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General info

* Companion policies provide additional guidance for interpretation, but don’t have force of law, but as a practical matter they do.
* Venture issuer is an issuer that is not listed on a major stock exchange
* Ontario and BC are founders of cooperative regulatory system
* Companion policies give additional guidance on how regulators should enforce national instruments
* When does the act apply? when the protection of people is required
* A **retail investor** is an individual who purchases securities for his or her own personal account rather than for an organization.

# Intro

Why are securities so heavily regulated?

* Great depression – bad things happen in unregulated security markets
* The nature of securities markets creates the need for regulation. Investors pay enormous amounts of money to strangers for completely intangible rights, whose value depends entirely on the quality of the information that the investors receive and on the sellers’ honesty. (p.2) – investor is not in control of the money/investment
* Speculative aspect of securities creates a unique element of risk

Capital markets regulation has 3 components: securities regulation; banking regulation (fed jurisdiction, *Bank Act*); regulation of insurance products (prov jurisdiction)

* Capital markets are markets for buying and selling equity and debt instruments.
* Quebec & Saskatchewan have amalgamated capital market regulators (unified regulator).
* Canada wants to create a single common or national securities regime.

## What are securities?

**Types of securities**

* **(1) Debt securities:** company is borrowing money from investors – ex. bonds (secured), debentures (unsecured), commercial paper, gov debts. Features include: face value, maturity date, interest rate (also referred to as coupon rate)
  + Convertible bonds may be converted by the bondholder into a specified number of equity securities
* **(2) Equity securities:** company is selling investors a right to share in its future profits (note: carry more risk than debt securities); buying an ownership stake in the company
  + Share or stock – 3 fundamental rights: (1) right to share in profits through dividends; (2) right to share in residual profits upon liquidation/bankruptcy; (3) right to vote @ SH meetings. “Common” SHs are entitled to all 3, but “preferred” SHs have preferential rights to dividends/residual assets, but no right to vote.
  + A unit in a business trust or partnership
* **(3) Derivative securities:** derive their value from a “reference share” or other underlying asset or variable. Purpose: used for hedging risks (zero-sum gain: one person profits, the other loses the equivalent amount) and speculation.
  + Equity derivative is dependent on the projected future profits
  + “Futures Ks” are used to guard against increase in prices.
  + An “option” is a contract that entitles, but does not require, its holder either to buy or sell a particular security on a particular date at a specified price.
    - Underwritten options
    - Call (option to buy); put (option to sell)
  + “Swaps” are arrangements under which two parties agree to exchange particular cash flows over a fixed period of time.
  + “Short sale” works by securities loan K – borrowing security & selling it off in the market in anticipation that it will drop, buying it back, repaying loan and keeping profit for yourself.

**Where & how securities are first sold?** First, sell in an exempt market (private placement) – issuer may sell securities to pple known by its management, venture capitalists, or to other sophisticated investors, but not general public. Later, issuer may retain an underwriter to sell securities to the general public in an “initial public offering” (IPO) – issuer becomes a “reporting issuer” and therefore subject to a host of ongoing obligations under securities regulation. Reporting issuer can still issue more securities in the exempt market.

**Where & how securities are subsequently traded?** Traded among investors in the “secondary market” – between investors w/ no involvement by the issuer.

* Securities can be listed on stock exchanges, which provide considerable depth and liquidity.
* Certain securities (such as many derivatives, all corporate bonds & debentures) trade in “over-the-counter” markets.
* Institutional investors can arrange for private trades w/ other investors in the “upstairs market”.
* Also, a range of alternative trading systems (ATSs) exist.

## Purpose of securities regulation

Unique features of securities markets have led to the disclosure-based approach – securities regulation seeks to ensure investors are aware of the risks to which they are exposed, rather than attempting to eliminate all risk.

1. **Investor Protection:** provides investors with protection from unfair, improper, or fraudulent practices – how? Through info disclosure!
2. **Efficiency:** foster fair and efficient capital markets, which involves striking a balance in that investor protection schemes cannot be so onerous as to deter corporations from using capital markets to raise funds
   1. capital markets help to allocate savings to businesses to put them to productive use
3. **Transparency:** to promote investor confidence in the capital markets
4. **Address systematic risk:** which involves risk of breakdown among institutions & other market participants in a chain-like fashion that has the potential to affect the entire financial system negatively.

The first three objectives are enshrined in Canadian securities legislation. The fourth objective can be viewed as a component of the other objectives, but also requires separate treatment in the wake of the global financial crisis (GFC) and the 2011 *Reference re Securities Act* decision.

**Reference re Securities Act:** the proposed federal *Securities Act* was rejected as unconstitutional by the SCC, but the court held that systematic risk falls under federal jurisdiction.

**How are these objectives achieved?** Canadian securities regulation uses 3 basic techniques: disclosure of all material info; registration of intermediaries involved in securities biz (includes brokers, firms, etc.); after the fact enforcement by regulators

* None of these methods attempt to eliminate risk altogether. They are trying to ensure that investors can fairly evaluate securities, they are fairly priced, have access to all relevant information in deciding whether or not to make investment

## Structure of the Commission

* Securities regulation in each province is done by the Commission.
* Structures of the Commissions mirror US securities regulation
* A distinctive feature is the independence of the commissions from the government – they are, to an extent, separate and independent from the departmental chain of command. They also possess important “rule-making” powers. They have the ability to make decisions that allow for imposition of fines and penalties.
* **2 basic purposes:** 1) protecting investors from unfair, improper or fraudulent practices; and 2) promoting efficient capital markets and confidence in those markets.
* **Guiding principles** – OSA identified explicitly, but none in BCSA; *Crawford Report*; *Hockin Report* – these reports have made recommendations, but neither have been legislatively incorporated (p.85).
* **Administrative structure:** vary by jurisdiction, but most are two-tier (p.86):
  + The first level is the “official Commission” – consists of a tribunal; members called commissioners one of whom is designated as Chair; commissioners generate policy and make decisions in administrative enforcement proceedings
    - Commissioners are appointed by Lieutenant Governor in Council (cabinet of the Prov gov); securities acts don’t require specific qualifications for the position – but the *Kimber Report* has made recommendations (p.87). BCSCn members are subject to term limits in *ATA* & may be reappointed
  + The second level is the staff, which runs the Commission’s day to day operations.
    - Staff are employed through employment Ks
* Commissions delegate substantial “front line” regulatory responsibility to the self-regulatory organizations (SROs) and to the exchanges that operate across Canada.
* Commission has rule-making powers; generally, follow “notice-and-comment” rule-making (p.89-91).
  + Have to make sure not legislative in nature though – *Ainsley* Distinction

## Nationally regulated system

There are movements to move to a nationally regulated system (ch.17)

* In 2008, Hockin report came out with proposals for a single security regulator
* In 2010, there were attempts to implement a federal legislation. But in **Reference Re Securities Act,** the SCC held such legislation to be unconstitutional.
  + Feds argument based on “general trade & commerce power” and “global systematic risk” was rejected
  + SCC ruled pith & substance to be w/in provincial legislative power – but ruled that there is room for the federal government to legislate for systematic risk & data collection
* Cooperative Capital Markets Regulatory System (p.674)
  + Opposed by Quebec & Alberta

# Historical development of securities regulation

“blue sky” US state laws enacted beginning in 1912 all called for merit review. However, since the 1933 US Securities Act, securities regulation in most jurisdictions has been disclosure-based (p.837).

Modern era of securities regulation began in

* England in the 13th century w/ licensing requirements for brokers
* The US during the Great Depression
* Canada in 1965 *Kimber Report*

# Theories of capital markets regulation

**Institution-based structure of financial regulation**

Currently, Canada has a three-part institutional structure. The two main alternatives are:

* **the “integrated” model** (p.830): a single agency responsible for regulating what have traditionally been regarded as the securities, banking and insurance markets. Adopted by Norway, Denmark, and Sweden. Reasons: more effective in supervising financial conglomerates; will realize certain economies of scale. UK adopted in 2000 b/c of the increasing blurring of the boundaries among securities, banking and insurance – but abandoned in the wake of the GFC.
* **the “twin peaks” model** (p.832): established two regulators, based not on the industries they regulate but on their regulatory objectives – one focuses on consumer protection; the other on prudential supervision. Used in Australia and Netherlands, and the UK has recently transitioned to one.
  + **The blueprint proposal** incorporates elements of twin peaks regulation w/out embracing it completely (p.832 for details).

**Prudential regulation** is concerned w/ safety & soundness of financial institutions.

* Concerned w/ ensuring safety and reducing risk

**Consumer protection regulation** attempts to ensure that consumers are aware of the risks to which their investments are subject (ex. through disclosure).

* Tolerant of risk conditional on adequate disclosure.

**The Efficient Markets Hypothesis (EMH)** p.835

EMH asserts that capital markets are efficient in the sense that “all available info” about a security is “fully reflected” in its price. One of the things that makes the EMH a controversial theory is its prediction that even though info is not immediately and costlessly available to all market participants, the market will act as if it were. Also, market prices often fluctuate in ways that can’t be explained by the arrival of new info.

**The Disclosure Paradigm** p.837

Disclosure became a regulatory requirement in 1933. Subject to at least 3 critiques: each premised on a different source of market inefficiency.

* **Behavioral economics:** one fundamental assumption is that investors are more or less perfectly rational – but in reality, individuals are imperfectly rational which suggests caution w/ respect to the EMH.
  + Turner Review
* **Volume of mandatory disclosure:** sheer volume of mandatory disclosure is actually counterproductive.
* **Complexity:** capital markets are more complex today than when disclosure became a regulatory requirement: 1) issuers finance their activities in increasingly complex ways, 2) there are now novel types of securities; 3) interconnectedness.

# Foundational concepts

The scope of securities regulation in Canada is based on 3 fundamental concepts:

1. Security – defined inclusively
2. Trade, and – defined inclusively
3. Distribution – defined exhaustively

A transaction that involves a security, trade and distribution is subject to the full range of securities regulation.

* Note – there are statutory and discretionary exemptions
* Definitions of security and trade are intentionally overbroad to ensure they catch every transaction the Commissions deem necessary to regulate, including new or unique formulations and structures – which prevents people from devising transactions to escape regulation 🡪 **“catch-then-exclude” strategy**

## What is a security?

Two interpretations guide definition of securities:

* A broad, flexible approach is appropriate since securities regulation is protective, not punitive.
* And, courts will adopt substance over form. In other words, they focus on the general economic effects of the whole transaction rather than the specific technical details of any parts of it.

“security” is defined in section 1(1) of BC *Securities Act*, which Provides an inclusive definition of the term.

s.1(1) **security includes**

(a) a document, instrument or writing **“commonly known” as a security** – *to ensure broad/flexible interpretation*

* Catch-all term
* The issue is determining what is common knowledge?
* Knowledge that is common among securities professionals (sophisticated analysts, securities lawyers), not laypersons: **Glenn**; **Geldermann**
* The Quebec Securities Commission held that proof of common knowledge “must be based on an overwhelming set of facts and conclusive evidence”: **Geldermann**

(b) a document **evidencing title to, or an interest** in, the capital, assets, property, profits, earnings or royalties **of a person** – *reflects goal of protecting investing public*

* This includes property interest acquired for the purpose of making an investment, rather than buying a commodity to merely acquire an interest in property. **The investment or speculative purpose of the transaction is key.** The K will typically feature performance of a service by others that is meant to increase value of the property.
* Whether the document shows a form of investment or speculation? Is there an expectation of return based on work of another?
* **\*Swain: Title doc for a ½** interest in a pair of breeding chinchillas was held to constitute a security b/c the vendor agreed to share w/ the purchaser the profits gained from breeding the chinchillas. Purchaser was making an investment, not buying a pet.
* **\*Brigadoon: scotch whisky receipts** were held to be securities b/c they were bought & sold as an investment (hoping its value increased as it aged), not as inventory or for consumption (didn’t purchase w/ a view to take possession).
  + *Individuals purchased scotch stored in Brigadoon’s warehouse. It was aged for a number of years and then sold by Brigadoon on behalf of its owners to various blenders.*
* **Raymond Lee:** **Control can help determine whether something is security or not**
  + *co. solicited people w/ inventions and would help ppl with their patent application + marketing in return for 20% interest in invention = NOT security, inventors still in complete control!*
* **Re Sunfour Estates:** co-tenancy interests in undeveloped commercial real estate were NOT sec. Land only developed if purchasers agreed to. Profit depended on value of real estate, not efforts of 3rd pty, **purchasers** retained complete control of prop.
* Actual document need not even exist!
* **Franchise agreement** may be a security either b/c it represents a “document evidencing...” or as an investment K. In either case, the amount of control the franchisee has over its investment will likely determine the issue. **Look @ the KEY elements of the agreement! \*Re Century 21**
* Think about: who has possession? Is there a separation of ownership & control? Is there profit sharing? **Arguably X is securities b/c the purchasers didn’t purchase [the good] w/ a view to take possession of it.** **They bought it as an investment, hoping its value would increase as it aged.**

