SECURITIES REGULATION LAW 463 CAN

WATERS AND SOLLIS

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**PART 1: INTRODUCTION TO SECURITIES LAW**

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| **Objectives of Securities Law**  **1.** Protection – Providing protection for investors from unfair, improper, or fraudulent practices  **2.** Efficiency – fostering fair and efficient capital markets involves striking a balance; investor protection schemes cannot be so onerous as to deter corps from using capital markets to raise funds  **3.**  Transparency – instills confidence in the capital markets |

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| **Strategies**  **1.**  Disclosure – one of the key ways in which regulators set out to achieve these objectives, by ensuring that companies must disclose as much info as possible to investors and incurring liability for failing to do so  **2.**  Registration – ensuring strict and onerous registration requirements for financial intermediaries  **3.**  After the Fact Enforcement – in the event that any of these rules are breached, civil and criminal liability impact companies w/r/t to their disclosure and registrants who do not fully comply with the rules they are required to follow. |

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| **Category, Sub-Category, & Document Type Numbers** | | |
| **Category (1st digit)** | **Sub-Category (2nd digit)** | **Document Type (3rd digit)** |
| 1. Procedure and Related Matters | 1. General  2. Applications  3. Filings with Securities Regulatory Authority  4. Definitions  5. Hearings & Enforcement | 1. National or Multilateral Instrument (Rule) and any related Companion Policy and Form  2. National or Multilateral Policy  3. CSA Notice or CSA Staff Notice  4. CSA Concept Proposal or Discussion Paper  5. Local Rule, Regulation, Or Blanket Order or Ruling and any related Companion Policy or Form  6. Local Policy  7. Local Notice  8. Implementing Instrument (Local Rule that gives effect to NI/MI)  9. Miscellaneous Item (i.e. a Form that does not relate to another Instrument or Policy) |
| 2. Certain Capital Market Participants | 1. Stock Exchanges  2. Other Markets  3. Trading Rules  4. Clearing & Settlement  5. Other Participants |
| 3. Registration and Related Matters | 1. Registration Requirements  2. Registration Exemptions  3. Ongoing Requirements Affecting Registrants  4. Fitness for Registration  5. Non-Resident Registrants |
| 4. Distribution Requirements | 1. Prospectus Contents – Non-Financial Matters  2. Prospectus Contents – Financial Matters  3. Prospectus Filing Matters  4. Alternative Forms of Prospectus  5. Prospectus-Exempt Distributions  6. Requirements Affecting Distributions by Certain Issuers  7. Advertising and Marketing  8. Distribution Restrictions |
| 5. Ongoing Requirements for Issuers and Insiders | 1. Disclosure – General  2. Financial Disclosure  3. Timely Disclosure  4. Proxy Solicitation  5. Insider Reporting  6. Restricted Shares  7. Cease Trading Orders  8. Corporate Governance |
| 6. Take-Over Bids and Special Transactions | 1. Special Transactions  2. Take-over Bids |
| 7. Securities Transactions Outside the Jurisdictions | 1. International Issuers  2. Distributions Outside the Jurisdiction |
| 8. Investment Funds | 1. Investment Fund Distributions |
| 9. Derivatives | 1. Trades in Derivatives |

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| **PART 2: FOUNDATIONAL CONCEPTS** |

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| **What is a security?**   * Basically, it’s an instrument that is issued to raise funds to capitalize an entity and as a result, generate profits * How one can fund business ventures * Noted exceptions: mortgage, bank/savings accounts, contracts of insurance, exchange contracts |

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| *British Columbia Securities Act* (“BCSA”)  **s.1(1) “security”** includes  (a) a document, instrument or writing “commonly known” as a security,   * Substance over form - would the informed professional say this is a security?   (b) a document evidencing title to, or an interest in, the capital, assets, property, profits, earnings or royalties of person,   * Includes a corporate person   (c) a document evidencing an option, subscription or other interest in or to a security,   * Anything entitling you to a security in the future is also a security * For example, employee stock options used as compensation; 3rd party options in which a shareholder will grant another party the option to acquire the shares instead of selling them outright; stock exchange options to acquire securities, commodities, or currencies in the future, which can be used both for speculation and risk mitigation   (d) a bond, debenture, note or other evidence of indebtedness, share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certificate or subscription other than  (i) a contract of insurance issued by an insurer, and  (ii) an evidence of deposit issued by a savings institution,   * Companies can capitalize (in simplistic terms) either through debt financing or equity financing   (e) an agreement under which the interest of the purchaser is valued, for the purposes of conversion or surrender, by reference to the value of a proportionate interest in a specified portfolio of assets, but does not include a contract issued by an insurer that provides for payment at maturity of an amount not less than 3/4 of the premiums paid by the purchaser for a benefit payable at maturity,   * A proportionate interest in a portfolio of assets * Read literally, could cover everything (so must be interpreted in light of the purpose of the Act) * An interest in a security is a security via an intermediary, such as a mutual fund or a hedge fund * N.B.: savings in banks (deposits) are NOT securities   (f) an agreement providing that money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any person,  (g) a profit sharing agreement or certificate,  (h) a certificate of interest in an oil, natural gas or mining lease, claim or royalty voting trust certificate,  (i) an oil or natural gas royalty or lease or a fractional or other interest in either,  (j) a collateral trust certificate,  (k) an income or annuity contract, other than one made by an insurer,  (l) an investment contract,   * Catch-all; not defined; broad   (m) a document evidencing an interest in a scholarship or educational plan or trust,  (n) an instrument that is a futures contract or an option but is not an exchange contract, or  (o) a permit under the [*Oil and Gas Activities Act*](http://www.bclaws.ca/civix/document/id/complete/statreg/08036_01),  whether or not any of the above relate to an issuer, but does not include an exchange contract |

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| 1. Legislation is remedial, not punitive 2. Focus on substance over form    1. Economic reality is key    2. Be prepared to broaden the definition of security if it’s called for 3. Look to the whole of transaction and not on a piecemeal basis    1. As a whole, is this a security? |

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| **Debt & Equity Financing**  Two ways to raise money and financing  **Debt Finance**  Bank loans, short-term promissory notes   * + - Commercial paper     - Bonds and debentures     - Treasury bills (short term evidence of debt) * N.B. an account payable is NOT a security   **Equity Finance**  Common shares have 3 inherent rights attached:   * + vote   + dividends   + participation in liquidation/return of capital   Preferred shares can have a myriad of attributes, but give holder priority over common shareholders w/r/t votes, dividends, or return of capital   * + both debt and preferred shares can be convertible into common shares   Restricted shares usually have their voting rights severely limited, get a fraction of a vote or only get to vote in certain circumstances   * Subscription receipts, installment receipts, limited partnerships, trust units (i.e. mutual funds. Big difference: contractually created entity so they avoid corporate law).   Right to acquire shares is when you don’t have the shares in your possession right now   * For example, subscription receipts where one buys shares from a treasury although the shares cannot be issued now or the investor doesn’t want to currently risk the funds   Options are securities but are not used to raise funds: essentially give you the right to purchase shares at a fixed price (but there is no obligation to do so).   * + Employee stock options (compensation device)   + Third party options (a transfer of stock options often found in shareholder agreements)   + Stock exchange options   + Warrants entitle investor to buy shares over period of warrant at a fixed price set today with no money down |

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| **Investment Contracts** |

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| *British Columbia Securities Act* (“BCSA”)  **s.1(1)(l)** → catchall phrase that isn’t legislatively defined in either Canada or the US   * Policy - protection of the investing public - *Pacific Coast* |

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| **WHAT IS AN INVESTMENT CONTRACT?**  ***PACIFIC COAST***  **1.** Is there an investment of money in a common enterprise?  **2.** Is there an expectation of profits?  **3**. Are the profits to come solely from the efforts of others? (Efforts made by those other than the investor are the undeniably significant ones)  **BUT** → courts will take a policy driven, flexible approach to these tests with a focus on the economic realities of the transactions in question using both *Howey* and *Hawaii* tests |

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| ***Securities and Exchange Commission v. WJ Howey et. al.*, US Supreme Court 1946**  Facts: Defendants were incorporated under Florida law, sold *real estate contracts* for half of their citrus groves to finance future developments at a set price per acre and then convey a warranty deed to the buyer when the full purchase price was paid. Buyer then could lease it back to the company using a *service contract*. Mails and instrumentalities of interstate commerce were used in the sale of land, no registration statement of letter of notification was filed with the Commission  Issue: Can these contracts (leaseback agreements) be characterized as an “investment contract” for the purposes of s.2(a)(1) of the *Securities Act*?  Majority: Investment contract has been construed broadly to afford the investing public a full measure of protection, substance over form, emphasis on economic reality  o It is a contract for “the placing of capital or laying out of money in a way intended to secure income or profit from its employment” – usually when individuals are led to invest money in a common enterprise with the expectation that they will earn a profit solely through the efforts of the promoter (someone other than themselves)  o Here, the agreements are investment contracts  o WHY? – because they offer an opportunity to contribute money and share in the profits of the citrus fruit enterprise that is partly owned/managed by the corporation offering the opportunity – meets all elements of a profit-seeking business venture  o Cannot avoid the statutory regulations simply by the form that the contracts take  o **Test: Does the scheme involve (1) an investment of money in a common enterprise with (2) an expectation of profits (3) to come solely from the efforts of a third party? If yes, then it’s an investment contract**  Dissent: Innocent transactions shouldn’t be brought within the scope of the Act just because certain versions of them would be |

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| ***State of Hawaii v. Hawaii Market Center, Inc. et. al.*, Superior Court 1971**  Facts:   * HMC sold “founding memberships” to promoters who could then earn money by selling additional memberships, referring others to shop there. Focus on marketing to additional promoters, not on sale of merchandise.   Issue:   * Does this scheme constitute an investment contract and therefore a security?   Holding:   * Departure from the *Howey* test because it’s too mechanical and based only on the concept of investor participation * Fundamental question is whether the statutory policy of affording broad protection to investors should be applied even to those situations where an investor is *not inactive, but participates to a limited degree in the operation of the business*? * Securities sale = the public solicitation of venture capital to be used in a business enterprise and the investor’s money is then subjected to the risks of this enterprise over which he has no control * **Test: in Hawaii, an investment contract is created whenever (1) an offeree furnishes initial value to an offeror, (2) a portion of this initial value is subjected to the risks of the enterprise (“risk capital test”), (3) the furnishings of the initial value is induced by the offeror’s promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value will accrue to the offeree as a result of the operation of the enterprise, and (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise** * Here, the transactions involve valuable consideration paid for the right to receive future income from the corporation, overcharges are the initial value and they are subjected to the risks of the enterprise – offeree’s expectations as to a valuable return includes fixed fees, not just profits – focus on quality over quantity of participation in operations of the enterprise, it must be practical/actual control to negate finding of a security because then the offeree can safeguard his own investment, founder-members have no power * Agreements are investment contracts and must be registered prior to distribution |

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| ***Pacific Coast Coin Exchange v. Ontario (Securities Commission)*, SCC 1978**  **\*re-defines and interprets “common enterprise\***  Facts:   * PCCE offered bags of silver coins for sale to members of the public, for cash/on margin (on credit) – most on margin. * Promos described these as investments operating as protection against inflation. Buyer could then resell the bags through PCCE. * PCCE earned commission on all contracts to buy and sell.   Issue: Are these agreements investment contracts for the purposes of the *Securities Act*?  Majority: Starting point is the protection of the investing public   * Substance over form, in light of economic realities * Look to the *Howey* test: Does the scheme involve an investment of money in a common enterprise, with profits to come solely from the efforts of others? * Is there a common enterprise? Are the profits to come solely from the efforts of others? * Solely = whether the efforts of people other than the investor are the undeniably significant ones? * **Common enterprise = when the investor’s fortunes are interwoven with/dependent on the efforts/success of those seeking the investment/third parties**   + Met here, commonality is between the investor and promoter – dependant on PCCE because if PCCE doesn’t properly invest then the buyer won’t get any return, key to success with the promoter alone   + Dissent: Starting point is that commodity futures contracts are not per se within the Act’s regulatory regime.   + Agreements concern margin purchases under the terms of PCCE’s standard commodity account agreements.   + Result was that the customers were tied to the PCCE to consummate their purchases   + PCCE fixed the base price, gathered up a pool of money, they were solvent – substantial reliance on the market that was outside of the promoter’s control   + This is an innocent transaction and like the dissent in *Howey*, shouldn’t be brought within the scope just because various bad versions are – not an investment contract   **\*Note: in *Lazerman* the trade of silver bars on margin was not considered an investment contract because there was a commodity exchange for bars, and thus there was no market making. In *Pacific Coast*, there was the trade of silver coins which had no commodity exchange Thus expertise of *PC* was essential to finding market for sale of silver and generation of profits for investors.** |

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| ***Universal Settlements International Inc.*,OSCB 2006**  Facts:   * Viatical settlements are held to be securities. USI’s business was finding investors for viaticals and Americans interested in selling viaticals.   Issue:   * Are these instruments investment contracts and therefore subject to the prospectus and registration requirements?   Holding:   * Investment with a view to profit, but is this a common enterprise where profits are derived from the *undeniably significant efforts* of persons other than the investors? * Investors get fixed returns, not profits – they however do not exercise any managerial control over their investment * After the investor makes his investment, then USI engages in the work such as evaluating medical conditions, matching people etc. – profit as expected depends on whether death occurs within the period estimated by USI * Here, USI’s relationship with investors is a common enterprise, profits of this common enterprise are derived from the undeniably significant efforts of USI – therefore, investment contracts and securities for the purposes of this Act   Takeaway: viatical settlements are securities + 3rd prong of *Howey* test is described as “undeniably significant efforts” of 3rd parties   * Example of how courts will take a policy driven, flexible approach to these tests with a focus on the economic realities of the transactions in question |

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| * Sale of franchises is not a security (***Century 21 Real Estate***) * Timeshares can sometimes be securities * Golf club ownership stakes can be securities, and golf club membership can be a security (potentially) if transferable |

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| **What is a Trade?** |

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| Key = a disposition of a security for valuable consideration   * Includes a sale, lease, assignment * Excludes a mortgage by legislation, a purchase, gift, inheritance, separation of spouses, splits of private + public companies, collateral   + WHY? - because the policy goal of legislation is to regulate the people in the business of selling the securities * **CP 31-103**   **5 indicia that someone is in the business of trading**   * + Someone is holding themselves out as a dealer/in the biz   + Acting in an intermediary capacity or a market facilitator (even if just on the buy side)   + Carrying on with regularity   + Being/expected to be compensated for the activity of trade   + Directly/indirectly soliciting others in connection with the activity * Policy reasons for caring about this: due diligence, proficiency, background checks, capital requirements/capital adequacy (properly capitalized, report, file statements with regulators). * Recall three objectives of securities law! |

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| ***British Columbia Securities Act* (“BCSA”)**  **s.1(1) “trade” includes**  (a) ANY disposition of a security for valuable consideration whether the terms of payment be on margin, installment or otherwise, but does not include a purchase of a security or a transfer, pledge, mortgage or other encumbrance of a security for the purpose of giving collateral for a debt,   * Only a trade if you’re selling it, not if you’re the one buying it   (a.1) entering into a futures contract,  (b) entering into an option that is an exchange contract,  (c) participation as a trader (i.e., intermediary) in a transaction in a security or exchange contract made on or through the facilities of an exchange or reported through the facilities of a quotation and trade reporting system,  (d) the receipt by a registrant of an order to buy or sell a security or exchange contract,  (e) a transfer of beneficial ownership of a security to a transferee, pledgee, mortgagee or other encumbrancer under a realization on collateral given for a debt, and  (f) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the activities specified in paragraphs (a) to (e)   * Catchall provision * Note: general points on legislative definition   Sale for valuable consideration – raises questions such as why purchases and gifts are not covered?  Trades by professionals – regulation of people who carry out trades on behalf of others  Trades by control persons – done for the providing collateral for a debt made in good faith  Acts in furtherance of a sale – any act in furtherance of a sale is a security (pre-sale activities, sales pitches etc.), done to meet the concern that these could contain tactics/misrepresentations to influence the buyer and otherwise wouldn’t be caught by this legislation |

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| **Jurisdiction**  If one trades in a jurisdiction then subject to that jurisdiction’s securities’ legislation   * Therefore, the catchall provision of **s.1(1)(f) of BCSA** will ensure that a company doing “any act in furtherance of a trade” in a province is trading there, regardless of whether the company has a physical presence there * Policy - bring more parties into the net of the securities’ legislation   ***Regina v Mackenzie Securities***→ registered ON broker sends prospectus to MB without complying with MB Act specifically   * Is this a breach of the MB Act? * Yes, because **any trade in MB or solicitation of clients must comply with the MB Act, even if there is no physical presence there**   ***Re World Stock Exchange*** → Cayman Islands corporation solicited Albertan companies/people through an Internet based stock exchange that was accessible in AB   * The “fundamental principles of securities regulation do not change based on the medium.” * Trade in AB, the AB Securities Commission can sanction them |

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| **Registration Requirements** |

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| A trade of a security triggers the registration requirement *if* it rises to the level of “being in the business”  *British Columbia Securities Act* (“BCSA”)  **s.34** - Persons who must be registered as a dealer  A person must not [be in the business of]  **(a)** trade in a security or exchange contract,  **(b)** act as an adviser,  **(c)** act as an investment fund manager, or  **(d)** act as an underwriter,  unless the person is registered in accordance with the regulations and in the category prescribed for the purpose of the activity.   * Any entity in the business of trading (see **CP 31-103** factors) must register as a dealer * See **CP 31-103 8.4(1)** for registration exemptions   **s.48(1)** - if the commission or the executive director considers that to do so would not be prejudicial to the public interest, the commission or the executive director may order that  (a) a trade, intended trade, security, exchange contract or person, or  (b) a class of trades, intended trades, securities, exchange contracts or persons  is exempt from one or more of the requirements of Part 5 or the regulations related to Part 5.  **Business Triggers:** (5 indicia of being “in the business of trading securities”) requires registration and is set out in **CP 31-103**:  o directly or indirectly holding oneself out as being in the business/activity of trading  o acting in an intermediary capacity or as a market maker  o directly or indirectly carrying on the activity with regularity, repetition, or continuity  o being or expecting to be remunerated for the activity of trading  o directly or indirectly soliciting others in connection with a trade in securities  **NI 31-103 s 8.4 (1)** In British Columbia and New Brunswick, a person or company is exempt from the dealer registration requirement if the person or company  (a) is not engaged in the business of trading in securities or exchange contracts as a principal or agent, and  (b) does not hold himself, herself or itself out as engaging in the business of trading in securities or exchange contracts as a principal or agent  Policy Rationale:  “Recall the three objectives of securities law”   * Proficiency requirements, background checks etc. * Basically the Commission does due diligence on you   + Eg. looking for a history of fraud * Proficiency * Also, must be properly capitalized in order to compensate for any losses stemming from illegal activity of brokers |

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| **Prospectus Requirements** |

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| **What is a Distribution?** |

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| If you have a trade in securities that constitutes a distribution, this triggers the prospectus requirement  Distributions can be direct (private placement) or done through intermediaries  *British Columbia Securities Act* (“BCSA”)  **s.1(1)** - "distribution" means, if used in relation to trading in securities,  **(a)** a trade in a security of an issuer that has not been previously issued,   * Securities new to the market, usually issued by the entity itself   **(b)** a trade by or on behalf of an issuer in a previously issued security of that issuer that has been redeemed or purchased by or donated to that issuer,   * Rarely seen, someone sells the shares back to the company who then sells them to someone else - sold again on behalf of issuer * WHY? - the issuer could have access to “material information” that the public does not   **(c)** a trade in a previously issued security of an issuer from the holdings of a control person,   * Sales by a control person, not the issuer itself * **s.1(1)** - person or combo of people acting in concert who hold sufficient numbers of voting rights attached to securities to affect control of the issuer materially (rebuttable presumption that >20% of outstanding voting rights = insider)   + This isn’t actual control - ability to “materially affect” * WHY? - control persons are presumed to have insider knowledge, which is unfair to non-insiders   + Here, there is an assumption of access to information and influence   + This is important to the market because it sends a signal - “should I sell too?”     - Therefore, this sale could constitute a “material event” that can influence the market value/price   **(d)** a trade by or on behalf of an underwriter in a security that was acquired by the underwriter, acting as underwriter, before February 1, 1987, if the security continues, on February 1, 1987, to be owned by or on behalf of that underwriter so acting,  **(e)** a trade deemed to be a distribution  **(i)** in an order made under section 76 by the commission or the executive director, or  **(ii)** in the regulations,  **(f)** a transaction or series of transactions involving further purchases and sales in the course of or incidental to a distribution   * Serves as a catch-all   **(g)** a prescribed class of trade or transaction; |

