October 2017

NEWS ROUND UP

A Morrison & Foerster summary of recent developments affecting Israeli companies active in the capital markets.

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Treasury Report, Part II: Regulation of the Capital Markets

The U.S. Department of the Treasury ("Treasury Department" or "Treasury") issued its second report (of four reports), titled "A Financial System that Creates Economic Opportunities, Capital Markets" (the "Report"). The Report was issued in response to Presidential Order 137772 setting forth the Core Principles that should guide regulation of the U.S. financial system. The Report addresses various elements of the capital markets, from the equity and debt markets, to the U.S. Treasury securities market, and to derivatives and securitization. The Report also addresses the role and regulation of financial market utilities and clearinghouses.

Like many movie sequels, which are somehow less compelling than the original, this second installment is less cohesive than the first Treasury report, which focused on the regulation of depositary institutions. The Report notes that certain aspects of the capital markets regulatory framework are working well, but other elements would benefit from better "calibration." To that end, the Report recommends various measures, most of which would not require legislation, which would promote capital formation.

The Report reviews now-familiar ground, lamenting the decline in the number of U.S. public companies and initial public offerings in the United States in recent years. While noting that it is difficult to isolate the cause for the decline in the number of initial public offerings ("IPOs"), the Report attributes the decline at least in part to increased regulatory burdens facing U.S. public companies. The Report's recommendations are largely consistent with provisions of various standalone bills introduced in Congress this session, many of which have been subsumed into the Financial CHOICE Act. Below, we highlight the Report's key recommendations:

- Certain of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") mandate requiring specialized disclosures, such as conflicts minerals disclosures, should be repealed and withdrawn.
- Duplicative, redundant, or outdated disclosures required by Regulation S-K should be modified or eliminated. The Securities and Exchange Commission (the "SEC") is already addressing amendments to Regulation S-K, since the SEC was required to take action in this regard by the FAST Act. (See next article.)
- The SEC should permit all issuers, not only emerging growth companies ("EGCs"), to conduct test-the-waters discussions. A bill was recently introduced in the U.S. House of Representatives that would do just this. The Report also recommends that EGCs be able to retain their status for up to 10 years.
- The SEC should explore a number of options to evaluate the role of proxy advisory firms, including regulation of their activities, and increasing the requirements for shareholder proposals.

- States and the SEC should investigate means to reduce the costs of securities litigation.
- The benefits of scaled disclosure should be extended, including by amending the definition of "smaller reporting companies" ("SRCs"). The SEC has already proposed, and is expected to adopt, amendments to the SRC definition.
- The rules and regulations relating to research should be consolidated, evaluated, and harmonized.
- Regulations relating to Tier 2 Regulation A offerings and crowdfunding should be reviewed and revised to allow for more flexibility.
- The efficiencies associated with private capital-raising should be preserved by, among other things, expanding the categories of sophisticated investors included as "accredited investors."

The Report also addresses equity market structure issues, as well as corporate bond market liquidity.

To learn more, read our client alert.

FAST and Furious: Proposed Amendments to Regulation S-K Requirements

In recent months, there has been an active dialogue regarding the regulatory burdens for public companies and whether these burdens have contributed to the decline in the number of U.S. IPOs and companies listed on U.S. securities exchanges. One of the burdens cited by commentators relates to the extensive disclosures required under the SEC's rules and regulations for companies seeking to register IPOs under the Securities Act of 1933 and also for public-reporting companies in their filings under the Securities Exchange Act of 1934 (the "Exchange Act"). Long before the days of the recent presidential order seeking to limit new regulations and eliminate existing regulations, the SEC had already embarked on its own disclosure effectiveness initiative; however, in recent months, the "push" for regulatory burden relief has become a shove.

The SEC's release of proposed amendments to certain Regulation S-K requirements, which we summarize in the link below, are likely just the first of several disclosure-related amendments to be issued.

To learn more, read our client alert.

Practice Pointers on Pre-funded Warrants

Pre-funded warrants are a type of warrant that allows its holder to purchase a specified number of a company's securities at a nominal exercise price. The nominal exercise price is typically as low as $0.01 per share (often referred to as "penny warrants"). The term "pre-funded" refers to the structural feature that allows the company to receive, as part of the pre-funded warrant's purchase price, the exercise price that would be due for a traditional (not pre-funded) warrant, except for the nominal exercise price, at the time of the warrant's issuance instead of at the time of the warrant's eventual exercise.