(c) a document evidencing an **option, subscription** or other interest in or to a security

* **Option:** a K that entitles the buyer to either buy (“call” option) or sell (“put” option) a particular security at a particular date at a specified price.
* **Subscriptions** are sign-up forms for purchasing securities.
* **Rights:** granting existing securityholders rights to purchase a specific number of additional securities for a specific price w/in a specific period.
* **Warrants:** right to purchase a specific number of equity securities at a specific price and during a specific time period.
* anything entitling one to a security in the future is a security (employee stock option for compensation)
* interests in a security 🡪 derivatives

(d) **debt security:** a bond, debenture, note or other **evidence of indebtedness**, share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certification or subscription other than

(i) a **contract of insurance** issued by an insurer, and

(ii) an evidence of **deposit** issued by a savings institution

* Issue: distinguishing a debt security from a doc evidencing indebtedness that is not a security!
* in \***Gill**, the court applied the **Revs test** (from a U.S. case) under which there is a rebuttable presumption that certain types of notes (like receipts) are securities. There are 4 relevant factors: **1) motivation behind the transaction:** if seller wants to raise $ and buyer wants to profit from the returns the instrument is expected to generate – the instrument is likely a security; **2) intended distribution of the instrument:** if it is one in which there will be “common trading for speculation or investment”, it’s a security; **3) reasonable expectations of the investing public:** the more the public expects a security the more likely it’s a security; **4) existence of another regulatory regime:** if there is no other regulatory scheme that reduces the risk of the instrument, it’s likely a security.
  + Must look @ substance!
  + If listed in definition, then there is a presumption that it is a security – but the presumption can be rebutted

(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 ¾ of the premiums paid by the purchaser for a benefit payable at maturity

* Units & shares of open-ended investment funds – ex. “mutual funds”

(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 other 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 issuer

(l) **an investment contract** – catchall provision; *per* ***Pacific Coast*** *policy goal of the provision is protection of the public*

(m) a document evidencing an interest in a scholarship or educational plan or trust,

(n) an instrument that is a future contract or an option but is not an exchange contract

(o) a permit under the Oil and Gas Activities Act,

whether or not any of the above relate to an issuer, **but does not include an exchange contract**

**Investment Ks** – not defined in the Act

**If a capital raising instrument does not specifically fit w/in the enumerated list in the Act, then determine whether it can be characterized as an investment K?**

The leading Canadian case w/ respect to investment Ks is \***Pacific Coast**, where the SCC looked at US jurisprudence. Chief Justice Laskin dissented – he is against overly broad interpretation of investment Ks.

* **\*Howey (US): The test of whether there is an “investment contract” under the Securities Act is whether the scheme involves an investment of money in a** **common enterprise** **w/ profits to come solely from the efforts of others**; and, if that test be satisfied, it is immaterial whether the enterprise is speculative or nonspeculative, or whether there is a sale of property w/ or w/out intrinsic value.
  + Key quote: An investment K means a K, transaction, or scheme whereby a person invests money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party – it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed by the enterprise.
  + The SCC in **Pacific Coast** adopted a more realistic formulation of the word “solely” in the Howey test: whether **the efforts made by those other than the investor are the undeniably significant ones,** those essential managerial efforts which affect the failure or success of the enterprise. The court alsoheld that a “common enterprise” is an enterprise in which the fortunes of the investor are interwoven w/ and dependent upon the efforts and success of those seeking the investment or of third parties. The commonality necessary for an investment K is that between the investor and the promoter, rather than between the investors themselves.
  + Expectation of profit
* **\*State of Hawaii (US): “risk capital” test** has 4 parts: (1) offeree furnishes initial value to offeror; (2) at least a portion of the initial value is subject to the risks of the enterprise; (3) offeror induces the initial value through promises or representations, which lead the offeree to the reasonable understanding of accrual through the operation of the enterprise; (4) offeree does not have practical and actual control over the enterprise’s managerial decisions.
  + When capital put at risk there is potentially a security

The court in **Pacific Coast** adopted a broad, flexible approach for interpreting investment Ks. The common enterprise tests (**Howey**) and risk capital (**Hawaii**) tests are always helpful in determining whether a given K is an investment K, it is not strictly necessary that either be satisfied. What is necessary is that finding the K in question to be an investment K (and therefore a security) would support and advance the policy goals of securities regulation generally.

In all 3 cases, one key criteria in determining whether an investment K is a security for the purposes of securities law is the degree of managerial control exercised by the issuer. The less managerial control **investor** has and the more capital is @ risk – more likely that it is a security.

|  |  |
| --- | --- |
| **Pacific Coast** | purchasers bought bags of silver coins on margin (i.e. substantial party of the purchase price on credit). Majority of the purchases did not actually pay the full price & closed their margin accounts by selling their bags back to Pacific (never actually physically possessed the bags) // issue: were the margin purchases investment Ks and therefore securities? // H: yes!   * Laskin dissenting: price of silver set by markets over which Pacific has no control |
| **Howey** | Howey sold real estate Ks for half of its citrus groves. The purchaser of the land could then lease it back to the service company, via a service K, which would tend to the land, harvest, pool, and market the produce. // I: was payment for land security? // H: investment Ks |
| **State of Hawaii** | Hawaii Market Center sold “founding” memberships to promoters who could earn money through selling additional memberships by referring others to shop at the store using the promoter’s buyer’s card. // I: do the memberships sold by HMC constitute a security? // H: scheme in question was a security   * Court said that the Howey test is too narrow & adopted the risk capital theory |

**\*Lazerman:** similar to Pacific Coast w/ only 2 material differences:

* commodity was silver bars, not silver coins: there was a formal exchange for silver bars, which meant that purchasers did not have to rely on the company to create a market for the commodity. Profit depended on market price of silver, not actions of L.
  + Laskin’s argument from Pacific held more weight here
* L segregated each purchaser’s funds whereas Pacific commingled all purchasers’ funds w/ its own. This means that L and purchasers did not share in each other’s profits or losses and, therefore, were not engaged in a “common enterprise”.

**Franchise agreements**

The question of whether a franchise agreement constitutes a security is determined on a case-by-case basis and will depend on the facts of the arrangement at issue. Two of the branches to the definition of “security” in subsection 1(1) are relevant to a determination of whether a franchise can be considered a security. First, a security includes “any doc constituting evidence of title to or interest in….” Second, a security is also defined to include any investment K. In either case, the amount of control the franchisee has over its investment will likely determine the issue. **Look @ the KEY elements of the agreement!**

* The seminal case on the interpretation of the investment K branch of the definition of security is **Pacific Coin.**
* In **\*Re Century 21,** a franchise agreement was examined by the Commission w/ a view to determining whether the agreement constituted an investment K or evidence of an interest in earnings of a franchisee w/in the meaning of the definition of “security”.
* F: under the agreement, franchisee was required to pay an initial fee and an annual service charge equal to a % of its gross income to use the Century 21 system. Although franchisee was characterized as an independent contractor responsible for its own biz operation, **franchisor** retained the ownership of all the right, title and interest in the trade name Century 21 and associated trademarks, goodwill and trade secrets.
* H: the franchise agreement was found not to have been a document constituting evidence of title to or interest in the requisite categories. Annual service charge based on gross income was analogous to a rental (if franchisor had an interest in franchisee’s profits, it may have been security).

## What is a trade?

Concept of trade is important b/c it triggers the registration requirement.

BCSA s.1(1) **trade includes**

(a) any **disposition of a security for valuable consideration** whether the terms of the 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**

* Disposition can be sale, lease, or assignment
* It is a trade to sell a security, but not a trade to buy a security. If buying a security not trading.
* **Henning:** original sale of an option is a trade, but not the attempt to exercise the option (*in Henning, option exercise, from Henning’s viewpoint was effectively a purchase and, therefore, not a trade).*
* not trade if there is a lack of consideration – ex. gift of common shares to EEs not a trade (**Re Anchor**); disposition to a charity

(a.1) entering into a **futures contract**,

(b) entering into **an option that is an exchange contract**,

* sub a.1 and b include acquisitions of derivatives, not only dispositions; and there is no valuable consideration requirement
* note: exchange K is not a security, but it is regulated by the Act.

(c) **participation as a trader** (i.e. intermediary) in a transaction in a security or exchange contract made on or through the facilitates of an exchange or reported through the facilitates of a quotation and trade reporting system

* captures activities of an agent of a broker executing securities trades through any stock exchange, quoting and trade reporting system or alternative trading system.

(d) the **receipt by a registrant** of an order to buy or sell a security or exchange contract

* registrant includes traders but also anyone else engaged in the securities industries
* trade occurs when a broker receives the order, not when it is completed

(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

* has to be from a control person (p.74)?

(f) any act, advertisement, solicitation, conduct or negotiation directly or indirectly **in furtherance** of any of the activities specified in (a)-(e)

* catchall provision designed to ensure that anything done that could contain tactics or misrepresentations to influence the buyer will be caught by this legislation
* note: no actual trade need ever be completed for there to be a trade! Ex. arranging a meeting could be a trade if its purpose is to promote a sale or disposition of securities. But may not be a trade if purpose is informational.
* Examples of trade: supplying a list of names of prospective clients to a broker; advertising before or after incorporation has been deemed a trade; sending letters to potential investors; an offer to sell (but not clear whether offer to purchase is a trade or not) – look @ p.76, 3.61 for more

**Geographical limitations of the definition of “Trade”**

Courts tend to be liberal in granting jurisdiction, which could result in more than one province having jurisdiction over the same transaction.

* Trading if positing online a document offering or soliciting trades and doc can be accessed by pple in that province
* Trade can occur in more than one province – requiring registration in both provinces

Is it a security? If no, done! --- is there a trade? --- is it a trade in the context of someone engage in Biz, if yes – then trigger registration requirement --- what if distribution (a subset of trade)? --- If you trade in securities and it is a distribution, you trigger the distribution requirement.

## What is a distribution?

**Once a security and a trade have been established, determine whether there is a distribution.**

Looking @ a trade in securities that is a distribution!