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| **What is a Reporting Issuer?** |

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| If an entity is a reporting issuer, then it is subject to a number of continuous disclosure requirements   * Mechanism whereby security law accomplishes the objective of ensuring the obligation to continuously disclose information to investors * A common way to qualify as a reporting issuer is to file a prospectus and receive a receipt from the Executive Director of the Commission   *British Columbia Securities Act* (“BCSA”)  **s.1(1) “reporting issuer”** means an issuer that  (a) has issued securities in respect of which  (i) a prospectus was filed and a receipt was issued,  (ii) a statement of material facts was filed and accepted, or  (iii) a securities exchange take over bid circular was filed,  under a former enactment,   * Securities issued under a predecessor Act + got a prospectus receipt = reporting issuer   (b) has filed a prospectus or statement of material facts and the executive director has issued a receipt for it under this Act,   * Securities issued under this Act + got a prospectus receipt = reporting issuer   (c) has any securities that have been at any time listed and posted for trading on any exchange in British Columbia, regardless of when the listing and posting for trading began,   * Listed on any stock exchange in the regulations (TSX for our purposes)   (d) is an issuer that has exchanged its securities with another issuer or with the holders of the securities of that other issuer in connection with an amalgamation, merger, reorganization, arrangement or similar transaction if one of the parties to the amalgamation, merger, reorganization, arrangement or similar transaction was a reporting issuer at the time of the amalgamation, merger, reorganization, arrangement or similar transaction,   * An entity is not a reporting issuer then combines with one, now it is a reporting issuer   (e) is designated as a reporting issuer in an order made under section 3.2,   * Regulatory power to deem an entity to be a reporting issuer   + For example, trading securities on exchanges not recognized by the Act   (e.1) is a person that is within a prescribed class of persons, or  (f) has filed a securities exchange take over bid circular under this Act for the acquisition of securities of a reporting issuer and has taken up and paid for securities subject to the bid in accordance with the circular,  unless the commission orders under section 88 that the issuer has ceased to be a reporting issuer |

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| **What is Materiality?** |

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| Efficient Market Hypothesis - rationale for our continuous disclosure system   * Relevant information is absorbed by capital markets so quickly that at any given moment the stock price is reflective of the market’s collective assessment of all available information   + Therefore, in an efficient market, value = price of a security, because its disclosure regime allows for accurate assessment of the underlying value by maximizing information available   + Christopher C. Nicholls, *Corporate Finance and Canadian Law* * Correct valuation of a share would be a function of the dividends a corporation would be expected to distribute over the course of its lifetime   + A. Klein and John C. Coffee Jr., *Business Organizations and Finance* |

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| **s.1(1) - "material change"** means,  **(a)** if used in relation to an issuer other than an investment fund,  **(i)**  a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of a security of the issuer, or  **(ii)**  a decision to implement a change referred to in subparagraph (i) made by  **(A)** the directors of the issuer, or  **(B)**  senior management of the issuer who believe that confirmation of the decision by the directors is probable, and  **"material fact"** means, when used in relation to securities issued or proposed to be issued, a fact that would reasonably be expected to have a significant effect on the market price or value of the securities;  Do not confuse a material change with a change in material fact.  A material fact must be disclosed, usually on a predetermined basis. A material change determines when a reporting issuer needs to make IMMEDIATE disclosure - must be immediately reported. |

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| * Disclosure is not required of every fact related to a security – threshold test is that of materiality (either a material fact or material change), whether in prospectus, annual report, continuous disclosure documents, or news release.   - **Market Impact Test (MIT)** determines materiality for purposes of both terms in Canada:  o Information is material if it could reasonably be expected to have a significant effect on the market price or market value of a security   * Found in **s.1(1)** of the BCSA w/r/t material change and material fact   - **Reasonable Investor Test (RIT)** is the US Test for materiality:  o Info is material if there is a substantial likelihood that a reasonable investor would consider it important to an investment decision. \*Note: the reasonable investor need only consider the information, not act on it.  **Realistically** → the RIT is creeping into the MIT because something that would reasonably be expected to have a significant effect on market price or value is something the reasonable investor would probably consider to be important in making an investment decision   * Seen in ***Coventree Capital***   ***Sharbern Holdings Inc v Vancouver Airport Centre*, 2011 SCC 23**   * Involved non-disclosure of material facts in offering memorandum in purchase of strata lots in the Vancouver Airport Hilton (prospectus-type document) * Investors alleged non-disclosure was of conflict-of-interest of developer of both Hilton and Marriott – TJ found in their favour * SCC found for the developer, held that omitted facts were not material on the basis of RIT   - Test for materiality:   1. Objective from reasonable investor; 2. A fact misstated/omitted is material if there is substantial likelihood if important to investor in making an investment decision (US test!); 3. Emphasis on substantial likelihood; not sufficient if the fact “might” have been considered important, not necessary that the fact would have changed the mind of the investor.  * Dealt with provisions of now-defunct Real Estate Act which governed real estate securities, rather than BCSA, and thus **use of MIT was not required**   ***In the Matter of Coventree Capital* (OSCB** **2011)**   * C was in the business of participating in the establishment of trusts to be sold in rated securitized units backed by mortgages (asset-backed securities) to high-end investors * In 2007 as housing bubble was about to burst, were warned that they would lose their rating – did not disclose this until 8 months later * Were brought to task for failure of timely disclosure of a material change – argued that this failure to disclose did not have any market impact (as market had already tanked) * OSCB held them to the standard of the RIT, said that markets are not a perfect reflection of value * This was appealed to Ont Gen Div Ct, who held that proper test was MIT, but that this test must be applied prospectively * Held that the RIT was in fact subsumed within MIT |

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| **Types of Markets** |

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| **- Primary Markets** entail the availability of previously unissued securities through prospectus process;  **I.** capital raising   * A primary market transaction (**distribution**) takes effect where the issuer sells its own securities or sells them through the services of an underwriter * Initial Public Offering – IPO (example)   o When an issuer is first offering securities to the public generally  o Debate over what constitutes public   * Prospectus - a document containing comprehensive disclosure   o  **Required** in all initial distributions of securities (aside from exempt distributions)  **- Secondary Markets** allow peoples to trade in securities upon which a prospectus has previously been filed   * Trading “issued” securities of a reporting issuer * Among the investors after the securities were sold for the first time * Issuer is out of the picture * Central Depositories - example   + Entities that hold inventories of shares and perform clearing services on a daily basis to facilitate rapid trading |

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| **Self Regulatory Organizations**   * SROs are second-level regulators who have authority delegated to them from the primary regulators to regulate standards and procedures of capital markets in Canada   + Primary regulators are the provincial securities’ commissions * SRO is defined in securities legislation; includes exchanges, alternative trading systems, and quotation systems   + “person or company that is organized for the purpose of regulating the operations and the standards of practice and business conduct, in capital markets, of its members and their representatives with a view to promoting the protection of investors and the public interest.” * In order to operate in Canada, an SRO must be recognized by applicable Securities Commission   + Subject to ongoing oversight by first-level regulators * **IIROC** (**I**nvestment **I**ndustry **R**egulatory **O**rganization of **C**anada) most important SRO apart from the exchanges   + Mandate is to set quality investment industry standards to protect market integrity – is both investigative and adjudicative in function much like commissions   + **IIROC** is retained by many marketplaces to be their regulator   **National Exchanges**   * Companion Policy to NI 21-101, *Marketplace Operation* regulates all marketplaces operating in Canada and sets out the distinction between different marketplace participants * Several exchanges exist in Canada where secondary market trading occurs * Largest is **TSX**, which facilitates trading among reporting issuers who want market liquidity for their securities – must file for listing on the exchange, has the most onerous listing requirements * **TSX-V** is the venture exchange, has less onerous listing and ongoing requirements in light of smaller size of companies generally listed on this exchange * **Montreal Exchange** is solely a derivatives exchange through agreement with TSX * **CNSX** and **Equitas** are alternative exchanges designed to compete with TSX, latter started out of concern about predatory high-frequency trading on TSX * Also a number of **quotation and trade reporting systems** – allow registered dealers to post offer and sell info and then sell them themselves instead of going through an exchange * Also a number of automated online programs which facilitate trading and which are regulated as exchanges * **TSX Private Markets** is an exchange designed to facilitate trade in securities from non-reporting issuers, such as those issued under prospectus exemptions   + Trading on the exempt market |

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| **The Passport System** |

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| All Canadian regulators except ON have agreed that one securities regulatory authority will act as the principal regulator for all materials relating to a filer (i.e. the regulator in their home jurisdiction)  o Expressly recognized by NI 41-101  o System reflects a new level of coordination among securities regulators  MI 11-102 + CP 11-102 are meant to implement a system that gives a market participant access to the capital markets in multiple jurisdictions by dealing only with its principal regulator and meeting the requirements of one set of harmonized laws  o OSC can still be a principal regulator, market participants in ON can still have access to capital markets in passport jurisdictions  Advantage: allows for considerable public policy debate  Disadvantage: time and cost of building consensus on required regulatory changes |

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| **The Prospectus Process** |

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| **s.61** (1) Unless exempted under this Act, a person must not distribute a security unless  (a) a preliminary prospectus and a prospectus respecting the security have been filed with the executive director, and  (b) the executive director has issued receipts for the preliminary prospectus and prospectus.  (2) A preliminary prospectus and a prospectus must be in the required form.   * A prospectus is filed with regulator and receipted, OR * The distribution is exempt from the prospectus requirement (either by qualifying for an exemption under NI 45-106 or applying for discretionary exemption from regulator under **s.76** BCSA)   What is a prospectus?   * Provides investors with detailed information re: the issuer in order to make informed valuation and investment decisions * **s. 63(1)** – overriding principle is that there be full, true, and plain disclosure of all material facts   ***Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission) (SCC 2011)***   * the court held that the statutory and public policy goals of the system include investor protection, capital market efficiency, and public confidence in capital markets * Elements = disclosure, regulatory oversight of the process, right of withdrawal and rescission for investors under certain situations and statutory liability for misrepresentations and omissions in relation to the prospectus * Issuer’s CFO, CEO, two directors, and the issuer’s underwriters must certify that the prospectus includes full, true and plain disclosure, giving rise to their liability |

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| **NP 11-202, *Process for Prospectus Reviews in Multiple Jurisdictions***   * Creates a uniform approach to filing prospectuses – introduced new procedure for issuers seeking to distribute across more than one Canadian jurisdiction through “passport system” * This system has been adopted by all Securities Regulators across Canada except Ontario * Recognizes “passport prospectus” and “dual prospectus” * NP 11-202 sets out the means by which an issuer can enjoy the benefits of coordinated review by the securities regulatory authorities in the various jurisdictions in which the issuer has filed a prospectus   Passport Prospectus   * If the the principal regulator is a passport regulator and the prospectus is not filed in ON, only the principal regulator will review it – issuance of a receipt by this regulator will trigger deemed receipt in each other passport jurisdiction where filed (MI 11-102) * If the principal regulator is the OSC and the prospectus is also filed in a passport jurisdiction, only the OSC will review it – issuance of OSC receipt will trigger deemed receipt in each other passport jurisdiction where filed (MI 11-102) * Use this if your principal regulator is not the OSC + you want to file outside of ON or if your principal regulator is the OSC + you file outside of ON   Dual Prospectus   * If the principal regulator is a passport regulator and the prospectus is also filed in ON, principal regulator will review it and the OSC will coordinate its review with the principal * Receipt by principal will trigger deemed receipt in each other passport jurisdiction where filed, and will evidence receipt of the OSC if it has come to the same decision as the principal * If your principal regulator is not the OSC + you want to file in ON   Other Uses for Prospectuses   * **s. 62 of BCSA** allows issuer to file preliminary prospectus and prospectus to become a reporting issuer even if there is no distribution contemplated at that time * Prospectus disclosure is also required where there is a sale of securities by persons having a controlling interest in the securities of an issuer, who are likely to have heightened access to info about the issuer. |

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| **The Prospectus Process**   1. Secure an underwriter 2. Develop and file a preliminary prospectus (receipt issued by securities regulator) 3. Comments and revisions during the waiting period 4. Filing of a final prospectus (receipt issued by securities regulator) 5. Distribution of securities once the receipt is issued |

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| **1) Securing Underwriters**   * **Two fundamental roles of underwriters in securities:**   **(1) to act a liaison between issuer and the investors in a public offering, and**  **(2) to ensure that the disclosure made by an issuer is complete and accurate**   * Underwriters give credibility to issuers because they have a reputation as an experienced market participant   **"underwriter"** means a person who,  (a) as principal, agrees to purchase a security for the purpose of distribution,  (b) as agent, offers for sale or sells a security in connection with a distribution, or  (c) participates directly or indirectly in a distribution described in paragraph (a) or (b),  but does not include  (d) a person whose interest in the transaction is limited to receiving the usual and customary distribution or sales commission payable by an underwriter or issuer,  (e) a mutual fund that accepts its securities for surrender and resells them,  (f) a corporation that purchases shares of its own issue and resells them, or  (g) a bank with respect to prescribed securities or banking transactions;  · Agency agreements   * A common type of underwriting agreement * UW promises to use its best efforts to sell the securities as an agent of the issuer * Commission up to 7% of the offering price   · Firm Commitment   * UW makes an agreement to purchase the securities and resell them * This is when the UW is confident she can make a profit between the issue price form the issuer and the price it will receive from sale of the securities = underwriter’s spread * One form is a “bought deal”   Bought Deal   * Underwriter makes a firm commitment at the preliminary prospectus stage * This agreement is signed before the prospectus is filed and within 4 days of signing it must be filed + a media release issued * ***Kerr v. Danier Leather* (SCC 2001)** – a bought deal process means the purchaser has no remedy of rescission against the issuer for misrepresentation re: issuer’s financial forecasts   + WHY? – b/c the issuer isn’t the principal/seller, the UW is   **Liability**   * **s.131 of BCSA** provides for underwriters’ liability in BC * In a sense the underwriter and the issuer are joint venturers, but in another more important sense they must be adversaries; * The underwriter must seek out and question all relevant and material facts concerning the issuer and reasonably ensure himself that these facts are fully and truly set before the investing public – in a unique position to discover and compel disclosure of the material facts of an offer. * Underwriter Certificates → included in the prospectus   + Certify that to the best of the underwriter’s knowledge, the information constitutes full, true and plain disclosure of all material facts   + **BUT** - this is only “to the best of our knowledge, information, and belief   + Different and less onerous than the “issuer’s certificate” because the directors and officers are in a better position to obtain information and data * They undergo a due diligence investigation   + This means the prospectus has better quality disclosure + good advice in terms of marketing and pricing the securities   **Due Diligence Defence**   * **s.131(5):** provides that underwriters are not liable for misrepresentation or omission of any material fact in the prospectus they signed off on, UNLESS the underwriters failed to conduct a reasonable investigation as to provide reasonable grounds for belief that there was no misrepresentation or omission   + Important that underwriters adopt a due diligence plan and ensure that the steps set out are taken * Reasonableness standard: standard required of a prudent person as required in the case is contextual * Two categories: business DD (need to be familiar enough with business to know what is/isn’t material) and legal DD [see IIROC “checklist” handout] * ***Escott v Barchris* (US 1968)**   + This is the leading American case   + No defense for the executives re: language barrier   + Cannot sub-delegate due diligence responsibility * ***Re AE Ames & Co. Ltd*.(OSCB 1972)**   + UW must seek out all relevant facts re: the issuer   + UW cannot merely rely on statements of issuers (beyond what the directors and officers say) * ***YBM Magnex International* (OSCB 2003)**   + Lead UW was First Marathon. OSC argued that auditors were misled. First Marathon had done a lot of due diligence, but hadn’t taken steps necessary to ensure that info was properly disclosed, such as ongoing investigation by US Justice Dept.   + OSC found that FM had failed to use DD defense and imposed sanctions.   + Threshold for material fact   + UWs must be on the lookout for red flags, and must avoid automatic reliance on statements by the issuer’s people. Back to idea of UWs as “gatekeepers.”   + Provides the threshold for material fact which needs to be disclosed   + The more material the representation or fact, the more important outside verification of that fact may be   + Whereas the issuer’s certificate must certify that the prospectus contains full, true and plain disclosure of all material facts the UW’s certificate only certifies that the prospectus contains the same but only “to the best of our knowledge, information, and belief.”     - “To the best of our knowledge, information, and belief” is a requirement to obtain information necessary to back it up before the underwriter can make an affirmation * ***Re Software Toolworks* (US 1992)**   + Not unreasonable for UW to rely on info from the managers where no reasonable effort could possibly verify the statement (cannot be verified by 3rd party)   + Qualify it (i.e. call it a risk factor) * Information provided by experts   + No set definition; but generally, information provided by experts within the scope of their profession   + Expert report has to be properly presented in preliminary prospectus; consent to be included in preliminary prospectus; reasonable for UW to rely on expert (qualified, report is within area of expertise, and independent). * Every UW responsible for misrepresentation if there wasn’t due diligence * Lead UW must have done what’s necessary; regulators must have seen what DD plan was, aware of any DD issues; but they don’t have to sit side by side lead UW through whole process   + Non-lead UW’s role is to ensure the lead underwriter has done what is necessary to discharge the due diligence defence * UW: site visits, interviews where appropriate, Q+A session before preliminary/final prospectus   **Risk Management**  **Market-out Clause**  **·**  Even in a firm commitment agreement the UW agreement usually has a market-out clause   * This is so the UW can terminate the agreement if it is acting reasonably to determine that the securities cannot be marketed profitably   **Disaster-out Clause**   * Allowsthe UW to terminate if a significant event affects the issuer’s business or the capital markets   ·  ***Retrieve Resources Ltd. v. Canaccord Capital Corp.***, BCSC 1994   * Does the phrase “state of the financial markets” refer to a general market downturn or the market for that issuer’s shares? * The agency agreement that a market-out clause re: the above phrase that would lead to the agent forming the opinion that the securities could not be privately placed * Court interprets it to refer specifically to the market in the specific shares to be placed   + Meant to give the UW protection in reference to the specific shares to be placed * **Invite other underwriters** (together, joint and severally liable) * **Indemnity from the issuer:** The UW can include an indemnity clause in the underwriting agreement (ex: the issuer indemnifies the UW from and against all losses, claims, damages, liability, reasonable costs and expenses) * **Accumulate sufficient expressions of interest before signing the underwriting agreement:** Before signing a firm commitment or bought deal agreement, the UW should solicit expressions of interest and not enter into the agreement unless there is sufficient interest – at least equal to the amount of securities the UW is taking on. * **Lockups and blackout periods:** The UW can require that the issuer, major shareholders, principal officers, and directors not sell securities for a specified number of days after the IPO without the UW’s consent (prevents market disruptions)   **Conflict of Interest**  · **NI 33-105, *Underwriting Conflicts*** requires a non-independent UW to make certain disclosures under a prospectus or other document   * Re: full disclosure of the relationship   · **CP 33-105CP** to **NI33-105**   * Sets out the framework and policy rationale   + Two basic objectives: ensure that investors are purchasing securities that have been priced through a process unaffected by conflicts of interest + receive full, true, and plain disclosure of all material facts re: the issuer and securities * Two basic requirements if not independent: full disclosure of the relationship giving rise to the potential conflict + an UW might have to participate in the transaction |