This type of warrant may be used to provide investors that have restrictions on their ability to own more than a specified percentage of a company's securities (for example, 9.99% or 19.99%) with the opportunity to invest additional capital without violating these ownership limitations. A pre-funded warrant provides a holder with the flexibility to avoid exceeding the ownership limit before exercising the warrant, while maintaining the ability to acquire the underlying securities at a nominal exercise price in the future when the investor is able to do so.

To learn more about pre-funded warrants, see our Practice Pointers.

Practice Pointers on Choosing Standards: "Commercially Reasonable Efforts," "Best Efforts" and Similar Standards

Contracting parties frequently use terms such as "commercially reasonable efforts," "reasonable efforts," "best efforts" or similar standards when describing their expectations regarding the performance of a party's obligations.

These terms appear in a wide variety of joint venture, financing, licensing, consulting and other key transaction agreements. These terms are inconsistently interpreted by courts and are often subjectively applied. A requirement that a party undertake its "best efforts" in performing its obligations is universally understood to be the highest standard, requiring a party to do everything, except bankruptcy, in order to accomplish the stated objective. On the other end of the spectrum, "reasonable efforts" is a less stringent standard, requiring the party only to do what it can within reason in order to accomplish the stated objective. "Commercially reasonable efforts" is at a level below "best efforts" and is generally interpreted as requiring the party to exert substantial effort without requiring that the party take any action that would be commercially unreasonable under the circumstances. However, "commercially reasonable efforts" is a standard that has received limited interpretation by courts.

In this article, we discuss how "commercially reasonable efforts," "reasonable efforts," and "best efforts" have been interpreted in recent court decisions and

considerations with respect to the use of these terms by contracting parties.

To learn more, see our Practice Pointers.

Update to Registration Statement Processing Procedures

In August 2017, the Staff of the SEC also recently updated the procedures relating to nonpublic review of draft registration statements as to IPOs and for other early stage companies. Specifically, the following guidance was added:

The nonpublic review process is available for Securities Act registration statements prior to the issuer's initial public offering date and for Securities Act registration statements within one year of the IPO. In identifying the initial public offering date, we will refer to Section 101(c) of the JOBS Act. The nonpublic review process is available for the initial registration of a class of securities under Exchange Act Section 12(b) on Form 10, 20-F or 40-F.

An issuer that has a registration statement on file and in process may switch to the nonpublic review process for future pre-effective amendments to its registration statement provided it is eligible to participate in the nonpublic review process and it agrees to publicly file its amended registration statement and all draft amendments in accordance with the time frame specified above.

See the procedures here.

Recently Published: Non-GAAP Explained

The use of non-GAAP financial measures by public companies continues to draw regulatory scrutiny and media attention. The SEC has the threefold mandate to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. The SEC has been focused recently on the prevalence and increased prominence of non-GAAP financial measures in company disclosures, amid concerns of their potential to distort actual company performance numbers and mislead the investing public.

In Morrison & Foerster and the International Financial Law Review's "Non-GAAP Explained", we give an overview of the history, specifics, considerations, enforcement issues and recommendations when using Non-GAAP financial measures.

To access our book, please click here.

Treasury Report Proposes Substantial Revisions to Controversial Tax Regulations

On October 2, 2017, the Treasury delivered a report to President Trump that proposes substantial revisions to eight sets of controversial U.S. federal income tax regulations (the "Report").

The Report was prepared in response to Executive Order 13789, which was issued by President Trump in April 2017 (the "Order"). The Order directed the Secretary of the Treasury to identify tax regulations issued on or after January 1, 2016 that impose an undue burden on U.S. taxpayers, add unnecessary complexity to the federal tax laws, or exceed the statutory authority of the Internal Revenue Service. Following the issuance of the Order, Treasury later prepared a notice in June 2017 (Notice 2017-38) that initially identified the eight sets of regulations that are the subject of the Report and that were effectively targeted for potential withdrawal or revision.