**WHAT?** Sale by an issuer or a controlling SH. Ex. IPO, seed capital (want to start a company and go to family for $), private placement

* Common to all: the issuer is selling shares to a 3rd party
* Distribution is the point in time where a security reaches the public

WHY? distribution triggers requirement for prospectus, or an exemption from requirement

* Prospectus is a document that provides disclosure on the security – time consuming & expensive
* Purpose of disclosure is to protect investors & allow them to make reasonably informed decisions
* Prospectus requirement exists in all provinces
* Biz of transacting in securities is interprovincial (?)

s.1(1) **a trade is a distribution if it is …** (this is an exhaustive list)

(a) **a trade in a security of an issuer that has not been previously issued**

* Tarde or sale of security from the treasury (previously authorizes, but not distributed) by the issuer itself
  + Once distributed then becomes a distribution b/c need a trade
* New issues on the market – IPO, seed capital, all shares not previously issued
* ex. sale of common shares by a company from its treasury to raise capital will be a distribution

(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

* Redemption: company has right to buy back
* Don’t come across this today, b/c usually canceled – now, companies have unlimited authorized shares
* someone sells the shares back to the company who then sells them to someone else + very rare + triggers prospectus requirements b/c the issuer could have access to “material information” that the public does not
* ex. preferred shares issued w/ a redemption feature; retraction feature

(c) a trade in a previously issued security of an issuer from the **holdings of a control person**

* sale by the control person not the issuer itself, triggers prospectus requirements
* **Who is a control person?** Defined in BCSA s.1(1) as a person or combination of people acting in concert who hold **sufficient number of voting rights attached to all outstanding voting securities of an issuer to affect control of the issuer materially**. There is a rebuttable presumption that a person/block with more than 20% of the outstanding voting rights is deemed a control person in the absence of evidence to the contrary (onus on the deemed person to disprove the control status). This can be rebutted in certain circumstances where you can demonstrate that you actually don’t have sufficient securities to affect control of the issuer. For example, if person A owns 22%, and person B owns 52%, then person A has no problem rebutting that he can’t control.
  + Threshold can be lower than 20% depending on the circumstances of a particular case. For example, the OSC held 14.6% to be control in **Re Deer Horn Mines Ltd.**
  + What is in concert? Doesn’t even need an agreement. There might be inferences based on the facts (ex. husband and wife).
* **Policy:** There is an assumption that control person has access to information not available to the general public (i.e. insider knowledge) 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.
  + When a control person sells, that moves the market price – so should take steps to bring to the attention of the market. P.172

(d) a trade by or on behalf of an underwriter in a security that was acquired by the underwriter, acting as an underwriter, before Feb. 1 1987, if the security continues on that date to be owned by or on behalf of the underwriter so acting,

* Historic – don’t worry about this category
* 1987 – this is when the current model came into force, which fundamentally changed what was in place before it

(e) a trade **deemed** to be a distribution

(i) in an order made under section 76 by the commission or the executive director, or

* s.76(1) 🡪 residual discretion of Securities Commission Senior staff to deem a distribution and force disclosure

(ii) in the regulations, --- *creating structure for the closed system*

* securities regulation in Canada introduced what is known as the **“closed system”** in 1979 – securities that are issued under a prospectus are freely tradeable. But when a purchaser acquires a security in a distribution in which the issuer of the security has relied on an exemption from the prospectus requirements (i.e. exempt distribution), the first trade of the security by the purchaser may be subject to resale restrictions. This is the result of what is referred to as the “closed system”. If the securities are not originally qualified by a prospectus, the securities are said to be caught w/in the “closed system” and securities regulations do not permit the person who originally purchased the securities to sell to other persons unless they can comply w/ another prospectus exemption or they meet certain conditions, often referred to as the “resale rules”.
  + securities issued under distribution that qualify for an exemption can be traded w/in the closed system.

(f) a transaction or series of transactions involving further purchases and sale **in the course of or incidental to a distribution** – catchall provision

* Ex. securities purchased by an underwriter during a distribution, where the underwriter plans to resell the securities. Resell is incidental to the original distribution, so deemed to be a distribution.

(g) a **prescribed class** of trade or transaction

* Commission has authority to expand, but has to be listed to count as distribution

**Distribution triggers the disclosure requirements designed to protect investors.**

Before 1987, term used was distribution to the public. This was complicated b/c it was uncertain who was the public. This is relevant when you want to interpret a prospectus exemption, where the wording is not clear OR seeking to apply for a discretionary exemption order.

* Public could be one person if needed protection
* If company distributing to employees, then public could be some of the employees
* A CEO that you play golf w/

**Different kinds of distribution**

**There are 2 types of distribution:** issuer can make it directly to the investors or through an underwriter.

* **Direct offerings:** private placement, rights offerings, crowd funding (low cost typically used by startups – raising money through the internet w/out the use of a dealer) – most direct offerings are exempt
* **Underwritten offerings:** UWs are registered dealers: to deal, to underwrite
  + Assist issuer w/ selling by (1) advising on the best way to raise capital, how to structure the transaction, (2) locate investors, (3) mechanics of collecting money & delivering security, (4) absorb some of the risks (if it’s a bought deal), and (5) provide credibility to the offering by attaching their name to it (underwriters don’t get involved w/out doing DD)
  + **3 categories: (1) bought deal offer:** this is the firmest commitment – UW commits to buy the securities at a fixed price & a certain amount before its gone to the market; if there is a macro-catastrophic event, then underwriter could walk away (“disaster out clauses”); **(2) marketed offering** commitment: UW agrees to buy securities after marketing, which required prospectus if didn’t fit w/in an exemption; would rely on expressions of interest; market out clause to get out of the risk); **(3) best efforts agency offering:** UW strictly act as the agent of the issuer – fee is less than the other 2 and results are less certain for the issuer
  + black Monday
  + underwriters need to have capital requirements

**Example:** is this a distribution?

**(1)** I sell shares of RBC and sell on stock exchange – not distribution b/c not the issuer; selling previously issued shares; Q: just bought in public market and small fraction of shares, not a distribution

* Qs to ask: did you buy under prospectus or an exemption? Are you a control person?

**(2)** offers for the first time 🡪 distribution; trade in security not previously issued

**(3)** random guy buying shares from a company - Buy previously shares from RBC – not a distribution, b/c not a trade

* F
* But if short Q – not a distribution b/c buying;

**(4)** private company selling 🡪 trade; previously issued 🡪 yes, distribution

with a private company it can be 3 ways:

1. If they sell any of their own securities, then it would be a distribution

* Only thing diff is that no prospectus b/c they are private

1. if PC sells pursuant to an exemption, and the person who bought it sells it again, then distribution
2. issue securities and buy back & then sell previously issued then that is distribution

**(5)** random guy bought shares of private company and sell 🡪 sold based on prospectus exemption of being a rich guy; yes, it is a distribution

* It is a distribution b/c if forces you to find an exemption

**(6)** 50% of shares of RBC and sell 1 share – why distribution? b/c control person

A trade in securities that was sold under a previous trade exemption could be an exemption. Section 5 of the book.

**(7)** marketing securities of a public company – considering to do another offering of securities, already done IPO 🡪 a security that constitutes a trade under (f) – an act in furtherance of a sale so trading – marketing securities that have not been issued yet.

A trade that would not be a distribution – Mike selling shares of a public company on TSX

Issuer/control person ---- sells security (primary markets) = distribution --- investors (not distribution unless control person, or bought under exempt distribution; if on prospectus or stock exchange, they would just be trades not distribution 🡪 these are called secondary markets) freely traded securities

## What is a reporting issuer?

The characterization of whether an issuer is a reporting issuer determines whether or not they are subject to continuous disclosure requirements and insider trading restrictions. One way for an issuer to crossover to become a reporting issuer is through … as per sub [d].

Ex. Private company decides to become public, file a prospectus and get receipt and sell shares

* Now, people buying in secondary market – no prospectus requirement for each transactions, but there are ongoing requirements of disclosure for reporting issuers.
* If material change in company – tell market, so people in the secondary market know about it.
* Prospectus works @ a point in time
* Continuous disclosure goes to investor protection, robust secondary markets
* NI 51-102
* Continuous disclosure applies to issuer; but exemption & prospectus attached to individual securities
* Arguing once prospectus out there and then continuous disclosure keeps it current, then issuer should be able to sell new securities at any time – we don’t have it yet, but there are people who think we should move towards this.
* Have to report material change, but not facts – why would RBC have to repot, but not Mike who is selling you the same thing – RBC selling more is diluting the share pool so have to tell people about it; RBC (like a control person) presumably has more info than Mike – obligation on issuer much higher is b/c they have far more access to info
* Prospectus ensures that any pricing changes from the info will happen before any purchases – takes a few weeks for things to be completed

s.1(1) **"issuer"** means a person who

(a) has a security outstanding,

(b) is issuing a security, or

(c) proposes to issue a security;

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,

* Ignore for exam!

(b) has **filed a prospectus or statement of material facts** and the executive director has issued a **receipt** for it under this Act,

* Why? b/c issued securities to public and now under an obligation to update them.

(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,

* Company can make an offering in Ontario and list on TSX – once lists on TSX, reporting issuer in BC
* Any issuer that is trading on an exchange in Canada, reporting issuer – even if not filed a prospectus there

(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
* Private issuer merges w/ a public company, so now securities of a reporting issuer
* Listing company becomes wholly owned by private company by merger or plan of arrangement – b/c one of the parties is a reporting issuer, resulting company becomes a reporting issuer

(e) is designated as a reporting issuer in an order made under section 3.2,

* Deemed to be a reporting issuer by the commission
* If the regulator says so – why would the commissioner do this? Missed what he said! Sometimes issuers want to become reporting b/c then able to have shares that can trade freely,

(e.1) is a person that is within a prescribed class of persons, **or**

* Prof skipped

(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,

* Will come back to this under take-over bids

**unless the commission orders under section 88 that the issuer has ceased to be a reporting issuer.**

## Materiality

Prospectus must include all **material facts!** Reporting issuer must report all **material changes!**

* Material fact is more onerous, it is broader.

**Tests for materiality**

What is disclosable rests on materiality, determined through the **market impact test:** info is material if it is reasonable to expect that the release of that info would impact the market price of the security (found in s.1(1) of the BCSA w/r/t material change and material fact). The test is clear, but the issue is how do you know impact on price? We tend to look @ the US test, which uses the **reasonable investor test** – info is material if there is a substantial likelihood that a reasonable investor would consider (need only consider the info, not act on it) it important to an investment decision.

**Material facts vs. material changes** s.1(1) BCSA:

**"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;

* At the time the fact comes to light, not what actually happens
* Concept of material fact is broader than concept of material change
* **Significance: Basic requirement for disclosure in a prospectus is full, true and plain disclosure of all material facts**
* Prospectus is point in time disclosure – so MF static

**"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

* Immaterial if mgmt never implements change or plan, must still disclose.
* Not external political, economic or social developments
* Tied to continuous disclosure obligation – so MC dynamic
* Ex. if management has been considering a significant transaction (ex. to buy), then the minute that senior management decides to implement that change and they feel that the board’s approval is likely is a material change.
* In **Coventree**, letter by sole crediting agency re policy change to not stop providing ratings for certain types of securities issued constituted material change.
* **Significance: material change is tied to continuous disclosure regime** (once a reporting issuer, if you have a material change, need to issue a press release. Also, if material change after filing a prospectus but before closing the distribution)

The case law and **NP 51-201 *Disclosure Standards***provide some guidance.

* Didn’t talk about NP

**NP 51-201 *Disclosure Standards*** sets out a non-exhaustive list of six broad categories of events that may give rise to **material changes:**

* **changes in corporate structure**, such as take-overs, mergers or changes in share ownership that may affect control of the corporation;
* **changes in capital structure**;
* **changes in financial results**, such as a significant increase or decrease in earnings projections, changes in assets or changes in accounting policy;
* **changes in business and operations**, for example a significant change in corporate objectives, the loss or gain of significant contracts, or significant resource discovery;
* acquisitions and dispositions; and
* **changes in credit and arrangements**.

To constitute a material change, **an external developmen**t must affect an issuers business, operations or capital in a particular way, different from others in its industry (perhaps b/c issuers’ material Ks or assets are particularly affected)**.**

**If a material change occurs during the distribution, the issuer must disclose the change. However, the issuer is not required to disclose material facts that do not amount to a material change during the distribution period (Danier).**

**Case law**

**\*Pezim v. BC**(SCC 1994) – Assay results

* New information about the value of an asset that is significant to investors’ valuation of the asset and of the securities representing ownership of that asset – is a **material change**.
* *Change in assay & drilling results held to be a material change – since from POV of investors new info relating to a mining property bears significantly on the value of the property.*
* *Would bundle results and disclose – before, disclosing some of the people bought it and later released*
* Concept of material fact is broader than change and anything that significantly impacts

**\*Re Siddiqi**(BCSCn 2004) – contemplated transaction (but not entered into) to help raise funds

* If the existence of negotiations could **reasonably be expected to affect securities’ price**, then the fact of the negotiations is **material only if** completed transaction itself would constitute a material change. Consider inherent uncertainties in the negotiation process.
* Negotiations were material as soon as there was sufficient degree of certainty that the transaction would be completed – reached in this case when parties made an informal handshake deal, even though not legally binding.
* 2nd branch of definition of material change – 1) material if actually happens & 2) sufficient degree of certainty that the task would be completed

**\*Kerr v Danier Leather Inc.** (SCC 2007) – misrepresentation context

* Future-oriented financial information (FOFI) – issuer’s forecasts about the future
* *Management did not disclose the contents of the internal analysis indicating that Danier might not achieve the forecast figures b/c of unreasonably warm weather // Issue: whether Danier should have disclosed or not?* 
  + *If internal analysis constituted a material change, then had to file an amendment.*
* The forecast in a prospectus carries an implied representation that the forecast is “objectively reasonable”. However, this implied representation does not extend beyond the date on which the prospectus is filed. Thereafter, the issuer is not required to disclose any **material facts** that arise later and call into question the reasonableness of the forecast. The issuer is required only to disclose **material changes**.
* Financing to raise money, filed a primary prospectus and got a receipt, filed a final one and got another receipt; now can actually close the distribution; got updated forecast that will sell less winter coats this yr – May 16 management says won’t tell anyone and closes distribution and then say hey we might sell less; share price went down!
* Material change?
* If material change, need to file an amendment
* It was just a change in the weather, not in their biz operation – counterargument is that you are going to sell less coats
* SCC: no express obligation to amend after receipt obtained – material fact, if happened on 5th had to put it in, but when you file final, there is no ongoing obligation to disclose material facts – only amend if material change
* This was not a change, this was triggered by unusual hot weather – although change in material fact, not material change

Only an important distinction in Canada

Can also face sanctions from the stock exchange; or security commissioner can get involved public interest overriding concern of security regulators and a basis to make orders

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Prof didn’t cover in class (start)

**Re Coventree Inc.** (OSC 2011)

?