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| **2) Develop and File Preliminary Prospectus**  **NI 41-101, *General Prospectus Requirements*** - rules regulating who gets entry to the market.  **Preliminary Prospectus**   * Contains all same info as final prospectus except price of securities, price paid to underwriter, and auditor’s report * The preliminary prospectus does not have to contain a price for the securities as this will be set based on market conditions at the time of filing the final prospectus. * It must include a resolution of the board authorising the filing, an underwriter agreement, financial statements, and certified notes by senior officers. * It must note that the document is not final. * Regulators only selectively review PPs, unless it is for an IPO, which gets a full review * Upon receiving a PP, so long as there is no need for additional filing requirements and conditions, which the executive director may deem necessary for the public interest (**s.64(1)**), the executive director must issue a receipt for the PP as soon as practicable after it has been filed.   **Long-form Prospectus** generally includes, but is not limited to:   * The issuer’s business plan * The issuer’s current and expected activities * Financial statements * The issuer’s capital structure * Estimated proceeds of the offering * Planned purpose for the utilization of the capital * The underwriting agreement * A description of the risk factors of the security * Disclosure of estimated net proceeds to be received   · **Form 41-101F1, *Information Required in a Prospectus***   * Prospectus’ goal is to give information concerning the issuer that an investor needs to make an informed investment decision * Materiality is determined in relation to an item’s significance to investors, analysts, other users   + **An item or aggregate is material if it is probably that its omission or misstatement would influence or change an investment decision with respect to the issuer’s securities**   Future-Oriented Financial Information (FOFI)   * Prospectus must also comply with the FOFI requirements for **NI 51-102** * Can be included in the prospectus but must include a cautionary note of the risk that actual performance may vary considerably from the forecast * Issuer must update the forecast when there is a change in the underlying assumption or external events * A RI must not disclose forward-looking information without a reasonable basis - must be based on assumptions which are reasonable in the circumstances * FOFI also must be limited to a period for which the info contained therein can be reasonably estimated * If they do disclose then they must include a number of things in the disclosure   ***Kerr v. Danier Leather Inc*. (SCC 2007)**   * SCC held the forecast did carry an implied representation of reasonableness until the prospectus was receipted on May 6, not up to May 16 results   + WHY? – number of statements imply that the forecast represents management’s best judgment and that it is based on facts and assumptions that reasonable business people with the same knowledge would make   ***Omnicare* (US 2015)**   * court held that issuer needs to disclose facts or assumptions material to the forecast   · Risk Factors: **Form 41-101F1**  o This new instrument arguably moves Canada towards the reasonable investor test when an issuer is deciding to disclose risk factors  o Risk factors include: experience of management, reliance on key persons, regulatory restraints etc.  Junior issuers: an issuer who is not yet a reporting issuer and whose consolidated assets and revenue are both less than $10,000,000 each) must disclose additional information in their long-form prospectus, including:   * The total funds available and a breakdown of those funds, * Estimated consolidated working capital up to the most recent month before filing, and * Total other funds available to be used to achieve the principal purpose identified by the issuer. |

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| **3) Revisions and Commentary: Waiting Period**   * “Waiting period” is defined in **NI 41-101** as the time between the issuance of a receipt for the preliminary prospectus, and the issuance of a receipt for a final prospectus.   + Can be as short as 10 days for short form prospectus, or as long as several months for smaller issuers or issuers that have no history in the market * **Limited marketing, advertising, and communications with investors**   + During this time the activities of the issuer are restricted in terms of their communication with potential investors * **Ongoing obligation to amend preliminary prospectus: material, adverse change**    + Issuer has an obligation to amend the prospectus if there any material change in the business or affairs of the issuer during the waiting period   + Issuer then revises accordingly and submits the final prospectus (receipt usually issued)   ·  ***Notice Re Cambior Inc*., (OSCB 1986)**   * A number of ads extolling the prospects of Cambior appeared in major newspapers   + A major contravention of the OSA * Factual test: can the advertising reasonably be considered to be in furtherance of a trade?   + Purpose of ads allowed during the waiting period is to alert the public to the availability of the PP, advice as to where to find the prospectus information, ability to solicit expressions of interest * Fine line between testing the market for expressions of interest and advertising * **NI 41-101, *General Prospectus Requirements*** **s.13.1(1)** → disclaimer that only a preliminary prospectus has been filed, where to find it + no securities will be sold until a final receipt has been issued   Preliminary Prospectus Amendment Requirements   * Filing amendments are practically quite onerous and expensive * As a prospectus must contain all material facts, ongoing disclosure requirements require the reporting of all material changes, which are differently defined than a change in material facts * **NI 41-101 6.5(1)** amendment requirement is triggered after a preliminary prospectus has been filed by a *material adverse change* ­– amendment must be filed as soon as practicable, but within 10 days of change   + Applies up until the receipt for the final prospectus is issued |

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| **4) Filing a Final Prospectus: Receipts**   * Receipt triggers ability to distribute securities * **s.65:** deals with receipts, says that subject to **s 64**, executive director of commission must issue a receipt for preliminary prospectus as soon as practical after it is filed   + This is when one becomes a reporting issuer * **s.65(2):** provides the same unless executive director considers it to be prejudicial to the public interest to do so. * CSA has issued staff notices which set out circumstances in which they will refuse to issue a receipt for a prospectus:   + **41-305** deals with share structure issues on IPOs   + **41-307** deals with concerns w/r/t issuers’ financial conditions and sufficiency of proceeds from a prospectus offering, which address circumstances where regulators have concerns with disclosure in prospectuses |

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| **5) Distribution of Securities: Amendments & Prospectus Rights**  Final Prospectus Amendment Requirements - post-receipt, pre-closing   * **NI 41-101 6.6(1)** amendment requirement is triggered where a *material change* occurs after a final prospectus has been filed but before the completion of the distribution ­– amendment must be filed as soon as practicable, but within 10 days of change * The requirement changes to reflect the finality of the prospectus, where investors are actually relying on the disclosure in the ensuing distribution (gap between receipt and closing)   ***YBM Magnex International Inc*. (OSCB 2003)**   * Test for materiality is “market impact:” would this fact be reasonably expected to significantly affect the market price/value of the securities?   ***Pezim v. BC* (SCC 1994)**   * A material change can occur between the issue of the receipt for the preliminary prospectus + the end of the distribution period (12 months max.) * Court noted that material facts are much broader than material changes * There is an express obligation to amend and prospectus when there are changes in the business, operation, assets or ownership of the issuer that would reasonably be expected to have a significant effect on market price or value – affirmed in ***Kerr***   ***Kerr v. Danier Leather Inc*. (SCC 2007)**   * There is no obligation to amend a final prospectus for the modification of material *facts*, just *changes*   + WHY? – because if a filer has complied with the Act’s regulatory obligations then it would be contrary to the scheme of it to find civil liability for failing to disclose post-filing info that isn’t a material *change*   + Basically, if poor results are due to a material change (for example, a restructuring) then that should be disclosed, but no obligation on the results themselves   + Business Judgment Rule     - Court finds that this does not apply to the duty of disclosure – cannot be used to undermine the Act   **Withdrawal Right (2 day “cool down” period):**   * **s.83(1):** the final prospectus must be delivered * **(a)** before any purchase contract is entered into or * **(b)** within two days of signing the final purchase agreement, or the agreement is not binding. * **s.83(3):** If an investor sends the issuer a written notice of their intention to withdraw from the agreement of purchase and sale within **two days** of receiving the FP, and any other document they are entitled to, then the purchase contract is not binding. The issuer will want these two days to elapse before closing. * If there is no delivery of prospectus, there is no limitation period on this right   **Right of Rescission**   * rights to damages against the issuer or a right to rescission in the event of misrepresentation in the prospectus (misrepresentation can include untrue statement of facts or omissions of facts) * **s.131(1)(a):** if a prospectus contains a misrepresentation at the time of the purchase, purchaser is deemed to have relied upon that misrepresentation   + Therefore, easier to make out than the common law tort * **s.131(1)(b):** Right to damages against…   + (i) the issuer or a selling security holder on whose behalf the distribution is made,   + (ii) every underwriter that is in a contractual relationship with the issuer or selling security holder on whose behalf the distribution is made,   + (iii) every director of the issuer at the time the prospectus was filed,   + (iv) every person whose consent to disclosure of information in the prospectus has been filed, and   + (v) every person who signed the prospectus. * **s.131(10):** Provides test for damages - defendant is not liable for damages they can prove are not the result of depreciation of the share price as a result of misrepresentation * Not liable for misrepresentation in FLI where there is a reasonable basis for conclusions made, identify info/material factors that could cause it to be wrong, and identify the assumptions made   ***Pearson v. Boliden* (BCCA 2002)**   * Rejected a claim for a loss arising before the misrepresentation was revealed   + WHY? - the depreciation was merely due to a bad sale - rescission right is not meant to protect investors from their own bad deals |

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| **Alternate Prospectus Forms** |

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| **- Short Form Prospectus (SFP): only available to reporting issuers with good disclosure record**   * Governed by **NI 44-101, *Short Form Prospectus Distributions*** * SFP incorporates reporting issuer’s continuous disclosure obligations, allows incorporation of information disclosed in LFP * Must be a reporting issuer who has filed all continuous and timely disclosure documents, securities must be listed or posted for trading on an eligible exchange * One key element of SFP is that you are able to engage in a limited amount of marketing activities provided the SFP is filed within 4 days of commencing those activities * This allows for a much firmer commitment on the part of the underwriters as to what they’re underwriting (enormously useful to UWs) * What information does the short form prospectus provide?   **i.** the distribution plan  **ii.** the intended market  **iii.** what the proceeds will be used for  **iv.** rights attaching to the securities  **v.** any proposed acquisition that has progressed to a state where a reasonable person would believe that the likelihood of the acquisition being completed is high  **vi.** other relevant information  **- Shelf Prospectus: only available to reporting issuers with good disclosure record**   * Same eligibility requirements as for a SFP * Governed by **NI 44-102, *Shelf Prospectus*** * Allows reporting issuer, in addition to the continuous disclosure info assumed to be available, to incorporate more information with regards to the certain kinds of securities wished to offer * Gives issuers flexibility to respond quickly to opportunities in the market – have 25 months to close on the offer once opened (distribute securities) * Advantage: to distribute you only need a supplement updating information and this does not need to be reviewed by the regulator   **-  Post-Receipt Pricing Prospectus**   * Type of prospectus available to issuers who do not qualify to prepare SFPs * Available to all issuers and used for a specific transaction + single type of security   + Reviewed by regulators, on the shelf for 90 days   + 90 days can be extended if a supplemental PREP prospectus is filed within a specified time   **-  Multi-Jurisdictional Disclosure System (MJDS)**   * Allows issuers in Canada and US to access the markets of the other to avoid the expense of complying with the other’s registration scheme (primarily Canada > US) * **Companion Policy to National Instrument 71-101, *The MJDS***   + Purpose = to reduce duplicative regulation in cross-border offerings, issuer bids, take-over bids, business combinations and continuous disclosure/other filings   **- Capital Pool Companies**   * Not very popular in Canada, essentially raise a pool of money without setting out specific use of proceeds other than some general investment criteria * These are companies that are looking for early financing and historically regulators were reluctant to issue a receipt for a prospectus filed by a CPC * Follow a specific set of rules, including completing a qualifying transaction within 2 years, but generally give more flexibility in terms of what can be done with capital |

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| **Exempt Market Transactions** |

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| **Exempt Market Transactions**   * Instances in which new securities can be issued without compliance with disclosure requirements * Exemptions enable capital to be raised on more flexible and cost-effective terms * Exempt market exists on two levels (for reporting and nonreporting issuers):   o Transactions between issuers and investors  o Resale transactions, where initial rationale for exemption may not apply   * **NI 45-106** governs the majority of circumstances in which issuer/investor transactions may take place without a prospectus * **NI 45-102** provides resale rules which are designed to prevent “backdoor underwriting” or the use of exemptions to widely disseminate securities without a prospectus * Securities issued without a prospectus are not freely tradable unless certain conditions are met   + These rules/regulations apply to both reporting and non-reporting issuers alike * In most jurisdictions, this means that the regulation of securities distributions is “closed” in that all possible legal ways of issuing securities are contemplated by legislation (i.e., can’t trade “freely” on the open market/stock exchange). * In BC there are three ways to trade securities freely   + Prospectus   + Legislative/Regulatory prospectus exemption   + Discretionary prospectus exemption * Securities distributions made under exemptions are sometimes known as “private placements” to distinguish them from prospectus offerings   **Policy Objectives**   1. **Private Issuers →** To address specific problems of start-ups, small, and medium-sized issuers by allowing them more flexibility to generate initial amounts of working capital    1. Response to the concern that established financial institution creditors or sophisticated investors may be unwilling or legally discouraged from investing in start-up/small enterprises 2. **Friends, Family, and Business Associates →** Acknowledgement that some wealthy/sophisticated investors are capable of making investment decisions without a prospectus – in the interests of market efficiency, prospectus disclosure rules can be relaxed where the buyers of securities fall into such categories    1. Such investors are assumed to be capable of acting rationally in their economic self-interest and seeking out relevant info directly from the issuer 3. **Founder, Control Person, and Family →** Prospectus requirement may be relaxed where issuers issue securities to those with whom they have a pre-existing relationship    1. WHY? – the investor has or has access to adequate current information about the issuer and its financial prospects    2. Justifies exemptions such as rights offerings, wherein additional securities are offered to existing holders; trades to senior executives; general employee-related exemptions; family, friends, and business associates exemption, etc. 4. **Safe Security Exemption →** Some types of securities are so safe that a prospectus is considered redundant    1. **ss 2.34-38** of **NI 45-106** lists such securities, which includes bonds, debentures, or other indebtedness of governments, municipal corporations, Ontario school boards, other financial institutions, charitable issuers, etc.  * Each of these policy rationales contemplates the relationship between disclosure and risk involved in investing in particular securities, with low risk allowing for more relaxed disclosure requirements in certain situations   **Registration Exemptions**   * Whether or not a distribution requires a prospectus, it will trigger the registration requirement * Although in most cases, prospectus and registration exemptions will overlap, this should not be assumed * **NI 45-103** sets out registration requirements as well as exemptions from registration   **Selected Prospectus Exemptions**  **Small and Medium-Sized Enterprises and Start-ups**  **Private Issuers (NI 45-106 s.2.4)**   * Definition of “private issuers” provided at s **2.4(1) of** **NI 45-106**:   o Not a reporting issuer or investment fund  o Applies to closely-held issuers whose shares are beneficially owned by no more than 50 persons, exclusive of employees/former employees of the issuer/affiliates  o Requires restriction on share transfer contained in issuer’s constitutional docs or shareholder agreements, which enables issuer to control or be aware of changes/increases in the number of shareholders  o Issue must be to enumerated classes of persons (spouses, relatives, etc) set out in s **2.4(2)(a-l):**  **(a)** a director, officer, employee, founder or control person of the issuer,  **(b)** a director, officer or employee of an affiliate of the issuer,  **(c)** a spouse, parent, grandparent, brother, sister, child or grandchild of a director, executive officer, founder or control person of the issuer,  **(d)** a parent, grandparent, brother, sister, child or grandchild of the spouse of a director, executive officer, founder or control person of the issuer,  **(e)** a close personal friend of a director, executive officer, founder or control person of the issuer,  **(f)** a close business associate of a director, executive officer, founder or control person of the issuer,  **(g)** a spouse, parent, grandparent, brother, sister, child or grandchild of the selling security holder or of the selling security holder’s spouse,  **(h)** a security holder of the issuer,  **(i)** an accredited investor,  **(j)** a person of which a majority of the voting securities are beneficially owned by, or a majority of the directors are, persons described in paragraphs (a) to (i),  **(k)** a trust or estate of which all of the beneficiaries or a majority of the trustees or executors are persons described in paragraphs (a) to (i), or  **(l)** a person that is not the public.   * **NOTE:** can issue securities under this exemption to persons not enumerated if you can satisfy the requirement that they are not members of the public re: (l) * Issuer cannot have previously issued securities to persons not in the above classes. * Policy rationale: These persons are in a position to know the issuer or to find out about it without requiring a prospectus to provide the info. The test for who constitutes “the public” has been set out in various cases, but is largely contextual. * ***Securities and Exchange Commission v. Ralston Purina Co*** sets out “need to know test,” which applies whether the persons who are offered the securities need to know the kind of info that a prospectus would provide * ***R v Pipegrass*** provides the “common bonds test,” where the public is those who **are** not in any sense friends or associates of the issuer, or persons having common bonds of interest or association   + WHY? – not stated, but probably because one isn’t likely to take advantage of those people + those people probably have access to the information that a prospectus would disclose   + Mark R. Gillen, *Securities Regulation in Canada*   **Friends, Family, and Business Associates (NI 45-106 s 2.5)**   * Can be either a private issuer or a reporting issuer * No restriction on the number of investors to whom securities may be sold * This exemption allows you to sell securities in **any amount without providing any disclosure to the following:**   **(a)** a director, executive officer or control person of the issuer, or of an affiliate of the issuer,  **(b)** a spouse, parent, grandparent, brother, sister, child or grandchild of a director, executive officer or control person of the issuer, or of an affiliate of the issuer,  **(c)** a parent, grandparent, brother, sister, child or grandchild of the spouse of a director, executive officer or control person of the issuer or of an affiliate of the issuer,  **(d)** a close personal friend of a director, executive officer or control person of the issuer, or of an affiliate of the issuer,  **(e)** a close business associate of a director, executive officer or control person of the issuer, or of an affiliate of the issuer,  **(f)** a founder of the issuer or a spouse, parent, grandparent, brother, sister, child, grandchild, close personal friend or close business associate of a founder of the issuer,  **(g)** a parent, grandparent, brother, sister, child or grandchild of a spouse of a founder of the issuer,  **(h)** a person of which a majority of the voting securities are beneficially owned by, or a majority of the directors are, persons described in paragraphs **(a)** to **(g)**, or  **(i)** a trust or estate of which all of the beneficiaries or a majority of the trustees or executors are persons described in paragraphs **(a)** to **(g)**.   * Cannot pay commission or finder’s fee to any director, officer, founder, or control person of issuer/affiliate in connection with such a distribution – this undermines the assumption of the standing close relationship upon which the exemption is based   + Basically, you can’t have a 3rd party find purchasers under this exemption * Determination of “close personal friend” and “close business associate” requires a level of qualitative assessment, at odds with general objective standards used in securities regulations * This exemption is not available in Ontario * Issuers who distribute securities under this exemption are required to file a report (**45-106F1**) in the jurisdiction where the distribution takes place within 10 days   **Founder, Control Person, and Family (NI 45-106 s 2.7)**   * Available in Ontario only, applicable to founders of issuers and their relations, relations of executive officers or directors, and to control persons * Much more tightly circumscribed exemption, which does not allow prospectus-exempt securities to be distributed to “close personal friends” or “close business associates”   **Government Incentive Security Exemption (OSC 45-501)**   * GIS is security or unit/interest in partnership which invests in a security issued by a company which has agreed to renounce amounts in favour of the holder that will constitute expenses for Canadian exploration, development, or oil gas and property * Also applies where the unit or interest is in a joint venture issued in order to fund these expenses * These are tax incentives meant to promote the activities of junior exploration issuers in the resource sector and northern communities by making it easier for them to capitalize * **s.2(1) of OSC 45-501** sets out substantive limits:   o Maximum of 75 investors may be solicited  o Maximum of 50 investors may purchase GIS  o Investors must have “access to” substantially same info as in prospectus  o Must be an investor capable of evaluating the info as a member of enumerated classes  o Investors must be supplied offering memoranda  o No publicity or advertising  o 12-month limit on promoting other issues under this exemption  o report required within 10 days of issue  **Wealthy/Sophisticated Investor Exemptions**  **Accredited Investor Exemption (NI 45-106 s 2.3)**   * Financial institutions such as banks, loans or trust corporations, insurance companies, credit unions, appropriately regulated pension and mutual funds, and govts are designated as accredited investors as defined in **s 1** * individuals can qualify for this status by way of several assets tests:   + “financial assets test” requires aggregate realizable value exceeding $1M before taxes, but net of any related liabilities   + “net asset test” requires that net assets must “reasonably reflect” an “estimated fair value” of $5M   + “income test” net income before taxes exceeding $200K in 2 most recent calendar years or whose combined spousal income exceeded $300K over that time * **s 2.3(1):** Dealer registration requirement does not apply to a trade where purchaser is an accredited investor and a principal * **s 2.3(2):** Prospectus requirement does not apply in the aforementioned circumstances   + Since only purchaser must be accredited investor, this can apply to both first and second stage transactions * Where accredited investor is an individual, purchaser is required to submit risk acknowledgment form which states that individual understands the risks inherent to making a purchase under this exemption   + Must also report this trade to the regulators within 10 days * Policy rationale: these market participants have the investment expertise and/or financial resources that they don’t need a prospectus before making an investment decisions   **Minimum Amount Investment Exemption (NI 45-106 s 2.10)**   * **s 2.10(1)** prospectus requirement does not apply to a distribution of a security where the purchaser acts as a principal and the acquisition cost is not less than $150K cash and distribution is of securities of a single issuer * **s 2.10(2)** does not apply if the purchaser was created/used solely to purchase the securities under this exemption * this exemption is *no longer available to individuals*, but can be useful for financing * Policy rationale: If an investor was prepared to pay so much then it could be assumed that she was sophisticated enough to make the decision without information in a prospectus   **Pre-Existing Relationship Exemptions**  **Dividends (NI 45-106 s 2.31)**   * Where company issues its own securities in payment of a dividend to security holders, an exemption is provided to what would otherwise technically be a distribution   **Business Combinations/Reorganizations (NI 45-106 s 2.11)**   * Dealer registration requirement does not apply to trade of security in connection with an amalgamation, merger, reorganization, or arrangement if it falls under one of the following: (1) made under statutory procedure; (2) described/disclosed in an appropriate circular, approved by security holders, or (3) which is a dissolution/winding-up of an issuer * When a company offers its shares in exchange for the shares of a target in a takeover bid, this is technically a distribution * Policy rationale: Takeover bid or amalgamation will be accompanied by the same sort of disclosure that would be contained in a prospectus (bid circular)   + regulators do not want to add to the difficulties of an issuer in financial distress, and creditors may have access to other avenues of information through the terms of their debt agreements   **Conversion/Exchange of Securities (NI 45-106 s 2.42)**   * Some securities carry with them a conversion or exchange feature which, when executed, involves issuing the new or underlying securities * Issue of underlying securities is exempted from prospectus requirement where that issuance is in accordance with the terms and conditions of the previously issued securities * Requires prior written notice to the regulator, who may object to the issue within 10 days of receipt of notice * Policy rationale: the SH receiving the issuer’s own securities already knows enough about the issuer to make an informed decision; the SH receiving securities of a RI has access to the RI’s CD and needs no additional information.   **Rights Offerings (NI 45-106 s 2.1)**   * Exemption also exists for the granting of rights by an issuer to its security holders to acquire additional securities of its own issue and the issue of securities pursuant to the right * This exemption does not apply if the rights offering is to effect a “major financing” (exercise of rights would result in 25%+ of the outstanding securities in the class) * Policy rationale: This provides a useful means of alternative financing and often includes “standby commitment” by an investment bank which undertakes to purchase any securities not taken up by existing holders   + Again, requires prior written notice to the regulator, who may object to the issue within 10 days of receipt of notice   + There are limitations on this exemption, which may not be used for “major financing” (25% of the outstanding securities of the class to be issued if fully subscribed), to finance a major undertaking or reactivation of a dormant issuer, or where the securities issuable are into a new class     - BLG, *Securities Law and Practice*   + Notice must be provided to shareholders and regulators in the form of a rights offering circular which prescribes some prospectus-like info as per **NI 45-101**   **Trades to Employees (NI 45-106 s 2.24)**   * Where participation is voluntary, provides an exemption to distribution of securities to employees of issuer/affiliates, including executive officers, directors, consultants   + Can be either the issuer or a control person + to its employees or those of its affiliates * No disclosure requirements, but additional requirements exist for “unlisted reporting issuers” * Policy rationale: basis for incentive plans where employees get equity participation in the company as part of their remuneration package (eg. stock options)   **Issues Related to Offering Memoranda**   * Provinces are split into several groups w/r/t their use of Offering Memoranda Exemption   o Group 1: British Columbia, New Brunswick, Nova Scotia, Newfoundland  o Group 2: Alberta, Manitoba, NWT, PEI, Nunavut, Saskatchewan, Quebec  o Ontario limits use of this exemption to conjunction with another exemption  o In both groups a disclosure requirement must be delivered to the purchaser and a risk acknowledgment  **Offering Memorandum Exemption (NI 45-106 s 2.9)**   * Group 2 extends exemption to eligible investors unless the transaction does not exceed $10,000 * Prescribed form requiring detailed disclosure but less onerous than a prospectus * Available for reporting and non-reporting issuers, very useful   **Discretionary Exemptions**   * ***BCSA*, s.76** → can apply to the regulator for a transaction-specific exemption from the prospectus requirements * Will this be prejudicial to the public interest?   + Focus on objective of investor protection in this analysis     **BC Instruments**  **Existing Security Holders (BCI 45-534)**   * Provides exemption available to reporting issuers with securities listed on Canadian exchange, issuing securities of that listed class or convertible into that class * Requires only a news release, no offering document * Restriction on how much each security holder can buy   **Crowd-Funding (BCI 45-535)**   * Provides exemption for crowdfunding of capital * Only for non-reporting issuers with capital stock of $500K at $1500 per investor * 90 day distribution window * This is a way to raise relatively small amounts of money from a variety of sources   **Investment Dealer (BCI 45-536)**   * Exemption provided as of January 2016 * Available to reporting issuer with securities listed on Canadian exchange which is up to date in its disclosure requirements   + Only required documentation is subscription agreement between purchaser and issuer, news release which meets certain disclosure requirements, **purchaser must obtain advice as to suitability of investment – if in Canada, must be from registered investment dealer**   + Subscription agreement between investor and issuer, investor must get advice from an investment dealer as to the suitability of this investment * Securities must be of a listed class * Amount that can be purchased/raised is unlimited * Fair amount of debate on this, as it gets to the heart of the prospectus system → and it’s available to anyone without a prospectus |

