enable a financial institution or creditor to:

- identify relevant patterns, practices, and specific forms of activity that are "red flags" signaling possible identity theft and incorporate those red flags into the Program
- detect red flags that have been incorporated into the Program
- respond appropriately to any red flags that are detected to prevent and mitigate identity theft, and
- ensure the Program is updated periodically to reflect changes in risks from identity theft.

Written Programs need not be complex, provided a few fundamentals are incorporated. If an organization determines that its operations present a low risk for identity theft, the program can likely incorporate its existing informal procedures. After all, most businesses, as a matter of course, would take action upon receiving a report of identity theft concerning one of their accounts or being presented with truly suspicious account documents or clearly inconsistent personal identification.

Pepper Point: Bottom Line? Under the expansive definitions, there are potentially millions of U.S. "creditors" and "financial institutions." Many maintain accounts "primarily for personal, family, or household purposes, that involve or are designed to permit multiple payments or transactions." Many more will find it difficult to determine if they maintain "any other account for which there is a reasonably foreseeable risk to customers or the safety and soundness of the financial institution or creditor from identity theft."

Although there is no private right of action under the Red Flags Rule, failure to comply with the Red Flags Rule could expose a company to negligence-based litigation risk, not to mention action by a regulator. Compliance for low-risk organizations may largely incorporate prudent business procedures. The default should be to create and enforce a Program compliant with the Red Flags Rule.

Entities operating exclusively outside the United States but who meet the definition of "creditor" or that of "financial institution" *and* who have "covered accounts" with more than a few U.S. parties, should strongly consider adopting a U.S. Complaint Program, if for no other reason than customer expectations.

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Endnotes

1 The Red Flags Rule was originally enacted as part of the Fair and Accurate Credit Transactions Act. Recent developments affecting the Red Flags Rule include the U.S. District Court for the District of Columbia decision in October that the FTC may not apply the Red Flags Rule to attorneys, and bill H.R. 3763 (passed by a House vote of 400-0 and currently awaiting Senate action) that would exclude any health care practice, accounting practice, or legal practice with 20 or fewer employees from the meaning of "creditor" under the Red Flags Rule. H.R. 3763 would additionally exclude from the definition of creditor under the Red Flags Rule any other business that the FTC determines: (1) knows all its customers or clients individually, (2) only performs services in or around the residences of its customers, or (3) has not experienced incidents of identity theft and identity theft is rare for businesses of that type.

2 *See* http://www.fdic.gov/news/news/press/2009/pr09088a.html. Like many federal consumer protection laws, the Red Flags Rule does not expressly address extraterritorial applicability. Entities located outside the United States, such as foreign branches of U.S. banks, are generally not required to comply with the new rules. However, the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the FTC have collectively advised, as a matter of safety and soundness, that financial institutions are strongly encouraged to implement an effective identity theft prevention program throughout their operations, including in their foreign offices, consistent with local laws.

3 Accepting credit cards as a form of payment does not in and of itself make an entity a creditor. Creditors include, but are certainly not limited to finance companies, automobile dealers, mortgage brokers, utility companies, and telecommunications companies.

4 http://www.ftc.gov/bcp/edu/pubs/business/idtheft/bus23.shtm.

Canada's New Push to Punish White-Collar Crime

Facing a recent wave of Ponzi schemes and accounting frauds, the Canadian government recently introduced legislation to provide tougher sentences for fraud in an effort to step up enforcement against white-collar crime. "Fraud can have a devastating impact on the lives of its victims, including feelings of humiliation for having been deceived into voluntarily handing over their life savings," said Justice Minister Rob Nicholson, surrounded by fraud victims as he made his public announcement. "This legislation will help crack down on white-collar crime and increase justice for victims by providing tougher sentences for the criminals responsible."

Proposed changes are similar to some U.S. anti-fraud provisions. Will enhanced penalties mean more fraud prosecutions?

These proposals come as Canadian officials address a surge of financial crimes similar to what has struck the U.S. in recent months. A Canadian court last month imposed a 13-year sentence on a former financial firm chief executive, described as the biggest fraudster in Canadian history. Another fraud suspect, accused of defrauding 180 people of at least $75 million, is scheduled for a court appearance in December 2009. Also, the alleged mastermind of Canada's largest Ponzi scheme, accused of defrauding $400 million from 4,000 investors, was arrested in September 2009 at the Calgary airport.