**Re Kapusta** (2011 ASC) – illegal insider trading decision

* *A public oil & gas company found a new pool of oil*
* Subsequent events alone cannot determine that a change was material at the time that it occurred, but they may support or corroborate a finding of materiality made on other grounds.

**Proposals for reform**

* Move from the present bimodal “material facts” and “material changes” approach to materiality to one all-encompassing “material information” standard. (p.203)

End!

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# The prospectus

Bre-X (fraud case) led to NI 41-101

**WHAT?** Prospectus is a disclosure document!

* Prospectus is the cornerstone of the disclosure based regime we have in North America designed for protection of investors.
* 150 - 250 pages is normal for an IPO issuer

**Requirements:** first have to make sure you satisfy 63(1) and then have to satisfy the form requirement!

**Purposes:**

* Can’t sell securities to public unless have a prospectus or an exemption
* Theoretically, using to market security. Can’t use info that is not used in the prospectus.

**Downside:**

* Triggers massive liability for issuer
* This is an incredibly expensive way to raise $
* Barrier for private companies wanting to enter the public market. There has to be a threshold size for an IPO before it is cost effective to access the public market

**Why prospective exemptions are important?**

* An expensive process
* Important for a control person who wants to sell – they can piggy back off of a prospectus

## How to raise capital?

**Three ways to raise capital – primary market transactions**

(1) Initial Public Offering – Issuing Securities to the Public for the First time

|  |  |
| --- | --- |
| **Pros** | The issuer can access the broadest possible market for its securities, increasing its ability to raise capital and investors enjoy enhanced liquidity for the issuer’s securities because of the ability to trade on public markets. The value of the securities can be formally established and other financings facilitated more efficiently. |
| **Cons** | **An IPO is a distribution: S1(1) “distribution” (a)** – this triggers the prospectus requirement and this process, including continuing disclosure responsibilities, as they are now a reporting issuer (**S1(1) “reporting issuer” (a)**), can eat up resources, especially for small issuers. It creates a high opportunity cost to comply with the regulations and there can be increased delays for issuers seeking regulatory approval in multiple jurisdictions. IPOs tend to be very time sensitive, so a failure to offer within the opportune market window can impact the price of securities. IPOs also lead to an increased vulnerability to takeovers. Finally due to disclosure requirements, IPOs can lead to increased public scrutiny of the issuer’s financial results, management and director performance. |

(2) Subsequent Public Offering – Issuance of Securities by an Already Public Issuer

|  |  |
| --- | --- |
| **Pros** | The issuer has another opportunity to raise more capital in the broad public market. |
| **Cons** | Issuance of another set of securities is still another distribution (**S1(1) “distribution” (a)**) and so the prospectus requirement is triggered again, but it is possible that the reporting issuer can file a short form prospectus, since so much information is already publically available. **NI 44-101** sets out the test to determine whether an issuer can file a SFP – SEE PAGE 7 |

(3) Private Placement – A sale of Securities Effected by Means of an Exemption from the Prospectus Requirement as per NI 45-106

|  |  |
| --- | --- |
| **Pros** | Issuing securities without filing a prospectus greatly reduces the cost, both time and money, needed to obtain capital. |
| **Cons** | You have to qualify for the exemption. |

## Contents of a prospectus

**Rational:** A prospectus provides investors with detailed information about the issuer so they can make informed valuation and investment decisions. This requirement goes back to the overarching goal of securities regulation – to protect the capital market from those seeking to take advantage of investors. Prospectuses are designed as an instrument to increase public confidence in public offerings and the capital market in general, and to enhance transparency of market transactions.

|  |  |
| --- | --- |
| **Prospectus required** | The requirement for prospectus is set out in s. 61 of BCSA  (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.   * Once filed both & received receipt, then can make distribution   (2) A preliminary prospectus and a prospectus must be in the required form.  ***A 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.*** |
| **Contents of prospectus**  s.63 | Basic requirement for disclosure in a prospectus is full, true and plain disclosure of all material facts …  (1) A prospectus **must provide full, true and plain disclosure of all material facts** relating to the securities issued or proposed to be distributed.   * **Full:** means all the facts that are material; can’t pick & choose; sufficient to permit investors make an informed investment decision * **True:** accurate, not misleading (either by using words or omitting words), no omission of material facts * **Plain:** wording needs to be understandable to an ordinary investor – not just lawyers & investment banker   + Prof: but ordinarily looked @ by lawyers and analysts   + Schools of thought: 1) the important things can get buried, so prospectus should be focused; 2) pointless to direct at ordinary person. Ps are analyzed by sophisticated people who provide advice to investors, and they are not at a high enough level for these people. * **Material fact** is defined in s.1 using the market impact test – a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.   (2) A **preliminary prospectus** must substantially comply with the requirements of this Act and the regulations respecting the content of a prospectus. |
| **Form & content of prospectus is prescribed in**  NI 41-101 | Regulation of specific contents is set up in **NI 41-101**  s.3.1(1) Subject to subsections (2), (2.1) and (3), an issuer filing a prospectus **must file the prospectus in the form of Form 41-101F1.**  (2) An issuer that is an investment fund, other than a scholarship plan, filing a prospectus must file the prospectus in the form of Form 41-101F2.  (2.1) An issuer that is a scholarship plan filing a prospectus must file the prospectus in the form of Form 41-101F3.  (3) An issuer that is qualified to file a short form prospectus may file a short form prospectus.  Forms:   * General form: Base form is set out in Form 41-101F1   + Look @ the copy provided by prof * Specialized forms:   + Investment funds   + Exchange credit accounts |

Book divides requirements into 3 different categories:

* Non-financial disclosure
* Financial disclosure
* Information about the future

**Content requirements set out in** Form 41-101F1 (pp.210-214)

(1) Cover page disclosure – not a single page b/c amount of disclosure required is simply too much

* Disclaimer
* **Preliminary P** has red herring language, which contains cautionary wording advising readers that it is preliminary info
* New issue – doesn’t mean IPO (which is the initial issue)
* Secondary offering means that control person’s security
* A table that sets out the price per security
* Disclosure of expenses of offerings (doesn’t include UW expenses) – not required in 1967

(2) Table of contents

(3) Summary of prospectus

* Cautionary wording

(4) Corporate structure – basic info about the issuer and its subsidiaries

(5) Description of biz: provides info about industry background, market, history of issuer over the last 3-yrs

* For new biz, taking biz plan and putting it in legal language
* For mining and gas issuer, there are specific requirements
* **For mining**, NI 43-101 mandates independent geological report on issuer’s property (which will be referenced in the prospectus)

(6) Use of proceeds – one of the big disclosure items

* focuses on what the issuer is going to do w/ the cash that it raises through the financing
* **junior issuers** more detailed disclosure required
* we have a disclosure system, but this is one area that merit is looked at – Commission looking at whether funds going to be sufficient to implement biz plan?

(7) Dividends or distributions

(8) Management’s discussion & analysis (MD&A)

* narrative description of the issuer’s financial statement

(9) Earnings coverage ratios – don’t worry about this one

* only applies to debt offerings

(10) Description of the securities distributed

* equity: common, or restricted (what are the material restrictions)
* debt: terms, covenants

(11) Consolidated capitalization

(12) Options to purchase securities – disclose by category, not individually

* How many shares outstanding? How many rights granted? What prices? What terms?

(13) Prior sales

(14) Escrowed securities & securities subject to contractual restriction on transfer

* There are requirements of stock exchanges & national instrument
* to ensure cheaply issued securities before an IPO don’t come back onto the market too quickly to the detriment of investors
* disclose escrow terms

(15) Principal securityholders and selling securityholders

* Principal = those that hold 10% or more
* Selling: usually control person – someone selling as part of the prospectus distribution on a secondary offering

(16) Directors & executive officers – info about these parties

* 5-yr personal info
* disclosure of any security offences going back 10-yrs – goes to the character of the parties
* conflicts of interest
* more info required for **junior issuers**

(17) Executive compensation

(18) Indebtedness of directors and executive officers

(19) audit committees & corporate governance

* to ensure proper oversight of senior management
* the most important for oversight is the audit committee

(20) Plan of distribution – talk about underwriters

* are the obligations of UW joint or several?
* When can UW terminate?
* Min distribution

**(21) Risk factors** – this is an important one

* they should be prioritized most serious to least
* probs categorized – risk factors relating to the industry, issuers …
* there can be liability for an issuer if they did not disclose a risk factor that they ought to have disclosed

**(22) Promoters** – disclose if promoter w/in 2-yrs prior to the prospectus & they have to certify the prospectus

* not every company has one even in IPO stage
* defined in s.1 **"promoter"** **means, if used in relation to an issuer, a person who**

(a) acting alone or in concert with one or more other persons, directly or indirectly, takes the initiative in **founding, organizing or substantially reorganizing** the business of the issuer, OR

(b) in connection with the founding, organization or substantial reorganization of the business of the issuer, directly or indirectly receives, in consideration of services or property or both, 10% or more of a class of the issuer's own securities or 10% or more of the proceeds from the sale of a class of the issuer's own securities of a particular issue,

**but does not include a person who**

(c) receives securities or proceeds referred to in paragraph (b) solely

(i) as underwriting commissions, or

(ii) in consideration for property, and

(d) does not otherwise take part in founding, organizing or substantially reorganizing the business;

* ex. vendor who sells property to the issuer who then goes public

(23) Legal proceedings & regulatory actions

(24) Interests of Management & others in material transactions

* management has Ks w/ company

(25) Relationship b/w issuer or selling securityholder and underwriter

* any relationship that might cause an investor to think that the UW is influenced
* by certifying a prospectus an UW attaches credibility – part of the credibility of an UW being attached is that they are independent
* ex. UW is BMO capital and issuer uses Bank of Montreal as a bank – this won’t really be a problem. BUT if company owes BMO 30M & bank wants $ back, but company has no $ – bank suggest equity offering to raise capital and refers them to BMO investment to act as UW. This would require disclosure.
* some relationships are so significant that the Commission says the UW no longer independent and we require that there be included in the UW syndicate (b/c there is often more than 1 UW) that there be an independent UW who has agreed to buy a big enough piece of the offering so that the credibility is independent.
  + This might impact UW syndicate

(26) Auditors, transfer agents and registrars

(27) Material contracts: sensitive info can be redacted if prejudicial to issuer

* If require to disclose, must be filed on SEDAR

**(28)** **Experts:** every prospectus has at least 2 experts: auditors certifying financial statements & lawyers (approval for legal matters; opinions on regular matters)

* names; any material interest in the issuer; do they sit on the board?