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| **Resale Restrictions** |

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| **Policy Rationales**   * What happens when the original purchaser who qualified for an exempt transaction wants to resell the securities and this purchaser needs additional information? * To ensure that before shares are freely traded, there is full disclosure w/r/t the securities and their issuers, to protect subsequent investors upon resale * To prevent “backdoor underwriting,” wide and immediate distribution of securities without a prospectus   + This can make it too easy to transfer securities from the exempt to the publicly traded market * Difference between application of hold period and seasoning period is based on the possibility and ease of the prospectus exemptions available for each being exploited (especially the accredited investor exemption)   **Restricted (Hold) Period** **- more restrictive**   * These resale rules deem the first trade issued under a prospectus exemption to be a distribution and therefore to resell you need either an exemption or to comply with these requirements * **NI 45-102 s 2.3** states that **s 2.5** **applies to any securities distributed under founder, control person, and family exemption, GIS exemption, accredited investor exemption, minimum amount exemption, offering memorandum exemption, etc.** * **NI 45-102 s 2.5(1)** says that unless the conditions in **s 2.5(2)** are satisfied, first trade made under an exemption (per **s 2.3**) is deemed to be a distribution:  1. Issuer is/has been reporting issuer for 4 months in Canadian jurisdiction immediately preceding the trade 2. at least 4 months have elapsed from the distribution date 3. must comply with legend requirements and record date of distribution 4. cannot be a control distribution 5. no unusual effort is made to prepare the market or create additional demand 6. no extraordinary commission or consideration is paid to a person/company in respect of the trade 7. if selling security holder is insider or officer of issuer, they must have no reasonable ground to believe issuer is in default of securities regulation  * Main exclusion is the private issuer exemption * Convertible securities = if the original security was acquired under an exemption to which the 2.5 resale rule would apply, then it also applies to the converted/underlying security * 5 → BLG, *Securities Law and Practice* says an unusual effort to prepare the market/create a demand has taken place if one of the following activities is engaged in by or on behalf of the vendor   + Dissemination to prospective purchasers of material soliciting orders to purchase (unless it’s just a letter of communication re: identifying securities and advising their availability)   + Formation of a selling group to coordinate the efforts of more than one registrant to effect the sale   + Implementation of any plan to manipulate or adjust the market price of securities (other than price stabilization)   + Marking of a sale to a purchaser with whom the vendor is not dealing with at arm’s length to put the purchaser in a position to resell the securities free of constraints   + Re control block sales if there is a market for the securities then making a sale other than a sale made in the market in which securities of the particular class are customarily traded and in a manner customary in the market/sale made under an exemption * 6 → BLG, *Securities Law and Practice* says that an extraordinary commission or consideration is paid in respect of a trade if the trade is effected….   + On an agency basis + aggregate compensation paid to the registrant through whom the securities are sold is greater than that which is customary in agency transactions of a similar size/similar securities in the relevant market (fair market value comparable transaction)   + Through a stock exchange or other market in which it is customary for registrants to trade on an agency basis but the securities are instead sold by the vendor to another registrant acting as principal if the sale was pre-arranged to avoid operation of clause (a)   + Through the sale of securities by the vendor to a registrant and the excess of the then market value of the particular securities over the price paid is greater than that which is customary in principal transactions of similar size/similar securities in the relevant market   **Seasoning Period - less restrictive**   * **NI 45-102 s 2.6** seasoning period applies to securities issued under those exemptions based on **pre-existing relationships, such as private issuer exemption, stock dividend, rights offering, distribution to employees, or business combination** * Applies often where there is a transaction takeover with accompanying notice requirement that means market will have adequate disclosure prior to resale * Unless conditions set out in **s 2.6(3)** are satisfied, trade is deemed to be a distribution:  1. Issuer is/has been reporting issuer for 4 months in Canadian jurisdiction immediately preceding the trade 2. cannot be a control distribution 3. no unusual effort is made to prepare the market or create additional demand 4. no extraordinary commission or consideration is paid to a person/company in respect of the trade 5. if selling security holder is insider or officer of issuer, they must have no reasonable ground to believe issuer is in default of securities regulation  * provided issuer has been a reporting issuer for at least 4 months, securities can be resold at any time * Convertible securities = if the OG security was acquired under an exemption to which the 2.6 resale rule would apply, then it also applies to the converted/underlying security   **Control Distributions**   * Sales by control persons are considered to be distributions even if originally acquired by means of a prospectus   + Unlike other resale exemptions, which deem trade to be a distribution if conditions are not met * These rules apply if the restricted/exempt security holder IS a control person * If the control person purchased securities in the exempt market and now wants to sell those securities, he or she must do one of four things: * File a prospectus   + - e.g. include his or her securities as part of secondary offering of the issuer; * Apply for discretionary exemption from the regulator under **s.76** of the *BCSA*   + - Unlikely to be granted * Find a purchaser who qualifies for an exemption   + - Thus keeping the securities in the exempt market * **Satisfy the 5 resale conditions set out in NI 45-102 s 2.8** → what is essentially a prospectus exemption to a control distribution where conditions in **s 2.8(2)** are satisfied  1. Issuer (who originally issued the restricted securities) is/has been reporting issuer for 4 months in Canadian jurisdiction immediately preceding the trade (i.e. they had to comply with continuous disclosure requirements for at least 4 months) 2. Control person who is selling held securities for at least 4 months 3. No unusual effort is made to prepare the market or create additional demand (i.e. no advertising) 4. No extraordinary commission or consideration is paid to a person/company in respect of the trade 5. If control person who is selling the securities is insider or officer of issuer, they must have no reasonable ground to believe issuer is in default of securities regulation.  * Must complete and sign form **45-102F1** and filed on SEDAR at least 7 days before first trade of securities   ***Jones v. FH Deacon Hodgson Inc* (Ont SCJ 1986)**   * Shares issued without prospectus, declined in value after many years and issuer was sued * **s.52** clearly prohibits trading shares unless a prospectus has been filed + receipt obtained from the OSC director   + Purpose of this “is to protect the general public against schemes or campaigns to sell shares or securities of doubtful value of unwary investors” – ***Northwestern Trust,* SCC**   + Here, the breach is fundamental to the statutory scheme of protecting the public against unauthorized trading     - Purchaser is not time-limited from seeking a remedy + can nullify contract (void) * Issuer argued the action was statute-barred by 3-year limitation period on prospectus actions * This was not omission/misrepresentation of prospectus, and so court held that limitation period did not apply * Without fundamental prospectus requirement, transaction was nullified and purchaser was entitled to return of purchase price * **If prospectus exemption conditions are not met, distribution is illegal and can be set aside at any point in time** |

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| **Continuous Disclosure Requirements** |

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| **S.85 *BCSA:***  A reporting issuer must, in accordance with the regulations,   1. Provide prescribed periodic disclosure about its business and affairs, 2. Provide disclosure of a material change, and 3. Provide other prescribed disclosure   **Fundamental Components**  **·**   1. Periodic disclosure of interim and annual financial statements and accompanying reports 2. Timely and accurate disclosure of material changes experienced by the issuer   **Policy Rationales**   * Continuous disclosure obligations are imposed because the vast majority of the trading of securities occurs on secondary markets and regulators want those on the secondary capital markets to have access to sufficient disclosure to promote efficiency/market confidence   + 94% of all capital market activity in CDA is in the secondary markets   + No prospectus so the CDN regime is key to ensuring that issuers provide investors with the most accurate and current information possible on which to base their risk and investment choices * Makes capital raising process easier for reporting issuers by allowing them to rely on the body of disclosure already provided and circumvent the most stringent prospectus requirements * Plays a normative function in governing the affairs of companies/businesses by requiring disclosure of their ongoing business practices (thus encouraging best business practices and by extension investor protection)   + Issuer must disclose periodic results, changes + explain them to existing and potential investors etc.   + Faith Stevelman Kahn, “Fiduciary Duty, Limited Liability, and the Law of Delaware”     - Shareholders have a fundamental right to determine on an informed, rational basis whether to keep their capital invested in the firm or to divest it therefrom * Enron scandal concerned fraudulent financial reporting on the part of the company – spurred the creation of regulations which ensured * **NI 51-102** governs continuous disclosure requirements;applicable to Management Discussions and Analysis (MD&A), proxy solicitation, annual information forms, information circulars, as well as the forms with which they must comply   **Periodic Disclosure Requirements** → regular, set intervals   * Remember, only reporting issuers * TSX listed distributors must file annual documents which provide prospectus-level disclosure * Disclosure which must be made periodically within timeframes prescribed by securities legislation (or stock exchange agreements)  1. **Financial Statements**    * Financial Statements (annual or quarterly)    * Annual statements must be released within 90 days of the end of reporting issuer’s fiscal year, or 120 days for venture issuers, must be audited and accompanied by auditor’s report    * Quarterly/Interim statements are disseminated over three month periods, do not need to be audited    * **Part 4 of NI 51-102** sets out detailed requirements for what information financial statements must contain. Generally, they must include an income statement, a balance sheet, a statement of retained earnings and a cash flow statement.      + If a RI has not completed its first financial year then it must file an interim financial statement for the interim periods of the RI’s current financial year (unless more than 3 mths. in length)      + If the RI has completed its first financial year, interim financial statements for the interim periods of the reporting issuer’s current financial year must be filed 2. **Management Discussions & Analysis (MD&A)**    * Companion info released alongside financial statements    * Designed to explain the results of financial reports by putting them in the context of the business and providing mgmt. insight into the business practices    * The MD&A should analyze the financial statements, discuss the dynamics of the business, discuss current or pending obligation and liabilities, and provide management’s insight on how the issuer is likely to perform in the future      + Contains reflective and prospective analyses      + Should discuss both positive and negative developments and any material changes from the last reporting period + reconciliation with any offering document, current or pending legal proceedings, contingent liabilities etc.    * Definition of material differs a bit from the statutory formulation of material change: “Would a reasonable investor’s decision whether or not to buy, sell, or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated? If so, it’s likely material.”    * MD&A is a “narrative explanation” from the issuer’s management of the most important aspects of the issuer’s position and condition    * Form is set out at Part 5 of **NI 51-102 F1**    * Venture issuers without significant revenue in the past two financial years must disclose in their MD&A capitalized or expensed exploration and development costs, expensed research and development costs, and deferred development costs (increased disclosure requirements) 3. **Annual Information Form (AIF)**    * Quite similar to part of what is set out in prospectus, requires very detailed disclosure regarding issuer itself      + History, operations, and financial affairs of the reporting issuer    * It must also include a discussion of the issuer’s prospects, disclosure of social and environmental policies that are fundamental to the issuer’s operation, and disclosure of risk factors such as environmental and health risks, or political considerations.    * Must be filed within 90 days of issuer’s financial year end for reporting issuers      + Bu no obligation to send it directly to security holders because it’s publicly accessible on SEDAR    * **Part 6 of NI 51-102** sets out requirements for AIF    * **Form 51-102F2, *Annual Information Form*** 4. **Information Circular and Proxy Solicitations before AGMs**    * **NI 51-102 s.9.1:** all reporting issuers must distribute a proxy form and information circular to all registered holders of voting securities in advance of a SH meeting. The form allows someone to vote on the SH’s behalf, and information circular sets out the date and time of the meetings, and matters to be acted on at a meeting, plus any supporting information    * Most common type is the **mgmt. circular** which is done every year after AGM    * **Dissident circular** can happen where a group of shareholders requisitions a meeting – i.e. in order to replace mgmt. – if soliciting votes from more than 15 shareholders, are governed by the same disclosure requirements as issuer would be    * Once prepared, circular must be sent to all shareholders of the issuer – beneficial ownership is critical here      + Special rules when proxies are solicited from the non-registered beneficial owners (**NI 54-101, *Communication with Beneficial Ownerships of Securities of a Reporting Issuer***)      + Objectives = to give all security holders the opportunity to be treated alike, to encourage efficiency, to ensure that the obligations of each party in the securityholder communication process are clearly defined and equitable      + Reporting issuer must send notice of a meeting requesting beneficial ownership information from intermediaries within a specified period prior to a SH meeting    * Detailed requirements for communications with beneficial shareholders are set out in **NI 54-101**    * **NI 51-102 F5, F6** contain executive compensation disclosure requirements to be released after AGM      + For example, in respect of stock appreciation rights and compensation for a “named executive officer”      + WHY? – to provide insight into executive compensation as a key aspect of overall stewardship and governance of the company and will help investors understand how decisions about executive compensation are made   ***Re Research in Motion Ltd. Settlement Agreement,* (OSCB 2009)**   * Granting stock options over 10 year period in a manner inconsistent with terms of their stock option plan and their ongoing disclosure * RIM was “backdating” stock options, officers had to remit entire surplus value and reimburse RIM for the costs of the investigation * OSC held that RIM was not providing accurate information in their annual information circulars   RIM was a RI, obliged to make certain annual and periodic disclosure and in many of its filings RIM made statements that contained misleading or untrue statements, in particular that the options were priced at FMV   * Basically RIM’s Board approved a stock option plan but then proceeded to grant a large number of options contrary to the plan * Gave a benefit not permitted in the in plan (contrary to public interest) * Individual directors and officers had a duty to RIM to provide proper oversight to ensure policies and procedures + disclosure obligations under the Act were complied with fully, accurately, and in a timely way   **Timely Reporting Requirements** → triggered by material change in the issuer’s affairs   * **Part 7 of NI 51-102** sets out material change disclosure requirements, which include an immediate press release and a full report to be released as soon as practical i.e. within 10 days, unless it would be unduly prejudicial to the issuer to disclose the information, in which case they can disclose confidentially to the regulator directly   + Must make this continuous disclosure through electronic filings on the SEDAR system + public website   + Once an issuer determines that a material change within the meaning of securities legislation has occurred then the statute imposes a reporting obligation   **Material Change Report**: An MCR is a disclosure document intended to inform Commissions, market participants, and the public about certain important changes in the issuer’s affair.   * Several requirements to be set out in a material change report:   + - name and address of company     - date of material change     - date of news release which announced     - summary of the material change     - full description of the material change     - signed by the company * Limited relief when disclosure would be unduly detrimental to the interests of the issuer + where that decision is arrived at in a reasonable manner   + - **s.7.1** provides the relief * Form **51-102F3, “*Material Change Report*”**   **“Material Change”:**   * **s.1.1** defines material change  1. A change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer; or 2. A decision to implement a change referred to in paragraph (a) made by the board of directors or other persons acting in a similar capacity or by senior management of the reporting issuer who believe that confirmation of the decisions by the board of directors or any other persons acting in a similar capacity is probable   **Policy Rationale for MCRs:**   * Ensure markets perform their pricing and evaluation functions in the most prompt and efficient manner * Prevent insiders from taking advantage of their special position   **Disclosure of Significant Acquisition**   * All reporting issuers must are required to file a business acquisition report (BAR) within 75 after the date of acquisition of a business or related business - venture issuer has 120 days after the date of acquisition   + As per **NI 51-102 s.8.2** and **s.8.3** * **s.8.3(2)** has several significance tests re: what is a significant acquisition   + All apply to non-venture issuers (note the more than 20% threshold) * The asset test, the investment test, the income test * BAR includes an income statement, statement of retained earnings, cash flow statement, balance sheet, notes to the financial statements and annual financial statements must be audited * **Policy Rationale:** allow transparency and comparability in the financial data underpinning the significant acquisition   ***Pezim v. British Columbia (Superintendent of Brokers),* (SCC 1994)**   * Company discovered minerals at their holdings which increased their value significantly, decided to issue options prior to disclosing this discovery in order to make a windfall from the options - that shit ain’t cool * Sets out test for material change:   o in relation to the affairs of issuer  o in relation to the business operations and assets of the issuer  o material - reasonably would be expected to have a significant effect on the market price of value of the securities of the issuer  ***Kerr v Danier Leather Inc* (SCC 2007)**   * Did not announce material financial forecasts between the filing of their preliminary and final prospectuses * SCC held that a change in financial results may reflect a material change, but as the forecasts were the result of factors external to the company, there was no material change in this instance   + Information amounting to material facts but not changes that arise subsequently cannot support **s.130(1)** action * “Material change” is limited to a change in the business, operations or capital. This limitation is a deliberate, policy based “attempt to relieve reporting issuers of the obligation to continually interpret external political, economic, and social development as they affect the affairs of the business, unless the external changes will result in a change in the business, operations or capital of the issuer.”   ***Re AiT Advanced Information Technologies Corp*. (OSCB 2008)**   * AiT was in the process of being acquired by Motorola * Failure to disclose agreement prior to signing of definitive agreement (merger transaction) with acquirer was held to be failure to disclose a material change * It had previously been thought to be premature to disclose information prior to commitment from both parties of intent to come to an agreement * Probability magnitude test may be persuasive in deciding whether disclosure is necessary * Quoting ***YBM***: “The test for materiality in the Act is objective and is one of market impact. An investor wants to know facts that would reasonably be expected to significantly affect the market price or value of securities.” * As per ***Re Siddiqi*** – whether something is material depends on the facts * “In the context of a merger and acquisition transaction, it is necessary to establish whether there is sufficient commitment from both parties of the transaction to determine whether a “decision to implement” the transaction has taken place   + This is a question of mixed fact and law – it is not a bright-line test   + The mere fact that legal and financial advisors were retained doesn’t amount to a material change   **Note: Probability/Magnitude Test**   * This is the US law on materiality * Sometimes material changes are contingent/uncertain   + This test is to analyze when these events (mergers, lawsuits etc.) become sufficiently crystallized that they are required to be disclosed as material changes   + What is the probability that it will occur having regard to all known facts? * ALSO – assess the magnitude/significance of the change: would the information be viewed by reasonable investors as important information for making a decision to buy, sell, or continue to hold their securities   ***YBM Magnex International Inc* (OSCB 2003)**   * YBM got notice of Deloitte’s decision to suspend auditing and not provide auditor report one month prior to the filing of their annual financial notice – failure to meet this disclosure requirement results in cease-trade orders * OSC applied both market impact test and probability magnitude test (an American test the OSC held was helpful, but not binding) * Reasonable investor test or substantial likelihood test found in ***TSC Industries, Inc. v. Northway Inc.* (US 1976)**   + This test analyses the current value of information as it affects the price of securities discounted by the chances of it occurring (Commission applied this in ***Re Sheridan*** and ***Re Donnini***) * OSC found that YBM had, by disclosing the info only 18 days after receiving it, had failed to disclose the material change that they would not be making their periodic disclosure obligations * Auditors = not a guarantor of financial statement accuracy but still a crucial role re: the public   + Therefore, was the audit suspension a change in the business, operations or capital of YBM that would reasonably be expected to have a significant effect on the market price or value of the securities?   + Yes and a press release 18 days after the suspension was not “forthwith.” |