The new revisions to Canada's laws would include a two-year mandatory jail sentence for fraud of more than $1 million, and aggravating factors similar to those contained in the U.S. Sentencing Guidelines to be considered in fraud sentencings. These factors include the financial and psychological impact of the fraud on its victims, whether the fraudster violated licensing rules or professional standards and the sophistication and magnitude of the fraud scheme. Also similar to current U.S. law, the proposal would require judges to consider ordering restitution to victims in all fraud cases.

"We see how white collar crime is treated much more seriously in the United States," said Richard Powers, associate dean at the Rotman School of Management at the University of Toronto. "And we have the same situations up here and they seem to get a slap on the wrist in comparison." But some critics counter that these proposals all are reflected in present practices in Canadian courts, and the two years of imprisonment is less than what would be called for in a similar scheme prosecuted in the U.S. federal courts. Echoing opinions voiced over the U.S. response to the recent fraud wave, some critics say the change truly needed is more vigorous enforcement.

In any event, entities operating in both Canada and the United States should take reasonable steps to protect themselves against fraud, including:

- conducting risk assessments
- ensuring the use of proper internal controls
- operating under an appropriate compliance program.

The professionals at Pepper Hamilton have deep experience with these issues, and stand ready to help make realistic assessments of how best to protect your business.

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The Latest on Climate Change

U.S. Emissions Legislation Still Moving Through Legislative Process

U.S. Senate Bill 1733 (the Kerry/Boxer bill), introduced October 23, 2009, is broadly similar to U.S. House Bill 2454 (the Waxman/Markey bill) adopted in June 2009. The Senate bill covers the same greenhouse gases (GHG) and facilities, uses almost all the same caps, and includes essentially the same trading system as the Waxman/Markey bill, and provides comparable incentives and subsidies to offset the effects on the economy.

But there are key differences. The Senate bill:

- requires covered GHG emission sources to reduce their emissions by 20 percent below 2005 levels by 2020 (a little more stringent than the Canadian Turning the Corner Plan reductions from 2006 levels), as opposed to the House cap, a 17-percent reduction
- does not preempt the Environmental Protection Agency (EPA)'s ongoing effort to regulate GHG emissions under the Clean Air Act (CAA) or state regulations after 2017, which could result in 50 conflicting mandates. In fact, the Senate bill in effect codifies the EPA's PSD tailoring rule and sets a limit of 25,000 tons per year (avoiding one of the legal weaknesses in the proposed Prevention of Significant Deterioration (PSD) rule) and ensuring the worst of both worlds (cap-and-trade and command and control CAA regulation).
- imposes a lower offset limit, which will increase the price of allowances and the cost of the program, according to the EPA
- reduces the total amount of free allowances, primarily to reduce the national deficit, and
- provides a $28 price cap on GHG emission allowances, lower than the House bill's cap.

While the EPA's cost analysis finds the cost differences between the two bills minimal, other assessments conclude that the Senate bill's reduction of free allowances significantly increases cost effects, particularly for low-income households and energy-intensive industries. Prospects for passage this year are uncertain.

EPA Regulation Also Moves Forward, Classifying CO_2 as a Pollutant and Requiring Permits for Many U.S. Facilities

The EPA has moved ahead with proposed regulations that will classify carbon dioxide (CO_2) as a pollutant under the Clean Air Act and thereby will trigger permitting requirements. On October 27, the EPA proposed limiting the effect of these permit requirements, at least initially, to facilities that emit more than 25,000 tons per year of GHG. There is no doubt that this regulation, expected to be finalized in April 2010, will be challenged in court. If the rule's effectiveness is not stayed by this litigation, the new regulatory requirements will go into effect, creating major problems for both covered facilities and the EPA's ability to manage such a massive regulatory scheme. As some form of regulation is inevitable (either due to legislation or these regulations), companies would be well advised to determine their greenhouse emission levels.