(29) Other material facts – this is a catchall

(30) Rights of withdrawal and rescission – there are statutory rights

(31) List of exemptions from instrument – often don’t have anything to disclose here

**(32) Financial statement disclosure** – they are a key part of the prospectus

* there might be several sets if M&A
* audited FS for 3-yrs if biz has been around for 3yrs – challenging if biz acquired w/in these yrs and it was private and no audit
* if P filed more than 60 days after fiscal quarter end, have to include unaudited interim statements
  + ex. company has fiscal end of Dec 31 and filing in June, have to include first quarter March 31 interim statement, which would not have to be audited but have to be reviewed by outside counsel

(33) Credit supporter disclosure, including financial statements

(34) Exemptions for …

(35) Significant acquisitions

* statement of biz that you have recently acquired

(36) Reverse … – don’t see often

(36A) Marketing materials – relatively new requirement & where marketing materials are used they need to be incorporated into the prospectus by reference or actually included

### (37) Certificates (**NI 41-101**)

Two forms, which are both short (fairly important requirement)

* **issuer certificate:** required to be signed by CEO & CFO of the issuer, and any 2 directors other than CEO/CFO
  + Form 41-101F1, s.37.2: **an issuer certificate form must state:** “This prospectus constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by the securities legislation of [inset the jurisdiction in which qualified]”
  + this is an unqualified statement that gives rise to liability for the issuer, each of the directors & officers that have signed
* **UW certificate:** signed by every UW listed
  + Form 41-101F1, s.37.3: **Same as issuer certificate, except prefaced w/** “to the best of our knowledge, info and belief” – b/c it is qualified it gives UWs an escape from liability that is not available to the issuer (DD defence). Meaning that if UW not aware of a false statement, he might not be liable.
    - Have to read in conjunction w/ civil liability sections of the act which demonstrate that UW can only avoid liability for a material statement or misrepresentation;

(38) Transition

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Prof didn’t cover in class (start)

**Financial disclosure:** Each prospectus must contain certain **recent, audited financial statements**. Must follow International Financial Reporting Standards (IFRS). Key items:

* Financial statement disclosure for issuers: annual financial statements for past 3 years
* Credit supported disclosure
* Significant acquisitions
* Probable reverse takeovers

**Information about the future**

Regulatory requirements governing info about the future are contained in NI 51-102 *Continuous Disclosure Obligations* – these provisions are also incorporated into the prospectus contest Form 41-101F1.

* Financial outlook
* Future-oriented financial information (FOFI)
* Forward-looking info

Since these are based on assumptions – both substantive reasonableness and disclosure from the issuer is required

* Safe harbor provisions
* There is no implied representation that the info will be objectively reasonable at some date after the prospectus is filed. If events change materially, an issuer will have to file an **amended prospectus** (if it is during the distribution period) or a **material change report** (after the distribution period has ended).
* To assess adequacy of disclosure of future info – the question is only whether such info is objectively reasonable as of the date the prospectus is filed.

**Accompanying documents**

* Auditor’s report required for financial statements
* Creditor supporter certificate, if there is one
* Any expert (lawyer, engineers, auditors, appraisers) who prepares or certifies any party of the prospectus or documents related to the prospectus filing must file a “consent” to that info being used.
* Issuer must submit appropriate fees

**Regulatory discretion**

Receipts for prospectus

65(1) Subject to section 64 (1), the executive director must issue a receipt for a preliminary prospectus as soon as practicable after it has been filed under this Part.

(2) Subject to the regulations, the executive director must issue a receipt for a prospectus filed under this Part unless the executive director considers it to be prejudicial to the public interest to do so.

* **Equal Treatment of Asbestos Minority SHs:** SCC affirmed that this is a broad grant of jurisdiction – but not unlimited.
* **Re Cycomm:** Director concluded that an officer’s past misconduct meant that Cycomm would not operate w/ integrity (standard of proof: BOP)
* **Inland National Capital:** w/in the Director’s discretion to withhold issuance of receipt b/c a fundamental prerequisite is that the issuer has, at least, a reasonable and specific business plan.

(3) The executive director must not refuse to issue a receipt for a prospectus without giving the person who filed the prospectus an opportunity to be heard.

End!

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## The prospectus process

**A prospectus is required for: IPOs; subsequent public offerings; some secondary offerings (ex. resale by control person) // Going public generally requires the preparation of a disclosure document called a prospectus containing all material information concerning the business and securities to be offered.**

Almost all filing is done electronically through SEDAR.

**Step #1:** **Secure services of an UW**

* Engage an UW to help w/ the marketing process
* Find syndicate of investors
* Negotiate underwriting agreement – negotiated by UW counsel
* Look @ UW arrangements heading

**Step #2:** **File a preliminary prospectus & obtaining a receipt** (p.226)

* Has to satisfy s.63 & form requirements in NI 41-101
* Contains all the 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.
* Preliminary prospectus contains red herring language. Cover page must contain a note that the prospectus is not final, info in it may be amended, no securities may be sold before the final prospectus is receipted.
* Allows you to engage in preliminary marketing activities, and **after obtaining preliminary receipt to solicit expressions of interest.** The UWs fill a book, which is based on expressions of interest not binding commitments.
  + In reality, expressions of interest are like biz handshake. If back out of commitment, you will be blacklisted.
* Preliminary Preceipt usually issued automatically. Very cursory review to ensure certificates attached properly (issuers certificate and UW certificate); checks that the form of the prospectus is followed. There might be deficiencies in disclosure, but the staff won’t check at this point.
* **For an IPO** – there is no pricing info or how many shares
  + Won’t know how many units are being sold
  + i.e. if you’re doing best efforts, this gives a marketing tool for your syndicate to go to their networks to see how big an offering it can be and what price it can be. Can start taking offers from each syndicate.
  + Orders not legally binding orders – b/c need the final prospectus before they can be binding – b/c this is a distribution and can’t do w/out a prospectus (and need a final one for it)

**Step #3:** **Waiting period** / **review & comment**

**Waiting period:** the period of time between when the issuer receives a receipt from the Commission for its preliminary prospectus, and when it receives the receipt for its final prospectus (defined in NI 41-101). Majority of marketing activity happens at this stage.

* **not allowed to sell or accept an offer to buy** – doing so is called “gun-jumping”

**Activities permitted during the waiting period:**

* **Road show:** during the waiting period, **usually in the context of an IPO offering**, management & investment banks go on the road and meet w/ various institutional management (NI 41-101 part 13). There’s requirements on what docs can be presented – can’t present the prospectus, but can do a summary; there can be certain marketing materials, but have to be filed w/ the regulator.
  + Comparables is the only thing that can be in marketing but doesn’t have to be in prospectus
* **Green sheets:** summaries prepared by investment dealers, not intended for members of the public
* **Risk** is that you make a statement during the interim period that you can’t put in prospectus (b/c you can’t back it up), then you have to pull the offering.
* Lawyers usually send a **scare memo** – goes to the pple in the company who know about the offering that they can’t tell anyone about the offering. Restrict statements that are made to the public so they don’t hit the marketing restriction.

**Comment letters** might come from the regulator

* After the issuer resolves all comments, they will be cleared for final filing.
* Now, in a position to file final prospectus and **sign UW agreement** (which binds the UW to purchase the number of securities).
* s.78 talks about UWs being able to solicit expressions of interest during the waiting period.

**Step #4:** **File the final prospectus and obtaining a receipt** (p.232)

First, sign the UW agreement, then file the prospectus right after. Issuers must submit a “blacklined” copy of the prospectus when submitting the final prospectus. A black-lined copy shows all of the changes made from the preliminary prospectus.

Issuer can get a final receipt once all deficiencies are resolved. Commission does not have to issue if they are not of the view that it is in the public’s interest. Situations where a receipt won’t be issued:

* Adequacy of financial resources; insolvency concerns
  + Follow-up offering – want to raise equity b/c insolvent // commission won’t issue a receipt b/c working capital deficient
* Use provision is not specific enough – if the biz plan has lots of alternatives, but nothing specific – then blind pool & commission won’t issue receipt for blind pool type company
  + Exception: filing for capital pool company
* If the capital structure is flawed/unfair – has to do w/ the issuance of too many shares too cheaply to the management or promoter of the company
* If there is not going to be a public market for the securities
* If the offering looks too promotion. i.e. looks too good to be true.
* Concern about misrepresentation
* Commissioner concerned that issuer’s pre-public SH’s have entered the escrow requirements in NI 46-201
* If it’s a questionable biz (i.e. payday loans)

**Step #5:** **close the offering & distribute securities**

Once issuer obtains receipt for its final prospectus, it can begin distributing securities under it. Have to deliver copy of final prospectus to everyone who has expressed interest to purchase.

* There is a lag b/w receipt & when you start selling (saw in **Danier** case)
* Money changes hands – UW collects proceeds
* Funds flow to the issuer --- securities issued to UW --- UW distributes to investors
* Can close in about a week – can’t be less than 2 days

### Pre-Marketing & marketing restrictions

Generally, not allowed. Occurs when a party communicates with potential investors before a public offering and includes other promotional activity that occurs **before a preliminary prospectus is filed**. **DO NOT engage in any marketing activities before the preliminary prospectus is filed. Otherwise trading in securities that constitutes distribution before filing a preliminary prospectus, which is in violation of securities law.**

**But there are** **exemptions that allow for pre-marketing:**

**#1 Short Form Prospectus and Bought Deal Exemption (**NI 41-101, Part 7**): IF** doing a short form prospectus (already reporting issuer) and UW doing it on a bought deal that is strict (cannot get out) **//** Allows investment dealer to engage in road shows and provide standard term sheets and marketing materials **after a bought deal has been announced but before the reporting issuer has obtained a recipe** **for the short form preliminary prospectus.** // Allows you to solicit expressions of interest 4-days before filling a preliminary prospectus

**Solicitations of expressions of interest:** 7.2 Subject to subsection 7.4 (2), **the prospectus requirement does not apply to a solicitation of an expression of interest made before the issuance of a receipt for a preliminary** **short form prospectus** for securities to be qualified for distribution under a short form prospectus pursuant to this Instrument or for securities to be issued or transferred pursuant to an over-allotment option that are qualified for distribution under a short form prospectus pursuant to this Instrument, **if**

* *General rule is that you can’t engage in trading w/out a prospectus*

(a) before the solicitation (*agree before engaging in any marketing actitivities*),

(i) the issuer has **entered into a bought deal agreement**;

* + - Defined in s.7.1(1) – “bought deal agreement” means a written agreement (a) under which one or more underwriters has agreed to purchase all securities of an issuer that are to be offered in a distribution under a short form prospectus on a firm commitment basis, other than securities issuable on the exercise of an over-allotment option, (b) that does not have a market-out clause, (c) that, other than an over-allotment option, does not provide an option for any party to increase the number of securities to be purchased, and (d) that, other than what is agreed to under a confirmation clause that complies with section 7.4, is not conditional on one or more additional underwriters agreeing to purchase any of the securities offered;

(ii) the bought deal agreement has **fixed the terms of the distribution**, including, for greater certainty, the number and type of securities and the price per security, and requires that the issuer file a preliminary short form prospectus for the securities not more than four business days after the date that the bought deal agreement was entered into; and

(iii) immediately upon entering into the bought deal agreement, the issuer issued and **filed a news release** announcing the agreement,

(b) the issuer **files a preliminary short form prospectus** for the securities pursuant to this Instrument **within four business days** after the date that the bought deal agreement was entered into,

(c) upon issuance of a receipt for the preliminary short form prospectus, a copy of the preliminary short form prospectus is sent to each person or company that, in response to the solicitation, expressed an interest in acquiring the securities, and

(d) except for a bought deal agreement under paragraph (a) or a more extended form of underwriting agreement referred to in subsection 7.3 (6), no agreement of purchase and sale for the securities is entered into until the short form prospectus has been filed and a receipt has been issued.

* + *They are prohibited from making phone calls – can’t b/c engaged in act in furtherance of trade and not registered as an issuer*

**#2 Testing the Waters IPO Exemption** **(**NI 41-101, s.13.4**):** Permits pre-marketing of IPO deals before filing preliminary prospectus.

* **Req’s: 1)** Non-public issuer (i.e. not a RI), **2)** Investment dealer (UW) must make the solicitation on the issuer’s behalf.
* **7 Conditions: i)** a reasonable expectation of filing a preliminary long form prospectus in one or more Canadian jurisdictions**, ii)** Has to be an investment deal (only UW can take advantage), **iii)** None of the controlling SH’s can be already public companies, **iv)** Only talk to accredited investors**, v)** note on materials that not prospectus, **vi)** Anyone talked to has to sign a confidentiality document, **vii)** Have to stop testing at **least 15 days before filing preliminary prospectus**.

### Delivery requirement

Where securities are being sold under a prospectus, when must a prospectus be delivered to a purchaser in connection w/ the distribution?

Obligation to send prospectus: BCSA s.83(1) **A dealer,** not acting as agent of the purchaser, who receives an order or subscription for a security offered in a distribution to which section 61 applies **must**, subject to the regulations, **send to the purchaser,**

(a) before entering into the written confirmation of the agreement of purchase and sale resulting from the order or subscription, or

(b) not later than midnight on the **second business day** after entering into the agreement, (w/in 2 biz days)

the latest prospectus filed or required to be filed, with respect to the security, and any amendment to that prospectus, filed or required to be filed, under this Act.