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| **Corporate Governance** |

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| * Four important areas in which securities regulation and corp law overlap:   + Proxy solicitation process   + Corporate governance disclosure   + Officer certification requirements   + Audit committee independence * As US securities regulators have moved into the regulation of corporate governance, Canadian regulators have followed suit in order to ensure timely/cost-efficient access to the larger US markets for Canadian issuers * The division between corporate law and securities regulation is not always a bright line   **Proxy Solicitation**  **s.116, *BCSA* -** defines “proxy” as “a completed and executed form of proxy by which a SH has appointed a person as the security holder’s nominee to attend and act for the security holder and on the security holder's behalf at a meeting of securities holders.”   * **s.1.1 of NI 51-102** includes an identical definition of “proxy.”   **Shareholder Participation**   * If management of an RI gives notice of a meeting of its registered holders of voting securities, management must, at the same time or before giving notice, “send to each registered holder of voting securities who is entitled to notice of the meeting a form of proxy for use at the meeting.” * A fundamental governance principle is that a shareholder has to have the opportunity to be represented at a shareholders’ meeting – proxies are instruments which appoint agents to fulfill this function   + Canada, Senate, *Report of the Senate Standing Committee on Banking, Trade, and Commerce on Corporate Governance*     - Effective corporate governance grounded ongoing shareholder involvement and this is founded in continued communication between the company and its shareholders   + Exit is the sale of shares by investors dissatisfied with governance/direction of issuer   + Voice is the exercise of shareholder rights through the proxy process   + Both may be used to signal a lack of confidence in the oversight/mgmt. of the issuer’s business, but voice often allows for a more precise and direct articulation of confidence or lack thereof than exit * **s.9.1(1) of NI 51-102** requires mgmt to send proxy form and information circular to all registered shareholders when giving notice of a shareholder meeting * Issuer has an obligation to communicate with investors and provide them with info on a periodic and timely basis   **Solicitation**  **s.9.1(2) NI 51-102:** proxy form must be accompanied by an **information circular.** An IC must contain info to enable SH to make informed decisions on the proxy vote. Mandatory whenever there is a “solicitation,” with some exceptions.   * Information circular and proxy process allow holders to make informed decisions w/r/t their securities, and engage both securities and corporate law   + Shareholders that are not able to attend general meetings are granted a voice in decisions through the proxy process – as such, may express preference and exercise limited control over strategic direction of issuer * **The requirement to provide an IC applies to all proxy solicitations by management, as per:** * **NI 51-102 s.1.1:** Soliciting, in connection with a proxy, is (a) any request for a proxy; (b) any request to not execute a proxy form or to revoke a proxy; (c) any communication with a shareholder that a reasonable person would relate to giving, withholding, or revoking a proxy; (d) sending a form of proxy to a SH by management of an RI * involves providing the security holder the opportunity to appoint a proxy if they so wish, and also includes any communication with a shareholder which involves or may lead to the giving/holding/revocation of a proxy * Mgmt. must solicit proxies in order that investors are advised of their ability to participate and given the opportunity to exercise their proxy rights * This must occur for every AGM and special meeting called by the issuer * Where proxy requirements overlap within corporate and securities law, substantial compliance with one set of rules may relieve the need for compliance with the other through deemed compliance * Security holders may wish to communicate with one another to influence the governance/direction of the issuer or the outcome of a particular vote, and so can also solicit proxies – their ability to do so is highly codified * Circulars not distributed by the issuer itself are known as dissident circulars * In order to increase shareholder participation, amendments to the CBCA affected what was considered a proxy solicitation and what was simply shareholder communication   ***Re Pacifica Papers Inc* (BCSC 2001)**   * Large, negotiated merger transaction which required shareholder approval * Allegation was made that support agreements made between several of Pacifica’s larger shareholders and itself were in contravention of the *CBCA*, which at the time did not have an exemption for solicitations to 15 or fewer shareholders as under **NI 51-102** * Support agreement is an agreement to tender proxies in support of the transaction; P’s largest shareholder argued this was tantamount to proxy solicitation * **s.150(1)** ***BCSA*** prevents solicitation of proxies before the information or proxy circulars and notice of the shareholder meeting are distributed * Pacifica maintained that the wording of the act required some contemporaneity between solicitation of proxies and distribution of circulars, but not that distribution be prior to solicitation * BCSC held that P had indeed violated **s.150(1)**, and that support agreements were not valid or enforceable, but that this technical violation was not serious enough to invalidate the result of the meeting in question   + **BCCA disagreed that the support agreements aren’t binding simply due to illegality since proxies are always revocable** * BCCA upheld this decision, but disagreed with BCSC’s reading into the *Act* of distribution of circulars as a condition precedent to proxy solicitation   + **No firm view as to whether the interpretation of s.150(1) requiring compliance *before* proxies can be sent**   **Communicating with Beneficial Shareholders**   * **NI 51-102 s 9.2(2)** provides exemptions to circular requirements for solicitations made to the public by broadcast, speech, or publication where the solicitation is to <15 shareholders * Registered shareholder is the legal owner of the share, where one’s name is on the share itself or registered through the Canadian Depository System (CDS) * Beneficial ownership occurs where shares are sold through a ledger system, with the shares remaining in the registered ownership of an intermediary, held for the benefit of the purchaser * Shareholders’ rights are only exercisable by or on behalf of the registered shareholder, and improvements in communications with beneficial owners accords them similar recognition to registered shareholders * Voting information forms will be sent to beneficial shareholders asking which way they would like their vote to be cast, and the proxy submitted on behalf of the registered shareholder will vote according to the responses received to the voting information forms * A registered shareholder can delegate proxy back to the beneficial shareholder   + A beneficial SH who appoints herself as her own proxyholder is not put in the same position as a registered SH at the meeting   + WHY? – proxyholder must follow the proxy instructions + any other restrictions whereas a registered SH can decide how to vote right up until the question is put at a meeting * **NI 54-101** improves procedures for delivery of proxy-related info to beneficial shareholders, including extra time to allow for delivery beyond the requirement to solicit 21 days prior to the shareholder meeting in question + allows for delivery of documents via the internet/facilitates electronic communication during the proxy solicitation process   + Janis Sarra, “The Corporation as Symphony: Are Shareholders First Violin or Second Fiddle?”     - Describes the above changes + discusses the risk of depositories → barriers to participation that SHs have faced in their efforts to exercise proxy voting rights   + **NOBO** is a shareholder who does not object to being identified as the beneficial holder of the issuer’s stock ( = identified beneficial holder)   + **OBO** is a shareholder who wishes to remain anonymous * **NI 54-101** creates an obligation upon intermediaries to provide issuers with lists of **NOBO**s and **OBO**s on request, creating transparency in beneficial ownership, and permits issuer to communicate with its **NOBO**s * In some circumstances, an intermediary (such as Broadridge in Canada) will handle all communications between issuer and its beneficial shareholders   + Stuart Morrow, “Proxy Contests and Shareholder Meetings” → see next bullet * **NI 54-101** facilitates the delivery of proxy-related material to beneficial SHs and allows issuers to send materials directly to **NOBO**s   ***Telus* (example of proxy process in use)**   * Information circular was released because mgmt. was soliciting proxies; dissident circular was distributed advising voting against plan of arrangement proposed by mgmt. * Telus had a dual-class share structure with voting and non-voting shares; mgmt proposed to collapse system and issue all voting shares * SH Mason opposed plan of arrangement, bought up 19% of voting shares (not a takeover) and took up hedging position on both voting and non-voting shares in order to take advantage of arbitrage opportunity resulting from vote on plan of arrangement * Mason requisitioned a meeting to propose amendment of the Telus articles to prevent 1:1 conversion ratio, requiring a 1:1.08 ratio that would result in a premium for voting shares * Where voting rights of shareholders are at stake in the context of a proxy contest, this is usually the realm of corporate law rather than securities law   **Corporate Governance Disclosure**   * Provides guidance on corporate governance practices to achieve a balance between providing investor protection and fostering fair/efficient capital markets + confidence in them * Corporate governance standards are voluntary in Canada, but have a mandatory disclosure requirement for a reporting issuer to describe how it meets the objective of a guideline in lieu of implementing the specific and suggested governance standards – “comply or explain” model   + CDA has stuck with the voluntary standards as opposed to prescribed governance rules - **NP 58-201**   + Different than the USA where non-compliance and non-adherence are the same * **NI 58-101** sets out a series of disclosure requirements w/r/t corporate governance * **s.2.1 of NI 58-101** deals with venture issuer disclosure requirements (**Form 58-101F**)   + States that all reporting issuers must disclose the identity of independent and non-independent directors and describe the basis for that determination   + Must also disclose board attendance records, identity/role/responsibilities of independent lead/chair director * Form **58-101F1** sets out requirements for disclosure re:   + board of directors,   + its mandate,   + board position descriptions,   + orientation and continuing education,   + ethical business conduct,   + nomination of directors,   + compensation,   + other board committees, and   + assessments   + director term limits and other mechanisms of board renewal   + several policies regarding the representation of women on the board * **s.2.2 of NI 58-101** deals with non-venture issuer disclosure requirements   + Non-venture issuers have more detailed disclosure requirements, regarding what they do to facilitate exercise of independent judgment where a majority of directors are not independent, in-camera meeting schedules and minutes, whether there is a written code for its directors/officers/employees * All issuers must disclose if any of their directors is also the director of any other reporting issuer in Canada or another foreign jurisdiction   **Certification of Disclosure**   * Governance of issuers also includes certification requirements aimed at holding corporate officers accountable for the quality/accuracy of the issuer’s disclosures * **NI 52-109** deals with officer certification and sets out disclosure and filing requirements for all reporting issuers other than investment funds   + Goal = to improve quality, reliability and transparency of annual filings, interim filings, and other materials that issuers file or submit under securities legislation * Requires CEO and CFO (or “certifying officers” who are persons performing similar functions to a CEO/CFO if the company doesn’t have those positions) to personally certify that issuer’s annual/interim filings:   + do not contain any misrepresentations,   + the financial statements contained within fairly present the financial condition of the issuer for all material respects,   + results of operations,   + cash flow of the issuer,   + that there are internal controls to ensure that material information is conveyed to decision-makers,   + disclose to the auditor/audit committee any significant deficiencies in internal control + any fraud involving managers/employees with a significant role in internal controls     - CEO and CFO will be held liable for failure to disclose these “material weaknesses”   + they have supervised or evaluated the supervision of the issuer’s “Disclosure Controls and Procedures” and “Internal Control over Financial Reporting” using documentary evidence   ·  **Form 52-109F1** requires certifying officers to represent that the issuer has disclosed in its annual MD&A certain information about the certifying officers’ evaluation of the effectiveness of the DC&P  o Indicative of the assurances that officers have to make under the new National Instrument  o For example, reviewed the AIF, there are no misrepresentations, fair presentation, responsibility etc.  **· CP 52-109** sets out sanctions for false certifications  o Could potentially be subject to quasi-criminal, administrative or civil proceedings under securities law  **Fair Presentation**   * A quantitative and qualitative assessment   + Selection of appropriate accounting policies,   + proper application of accounting policies,   + disclosure of financial information that is informative and reasonably reflects the underlying transactions, and   + additional disclosure necessary to provide investors with a materially accurate and complete picture of financial conditions, results of operations, and cash flows * Certification that the financial information fairly presents the issuer’s financial condition is broader than simply affirming that documents comply with GAAP   + It means that a materially accurate and complete picture of the issuer’s financial condition   ***Kripps v. Touche Ross and Co.*, (BCCA 1997)** – what constitutes fair presentation?   * GAAP = a tool and when it doesn't result in fair presentation then it needs to be revised * ***ter Neuzen v. Korn***, **(SCC 1995)** the court said that “if a standard practice fails to adopt **obvious and reasonable** precautions which are readily apparent to the ordinary finder of fact, then it is no excuse for a practitioner to claim that he or she was merely conforming to such a negligent common practice.” * ***CNR v. Vincent*, (SCC 1979)** the court said that this deference is not blind acceptance: “…it is up the judge to lay down the criterion that will be used to determine whether has been fault; this is undoubtedly a question of law.” * Up to the court in a duty relationship to lay down in general terms the standard of care * Therefore, auditor cannot sign off on unqualified reports just because they were prepared in accordance with GAAP if the auditors know or ought to have known that the financial statements are misleading   **Audit Committees**   * Securities laws require reporting issuers to set up audit committees which have certain oversight functions regarding financial recording and reporting   + Under corporate law an issuer’s external auditors are responsible to the shareholders * BC has a corporate auditing committee requirement, but most jurisdictions do not * Auditor ‘capture’ = a problem when the lucrative fees for consulting services to corporate clients and other non-audit work far exceed audit fees   + Auditors therefore might not be independent or effective as gatekeepers * **NI 52-110** governs the inner workings of audit committees and ensure that external audits of AFS are conducted independently of mgmt. by assigning oversight to audit committee which is a subcommittee with independent members * Detailed independence requirements are set out in **NI 52-110** – absence of direct or indirect relation between individual and issuer which could reasonably be expected to interfere with the individual’s independent judgment   + **s.1.4(3)** gives a list of relationships with an issuer that would reasonably interfere with the exercise of the person’s independent judgment + list of related persons who cannot be on the committee   + For example, a person/company is an affiliated entity if controlled by the same person or company – control means the direct/indirect power to direct/cause the direction of the mgmt. and policies of a person/company whether through ownership of voting securities or otherwise etc. * All audit committee members must also be financially literate – must be able to read and understand financial statements of breadth/complexity similar to that provided by issuer * Right to pre-approval of non-audit services provided by accounting firms out of concern that their performance of other non-auditing, advisory roles might interfere with auditing services * Audit committee has to have the ability to retain independent legal counsel * Is often charged with financial risk mitigation on the behalf of the board, and will review every set of financial statement prior to publication by issuer |

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| **Insider Trading** |

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| **Policy: fairness**   * Regulation of insider trading is built on concerns relating to fairness * Stemming from the 1965 Kimber Report the legislation distinguishes between two scenarios:   + An insider can buy/sell securities in her company   + An insider cannot use confidential information acquired by virtue of position to make profits by trading in the securities of her company * Legislation - therefore we should have full, public disclosure of all transactions effected by insiders + sanctions for those who do not * This creates an incentive for issuers to promptly disclose material facts * Objectives - confidence in capital markets * Division between:   + those subject to reporting obligations – permissible insider trading, and   + those who will be subject to legislative prohibitions re: trading on MUI – impermissible insider trading   **Rationale: risk:**   * Inherent in the IT prohibition is the fundamental assumption of risk in trading -- trading in securities is essentially risky * Risk-free trades are not allowed because they undermine this basic concept * Therefore, the IT prohibition is based on a theory of “equal access” to information * Insiders should be required to a report if they are in a position to receive or have access to MNPI before it is disclosed and/or are in a position to have control over the issuer   **Critiques:**   * If IT allowed, share prices might more correctly reflect the value of the securities because to some extent would reflect ALL information * These arguments have not carried the day in Canada (nor would they go far as a defense) |