Our client alert, available here, summarizes the highlights of the Report, including the potential revocation of certain aspects of the highly controversial Section 385 "debt/equity" regulations.

SEC Chief Accountant Gives Remarks on Initial Coin Offerings

On September 11, 2017, SEC Chief Accountant Wesley Bricker gave a speech at the AICPA National Conference on Banks & Savings Institutions titled "Advancing High-Quality Financial Reporting in Our Financial and Capital Markets." Mr. Bricker dedicated a portion of the speech to discussing the importance of broker-dealer compliance, as well as regulatory and financial reporting requirements, relating to initial coin offerings (ICOs), also referred to as token sales. Mr. Bricker noted that in July 2017, the SEC issued a report on its investigation of an offering of digital tokens by The DAO, an unincorporated virtual organization. Mr. Bricker emphasized that, as stated in the SEC's report, the federal securities laws apply to those who offer and sell securities in the United States, regardless of whether the issuing entity is a traditional company or a decentralized autonomous organization, whether those securities are purchased using U.S. dollars or virtual currencies, or whether they are distributed in certificated form or through distributed ledger technology. Mr. Bricker stated that an entity involved in initial coin or token offering activities must consider the necessary accounting, disclosure and reporting guidance based on the nature of its involvement, including the preparation of financial statements. Mr. Bricker noted that issuers involved in initial

coin or token offerings should consider, for example, the application of SEC guidance in addressing the following questions:

- What are the necessary financial statement filing requirements?
- Are there liabilities requiring recognition or disclosure?
- Are there previously recognized assets that require de-recognition?
- Are there revenues or expenses requiring recognition or deferral?
- Is there a transaction with owners, resulting in debt or equity classification and possibly compensation expense?
- Are there implications for the provision for income taxes?

Mr. Bricker also noted that holders of coins or tokens should consider, for example, the application of SEC guidance in addressing the following questions:

- Does specialized accounting guidance (such as for investment companies) apply to the holder's financial statement presentation?
- What are the characteristics of the coin or token in considering whether, how, and at what value the transaction should affect the holder's financial statements?
- What is the nature of the holder's involvement in considering whether the issuer's activities should be consolidated or accounted for under the equity method?

A copy of the speech is available at this link.

Exempt and Hybrid Securities Offerings (3rd Ed.)

Practicing Law Institute's Exempt and Hybrid Securities Offerings is the first practical, accessible resource to provide you with comprehensive legal, regulatory, and procedural guidance regarding these increasingly popular offering methodologies.

Authored by Morrison & Foerster Partners Anna Pinedo and James Tanenbaum, the third edition of Exempt and Hybrid Securities Offerings provides a useful understanding of the applicable regulations and legal framework for these transactions, as well as the implications of these regulations for structuring transactions.

The treatise provides a detailed analysis of the regulations and guidance affecting exempt and hybrid securities offerings, and also offers market context and practical structuring advice. Packed with checklists, transactional timelines, SEC guidance, and a wealth of labor-saving sample documents, Exempt and Hybrid Securities Offerings describes the relative advantages and drawbacks of the most commonly used forms of exempt and hybrid offerings. It clearly explains:

- conducting venture private placements;
- traditional and structured PIPE transactions;
- institutional (debt) private placements;
- Rule 144A offerings;
- Regulation S offerings;
- Regulation A offerings and crowdfunding;
- shelf takedowns;
- registered direct and ATM offerings;
- confidentially marketed public offerings; and
- continuous issuance programs, including MTN and CP programs.

This comprehensive three-volume treatise has been updated to reflect changes brought about by the Dodd-Frank Act, the JOBS Act, the FAST Act, and other recent regulatory changes.

For more information, and to receive a 20% discount, please click here.

UPCOMING EVENTS

Digital Coin Offerings: SEC Guidance and Tax Considerations

IFLR Webinar, Tuesday, October 31, 2017

Token sales, also known as "ICOs," represent a new capital-raising method that is being explored by a variety of companies in the market. In the past few months, the U.S. Securities and Exchange Commission (SEC) has provided guidance concerning token sales. Although the SEC did not declare that all digital tokens constitute securities, it cautioned, among other things, that certain tokens may be securities and that existing securities frameworks apply to token sales, notwithstanding that digital tokens may be distributed via distributed ledger technology. In addition, the IRS has published guidance relating to tokens that are "convertible virtual currencies" and has indicated that these tokens generally are treated as property for U.S. federal income tax purposes. Token sales, and the legal and regulatory landscapes in the U.S. and around the world with respect to digital tokens, continue to evolve.