* They can’t buy until they get one of these b/c there might be important changes
* UW is the one that delivers the prospectus and if investor doesn’t want it has to notify the UW

**Withdrawal right:** BCSAs.83(3) an agreement of purchase & sale is not binging if w/in 2 days of receiving prospectus, the purchaser sends written notice of intention not to be bound by the agreement.

* The purchaser then has 2 “cooling off” days to decide to withdraw from the purchase.
* **If don’t receive a prospectus, how long do you have to withdrawal?** Unlimited withdrawal rights b/c the time frame doesn’t start until someone delivers you a prospectus
* What if you thought you had an exemption, but you really didn’t?

**Expiry:** A prospectus will lapse 12 months after the receipt for the final prospectus. Unless the issuer obtains an exemption or files a new prospectus, it cannot continue distributing securities under the prospectus after that point (NI 41-101, s.17.2)

### Civil liability for misrepresentation in prospectus

**What if the investor discovers a misrepresentation or omission the prospectus?**

BCSA s.1(1) **"misrepresentation"** means

(a) an **untrue statement of a material fact**, or

(b) an **omission to state a material fact** that is

(i) required to be stated, or

(ii) necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made;

|  |  |
| --- | --- |
| 131(1) | If a prospectus contains a misrepresentation, a person who purchases a security offered by the prospectus during the period of distribution  (a) is **deemed to have relied** on the misrepresentation if it was a misrepresentation at the time of purchase, and  (b) has a **right of action for 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. |
| 131(2) | A person referred to in subsection (1) (b) (iv) is liable only with respect to a misrepresentation contained in a report, opinion or statement made by the person. |
| 131(3) | If the person referred to in subsection (1) purchased the security from a person or underwriter referred to in subsection (1) (b) (i) or (ii) or from another underwriter of the securities, the purchaser may elect to exercise a **right of rescission** against that person or underwriter, in which case the purchaser has no right of action for damages against that person under subsection (1).   * Rescission: unwinds the K & they get their money back |
| 131(7) | A person is **not liable** under subsection (1) with respect to any part of the prospectus not purporting  (a) to be made on the authority of an expert, and  (b) to be a copy of, or an extract from, a report, opinion or statement of an expert  **unless the person**  (c) failed to conduct a **reasonable investigation** to provide reasonable grounds for a belief that there had been no misrepresentation, or  (d) believed that there had been a misrepresentation.  *DD Defence for UW!* |
| 131(8) | Subsections (5) to (7) do not apply to **the issuer or a selling security holder**.  *Defence in (7) doesn’t apply to the issuer.* |
| Note | rights of withdrawal are tied to delivery – it has nothing to so w/ misrepresentation |

**Standard of reasonableness is set out in** s.133 of BCSA. It is the standard that is required of a prudent person in the circumstances. There is no bright line test. What is needed? **Not simply accepting info given by management at face value, making independent inquiries to verify info**, engage experts (legal counsel – legal due diligence)

* In determining what is a reasonable investigation or what are reasonable grounds for belief for the purposes of sections 131 and 132, the **standard of reasonableness must be that required of a prudent person in the circumstances of the particular case.**

## Underwriting arrangements

Issuers may try to distribute securities themselves, through

* a **“direct issue”** (p.174), or
  + most successful where a small group of purchasers, already very familiar w/ the issuer, can absorb the entire issue.
  + Examples: rights offering (issuer offers existing securityholders the opportunity to purchase additional shares); an exempt offering w/ one or more institutional purchasers.
  + Crowdfunding
* they may enlist the services of an **underwriter**.

There are 3 main actors:

1. Issuer
2. Investor (pple buying securities)
3. UW = facilitates the distribution from the issuer to the investor base

**Role of the underwriter**

* Lend credibility to distribution process
* They have a significant distribution network
  + Have large connections with the 'buy side' - connections with institutional investors that would be participating in Canada
* Have the ability to access the available investor pool in Canada
* They also have access to investors in the US as well

Usually have a **syndicate of UWs** (all listed on the certificate)

* Lead UW (buying the largest portion)
* And then there will be a syndicate of other investment banks
* Reasons: spread out the liability of one offering
* Gives you multiple points of contact

**4 ways in which underwriters assist:**

* Advise issuers on their financial situation
* Assist issuers in the distribution of their securities offerings
  + Significant distributional network – strong ties w/ institutional investors & ability to distribute to retail
* Perform risk-bearing function
* Participation provides a seal of approval

**4 basic underwriting arrangements** (p.175) (amount of risk assumed by the underwriter)

* **Bought deal offering** (aka firm-commitment offering): UW commits to buy the entire issue at a set price before preparing the prospectus or canvassing interest among potential investors. UW takes loss if cannot sell sec, while Issuer gets its profit.
* **Marketed deal offering:** UW does not commit to purchase the issuers’ securities until it has an opportunity to market the deal to potential investors and assess market demand for the issue before the final prospectus and underwriting arrangement are completed.
* In both Bought Deal + Marketed Deal 🡪 UW hopes to sell at higher price to make profit: “The Spread” AND UW bears the risk of the issues not selling; the issuer benefits from these arrangements b/c it gets all the money in advance & bears no market risk
* **Standby underwriting:** UW commits only to purchase securities that are not sold to investors at a certain price.
* **Best efforts agency:** UW acts as the issuer’s agent and uses its best efforts to sell securities directly to investors on the issuer’s behalf – makes no commitment to purchase any of the issuer’s securities. Market risks and ownership of the securities remains entirely w/ the issuer.Dealer’s profit is a commission – either a fixed % or a range
  + More common for IPOs
* There are many variations on the basic agency arrangements

**Risk strategies of UWs** (p.177)

UWs and agents may take a variety of precautions, such as negotiating various “out” clauses, to reduce the risk that they will not be able to resell the securities. These clauses relieve the UW or agent of the obligation to take up the issue if, ex: state of financial market is such that securities cannot be marketed profitably – market out clause. Other risk minimization strategies: purchase group; banking group or underwriting syndicate; selling group

* Out clauses are contained in an UW agreement, but better to include in engagement letters as well.
* UWs begin their work based on an “engagement letter” (aka “bid letter”)
* **Stetson Oil**
  + An engagement letter for a private placement was a binding agreement
  + Market out clause vs. material adverse change (MAC) out clause
  + Market out clause can never be part of a bought deal b/c it is inconsistent w/ the underwriter taking the risk of being able to sell the securities profitably.
  + Disaster out clause only invoked in the event of a catastrophic macro event, circumstance or change in law of national of international general application which is not specific to a particular issuer or industry.

Compensated by spreads; today, UW compete for the privilege (and risk) of handling each offering.

**Secondary trading markets** (p.182)

After the initial distribution in the primary market, securities are bought and sold w/out any involvement by the issuer (unless repurchasing its own securities). Secondary market is divided into 5 additional markets:

* First market: compromised of stock exchanges
* Second market: trading in securities not listed on a recognized exchange – referred to as the “unlisted market” or the “over-the-counter” market
* Third market: face to face (or computer to computer) trading of listed securities between institutional investors w/ the assistance of dealers (aka upstairs-market) – investors bypass the stock exchanges
* Fourth market: face to face trades w/out the facilitation of dealers – trades directly between buyers and sellers
* Money market: trades by major or primary money market dealers (recognized as such by BOC) in short-term debt securities (called commercial papers)

## Amendment procedure

almost always exam question on it!

|  |  |  |
| --- | --- | --- |
| Amendment procedure is set out in NI 41-101 part 6 | | |
| **Amendment to a preliminary prospectus**  6.5 | (1) Except in Ontario, if, after a receipt for a preliminary prospectus is issued but before a receipt for the final prospectus is issued, **a material adverse change** occurs, an amendment to the preliminary prospectus must be filed as soon as practicable, but in any event within 10 days after the day the change occurs.  (2) The regulator must issue a receipt for an amendment to a preliminary prospectus as soon as practicable after the amendment is filed. | Class notes   * If material fact changes, don’t have to do anything * Material change, if it looks good – don’t need to file an amendment * But if a material change that is bad – then need to file an amendment |
| **Amendment to a final prospectus**  6.6 | (1) Except in Ontario, if, after a receipt for a final prospectus is issued but before the completion of the distribution under the final prospectus, **a material change** occurs, an issuer must file an amendment to the final prospectus as soon as practicable, but in any event within 10 days after the day the change occurs. | why is it a different standard from preliminary amendments? Change by definition is something that could have a significant effect on price… |

**What if material fact changes – does this ever have to be disclosed?** No – **Danier** case: the change (the forecast) was not a material change although it was a change in material facts.

* After filing the final P, if change in material fact, then don’t need to file an amendment – but if material change, then you would need to file an amendment and need to deliver to all investors before you close distributions and they will have 2 days before the withdrawal period expires
* But if happened before final prospectus, then they would have had to disclose b/c you need full disclosure of material facts – needed to be accurately disclosed or there would have been a misrep
  + if change in material fact between final & preliminary make sure reflected in final prospectus, have to disclose
    - don’t need to file an amendment
* why only for bad? If good, you are going to have it in final anyway, they would get a chance to review anyway
  + if adverse need to tell right away

Note: Amendments create uncertainty. Thus, lots of pressure to find not a material change.

## The passport system

Two instruments: All Canadian regulators except OSC have implemented MI 11-102 *Passport System*, and all Canadian regulators including OSC have agreed to cooperate under NP 11-202 *Process for Prospectus Reviews in Multiple Jurisdictions.*

* Multilateral instrument 11-102 deals with the system as a whole; various types of filings in jurisdictions
* Under the passport system, there is a principal regulator

**(A) If want to issue in BC and all other provinces except Ontario**

**Under the passport system,** an issuer wishing to distribute securities across multiple jurisdictions will generally have to deal w/ only one regulator – the principal regulator. The issuer files a prospectus called a **“passport prospectus”**. When the principal regulator receipts the passport prospectus, receipts are simply deemed in the other, non-principal jurisdiction except Ontario. Our capital markets are therefore more efficient than they would be if such issuers were required to deal separately w/ multiple provincial regulators.

* Preliminary receipt, get comments, final receipt
* Why not Ontario? Ontario has been an advocate for national securities regulation, and accepting the passport system is against its interest.

**(B) If want to do National, including Ontario**

When the issuer wishes to distribute in Ontario but OSC is not the principal regulator, the issuer files a prospectus called a **“dual prospectus”** w/ both the principal regulator and the OSC. Generally, the issuer deals w/ only the principal regulator and OSC advises the principal regulator (not the issuer) of any concerns.

* Have to go undergo two reviews: BC principal regulator; Ontario will conduct their own review and provide comments independent of BC.
* Receipt will have to be issued by BC on behalf of all passport jurisdictions and Ontario.

**(C) What if principle regulator is Ontario?**

* File nationally and receive receipts
* Receives comments only from Ontario
* Once final receipt obtained, eligible for every jurisdiction in Canada even though they’re not part of the passport system.

**Principal regulator** (p.238)

Generally, the principal regulator will be the jurisdiction where the issuer’s head office is located. If issuer’s head office is not located in a specified jurisdiction, the principal regulator will be the specified jurisdiction w/ which the issuer has the most significant connection. Factors considered (in descending order of importance) in determining connection:

* Location of issuer’s management
  + Ex. BC managed private issuer, you’d have a principal regulator in BC
* Location of issuer’s assets and operations
* Location of the Canadian trading market or quotation system on which the issuer’s securities are traded or quoted, and
* Location of issuer’s securityholders if the issuer’s securities are not traded or quoted on a Canadian trading market or quotation system.

**Filing materials**

* Filer should indicate in its SEDAR electronic filing its principal regulator and that it is filing under NP 11-202 and MI 11-102
* If principal regulator determined w/ the most significant connection test, then should indicate the connecting factor or factors used
* File on SEDAR a draft blacklined final prospectus as early as possible
* A seasoned prospectus (a prospectus used to issue securities w/in the previous two years) may be used

**Review of materials**

* Principal regulator will use its best efforts to issue a first comment letter w/in 10 working days of the date it receives the preliminary prospectus or pro forma materials.
  + Comment letter outlines problems in the preliminary materials, which the issuer must correct for a final receipt.
* In the case of dual prospectus, OSC uses its best efforts w/in 5 working days to either advise of material concerns or indicate OSC is clear to receive final materials.
* Time period for review may be extended if amendments mean the principal regulator is unable to complete a review in the time indicates.