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| **Reporting Insiders (Legal Insider Trading)**  **Legal IT:**   1. **Person is an insider** 2. **Does not have material non-public information (MNPI)** 3. **If a reporting insider, files an insider trading report**   **s.1(1)** – defines **“insider”**:   * 1. a director or an officer of an issuer (not necessary to have the title),   2. a director or an officer of a person that is itself an insider or a subsidiary of an issuer,   3. a person that has      1. beneficial ownership of, or control or direction over, directly or indirectly, or      2. a combination of beneficial ownership of, and control or direction over, directly or indirectly,   securities of an issuer carrying more than 10% of the voting rights attached to all the issuer's outstanding voting securities, excluding, for the purpose of the calculation of the percentage held, any securities held by the person as underwriter in the course of a distribution (a significant shareholder)   * 1. an issuer that has purchased, redeemed or otherwise acquired a security of its own issue, for so long as it continues to hold that security,   2. a person designated as an insider in an order made under section 3.2, or   3. a person that is in a prescribed class of persons; * Subsidiary: includes all chains of corporations under the control of the issuer + control is legal in that the issuer has more than 50% of the other corporation’s shares   + *BCSA* an issuer controlled by another issuer * **s.1(3)** For the purposes of this Act, an issuer is controlled by a person if   + (a) voting securities of the issuer are held, other than by way of security only, by or for the benefit of that person, and   + (b) the voting rights attached to those voting securities are entitled, if exercised, to elect a majority of the directors of the issuer     - A deeming provision re: control of affiliates for beneficial owners - insiders   **Insider Trading Reports (ITR)**   * Only reporting insiders must file ITRs   + **S 3.2 of NI 55-104:** insider must disclose their beneficial ownership of or control over the securities of the issuer   + Initial reports are required within 10 days of becoming an insider/change in holdings   + Subsequent changes must be reported within 5 days     - Threshold for reporting changes very low – any change requires report   **Who Files ITRs?**   * Definition of **“reporting insider”** is set out in the definitions of **NI 55-104** * Not all insiders have to report since this just turns on who we say can and cannot trade   + A director, CEO, CFO or COO of the reporting issuer, of a “major subsidiary” of the reporting issuer, or of a “significant SH” of the reporting issuer     - Major subsidiary is a defined term: includes a subsidiary which accounts for over 30% of the assets or revenue of the issuer.   + a significant SH of the reporting issuer     - More than 10%   + a person “responsible for a principal business unit, division or function of the reporting issuer”   + an individual who performs functions similar to functions performed to those listed above   + the reporting issuer itself   + An insider who, in the ordinary course of biz, receives or has access to information as to material facts or material changes concerning the reporting issuer before the material facts or material changes are generally disclosed; and (ii) directly or indirectly exercises, or has the ability to exercise, significant power or influence over the business, operations, capital or development of the reporting issuer; * Kathleen Doyle Rockwell and David Johnston, *Canadian Securities Regulation*   + Discussion of the legal obligation on insiders to file reports of their trades, developments re: the Internet, SEDI (system of electronic disclosure) etc. * Three instruments operating in tandem:   + **NI 55-104** → defines reporting insiders   + **NI 55-102** → *prima facie* all insiders must file an “insider profile” on SEDI + an ITR as a signal to the market   + **NI 55-101** → sets out insider reporting exemptions     - Major one is a director/officer of a subsidiary that is not a major one     - Commission has discretion to grant an exemption when it’s just and convenient       * ***Re British American Oil Company Ltd*.** “…in the complex of companies there are only certain groups of individuals who are privy to what might be viewed as executive or policy knowledge which would affect their market decisions.”       * Key factor = public benefit * **s.2(2) + (3)** – impose retrospective reporting requirements on directors and officers of entities that become insiders of reporting issuers * Division between **(i)**those subject to reporting obligations – permissible insider trading, and **(ii)**those who will be subject to legislative prohibitions re: trading on MUI – impermissible insider trading   **Illegal Insider Trading**  Definition: when the persons/companies in a special relationship to the reporting issuer trade with knowledge of a material fact/change that hasn’t been generally disclosed  In order to make a claim for illegal IT, **three elements** must be met:   * **Special relationship:** x must be in a special relationship with the reporting issuer in order to make out a claim against x * **Traded on material information:** the knowledge on which x purchased or sold the reporting issuer’s securities must meet the materiality threshold (ie. must be a material fact or a material change), and * **Not generally disclosed:** the information relied on by x in the purchase or sale of the reporting issuer’s securities must not be information that has been generally disclosed   **Special Relationship**   * **s.3(a):** “special relationships” include insiders, affiliates, and associates   + 1. of the issuer;        - “Affiliate”: an issuer is affiliated with another if one of them is a subsidiary of the other, or if each is controlled by the same issuer – **s.1(2) BCSA**        - “Associates”: there is an associate relationship between two persons if they are relatives (living in the same home) or partners; if a person has a “substantial beneficial interest” in or is a trustee for a trust; or if one person owns or controls more than 10% of the other’s voting securities     2. Of a person proposing to make a takeover bid of the issuer;     3. Of a person proposing to become party        1. to some sort of business combination (takeover, merger, amalgamation, rearrangement) with the issuer, or        2. acquire a substantial portion of its property; * **s.3(b):** a person engaging in or proposing to engage in any business or professional activity with or on behalf of the issuer or with persons mentioned in **s.3(a)** is in a special relationship   + Lawyers, accountants, experts etc. * **s.3(c):** expands special relationship to cover employees/directors/officers of the issuer or of anyone mentioned in **s 3(a)-(b)**    + Expands to include employees * **s.3(d):** someone who knows a material fact/change of the issuer from a previous relationship with the issuer such as those enumerated under **s 3(a)-(c)** is in a special relationship * **S 3(e):** **TIPPEE LIABILITY:** tippee knows of a material fact/change, having acquired the knowledge from another person at the time when **(i)** that person was in a special relationship with the issuer AND **(ii)** they knew or reasonably ought to have known the other person was in a special relationship with the issuer   + Expands the definition outwards indefinitely through the sharing of information   + Judged on a “reasonableness” standard   + **In other words, this is tippee liability.**   **Material Information**   * The knowledge on which the insider makes the trades must meet the materiality standard * ***Pezim v. British Columbia*, (SCC 1994)** – a fact doesn't need to be a material change to be a material fact * ***Re Donnini,* (OSCB 2002)**   + Probability/Magnitude test from ***Re Sheridan*** + a number of leading US cases     - Potential magnitude of the material fact re: value of shares determines how much probability of it occurring for a proposed transaction to be a material fact     - Here, very significant value so low probability needed     - ON legislation test is whether a fact “would reasonably be expected to have a significant effect on the market price or value” of securities – can use the US “market interest” test to determine this   + Under this, the information about the proposed transaction at the meeting was a material fact   **Generally Disclosed**   * Not defined in the legislation but case law has defined a test   ***Harold P. Connor* (OSCB 1976)**   * Test for whether a material fact or change has been generally disclosed:   + Information must have been disseminated to trading public   + Public must have been given adequate time to digest that information given its nature/complexity – **minimum 1-day requirement** * This test was later incorporated into **NP 51-201** – issuer’s responsibility to make sure the information has been disseminated   **Tipping**  For there to be a claim against *x* for tipping under **s.57.2(3)** of the BCSA, **three elements** must be met:   1. **The tipper (x) must be in special relationship with the reporting issuer;** 2. **The tipper (x) informs the tippee (y) of a material fact or material change other than in the necessary course of business** 3. **The information has not been generally disclosed**  * A tippee can also be a tipper if she is also in a special relationship with the issuer and passes material undisclosed information along to another person – chain can continue indefinitely   + Tipper (x) will be guilty even if the recipient doesn't know the tipper is in a special relationship   + For the tippee (y) to be guilty he must know that the tipper (x) was in a SR or reasonably ought to have known about the special relationship     - As per **s.3(e)** the tippee is also in a special relationship with the issuer because he or she got material information from someone in a special relationship + knew/ought to have known about the special relationship   ***R v. Rankin*, (ONCA 2007)**   * Rankin was a senior investment banker with access to lots of MNPI * had a friend named Daniel Duic who was found to have made a number of suspicious and profitable trades on issuers that were RBC clients over the course of 14 months, a number of which occurred after RBC would have had knowledge of the MNPI but prior to general disclosure of MNPI * OSCB prosecuted R for over 20 counts of tipping, was convicted, but this was overturned due to evidentiary issues   + Stands as an example of how difficult it is to enforce insider trading and tipping   **Prohibitory Provisions (*BSCA*)**   * **s.57.2(2): Insider Trading –** prevents purchase/trade of issuer’s securities where a person is in a special relationship with the issuer and knows of a material fact/change w/r/t issuer which has not been generally disclosed * **s.57.2(3):** **Insider Tipping –** where a person is in a special relationship with the issuer and knows of a material fact/change w/r/t issuer which has not been generally disclosed, they must not inform another party of that MNPI   + Provides exemption where that disclosure is part of ordinary course of business * **s.57.2(4): Takeover/Business Combo –** where a person is engaged in a takeover/business combinationwith the issuer and knows of a material fact/change w/r/t issuer which has not been generally disclosed, they must not inform another party of that MNPI   + Provides exemption where that disclosure is part of ordinary course of business * **s.57.2(5): Recommending –** prevents recommending another engage in a purchase/trade of issuer’s securities where a person is in a special relationship with the issuer and knows of a material fact/change w/r/t issuer which has not been generally disclosed   + Recommendee does not receive MNPI and is not liable   **Statutory Defences (BCSA)**  **S.57.4** provides defences to the abovementioned offences, including:   1. **Reasonable belief in other party’s knowledge**: a person does not contravene **57.2(2)** where one hasreasonable belief of other party’s knowledge of material fact/changes 2. a person does not contravene **57.2(3) or (4)** where one has reasonable belief of other party’s knowledge of material fact/change 3. a person does not contravene **57.2(2)** where transaction is entered under written automatic dividend reinvestment plan, purchase plan, or as the result of a written legal obligation entered prior to obtaining knowledge of the material fact/change or MOI 4. a person does not contravene **57.2(2)** where transaction is entered by an agent under specific unsolicited instructions of principal; where agent solicited instructions prior to knowledge of material fact/change or MOI; or where agent/trustee enters transaction because of principal’s involvement in written automatic dividend reinvestment plan, purchase plan, or written legal obligation 5. corporate persons do not contravene **57.2(2) or (5)** if no individual involved has knowledge of material fact/change or MOI or is acting on recommendation/encouragement of someone who does   **s.136.2** provides relief from liability for contravention of **s.57.2**   * a person is not liable if after a reasonable investigation occurring before the person entered transaction, informed another person of material fact/change, or recommended/encouraged transaction, person had no reasonable grounds to believe that material fact/change had not been generally disclosed   + ***Harold P. Connor* (OSCB 1976)** case above provides test for when something has been generally disclosed following a press release   ***Green v. Charterhouse Group Can Ltd.*,(ONCA 1976)**   * Π was negotiating to sell shares of issuer to ∆, whom became aware during this negotiation that company was about to be subject of a takeover bid * ∆ sent π a warning letter that there was MNPI in existence they might wish to know, but the court held that warning of the existence of MNPI ≠ disclosure of MNPI   + A “warning letter” isn’t enough to provide for this defence   + WHY? - this is a due diligence defence   **Common Law Defences**  Necessary Course of Business - defence to tipping  **NP 51-201:** idea of selective disclosure where a company discloses MNPI to one or more individual companies and not broadly available to the investing public   * A question of mixed fact and law that usually applies to communication with vendors, suppliers, officers, employees, parties to negotiations, lenders, legal counsel, auditors (professionals), government agencies etc. * Where a RI discloses MNPI in the necessary course of business, the issuer should ensure the recipients understand they cannot buy or sell the issuer’s securities until the info is disclosed, and cannot pass on the info * ***Royal Trustco Ltd. v. Ontario (Securities Commission)***, Div. Ct. 1983 – disclosing information to a SH as part of an attempt to defend a takeover bid is not in the “necessary course of business.”   Reasonable Mistake of Fact  ***Lewis v. Fingold*,(OSCB 1999)**   * Director became aware of information at a board meeting, sold shares in the company before the disclosure of this information * Provides **defense of reasonable mistake of fact**: Ontario Court of Justice has held it to be a defence is the SRP can prove it “had a genuine reasonable belief” that the information in question was not material (recall: definition of “material fact” is subjective, not objective, in this context).   + Did he believe that this information would have a substantial effect on the company’s share price?   + Onus on accused to show on a BoP that she had a reasonable belief that the information did not constitute a material fact   ***R v. Harper*,(OSCB 2000) -** discussion of the “reasonableness standard”   * Mining company which was conducting geochemical soil survey plus trench digging * Initial results were very favourable, and disclosed immediately by the issuer * secondary results were much less favourable, were not immediately disclosed, Harper sold 227,600 shares prior to the disclosure in knowledge of the MNPI * Issue in the case was whether H had a genuine and reasonable belief that the secondary results were not a material fact/change   + First, the results were a material fact   + Second, he couldn’t demonstrate on a BoP that he didn’t think these were material as demonstrated by the evidence that he knew + immediately released the good results   ***Re Azeff*,(OSCB 2015)**   * Finkelstein was an M&A partner for Davies used his position within firm to deliver material non-public information (MNPI) to his investment advisor at CIBC Wood Gundy, who would pass it on to a broker at TD, who passed it on to a further broker at TD and another at CIBC, who would all sell to their clients and make commissions, as well as trading for their own purposes. * This constitutes insider trading, as there was:   + A person with a special relationship with issuer (Finkelstein)   + With knowledge of a material fact/change   + Not known to the public generally   + Trade or tip made based on that knowledge * Question in this case is where does the special relationship stop? All brokers were found to be a part of the special relationship, because they knew or reasonably ought to have known about the special relationship of Finkelstein or Azeff through Finkelstein, but none of their clients whom they advised were found to share that relationships   **Best Practices for Countering Insider Trading**   * Blackout Policy: ban on trades which stays in place until 24 hrs after MNPI is no longer material or is made public, to prevent affiliates or partners from triggering insider trading provisions * Chinese Wall: separates entities by ways of internal policies and procedures to protect the flow of information and protect both employees and mgmt. from engaging in insider trading * Grey List: a list of stocks that are ineligible for trade by an investment bank's risk arbitrage division – composed of firms working with the investment bank, often in matters of mergers and acquisitions   + Those issuers that the registrant probably has inside information about |

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| **Change of Control Transactions** |