This webinar will explore the current legal, regulatory and tax landscape relating to token offerings and will consider the following:

- What are digital tokens and how are they typically used and sold?
- What guidance has the SEC provided regarding token sales, and what is the significance of that guidance?
- What guidance has the IRS provided regarding tokens and what tax considerations are relevant to tokens and token sales?
- What are some of the important other legal matters that token issuers and their counsel should be aware of when contemplating launching token sales?

To register, please click here.

BLOCKCHAIN + SMART CONTRACTS

The opportunities and legal considerations raised by blockchain and other distributed ledger technologies are vast and implicate nearly every legal content area.

Morrison & Foerster's Blockchain + Smart Contracts Group provides a holistic, comprehensive approach to the emerging blockchain, smart contracts and distributed ledger space. Our cross-practice, cross-industry, global team unites attorneys in our Financial Transactions, FinTech, Technology Transactions + Internet of Things, Data Security + Privacy, Financial Services Regulatory, Tax, Capital Markets + Securities and other legal content areas, and provides our clients with cutting-edge knowledge and strategic guidance.

Our clients appreciate our dexterity and experience in crafting new financial products and offering methodologies when off-the-shelf approaches do not work. It's true: we like complex financings and addressing novel legal questions.

Visit our Blockchain + Smart Contracts Resource Center.

CLIENT RESOURCE CORNER

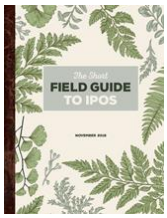
We have a number of resources available to our clients and friends including:

MoFo Jumpstarter.

Our Jumpstart blog is intended to provide entrepreneurs, domestic and foreign companies of all shapes and sizes, and financial intermediaries, with up to the minute news and commentary on the JOBS Act. Visit: www.mofojumpstarter.com

MoFo's Quick Guide to REIT IPOs.

Our Quick Guide to REIT IPOs provides an overview of the path to an IPO for a REIT. The guide also addresses regulatory, tax and accounting considerations relevant to sponsors considering forming a REIT. Our guide is available here: https://goo.gl/jwrKE1.



The Short Field Guide to IPOs.

In our Short Field Guide to IPOs we provide an overview of the path to an initial public offering and address a number of recent developments. Our guide is available here: https://goo.gl/Cvxa4S.

Capital Markets Practice Pointers.

In our practice pointers, which address a range of topics of interest, we offer guidance on frequent issues encountered in connection with securities disclosures and filings. Visit our Practice Pointer webpage at: https://goo.gl/FizH9N.

SOCIALLY AWARE
THE SOCIAL MEDIA LAW UPDATE

Social media sites are transforming not only the daily lives of consumers, but also how companies interact with consumers. Social media generates new legal questions at a far faster pace than the law's ability to provide answers to such questions. In an effort to stay on top of these emerging issues, and to keep our clients and friends informed of new developments, Morrison & Foerster has launched a newsletter devoted to the law and business of social media. Visit: www.mofo.com/sociallyaware.

CONTACTS

Ze'-ev Eiger
(212) 468-8222
zeiger@mofo.com

Lloyd Harmetz
(212) 468-8061
lharmetz@mofo.com

Anna Pinedo
(212) 468-8179
apinedo@mofo.com

ABOUT OUR ISRAEL PRACTICE

For more than four decades, Morrison & Foerster has participated in the development of the Israeli market, representing numerous Israeli companies globally, at every stage of their evolution, as well as the foreign investors or investment banks that finance those companies. We provide innovative securities and capital markets advice that is sharply focused on providing global capital markets access to technology-centric companies. We believe that this expertise, as well as our historic commitment to Israel, has contributed to our long and successful track record with Israeli clients. For more information, visit: https://www.mofo.com/practices/international/israel/.

ABOUT MORRISON & FOERSTER

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life sciences companies. We've been included on *The American Lawyer*'s A-List for 13 years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.