GHG Litigation on the Rise

Even before legislation or final regulation, increasingly lawsuits are being filed to require consideration of GHG emissions in permitting or as a basis for common law claims. The Second and Fifth Circuit Courts of Appeals held in recent weeks that plaintiffs may bring public nuisance mass tort lawsuits against companies for damages attributed to their greenhouse gas emissions. The more sweeping case is *Comer v. Murphy Oil*, an October 19 Fifth Circuit decision that allows property owners to sue five oil companies and utilities, seeking compensatory and punitive damages for losses suffered in Hurricane Katrina, which the plaintiffs link to the defendants' GHG emissions. While the likelihood of ultimate success on these theories is low, these court decisions are significant and will probably lead to additional lawsuits against industrial targets.

Tar Sands Remain Under Attack on Numerous Fronts

Developments related to tar sands include:

- On September 9, 2009, the Sierra Club and other U.S. and Canadian environmental groups sued the U.S. State Department, challenging the authorization of transborder transport of tar sands crude oil via a 1,000-mile pipeline from Alberta, Canada into

the U.S. (through North Dakota and Minnesota to Superior, Wisconsin) for processing into fuel. The suit claims that the U.S. did not address or did not adequately address the upstream and downstream "global warming impacts" (including effects from tar sands development in Canada) and consider the mitigation of these effects.

- Recently, the EPA granted part of a petition filed by five U.S. environmental groups delaying the issuance of a permit that BP North America needs to operate its Whiting Refinery in Indiana to refine oil from Canadian oil sands at a higher capacity in the future. According to the EPA, the permit had not adequately accounted for increased air pollution associated with processing the high-sulfur crude oils. The EPA, however, denied the environmental groups' demand that the permit regulate the project's GHG emissions and consider potential technological controls to reduce GHG emissions. This decision, which may be appealed administratively or in the courts, is not likely to delay the $3.8 billion modernization project since the permit is not required until 2012.
- The California Low Carbon Fuel Standard statute enacted last spring requires that transportation fuel sold in California, on average, have lower carbon content over time. Because there are allegedly more GHG emissions resulting from the lifecycle of producing tar sands compared to other fuels, such low-carbon fuel standards may tend to decrease the market for transportation fuel derived from tar sands. Of course, if such GHG emissions are controlled (e.g., through sequestration), the difference between fuels may be lessened. Neither the current House nor Senate bills contain a federal low-carbon fuel standard.
- On October 19, the Secretary of Interior requested Interior's inspector general to investigate six oil shale lease addenda issued on January 15, 2009, near the end of the Bush administration, which amended research, demonstration and development leases. Interior, however, also announced a second round of U.S. oil shale leases and reiterated its long-term commitment to performing research to succeed in developing oil shale (which is similar to Canadian tar sands) as a fuel source. It is prudent to anticipate attempts by citizen groups to delay and stop such projects and, in the U.S., lawsuits are likely.

SEC Regulation: Shareholders Can Force Climate Change Financial Exposure

On October 27, the Securities and Exchange Commission issued a staff bulletin reversing previous policy and announcing that shareholders can force publicly traded companies to disclose their climate-related financial exposure. This change is expected to require a wide range of companies to conduct assessments of their climate change-related financial risks. In turn, this increases the need for companies to consider climate change effects in their day-to-day and strategic business decisions.

Pepper Point: As this article went to press, Republicans scored strong gubernatorial election victories in two major states, Virginia and New Jersey; these wins may affect the willingness of moderates to vote for a wide-ranging climate bill. Also, Sens. John Kerry, Lindsay Graham, and Joe Lieberman announced that they were going to work on compromises to S. 1733, particularly relating to incentives for building nuclear power plants and allowing more oil drilling (among other issues). Since all three senators are good friends with Sen. McCain, and at least Sens. Lieberman and McCain (in addition to Kerry) favor some form of cap and trade, this public effort raises interesting possibilities. However, there are no guarantees, given the strong opposition in the Democratic base to nuclear power plants and oil drilling.

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Cross-Border Corporate and Securities Updates

SEC Releases Bulletin on Oil and Gas Industry Reporting

On October 30, 2009, the Office of the Chief Accountant of the U.S. Securities and Exchange Commission (SEC) issued updated guidance on how the agency's staff interprets accounting rules related to the oil and gas industry. The updates correspond with rulemaking that the SEC approved in December 2008 in an effort to modernize its oil and gas company reporting requirements to help investors evaluate the value of their investments in these companies. The principal revisions of the guidance, known as Staff Accounting Bulletin No. 113, include:

- changing the price used in determining quantities of oil and gas reserves
- eliminating the option to use post-quarter-end prices to evaluate write-offs of excess capitalized costs under the full cost method of accounting
- removing the exclusion of unconventional methods used in extracting oil and gas from oil sands or shale as an oil- and gas-producing activity, and
- removing certain questions and interpretative guidance that are no longer necessary, as well as making certain non-substantive editorial changes.