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| **Takeover Bids**   * Occur when a **bidder** corporation makes an offer to purchase outstanding shares of **target** corporation   + **Hostile bids** occur when target mgmt./directors do not invite and are not generally in favour of the bid   + **Friendly bids** occur when target mgmt. approves of the takeover and cooperates with the bidder in selling the bid to target shareholders * Takeover bid occurs with making of an offer, not with completion of transaction * Does not include an offer to acquire if it is a step in an amalgamation, merger, reorganization or arrangement that requires approval in a vote of security holders * Governed by **MI 62-104** except in ON, where **OSC Rule 62-504** and **Part XX of OSA** apply * **MI 61-101** in ON and QC governs edge cases where there are conflict-of-interest transactions   **S 1.1 of MI 62-104** defines takeover bid as:   * An offer to acquire outstanding voting securities or equity securities of a class made to one or more persons, any of whom is in the local jurisdiction or whose last address as shown on the books of the offeree issuer is in the local jurisdiction, where the securities subject to the offer to acquire, together with the offeror’s securities, constitute in the aggregate 20% or more of the outstanding securities   + 20% threshold may be met by the aggregate holdings of multiple parties acting “jointly and in concert”   **s.1.9(1) of MI 62-104 Acting Jointly & in Concert:** In this Instrument, it is a question of fact as to whether a person is acting jointly or in concert with an offeror and, without limiting the generality of the foregoing,   * 1. the following are deemed to be acting jointly or in concert with an offeror:      1. a person that, as a result of any agreement, commitment or understanding with the offeror or with any other person acting jointly or in concert with the offeror, acquires or offers to acquire securities of the same class as those subject to the offer to acquire;      2. an affiliate of the offeror;   2. the following are presumed to be acting jointly or in concert with an offeror:      1. a person that, as a result of any agreement, commitment or understanding with the offeror or with any other person acting jointly or in concert with the offeror, intends to exercise jointly or in concert with the offeror or with any person acting jointly or in concert with the offeror any voting rights attaching to any securities of the offeree issuer      2. an associate of the offeror.   **Launching a Bid**   * Two means of commencing a takeover bid:   + 1. The TOB can be initiated by delivering the bid to the offerees (the target’s company’s SHs) in the jurisdiction)     - Includes a takeover bid circular + a marketing document designed to convince shareholders to take the bid   + 2. Publishing an announcement of the takeover bid in a major daily newspaper     - If option 2 is chosen, must meet following conditions:       * **S 2.10(2) of MI 62-104** provides that if second method is chosen, bidder must also file and deliver a copy of the bid to target’s office       * **S 2.10(1) of MI 62-104** says this copy must be accompanied by a takeover bid circular * Offerors prefer the bidding process to conclude as quickly as possible (option #2), whereas target mgmt. generally prefers a longer bid period so that it can survey alternatives (option #1)   + WHY? – every formal TB must remain open for a minimum of 35 days (105 under the new rules)   + 35 days begins from the date the bid is commenced so a public ad can generally be placed up to 10 days earlier than a bid document can be mailed to SHs * Minimum deposit period:   + OLD RULES: TOB must allow offerees at least 35 days to decide whether to accept the bid and deposit their securities under the terms of the TOB (offeror may choose a longer period). During this period, the offeror may not take up, or actually purchase, any securities deposited under the TOB   + Purpose: ensure a reasonable time period for the target to assess and respond to the bid; rival bidders to emerge; create an open auction   + Shareholders can tender and exercise their withdrawal rights up until the expiry of this period   **Important Thresholds**   * 5%: US Public Reporting Threshold – CAN threshold for requisitioning shareholder meeting * 10%: CAN Public Reporting Threshold (insider, significant shareholder) + Early Warning System * 20%: Takeover bid requirements kick in * 33% + 1: blocks a special resolution (“negative control”) * 50% + 1: pass an ordinary resolution (control decision makers, other than special resolutions) * 66.7%: make a special resolution * 90%: if you buy 9/10 of the outstanding shares that you didn’t own beforehand, you can squeeze out the rest of the shares for the same price. The incentive to own 100% of shares is it can prevent minority shareholders from getting in your way, and so you don’t get oppression remedies.   **Policy**   * Up for debate, but generally in Canada takeovers are seen as good for the economy * Legislation is directed towards incentivizing them   + The buyer and not the seller is regulated here - THIS IS NOT A TRADE * Seeks to protect target shareholders by giving them enough opportunity to consider various bids, change their minds to withdraw shares post-tendering, all must be treated equally etc.   + Legislation do not address the needs of the bidder corporation   **Equality**   * Legislature relating to takeover bids essentially seeks to protect the interests of target shareholders and provide a series of obligations which govern the bidder’s behaviour * Through *pro rata* takeupand identical consideration, securities legislation seeks to ensure equal treatment for target shareholders   + *Report of the Committee To Review the Provisions of the Securities Act (ON) Relating to Take-Over Bids and Issuer Bids*   + Goals are fairness, even-handed treatment of target SHs, protection of minority SHs * *Pro rata* Takeup → a bidder may offer to acquire less than 100% of the shares and then more than the desired number are actually tendered   + In this case the target SHs are assured that the bidder will take up shares on a *pro rata* basis so that the bidder purchases the same proportion of shares from all tendering SHs according to the number of shares that each SH tendered * Identical Consideration → all holders of the target’s securities shall receive identical consideration   + Takes into consideration raised bids and ensures SHs aren’t punished for tendering early   + Controlling SHs can’t get any collateral benefits for their shares * **s.2.4(1) of MI 62-104** provides that if, within 90 days immediately before a takeover bid, an offeror acquired securities of the class subject to the bid in a transaction not generally available on identical terms to holders of that class of securities, must offer at least the consideration paid for those securities   + Must pay at least as much in takeover bid   + Identical consideration * **s.2.23 of MI 62-104** provides that all holders of the target’s securities shall receive identical consideration   + Prevents shareholders who tender early from missing out on profits later if the offer price is increased after they tender – also prevents side deals from being made with particular shareholder   + Identical consideration * **s.2.24 of MI 62-104:** offeror, or any person acting jointly or in concert with offeror, must not enter into any collateral agreement, commitment or understanding that has the effect, directly or indirectly, of providing a security holder of the offeree issuer with consideration of greater value than that offered to the other security holders of the same class of securities.   + Collateral benefit prohibition   + Identical consideration * **S 2.26(1) of MI 62-104** provides that if the bidder seeks a partial bid for less than 100% of the outstanding shares of the target, shareholders are assured that the bidder will take up the shares on a ***pro rata*** basis so that the bidder purchases the same proportion of shares from all tendering shareholders according to the number of shares each shareholder tendered (rather than first-come, first-serve on tendered shares)   + *Pro rata* takeup   **Disclosure**   * Ensures shareholders have full info about the bid and the bidder, including what % of the outstanding shares the bidder owns, terms and conditions of the bid, and bidder’s business plans for the target * **s.2.8 of MI 62-104 provides that all shareholders in a particular jurisdiction are entitled to receive the bid documents**   + Even where bid is commenced by advertisement, bidder must still deliver **a takeover bid circular t**o all shareholders of the target, after receiving a list of said shareholders * **s.2.12(1) of MI 62-104** provides that if there is any variation in the terms of a bid, bidder must deliver notice of variation to every person or company to whom the takeover bid circular or issuer bid circular was required to be delivered and whose securities were not taken up at date of variation * **s.2.17(1) of MI 62-104** provides within 15 days of a bid has been commenced, target’s board of directors must provide a **director’s circular** to its shareholders containing a recommendation to either accept or reject the bid (directors are also permitted not to make a recommendation). In preparing the information, should establish a special independent committee to assess the merits of the TOB.   + Failure of disclosure can lead to quasi-criminal sanctions, attraction of liability, or other consequences   + **Form 62-104F3**   **Early Warning Rule** requires any person who acquires control of 10% or more of the voting or equity securities of an issuer to issue and file a press release identifying the purchaser and the extent of their control in aggregate – every subsequent 2% increase requires a further press release   * Just for a reporting issuer * Then, every subsequent increase of 2% requires another press release and to file a report with the provincial regulator * Gives the target a heads up of potential takeovers (creeping takeover bids) + lets SHs find out other significant SHs in the company * **NI 62-103** provides for some exemptions for mutual funds or eligible institutional investors, entities with an increase in a class of securities arising solely from the issuer’s actions, and underwriters who have made disclosure by news release + a discretionary exemption   **Timing**   * **s.2.28 of MI 62-104** provides that a takeover bid must remain open for at least 35 days to provide target holders with time to consider the offer * **s.2.29 of MI 62-104** bidder cannot take up or accept any shares for purchase deposited by tendering shareholders during the 35-day period * **s.2.30(1) of MI 62-104** provides that target shareholders can withdraw their tendering at any point within the 35-day period * **s.2.32(2) of MI 62-104** provides that once shares are taken up they must be paid for within 3 business days + all tendered shares must be taken up with 10 days * **s.2.32(4) of MI 62-104** provides that a bidder may extend the offer period if it takes up all of the shares tendered during that period.   **Changes to Takeover Bid Requirements**   * **Policy Rationale:** Three key amendments motivated by long-standing concern about imbalance in the ability of American companies to “just say no” whereas this is not a legal option in Canada, recognition that 35-day period does not give target mgmt. enough time to conduct an auction in the face of a takeover bid, and the desire to facilitate the ability of target shareholders to make informed and/or coordinated decisions  1. **Bid Period Requirement:** Takeover bids must be in place for a minimum period of 105 days, except where:    1. target board issues release identifying a specified alternative transaction (white knight) starting auction    2. may adopt shorter period (no less than 35) but this applies for all bidders 2. **Minimum Tender Requirement:** a non-exempt takeover bid must receive tenders of more than 50% of outstanding securities not owned by offeror (creating de facto shareholder vote) 3. **10-Day Extension Requirement:** once a takeover bid has been made, must extend offer for 10 days once minimum tender condition and all other conditions of offer have been met (so that remaining holdout shareholders have opportunity to tender)   **Exemptions from Takeover Bid Requirements**   * BLG with Paul G. Findlay, ed., *Securities Law and Practice* - sets out exemption * **s.4.1 of MI 62-104** provides a **normal course purchase exemption** where the purchase is of not more than 5% of any class of the offeree issuer’s outstanding voting or equity securities in a 12-month period (includes any securities purchased by any means within prior 12-month period)   + Offeror must at the time of purchase count as a part of the 5% max. within a period of 12-months   + Target securities must be listed or quoted for trading on a published market   + Value of the consideration paid cannot exceed the market price of the target securities at the date of acquisition * **s.4.2(1) of MI 62-104** provides a **private agreement exemption (5 over 115)** whereby purchaser may enter single or separate agreements with up to 5 vendors – cannot be made to security holders generally and value of consideration paid may not exceed 115% of market price at date of bid (calculated by 20-VWAP)   + Also called the control block exemption   + Allows for derogation of the principles that all shareholders are to be treated equally * **s.4.3 of MI 62-104** provides a **non-reporting issuer exemption** where there is no published market for the securities that are the subject of the bid and there are no more than 50 holders of the securities that are subject of the bid * **s.4.4 of MI 62-104** provides a **foreign takeover bid exemption** where target securities are primarily traded on foreign markets and target has a *de minimis* number of security holders in Canada * **s.4.5 of MI 62-104** provides a ***de minimis* takeover bid exemption** where target has a *de minimis* number of securityholders in Canada:   + Maximum 49 beneficial holders of target securities in jurisdiction   + Who hold less than 2% of the outstanding shares of the class in the aggregate   + Security holders in the jurisdiction are entitled to participate in the takeover bid on terms at least as favourable as those that apply to general body of security holders of the same class   + Takeover bid materials must be filed on SEDAR and sent to security holders in the jurisdiction * **Exemptions Prescribed by the Regulations**    + Multi-Jurisdictional Disclosure System takeover bids technically are considered to be formal takeover bids but are exempt from the requirements   **Defensive Tactics**   * Generally have been found to be acceptable by regulators where actions of target board are intended to secure a better offer and thus a better result for the target shareholders, rather than mgmt. simply trying to entrench themselves in their positions * **NP 62-202** governs defensive tactics; can convince shareholders not to accept bid, or can act in a way which maximizes; value for shareholders * **S 1.1(4)** says that the following actions in the face of a takeover bid will come under regulatory scrutiny:   + the issuance, or the granting of an option on, or the purchase of, securities representing a significant percentage of the outstanding securities of the target company,   + the sale or acquisition, or granting of an option on, or agreeing to sell or acquire, assets of a material amount, and   + entering into a contract other than in the normal course of business or taking corporate action other than in the normal course of business. * **S 1.1(5)** says that unrestricted auctions provide the most desirable results in takeover situations and regulators will be reluctant to intervene in uncontested bids * courts can also intervene where shareholders invoke the oppression remedy or where directors have breached their fiduciary duty   **Policy**   * During a hostile takeover bid the target board is in an inherent conflict of interest * Fiduciary duty to the corporation means they must act in best interest of the company but will lose their positions if the bid is successful * Therefore, boards will often set up a Special Committee of Directors to review the terms of the bid and alternatives to the bid in order to make a recommendation to the board * **NOTE:** In CDA the board cannot simply say no to a takeover bid   **Shareholders’ Rights Plan (SRP) “Poison Pill”**   * Can be adopted prior to or during a takeover bid * Document sets out when a takeover bid will be permitted (usually the board has to approve it)   + If approval isn’t obtained or the bid is otherwise not permitted then the SRP is activated * Usually include a permitted bid clause, where takeover bid meets certain (usually onerous) terms favourable to the company * Gives the company the ability to grant a right to every existing shareholder to purchase additional shares in the company in the face of a takeover bid   + BUT no shares are issued to the bidder * Conversion rights usually exist at a horribly uneconomic rate, but when bidder begins to acquire shares, this “flips” to become a hugely discounted rate, diluting the market and making the company uneconomic to require for bidder * Canadian regulators have broad powers to cease-trade the trading of securities, including the exercising of rights – **s 89 of BCSA** * Once SRP is cease-traded, bid can proceed – SRP’s are usually implemented to buy the target time to find a white knight   Note → this technically discriminates between shareholders but allowed under CDN law   * + ***347883 Alberta v. Producers Pipelines Inc., Sask. CA 1991***     - Most important issue is whether the directors in adopting the defensive tactics culminating in the issuer bid met the onus to show that they acted in the best interests of the corp. as a whole + whether their actions were reasonable in relation to the threat posed     - Improper purpose would be to maintain control of the company     - Remedy would be to set aside the SRP and extending closing date of the issuer bid * Most efficient and widely used defensive tactic but has only ever been triggered once in CDA   + It’s basically intended to buy time for the target board   **White Knight**   * Where a board is faced with a hostile takeover bid, may look into finding a more favourable offer from a new bidder * Will then solicit a friendly takeover from new bidder, and enter support agreement to facilitate takeover * How does this come about?   + When faced with a HTB the target board might get the Special Committee to review the proposed transaction and alternatives to the bid   + It must canvass the market – ***Maple Leaf Foods***     - A friendly bid could come out of this process   **Crown Jewel**   * Agreement with third party to sell a significant asset if initial bidder is successful in its takeover bid * ***Re CW Shareholdings Inc*.** – CW made a HTB for WIC who signed a Pre-Acquisition Agreement with Shaw (white knight)   + Contained option in favour of WIC’s crown jewel, court said this was okay   **Break Fee- “bust-up fee”**   * Merger or acquisition agreement between target and white knight may contain a clause indicating that if the merger does not occur, target will pay a certain fee to the white knight * Thus deter target from breaking its agreement and induce white knights into agreements * Usually range from 3-5% of the value of the target company – adds to the cost of an acquisition of target by a bidder other than the white knight * Anita Anand, “Break Fees: Loathed but Legal”   + Break fees involve the allocation of corporate assets re: a contract   + Regulators have no authority to interfere + strike down a contract that SHs don’t like     - Probably only if the break fee would prevent SHs from getting a higher price     - WHY? - can assume jurisdiction re: investor protection   + Courts can always adjudicate on this though (oppression remedy, derivative action)   ***CW Shareholdings Inc v WIC Western International Communications Ltd* (Ont Gen Div 1998)**   * Deals with white knights, break fees, and crown jewel sales * CW and Shaw were both locked in battle to takeover WIC * CW brings oppression claim seeking to have agreement set aside, alleged breach of fiduciary duty by WIC mgmt. * Court cites ***Revlon*** which provided the defence of a reasoned and independent decision, acting on a rational basis with reasonable belief that actions would maximize shareholder value * In ***Maple Leaf*** it was held that the duty of mgmt. shifts once company is in play and is no longer just to maximize shareholder value but to act in the best interests of the company * Break fees are common in takeover bids, may be improper depending on quantum, but appropriate where:   + Necessary in order to induce a competing bid to come forward,   + Where bid represents better value for shareholders, and   + Break fee represents reasonable commercial balance between potential negative effect as auction inhibitor and potential positive effect as auction stimulator * Asset options are intended to be a competitive bid-stimulating inducement * May be an acceptable measure to take where:   + they do not represent a violation of the fiduciary duty to maximize SH value,   + balance between inhibition/stimulation has been struck well,   + price represents reasonable value for asset,   + and competing bid is at high enough value to justify option * **Court upholds business judgment rule** * **Remember, the Commissions can make a ruling to cease trade a certain bid re: inappropriate tactics in the public interest without forming a conclusion on the fiduciary arguments (court’s jurisdiction)** * **Two overarching considerations in this decision**   + Reluctance to intervene in the target board’s decisions   + Ensuring that target boards have the flexibility to respond to the bid   ***Re Royal Host Real Estate Investment Trust*, (OSCB 1999)** - leading CDN case on SRPs   * Test for cease-trading bid:   + Need to find balance between permitting board to fulfill fiduciary duty and protecting the rights of shareholders to tender shares as they see fit   + There is no “holy grail” to determine when a “pill must go”   + Starting point for the analysis is **NP 62-202, *Take-Over Bids – Defensive Tactics*** * In ***Re Canadian Jorex Ltd*.** Commission discussed policy   + “Primary concern….whether those tactics are likely to deny or severely limit the ability of SHs to respond to a TB or a competing bid or may have the effect of denying to SHs the ability to make a fully informed decisions and of frustrating an open TB process.” * Factors to be considered include but are not limited to:   + whether shareholder approval of the rights plan was obtained;   + when the plan was adopted;   + whether there is broad shareholder support for the continued operation of the plan;   + the size and complexity of the target company;   + the other defensive tactics, if any, implemented by the target company;   + the number of potential, viable offerors;   + the steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders;   + the likelihood that, if given further time, the target company will be able to find a better bid or transaction;   + the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company;   + the length of time since the bid was announced and made;   + the likelihood that the bid will not be extended if the rights plan is not terminated. * OSCB cease-traded SRP, which allows the bid to go to the shareholders who may choose to tender – in the end, CHIP found a better bid and Royal Host withdrew its bid.   **Litigation**   * Can be an effective defensive tactic in delaying takeovers, through court-ordered injunctions or otherwise * May involve challenges to disclosure provided in hostile takeover bid circular   + ***Re Chapters Inc*.** – ulterior motive for the application may have been to buy more time for the target SHs to consider the bid or look for alternatives   + ***Re Canfor Corp*.** – application again probably was to delay the transaction   ***RIM v. Certicom*,(Ont SCJ 2009)**   * C entered a negotiation with R, R signed confidentiality agreement which included a permitted use clause and a standstill period clause providing for a 6-month period * After expiration of 6-month period, R launched takeover bid for C, C commenced litigation for breach of confidentiality agreement * OSCJ held that R was permanently enjoined from making a hostile takeover based on confidential info by the permitted use clause which only allowed for its use in a negotiated transaction   Note → as per Waters, companies should wall off portions and put other safeguards in place to show the court that you didn’t actually use this information to decide to launch a bid  **Issuer Bid**   * Launching bid by which company purchases its shares from its shareholders in competition with the hostile bidder   **Director’s Duties**   * **s.122(1) of CBCA** provides that every director and officer of corp in exercising their powers/discharging their duties shall:   + Act honestly and in good faith with a view to the best interests of the corporation; and     - Fiduciary duty   + Exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.     - Duty of care as per the business judgment rule * Directors cannot merely reject takeover bid and then implement measures to frustrate it without creating value for shareholders (No “just say no” option in Canada) * Directors also cannot have conflicting interests with those of corp   + ***Revlon*** stands for the principle that if a company is up for sale, directors have an obligation to conduct an auction of the company – American case which is not followed in Canada.   ***Teck Corp v. Millar* (BCSC 1972)**   * Test for determining whether directors’ actions to frustrate control attempts were legitimate:   + Had to be acting in good faith   + Had to have reasonable basis for belief that interests of corp would be damaged by takeover (does not mean shareholder interests) * Since directors are in a position to act on behalf of those interested in company and will have to act on that basis, their actions and decisions should not be improper in and over themselves * Impropriety of director’s purpose depends on proof that their actions were actuated by a collateral purpose (other than company’s best interests)   ***347883 Alberta v. Producers Pipelines Inc.,* (Sask. CA 1991)**   * Most important issue is whether the directors in adopting the defensive tactics culminating in the issuer bid met the onus to show that they acted in the best interests of the corp. as a whole + whether their actions were reasonable in relation to the threat posed   + Improper purpose would be to maintain control of the company   + Remedy would be to set aside the SRP and extending closing date of the issuer bid   ***Maple Leaf Foods Inc v Schneider Corp* (ONCA 1998)**   * *Did Schneider’s mgmt. successfully take steps to avoid a conflict of interest?* * Several corps involved in takeover bidding for ∆ * Schneider family held 70.5% of voting shares of corp, and also had a coattail provision in articles which provided for event of hostile takeover and essentially gave family veto over any takeover bid * In face of bids from Maple Leaf and Smithfield, board of directors established special committee to assess bids, but family informed committee that it would only approve Smithfield bid * Corp took various actions to approve Smithfield bid in the face of higher bids from Maple leaf * Subsequently, 10% shareholders wrote to board that in/actions of special committee and family had contaminated the value maximization process * Court reviews basis for acceptable decisions by directors in jurisprudence and examines procedure of creation of special committee   + Special committee is comprised of those who do not have a conflict of interests and makes recommendations to board of directors, in order to protect conflicting interests between directors and minority shareholders   + If the board has acted on the advice of a committee composed of persons having no conflict of interest and it has acted independently + in good faith + made an informed recommendation as to the best available transaction for the SHs in the circumstances then the business judgment rule applies * **Duty of mgmt. shifts once company is in play and is no longer just to maximize shareholder value but to act in the best interests of the company** * Court says there is no duty to conduct an auction – but despite ***Revlon*** not being persuasive, where there are multiple bidders, an auction is appropriate   + **WHY?** – conducting an auction is just one way to prevent a conflict of interest * Where there is only one bidder, a market canvas may be an appropriate response * **As long as proper procedure is implemented and followed, courts will generally defer to decisions made by directors/special committee**   ***Re BCE Inc* (SCC 2008)**   * *Does mgmt. owe any direct duty to stakeholders beyond duty owed to corp?* * Some of BCE corp family was in financial difficulty – mgmt. can up with plan of arrangement under which Bell Canada, a profitable subsidiary, agreed to take on debt of parent company * Group held debentures in Bell (making them secured creditors) and the rearrangement plan would cause the value of their debentures to fall   + Attempted to use oppression remedy to call mgmt. to account * Can look at the interests of the various groups mentioned in *Peoples*, including shareholders, debenture holders, employees, the environment, and the community at large, and to both short/long term interests of corp – it may be possible that decisions unfairly disregard interests of certain stakeholders * Mgmt. is required to come up with a defensible balance of interests and show they have prioritized interests as best as possible * Stakeholders are fundamentally entitled to an expectation of fair treatment and consideration – though mgmt. is not under direct duty to these stakeholders, they may be obliged to consider their interest in acting in best interests of corp viewed as “good corp citizen” * SCC held in this case that debenture holders failed, because although they were able to assert a reasonable expectation of consideration of their interests, they were not able to demonstrate that this expectation went unfulfilled * **SCC confirms that directors must act in best interests of the corporation, regardless of whether interests of stakeholders are coextensive or not** * **Fair treatment and consideration: as long as directors demonstrate proper procedure and consideration of interests, courts should show deference to their decisions**   + As per the business judgment rule * **Fiduciary duty is broad, not confined to short-term profit or share value – its content varies with situation at hand** * **Directors must consider best interest of the corporation and at minimum ensure it complies with statutory requirements** |