**Opting out of dual review process** (p.239)

* OSC can opt out of a dual review at any time before the principal regulator issues a final receipt.
* Must provide the PR written reasons for its decision. PR will then forward reasons to the filer.

**Preliminary and final receipts** (p.240)

* Principle regulator responsible for issuing these
* PR will issue preliminary receipt when 2 conditions are satisfied:
  + (1) PR must determine that the filer has filed acceptable materials
  + (2) Filer must confirm, to the best of its knowledge and belief, that: the materials have been filed with, and fees have been paid to, the PR and all non-principal regulators; …
* PR will issue a final receipt if 4 conditions are met: …

|  |  |
| --- | --- |
| **preliminary receipt** | s.65: 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 a very cursory review – checks that issuer and UWs certificates attached, and form of the prospectus followed * There might be deficiencies in disclosure, but the staff won’t check this at this point |
| **final receipt** | You’ll only get the receipt if all the deficiencies have been resolved.  s.65(2): unlike receipt for preliminary P, the Commission doesn’t need to issue a receipt for final P if the executive director considers it to be prejudicial to the public interest to do so.  **Examples** **of public interest** for refusal of receipt (some of these may be **deficiencies** too - if they can be resolved - prof hasn't explicitly said what's what)  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 |

## Alternative forms of prospectuses

1st time an issuer distributes non-exempt securities (i.e. during IPO), it must prepare, file and distribute a **“long form”** prospectus.

**Are there alternatives to the long form prospectus? Yes.**

These alternative forms typically require less time & expense to prepare, which improves the efficiency of capital markets. It would be inefficient to require issuers to issue a long prospectus each time. To ensure investors are adequately protected, alternative forms are only available to issuers that make adequate disclosure in other ways (ex. through continuous disclosure).

* P. 235 brief history
* Investment dealer underwriting an offering under an alternative form of prospectus can conduct road shows and distribute standard term sheets and marketing materials in much the same way as it would for an offering made pursuant to a long-form prospectus.
* Have to fully disclose material fact (b/c need full true…) and change

### (1) Short Form Prospectus (p.235)

Commonly/most frequently used by companies that are already a reporting issuer (subject to continuous disclosure and required to update for material changes). If can’t use short form, then will do a private issue.

* It is not only used for a bought deal; it is most commonly used for bought deals

Differences **b/w long & short P**

* Main diff: short allows you to incorporate material that you have previously set out in your disclosure by reference
* Much shorter process; can be done in like 3 wks
* Usually used in a bought-deal offering (commitment by UW to buy all the securities at a set price from the issuer w/out engaging in additional marketing materials. This is the firmest type of commitment).
  + There is nothing that says that short forms have to be linked to bought deals. But, issuers will go for the bought deal option if they have the opportunity b/c they offload the bulk of the risk on the UW.
* Short form prospectus can have pricing info in some circumstances, but preliminary P can never have pricing info – exemption for solicitations of expression of interest in NI 44-101 s.7.2
  + Under the short form prospectus rules, there is the option of 4-day marketing period to solicit expressions of interest before you file preliminary prospectus, so based on that can get info on pricing.
  + No such exemption under 41-101 for preliminary prospectus rules, so soliciting expressions of interest under long form preliminary prospectus would be trading & distribution.

**Basic Qualification Criteria** – **To qualify, issuer MUST be short form eligible**

s.2.2 an issuer is qualified to file a prospectus in the form of a short form prospectus for a distribution of any of its securities in the local jurisdiction, **if the following criteria are satisfied:**

(a) the issuer is an **electronic filer** under NI 13-101; (*on SEDAR*)

(b) the issuer is a **reporting issuer** in at least one jurisdiction of Canada;

(c) the issuer has **filed with the securities regulatory authority** **in each jurisdiction in which it is a reporting issuer** **all periodic and timely disclosure** **documents that it is required to have filed** in that jurisdiction (i) under applicable securities legislation, (ii) pursuant to an order issued by the securities regulatory authority, or (iii) pursuant to an undertaking to the securities regulatory authority;

(d) the issuer has, in at least one jurisdiction in which it is a reporting issuer, (i) **current annual financial statements,** and (ii) a **current AIF** (*Annual Information Form*);

* + must have current annual financial statements and current Annual Info Form (AIF) in 51-102F2 on file as part of its CD in at least one jurisdiction. This is KEY!
  + It mirrors some of the info that will be on a prospectus

(e) the issuer’s **equity securities are listed and posted for trading** on a short form eligible exchange **and the issuer is not an issuer** (i) whose operations have ceased, or (ii) whose principal asset is cash, cash equivalents, or its exchange listing.

**Notice of Intention and Transition**

s.2.8(1) an issuer is **not qualified to file** a short form prospectus under this Part **unless** it has **filed a notice declaring its intention to be qualified to file a short form prospectus at least 10** **business days prior to** the issuer filing its first preliminary short form prospectus after the notice (a) with its notice regulator, and (b) in substantially the form of Appendix A.

This gave rise to the bought deal which a type of underwriting.

* So is bought deal not available under others?
* Challenges posed for counsel b/c of the abbreviated time frame – there is a condensed period during which have to complete DD
* In preparation for bought deal it is crucial to have reviewed the public disclosure record to make sure up to date.

### (2) Shelf Prospectus (p.236)

* NI 44-102 Shelf Prospectus sets out qualification & use
* Qualifies as broad a category of securities up to an amount that issuer reasonably anticipates selling in 25 months, and at whatever price.
* Reporting issuers that are eligible for the SFP are also eligible for the SP. This allows an issuer to file a SFP-style prospectus and leave it “on the shelf” for up to 25 months. At any point during that time, the issuer can take the securities “off the shelf” and distribute them.
* Within 2 days of pricing an offering, need to file a **shelf-supplement** which contains all the details about the offering and plan of distribution that were not in the base.
* Have to deliver base prospectus along w/ the supplement to the purchasers.
* We are seeing more of it.
* Advantage: once its cleared, can give you the ability to do a deal very quickly and to follow w/ a supplement.

### (3) MJDS (multi jurisdiction disclosure system) Prospectus (p.241)

MJDS permits US issuers to raise $ in Canada by allowing them to use US documents in place of Canadian documents, provided that they are in compliance w/ US securities legislation, with only a few additional disclosure requirements. NI 71-101 outlines the Canadian component that is required so US issuers can raise $ in Canada. US issuer needs to satisfy eligibility criteria similar to Canadian short form plus additional “public float” criteria (share of shares not held by control person needs to be less than $75M US).

Requirements

* Must be filed in Canada and with the SEC (US)
* the BC commission will only do a light review (form review)
* Relies on SEC to do the detailed stuff - there's a reciprocal American regulation that makes the Canadian Commission to do the work

Benefits (p.241)

* Increased depth and liquidity in our capital markets provided by US issuers which would not otherwise distribute securities in Canada.
* Cost-effective access to US capital markets provided by SEC’s reciprocal provisions.

### (4) Post-Receipt Pricing (PREP) Prospectus

There are no eligibility requirements. All issuers qualify to file a post-receipt pricing prospectus, but there are restrictions on what such a prospectus may be used to distribute. NI 44-103 sets out the requirements. This is a prospectus that can be long form or short form w/out pricing info. Issuer has 90 days after the receipt for the final PRP prospectus to do an offering.

# Registration requirements

on exam, need to know if registration requirement has been triggered or not but don’t need to know the technicalities!

**A trade of a security triggers the registration requirement if it rises to the level of “being in the business”. So, the issue here is to determine whether the trade rises to the level of “being in the business”?**

Intermediaries include:

* (1) “Dealers” who engage in biz of trading in securities & acting as UWs
* (2) “Advisors” who engage in the biz of advising in securities
* (3) “Investment fund managers” who direct the biz, operations or affairs of investments funds
* note: some categories are required to belong to a self-regulatory organization (SRO).

**why do we have a registration requirement?** It is intended to protect investors from unfair, improper or fraudulent practices and enhance capital market integrity and efficiency. Enhances investor confidence b/c there’s assurance that the person they’re dealing w/ is qualified and ethical. The info required under NIs allows regulators to assess an applicant’s fitness for registration w/ regard to, among other things, its solvency, integrity and proficiency – both at the time of registration & on an ongoing basis thereafter. Downside is that it is a time consuming and expensive set of requirements for registration/on-going reporting requirements.

**[Trade in securities] triggers registration requirement per** s.34.

A person or company shall not act as a dealer (which includes an UW), advisor or investment fund manager, or underwriter unless registered under the applicable securities legislation.

|  |  |
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| **Persons who must be registered:** s.34 BCSA **A person must not** | |
| (a) **trade in a security or exchange contract,** | The requirement to register as a dealer is triggered if the person/company holds itself out as engaging in the biz of trading (s.1(1) “dealer” w/ an additional provision in **NI 31-103 s.8.4**).  Dealer registration requirement!  s.1(1) **"dealer"** means a person who trades in securities or exchange contracts as principal or agent;   * dealers buy and sell; commonly known as stock brokers   **Business of trading in securities** – referenced in Ontario Act, but not BC; instead built into National Instrument 31-103 which sets it out as an excemption: not engaged in biz of trading then don’t need to be registered   * Get at it from different ways   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 |
| (b) **act as an adviser,** | The requirement to register as an adviser is triggered if the person/company holds itself out as engaging in the biz of trading.  s.1(1) **"adviser"** means a person engaging in, or holding himself, herself or itself out as engaging in, the business of advising another with respect to investment in or the purchase or sale of securities or exchange contracts;   * not necessarily engaged in buying and selling; can provide advise * what can constitute advice? Provide advice targeted to particular clients; ex. an analyst who writes a report on a particular stock – broadly speaking it is advice, but not w/in the registration requirement. * Need to express an opinion/recommendation (not facts) in a way that reflects a biz purpose. * Advising is: Mike I know what your risk is, and you should buy this. |
| “in the business” registration trigger | Companion Policy 31-103 s.1.3 sets out 5 factors for determining whether a person/company is “in the biz” of trading or advising in securities:  a) hold yourself out or market yourself as an advisor  b) intermediary  c) carrying on the activity w/ repetition; one-off basis, not engaged in biz  d) doing it for money; trading on behalf of a 3rd party\*  e) directly or indirectly soliciting - ex. contacting pple to solicit trades  proficiency requirement, ethical component, balance sheet requirements – registration requirements expensive, so capital market participants would want to avoid registration  why do care? Primarily, investor protection. Also, goes to investor confidence.   * Basically, the Commission does DD on you – ex. looking for history of fraud   A disclaimer that a purported adviser is not “advising” did not exclude a person from the scope of the definition before, and likely would still not (Re First Federal Capital) |
| (c) **act as an investment fund manager, or** | s.1(1) **"investment fund manager"** means a person that directs the business, operations or affairs of an investment fund;   * an investment fund can be public or private – pooled resource that are controlled by an advisor or manager and invested in accordance w/ objectives. i.e. mutual funds * Ex of private: hedge funds – these don’t require a prospectus, while the public ones |
| (d) **act as an underwriter,** | s.1(1) **"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; |
| **unless the person is registered in accordance with the regulations and in the category prescribed for the purpose of the activity.** | |

**firm Categories of registration**

* Purpose: (1) These categories specify the types of activities in which a firm is permitted to engage and (2) determine the framework of regulatory requirements that the firm must meet.
* A firm may need to register in more than 1 category.

|  |  |
| --- | --- |
| **Dealer categories** | There are 5 categories for firms required to be registered as dealers (pp.478-479):   1. Investment dealers: must be members of IIROC 2. Mutual fund dealers: must be members of MFDA, except in Quebec 3. Scholarship dealers 4. Exempt market dealers (EMDs) 5. Restricted dealers |
| **Adviser categories** | There are 2 categories for firms required to be registered as advisors (p.479):   1. Portfolio managers 2. Restricted portfolio manages |
| **Investment fund manager category** | Only one category: investment fund manager (pp.479-480) |

**Individual categories of registration**

Individuals who act on behalf of a registered firm must register in one or more individual categories. An individual may need to register in both firm and individual categories – ex. sole proprietor registered as a portfolio manager (a firm category) must also register as an advising representative (an individual category).