The guidance updates Topic 12 of the codification of staff accounting bulletins in order to make it consistent with the SEC's Final Rule Release, *Modernization of Oil and Gas Reporting*, issued December 31, 2008.

It is important to note that the statements in a staff accounting bulletin are not rules or interpretations of the SEC, nor are they published as bearing the SEC's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws.

TSX to Require Shareholder Approval for Dilutive Public Company Acquisitions - Minor Differences from U.S. Stock Exchange Rules

On November 24, 2009, an amendment to Section 611(d) of the Toronto Stock Exchange (TSX) Company Manual relating to securityholder approval for acquisitions of public companies will become effective. The amendment provides that TSX-listed issuers will be required to obtain securityholder approval when the securities issued in payment for an acquisition exceed 25 percent of the number of issued and outstanding securities of the listed issuer (on a non-diluted basis), regardless of whether the target being acquired is a private or a public company. Currently, the TSX requires securityholder approval for the issuance of securities as full or partial consideration for an acquisition in cases in which such number of securities exceeds 25 percent of the issued and outstanding securities of the listed issuer; however, this requirement does not apply in cases in which the listed issuer is acquiring a public company.

The initial proposal was published on April 3, 2009, and proposed to require securityholder approval for the issuance of securities in payment of the purchase price for an acquisition of a public company that exceeds 50 percent of the number of issued and outstanding securities of the listed issuer. There was significant opposition to the initial proposal: during the 30-day comment period, the TSX received 23 comment letters, the vast majority of which argued that the 50-percent threshold was too high and also argued that the threshold dilution level for public company acquisitions should be the same as for private company acquisitions, which is 25 percent.

Now, the TSX will require securityholder approval for the issuance as full or partial consideration for all acquisitions in cases in which such number of securities exceeds 25 percent of the issued and outstanding securities of the acquiring listed issuer. The amendment will not have any retroactive effect such that any transaction of which the TSX has been notified in writing prior to November 24, 2009 will not be required to comply with the amendment.

The preliminary expectations are that the new rule will have a significant effect on public company M&A transactions in Canada; potential effects include higher acquisition costs and increased deal risk. Acquisitions by way of a take-over bid will be affected also, as Canadian take-over bid rules require that an offer be open for acceptance for a period of 35 days, whereas a shareholders' meeting typically involves a period of 40 to 50 days.

The 25-percent threshold dilution level for shareholder approval brings the TSX more in line with the American exchanges: the NYSE requires shareholder approval if either (i) the number of shares to be issued exceeds 20 percent of the number of shares of common stock outstanding or (ii) the transaction will result in voting power equal to or greater than 20 percent of the voting power then-outstanding. Amex and NASD both adopt the 20-percent rule as well. (It should be noted, however, that the TSX does not have a corollary voting power test.)

Obama Administration Shrinks Sarbanes-Oxley Protections as Small Public Companies Win Exemption from Audits

On November 3, 2009, the House Financial Services Committee voted to exempt small public companies from having to comply with a provision of the Sarbanes-Oxley Act – the intent of which was to prevent financial fraud – that requires that companies hire auditors to examine their internal systems to ensure compliance with accounting reporting rules. The amendment would apply to public companies with a net worth of less than $75 million, which encompasses approximately half of all public companies. The amendment is part of an omnibus investor bill the committee is working on to reform financial regulations.

Proponents of the amendment argue that the costs of compliance with that particular provision are too burdensome, and affect companies' ability to grow and hire new people.

SEC Chairman Mary L. Schapiro strongly opposed the exemption, saying the law "leads management to better understand financial reporting risks, put in place appropriate controls to address financial reporting risks, and addressing internal control deficiencies in a more timely fashion." Former SEC Chairman Arthur Levitt was also sharply critical of any efforts to roll back Sarbanes-Oxley.

Although the provisions of the law that require companies to comply with audit requirements have not been fully implemented, the SEC recently announced that, starting next year, further delays would not be entertained.

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