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| **Civil Liability** |

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| **Civil Liability**   * Two main types: CL and statutory (primary and secondary)   + These two are not mutually exclusive   + Common to sue under both * CL civil liability in securities is the tort of misrepresentation   **Primary Market Liability**   * There has been a long-standing statutory liability for securities issued under prospectuses, takeover bids, or offering memoranda (i.e. primary market trades). The legislation establishes statutory civil liability for **misrepresentations** in a prospectus, an OM, or a circular for a TOB/issuer bid, including directors’ or officers’ circulars * **s.131 of BCSA** provides that someone who has purchased securities offered as part of distribution under prospectus from underwriter or issuer has a right of action re: misrepresentation   + Comparable provisions for other relevant documents such as the offering memoranda, circulars etc.   + In a takeover bid situation the party that issues the circular, anyone who signs it as officer/director, anyone who provided consent for a use of a report, opinion, statement can be liable * Deemed reliance provision, **s.131(1)(a)**   + Benefit in comparison to the common law tort of misrepresentation where you have to prove reliance on the misrepresentation * **s.131(1)(b):** Categories of ∆s who can be sued under primary market prospectus liability (joint and several):   + Issuer,   + Securityholder re: sales from a control block   + Underwriter,   + Every director at issuer at time prospectus was filed,   + Every other person who signs the prospectus (i.e. promoter, CEO, and CFO),   + Every person who provided consent to use opinions/reports/other info in prospectus (lawyers, accountants, geologists, engineers, etc.)   **Rescission** is available as a remedy if the purchaser still holds the securities, and only available against issuer and underwriter in a firm commitment (but if things are really bad, issuer is broke anyways)   * **s.131(3)** – rescission voids the contracts and puts parties back to square one (may mean returning the purchase price of securities)   **Damages** are also available against any of ∆s, representing the depreciation in value of the security that results from the misrepresentation (max is purchase price paid)   * ***Kerr v Danier Leather*** → “*prima facie* measure of damages is the depreciation in the price of the security, which is equal to the price paid less the post-misrepresentation price. * This amount then may be reduced under **s.131(10)** if the defendant proves that:   + (1) the depreciation in price was caused in all or in part by factors other than its misrepresentation; and   + (2) that the depreciation in price is not reflective of the depreciation in value experienced by the plaintiff. * **s.131(9) –** the UW can only be liable for no more than the total public offering price represented by the portion of the distribution underwritten   **Defences for Primary Market Prospectus Liability**  **Purchaser’s Knowledge of the Misrepresentation**   * **s.131(4)** - complete defence available if the defendant proves that the purchaser knew of the misrep. when she purchased securities * Only defence available to the issuer other than the depreciation defence re: quantum of damages   **No Knowledge**   * **s.131(5)(a) -** If the defendant can prove that the document containing the misrepresentation was filed without her knowledge or consent   **Withdrawal of Consent**   * **s.131(5)(b) -** If he or she withdraws consent previously given to a prospectus or takeover bid circular * Must occur after the issue of a receipt for the prospectus and before the purchase of the securities by the issuer + when the defendant becomes aware of the misrepresentation + provide reasonable general notice of the withdrawal (probably to investors who purchased on basis of the misrep.)   **Reliance on Expert**   * **s.131(5)(c) -** If the misrep. is in a portion of the prospectus made on expert authority or a part that purports to be an expert’s report/opinion then the defendant must prove she had no reasonable grounds to believe and did not believe there to be a misrep. * Also available for takeover bid circulars   **Due Diligence Defence**   * **s.131(6)-(7)** provides that ∆ is not liable unless he failed to conduct reasonable investigation to provide reasonable grounds to have no belief that there was a misrepresentation   + (6) - experts   + (7) - non-experts * Available for misrepresentations made in a prospectus or TB document * For experts re: their opinions and reports as well as for other individuals (directors) re: other portions of the prospectus – “non-expertised” parts of the prospectus * Not liable unless he failed to conduct “such reasonable investigation as to provide reasonable grounds for a belief that there had been no representation.” * **s.131(6)-(7)** – must also have not believed there to be a misrepresentation * ***Kerr v. Danier Leather*** suggests that the onus is on the plaintiff to prove the defendant didn’t act diligently. Court held that the parties did not make a reasonable investigation, because they did not analyze poor results and their cause (IT being held to a higher standard)   ***Escott et al v BarChris Construction Corp et al*., (USDC 1968)**   * Actions directors must take to rely upon due diligence defence will vary depending on amount of info, skillsets, and level of involvement each individual director has * Assessed the actions of the defendants on an objective standard   ***Re YBM Magnex International Inc*., (OSCB 2003)**   * Balance between a high standard of fitness and business conduct with allowing for directors and officers to take measured risks in the spirit of commercial activity   + “…it best to consider the reasonableness of the respondents’ diligence and their belief from the perspective of a prudent person in the circumstances. This necessarily entails both objective and subjective considerations including their degree of participation, access to information and skill.”     - Moves the analysis towards a **modified objective test** depending on the individual’s subjective qualities   ***Kerr v. Danier Leather*, (SCC 2007)**   * Purpose of securities legislation: “It protects investors from the risks of an unregulated market, and by its assurance of fair dealing and by the promotion of the integrity and efficiency of capital markets it enhances the pool of capital available to entrepreneurs.” * Actual loss – the statute and the case law does not say that a plaintiff must have sold their shares and crystallized their loss in order to recover   + WHY? – appropriate measure of damages is the difference between the price paid and the then value of the securities   **Secondary Market Liability**   * In 2006, ON was first province to introduce statutory liability for securities purchased on secondary markets – could bring claim against companies for losses suffered on secondary market due to faulty disclosure   + Now is standard in every market west of Québec   + **WHY:** liability for misrepresentation in continuous disclosure docs is especially important bc the vast majority of all security trades (94%) take place in the secondary market * **Two triggers for remedies:**   + **Failure to comply with continuous disclosure requirements**   + **Public material misrepresentation** * **s.140.1-140.94 of BCSA** sets out statutory secondary market liability in BC   + Misrepresentation can be in any document required by securities regulations, as well as other voluntary documents (such as letters to shareholders, news releases, etc.)   + Issuer, directors, any officer who authorized representation, anyone who knowingly influenced issuer/directors/officer to release representation, or any expert in whose report the misrepresentation was contained can all be held liable for misrepresentation * Docs are divided into core documents and documents: onus of proof on π is greater w/r/t non-core documents; easier to establish case with core docs.   + For officers of the issuer these include a prospectus, a takeover bid or issuer bid circular, directors’ circular, a rights offering circular, the AIF, the MD&A, and annual financial statements   + For officers who are not directors core documents also include material change reports and interim financial statements * **s.140.3(1)** provides right of action where responsible issuer or person with actual, implied, or apparent authority releases document containing a misrepresentation– reliance need not be proven * **s.140.3(2)** provides right of action where person with actual, implied, or apparent authority on behalf of a responsible issuer makes a public oral statement containing a misrepresentation– reliance need not be proven * **s.140.3(3)** provides right of action where influential person with actual, implied, or apparent authority on behalf of a responsible issuer makes a public oral statement OR releases document containing a misrepresentation– reliance need not be proven * **s.140.3(4) of BCSA:** provides right of action where responsible issuer fails to make timely disclosure of a material change and a person has purchased the issuer’s security between the time of the required disclosure of the change and its actual disclosure * **s.140.4(6) of BCSA** provides due diligence defence, available to any ∆ except issuer   + Damages vary greatly depending on who ∆ is; π is entitled to the greater of specified caps on damages or specified % of revenue/earnings ($1M cap for issuer, $25K for directors/officers)     - These caps do not apply where ∆ had knowledge and directly authorized/permitted/acquiesced in the making of representation   **Note**   * Applies to all reporting issuers, and to issuers with a “real and substantial connection” with BC, any securities of which are publicly traded * Difficult to prove reliance and causation in tort of misrepresentation – statutory liability removed reliance requirement inherent to the tort, and so this statutory enactment represented a significant change in civil liability * People still sue under misrepresentation, as statutory secondary market liability has certain damages limitations not inherent to CL * Private market placements still have no statutory civil liability.   ***IMAX*, (BCCA 2009)**   * Leave must be sought to bring secondary market liability before court * Π must have a *prima facie* case in good faith and with a reasonable likelihood of success in order to seek leave |

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| **Enforcement** |

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| * Every securities act in Canada has a number of provisions dealing with enforcement falling into three broad categories of enforcement:   + **Criminal** (true criminal from *CCC* and quasi-criminal powers in securities regs.)   + **Civil**   + **Administrative** - most widely used (v dank, v dank) * **s.142 of BCSA** allows BCSCB to order investigations that are:   + expedient to the administration of the BCSA,   + the regulation of securities in another province,   + in respect of matters regarding securities traded in BC/another jurisdiction * **s.143 of BCSA** gives broad powers of investigation to the enforcement branch of BCSCB without the need to satisfy any threshold evidential or suspicion requirements   + Usually initiated in response to a complaint, tip, or high-profile transaction   + Powers of the investigators   ***Deloitte & Touche LLP v Ontario (Securities Comm.)*, (SCC 2003)**   * *Did OSCB act properly in disclosing Deloitte’s info?* * info which Deloitte had been compelled to provide during an investigation of Phillip Services Corp., whose financial representations had been shown to be materially false * Normally such evidence is kept confidential by both commission and informant, but OSCB felt they needed this evidence to pursue claims against directors/officers of PSC   + Can order disclosure if it is in the “public interest” * Obtained an order to use it from OSCB, which was appealed up to SCC * SCC employed standard of reasonableness, felt that OSC had reasonably balanced privacy of Deloitte and public interest in prosecution of PSC directors/officers; had only disclosed what was necessary to pursue claims   + Balance = allowing for respondents to meet the case against them + a 3rd party’s privacy interests and expectations   + Stinchcombe relevance standard * **OSCB can do whatever the fuck it wants**   **Criminal Enforcement Powers**   * **ss.380, 382, 382.1 and 400 of CCC** all provide offences related to securities law – indictable offences for which prison sentences of up to 15 years are available.   + BUT - not a prominent feature of enforcement of securities law in CDA * **s.380(1)** – indictable offence to “by deceit, falsehood or other fraudulent means” defraud the public or any person of “property, money, or valuable security or any service” where the subject matter exceeds $5000 * **s.380(2)** – offence of affecting the public market prices of “stocks, shares, merchandise or anything that is offered for sale to the public” with intent to defraud * **s.382** – an offence to fraudulently manipulate stock exchange transactions by engaging in various strategies, such as matched orders and wash trading to “create a false or misleading appearance of active public trading.” * **s.382.1(1)** – insider trading – it is now an indictable offence to directly or indirectly buy or sell a security knowingly using inside information that the accused possesses by virtue of various relationships to the issuer   + **s.382.1(2) –** offence of tipping -- hybrid offence   + BUT – these are inconsistent in at least 3 ways with the quasi-criminal offence of insider trading in provincial securities statutes     - Under the CC the Crown has to prove that the accused knowingly used insider info. to trade securities, higher threshold     - It refers to trading in securities of issuers generally, not just reporting issuers     - Various relationships include “by virtue of being a shareholder of the issuer” in sub. (a) * **s.400** – anyone who “makes, circulates or publishes a prospectus…that he knows is false in a material particular, with intent” to induce someone to become a shareholder or partner, or to deceive or defraud members, shareholders, or creditors of a company is guilty of an indictable offence.   ***R v. Drabinsky*,(Ont SCJ 2009) - example of using the *Criminal Code* to prosecute a securities related matter**   * D knowingly prepared false financial statements which he knew could cause loss to his investors * Misrepresented earnings of company and withheld info from auditors * Court looks for proof of potential detriment or risk of pecuniary loss to 3rd person   **Quasi-Criminal Enforcement Powers**   * **s.155(1) of *BCSA*** provides quasi-criminal offences which must be proven BRD:   1. fails to file, provide, deliver or send a record that      1. is required to be filed, provided, delivered or sent under this Act, or      2. is required to be filed, provided, delivered or sent under this Act within the time required under this Act;   2. contravenes any of section **34, 49 to 57, 57.2, 57.3, 57.5, 57.6, 58, 59, 61, 85 (b), 87, 121, 122, 124, 125, 148 or 168.1 (1)** of this Act;   3. fails to comply with a decision made under this Act;   4. contravenes any of the provisions of the regulations that are specified by regulation for the purpose of this paragraph;   5. contravenes any of the provisions of the commission rules that are specified by regulation for the purpose of this paragraph.   ***R v Landen* (Ont SCJ 2008)**   * L was VP of mining company traded using MNPI, was charged under OSA * Had also tipped a friend, who borrowed money from L and bought a large number of shares * Because of higher burden of proof of BRD, friend could not be convicted on largely circumstantial evidence   ***R v. Zelitt*, (AJ Prov. Ct. 2003)** – example of how the trend is shifting, more likely to use QC powers   * Quasi-criminal proceedings in misrepresentation, failing to disclose material facts and changes, and providing false or misleading information * Found guilty, sentenced to 4 years in prison, fine of $1.85 mil, and prohibited from trading in securities or serving as director or officer of an issuer for 25 years   **Civil Enforcement Powers**   * Rarely exercised by provincial commissions * **s.157 of BCSA** gives BCSCB powers to apply to court where it thinks someone has contravened the act and it thinks bringing the matter before a court is in the public interest * Under this section, courts can exercise powers unavailable to commission, including setting aside transactions which are impugned (pretty radical/unusual), payment of restitution, disgorgement of illegally-made profits, and rectify non-compliance   + Orders to comply with securities law, rescinding transactions, requiring compensation or restitution, payment of damages, disgorgement, rectification of part non-compliance   **Administrative Enforcement Powers**   * Enforcement sanctions a violator of the act is most likely to encounter * Power to make orders of various kinds and impose sanctions on market participants following a hearing * Can make orders set out in governing statutes if it is in the “public interest” to do so   + Discretion of regulator to interpret public interest in accordance with statutory mandate   + Can do so without a breach of securities law + in quasi-criminal circumstances * Mary Condon, “The Use of Public Interest Enforcement Orders by Securities Regulators in Canada”   + Found significant variation in the kinds of matters that became the subject of administrative enforcement action across CDN provinces   + Unevenness in application of contextual sanctioning factors to individual respondents to justify specific types and quantum of penalties   + Notable consistency across the provinces in the articulation of public interest that was the basis for making orders     - Linked to goals of maintaining public confidence in and the integrity of the capital markets over market efficiency * **s.161 of BCSA** says that BCSCB can, after a hearing before commission, make a permanent order which is in the public interest do not require a breach of securities law, only a finding that the order is in the public interest * **s.161 of BCSA** provides for five kinds of orders:   + That a person comply with or cease contravention of the Act   + That a person cease trading in the securities involved in the violation (either of the specific issuer or generally)   + That any or all exemptions set out in regulations do not apply to that person   + That a person resign or be prohibited from acting as a director/officer of an issuer (any issuer, reporting, BC, Canadian, or otherwise)   + That a person’s registration be suspended * BCSCB can also make interim orders without prior need for a hearing   **Enforcement Actions Against Lawyers**  ***Wilder v. Ontario* (Ont Div. Ct. 2000)**   * OSC sought to reprimand a lawyer who represented YBM b/c his actions in connection with representing that issuer, allegedly misleading statements he made to regulators to the effect that YBM had obtained a series of favourable due diligence results conducted by independent parties * W sought judicial review that this order was beyond OSC’s jurisdiction * Purpose of the OSA = to provide protection to investors from unfair, improper or fraudulent practices, and to foster fair and efficient capital markets and confidence in those markets * Nothing inconsistent with the Law Society’s role in regulating the legal profession and the OSC’s exercise of jurisdiction in reprimanding W   **The Use of the Public Interest Power in the Absence of a Breach of the Statute or Regulations/Rules**  ***Re Canadian Tire Corp* (OSCB 1987)**   * Most significant case w/r/t the meaning of “in the public interest”   + As per ***Cablecasting***, the Commission has discretion that must be exercised in the public interest   + BUT – make sure to proceed with caution in such a situation * Takeover transaction was carefully structured to avoid triggering the coattails which existed non-voting public shares * OSCB could not point to any breach of the act or any regulations or even policies, was nothing illegal about it, but OSCB argued that it was nevertheless abusive of the non-voting public shareholders and not “in the public interest”   + WHY? - it is bound to have an effect on public confidence in the integrity of our capital markets + on public confidence in those who are controllers of major corporations * But note that participants in the capital market need to be able to rely on terms of the documents to conduct daily transactions   + The residual public interest test must therefore be invoked with caution     - Especially when there is no breach of the Act   + **\*\*The conduct/transaction must clearly be demonstrated to be abusive of shareholders in particular and capital markets in general\*\*** * The decision to impose a cease trade order does not depend on a finding of a breach of fiduciary duty   + WHY? – this is the court’s jurisdiction   + BUT – a breach + evidence of it can be important in supporting facts that would otherwise support a public interest order   **Sanctions Available in Connection with Public Interest Orders**  ***Asbestos Minority Shareholders v Ontario (Securities Comm.)* (SCC 2001)**   * The objective of the “in the public interest” power is restraining future conduct which is likely to be prejudicial to the public interest in fair and efficient capital markets * Legislature gave the OSC very wide discretion to intervene in activities related to the Ontario capital markets when it is in the public interest to do so   + BUT - this is not unlimited * Public interest jurisdiction is animated by **both** the purposes of the Act to provide protection to investors from unfair, improper or fraudulent practises and to foster fair and efficient capital markets and confidence in capital markets * This is also a regulatory provision - protective/preventative rather than punitive – as per ***R v. Wholesale Travel Group Inc.***, SCC 1991 the focus is protection of societal interests not the punishment of individual moral faults * Use administrative sanctions to restrain future conduct that is likely to be prejudicial to the public interest in fair and efficient capital markets   + ***Re Mithras Management Ltd*.**, OSCB 1990 – protect public interest by removing from the capital markets those whose past conduct is so abusive as to warrant apprehension of future conduct detrimental to the integrity of the capital markets * “In the public interest” power is not for the provision of remedies or meting out punishments; it is preventative and for the protection of the public interest * Normally used to revoke exemptions * Four considerations in the public interest section itself   + seriousness and severity of the sanctions applied for,   + effect of imposing such a sanction on the efficiency of, and public confidence on Ontario capital markets   + a reluctance to use the open-ended nature of the public interest jurisdiction to police out-of-province activities, and   + a recognition that these powers are preventive in nature, not remedial   ]  **General Deterrence**  ***Re Cartaway Resources Corp*.**, SCC 2004 – should regulators consider deterrence as an objective when applying sanctions under public enforcement provisions?   * Commission imposed sanctions in weighing several factors: general deterrence, protecting securities market, settlement agreements, specific circumstances of the case * Deterrent penalties work on two levels   + Society in general to demonstrate the negative consequences of wrongdoing (general deterrence)   + Individuals to show the unprofitability of repeated wrongdoing (individual deterrence) * General deterrence does have a role to play in policing capital markets b/c market systems are rational actors   + In line with American jurisprudence – ***United States v. Matthews***, 2d. Cir. 1986   + Appropriate/necessary consideration in making protective and preventive orders, really fits with the dictionary definition of preventive   **Management Cease-Trading Orders**   * CTO is the predominant type of order available under provincial administrative enforcement powers * CSA issued a notice in 2002 identifying circumstances in which a mgmt.-only CTO might be issued by the principal regulator instead of a general cease trading order in cases where reporting issuers do not file their financial statements on time * Current version is **NP 120193, *Cease Trade Orders for Continuous Disclosure Defaults***   **Judicial Review of Regulatory Decisions**  **· *Donnini v. OSC*, SCJ Div. Ct. 2003**   * An accused not pleading guilty is not and should not be subject to increased penalties simply because he has chosen to defend himself   + Here, unreasonable disparity between the suspension meted out to the other involved party and that to D     - Yes, this tribunal gets deference but doesn't mean the Court has to accept whatever it decides * Shouldn’t disturb the penalty imposed and substitute its judgment unless there is an error in principle or as per ***Takahashi v. College of Physicians and Surgeons*** the punishment clearly does not fit the crime * Generally, penalties should follow some recognizable pattern   + Here, the penalty for Donnini does not stand up   + ONCA later restored the OSC’s decisions: “The Commission wrote careful and extensive reasons on the sanctions issue.” |