* Generally prohibited from acting as a registrant for more than one firm.
* Individual categories of registration are:
  + Dealing representative: for firm in dealer category
  + Advising representative: for firm in advising category
  + Associate advising representative – all activities must be supervised by advising representative
  + Ultimate designated person (UDP): responsible for promoting compliance at the firm and overseeing the effectiveness of the firm’s compliance system – usually the CEO or sole proprietor of the firm (also looked @ p.487)
  + Chief compliance officer (CCO): responsible for monitoring and overseeing the compliance system at the firm, which includes establishing policies & procedures.
* Note: every registered firm is required to have a UDP and a CCO.

**Permitted individuals**

## Mechanics of registration

NI 33- 109 prescribes the format of all the forms that firm and individual applicants are required to use to submit information to the executive director.

**Procedural requirements** (482-483)

* A **firm applicant** must submit a completed Form 33-109F6 Firm Registration & enroll w/ the National Registration Dealer (NRD) administrator.
  + Also required to provide financial statements & a completed Form 31-103F1
* Upon completion of enrolment, an authorized rep submits all remaining registration info (including info about each individual applicant and permitted individual) by completing Form 33-109F4.
  + Individuals must be “fit for registration” based on specific criteria set out in NI 31-103 Part 3 and Form 33-109F4. The 3 fundamental criteria for assessing an individual applicant’s suitability for registration are: proficiency, integrity and solvency (484-485)
    - **Proficiency** component requires that individual applicants have the education, training and experience that a reasonable person would consider necessary to perform the activity completely.
    - **Integrity** (ethical component) requires that individual applicants have an honest character, lack of conflict of interest and do not have regulatory or legal actions against them
    - **Solvency** requires that individual applicants being sound financial condition. An individual who is insolvent or bankrupt may not be suitable.
      * an assurance fund to protect investors
* Every registrant must pay fees at the time of initial registration & annual fees using the NRD system.

Approval of registration

* Executive director shall grant registration unless appear that applicant is not suitable or that the proposed registration is objectionable. s.35 BCSA
* Before an executive director exercises its discretion, the applicant has the right to be heard. s.35(3) BCSA

## Exemptions from registration

|  |  |
| --- | --- |
| **International dealers** | International dealer exemption allows international dealers to trade a “foreign security” with the “Canadian permitted client” without having to register as a dealer in Canada as long as they operate pursuant to the requirements of the exemption. |
| **International advisers** | Allows international advisors to advise in a “foreign security” w/ a “Canadian permitted client” w/out having to register as an advisor in Canada. |
| **Client mobility** | Provides an exemption from the registration requirement for firms and individuals when a client moves to another jurisdiction. |
| **The Northwest exemption** | Dealer registration is not required for securities distributed under the accredited investor, family, friends and business associates, offering memorandum, and min investment amount exemptions. |
| **Generic advice** | Advisor registration requirement does not apply to one that acts as an adviser, if the advice provided is not tailored to the needs of the recipient of the advice­ – but if have an interest in the security being recommended, then must disclose.  Ex. advise delivered through articles in newsletters, newspapers and magazines, and info disseminated by TV, radio or various internet means (including chat rooms and bulletin boards). |
| **Capital accumulation plans** | Exempted from investment fund manager registration if required to register only b/c the investment fund is an investment option in a capital accumulation plan (CAP).   * Member can make investment decisions only among investment options offered w/in the plan. |

## Registration obligations

A registered individual or a permitted individual that leaves a registered firm to join another registered firm is able to transfer his or her registration automatically – but there can be no change in the individual’s registered category (p.501).

# Distribution exemptions

**Golden rule of securities:** if there is a trade in securities that is a distribution, then you have to file a prospectus, or rely on a prospectus exemption!

**Intro** (p.296)

An issuer has two options once a “security”, “trade” and “distribution” are established. First, the issuer or control block person can register (i.e. “qualify”) the securities using a prospectus and offer them for sale to the general public. Second, it can use an exemption from the prospectus requirement, if one is available, and offer the securities for sale under certain strict conditions (the nature of which depend on the exemption employed). The market for such securities is referred to as the **“exempt market”**.

Exempt market securities are subject to different conditions and rules than publicly-traded securities both when they are first distributed (in the primary market) and when they are subsequently resold (in the secondary market). The rules governing secondary trading in securities distributed under a prospectus exemption are called **“resale rules”**. Different resale rules apply to different types of exemptions from the prospectus requirement.

The term “private placement” is often used to denote an offering made using an exemption. A more accurate term is “exempt distribution”. Because exemptions avoid the prospectus requirement, they avoid much of the time, effort and considerable expense associated w/ preparing a prospectus and complying w/ the various continuous disclosure obligations that arise subsequently. There are 2 types of distribution exemptions:mandatory and discretionary.

Mandatory exemptions

* They have objective qualifications under the legislation.
* NI 45-106 Prospectus and Registration Exemptionsspecifies the types of issuers, securities and purchasers that qualify for particular distribution exemptions.
* Onus is on a claimant relying on an exemption to prove that it is available for all trades to all investors.
* NI 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations contain the requirements for registration of persons and exemption from registration of persons
* Private issuer exemption grants an exemption from the prospectus requirements if a “private issuer” trades securities to a person who “is not the public”.
* Underwriter exemption – a first trade by an UW of a security purchased in reliance on the UW exemption is a “distribution”. Therefore, UWs that have purchased exempt securities must provide a prospectus or use another exemption if they want to trade those securities (no hold period applies, so it cannot expire).

Discretionary exemptions

* Issuers must apply to the relevant Commission for these exemptions.
* Typically granted when an issuer meets most, but not all, of the requirements for a mandatory exemption (p.328).

A **key disadvantage** of the exempt market for issuers and investors is that secondary trading of exempt market securities is subject to certain restrictions. Securities acquired under a prospectus exemption may be re-sold only if

1. They are qualified under a prospectus;
2. The “resale rules”, including hold period requirements, are satisfied; OR
   1. NI 45-102 Resale of Securities contains the resale rules for exempt market securities.
3. They can be traded under some further exemption

Consequently, exempt securities are generally less liquid and more risky than are freely trading securities. The issue price of the former may be discounted to reflect this.

**The Closed System**

Every securities jurisdiction in Canada except Manitoba now operates a **“closed system”**. This model ensures that securities cannot be traded without either a prospectus or an exemption from the prospectus requirement. The idea is to prevent a security from trading freely when there is not enough publicly-available info about it (and its issuer) to permit potential investors to make informed investment decisions.

A trade in a security is deemed to be a “distribution” (triggering the prospectus requirement) unless it falls under an exemption. Security holders wishing to trade an exempt market security have 3 options:

1. continue to trade the security w/in the closed exempt market only, by relying on further exemptions
2. issuer may file a prospectus to qualify the securities already distributed
3. under the resale rules in NI 45-102, the securityholder may hold the exempt securities until a specified “hold period” expires (resale rules also impose additional requirements). The hold period is designed to allow time for info about the securities to build up in the marketplace.
   1. The hold period cannot expire until the issuer has also been a “reporting issuer”

**Reasons for using exemptions**

* P.300-301 – 5 reasons
* Costs of prospectus-level disclosure
* Benefits of prospectus-level disclosure

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\*Start of class notes\* Numbered exemptions were discussed in the class!\*

**There are two broad contexts where exemptions come up:**

**Companies**

* **Private issuer** who doesn’t want to become a reporting issuer
  + Won’t prepare a prospectus but wants to raise money for biz
  + If they want to issue securities, need to comply w/ requirements of at least one prospectus exemptions to avoid regulatory consequences of securities law.
* **Reporting issuer** (public company) might want to issue securities w/out relying on a prospectus in various situations:
  + if doing a second offering
  + dividends - they're a distribution

**Investors who have purchased securities pursuant a prospectus exemption**

* if they want to sell their securities again, they’d want to use a prospectus exemption so that they have the ability to sell securities, they can also rely on a prospectus, or comply w/ resale rules (so 3 ways if an investor, not a company, to resale securities).

**Why do we have prospectus exemptions? Policy Objectives**

Issuers use exemptions instead of qualifying a distribution w/ a prospectus for the following reasons:

1. Regulators acknowledge that businesses need alternate ways to raise capital other than the prospectus process b/c the prospectus process is time consuming and expensive and is not going to work for all issuers in all contexts.
2. Acknowledgement from regulators that some investors are so wealthy or sophisticated or both that they're capable of either making investment decisions on their own, paying someone to give them advice, or have enough money that they can suffer the consequences that the overarching investor protection policies that generally applies in securities law doesn’t necessarily apply to them.
   1. If wealthy but not sophisticated, the rational is that they can pay someone to give them advice.
3. In some cases, investors might have pre-existing relationships w/ the issuer itself and might have access to sufficient info about the issuer in order to make an informed decision about whether or not they should make a further investment
   1. Rights offering
4. Acknowledgement from regulators that some securities are **so safe** that you don't need a prospectus; the investor protection rational that drives prospectus doesn’t apply.
   1. government of Canada bond
   2. no need to know: investment is very safe p.319

Exemption in NI 45-106 available across the country, but there are additional requirements for some jurisdictions. Textbook outdated.

Why would you ever want a prospectus? When you become a reporting issuer your stock becomes free trading. To have a listing on a stock exchange need to be a reporting issuer.

## No need to know: wealthy/sophisticated investor exemptions

The most commonly used exemption applies to an investor that either has enough money or enough knowledge that they don’t need protection.

**(1) Accredited investors** (p.316)

**Available** to reporting (public) issuers, non-reporting (private) issuers, and SHs looking to resell; there are no limits on number of securities holders

**WHO?** Classes of investors that b/c of their sophistication don’t need the protection of a prospectus. “Accredited investors” is a defined term in NI 45-106 s.1.1. There are subcategories of persons that fall within this definition. Generally, it includes:

* Certain **financial institutions** such as banks, insurance companies, credit unions, most pension funds, mutual funds
* **Gov entities** – domestic, municipal, provincial, federal
* **Corporations** that meet the net asset test of 5 M
* **Individuals** can qualify by meeting one of three tests. This is one of the easiest ways for individuals to qualify for participation in exempt distributions.
  + **Financial Assets Test:** if individual (alone or w/ a spouse) holds 1M of financial assets net of any debt associated w/ them.
    - Financial assets a defined term in s.1.1 – cash, securities, insurance Ks that have a cash value – doesn’t include real-estate investments
  + **Total Net Asset Test:** all net assets, financial or otherwise, exceed 5M (the house comes in now, the car).
  + **Net Income Test:** net pre-tax income needs to exceed $200,000 for an individual or $300,000 together w/ spouse in each of the past 2-yrs, and w/ anticipation that it continues in the current yr.

Under NI 45-106 s.2.3, provided that the purchaser purchases securities as principal (that is for their own account) and is an accredited investor, the issuer is entitled to sell securities to these purchasers w/out a prospectus. An additional requirement if an entity is not a real person is that it has not been formed or used solely for the purpose of taking advantage of the exemption (s.2.3(5)).

* Ex. for a corporation, can’t bring 5 individuals w/ 1M each and incorporate for the sole purpose of having corporation invest as an accredited investor.

In practice, if acting for a company that seeks to raise money by way of private placement, almost always ensure that you include in the placement the possibility of accredited investors participating b/c it is the broadest, easiest basis for investors to qualify under. Have to include representations often in the form of a certificate that they need to sign when they subscribe the shares. The certificate will contain representations that the investor meets one of the criteria set out in the def & which one. Before, issuers didn’t need to take steps beyond certifications to rely on the exemption provided that they did not have any complementary info. Now, in 45-106 CP, issuers need to take steps to verify the accuracy of the representations that investors make. This is not a problem w/ banks but trickier when dealing w/ individuals. Various ways to find out. If broker involved, usually broker would know. If in doubt, the issuer should ask for further confirmation, such as tax returns.

The issuer must report the distribution w/in 10 days to the relevant Commission in Form 45-106F1, or, in BC, the somewhat more extensive Form 45-106F6.

Dealer registration requirement does not apply to a trade where purchaser is an accredited investor and a principal (s.2.3(1))

**(2) Minimum amount investment exemption** (p.318) 🡪 only for corporate investors

Available to anybody to use – not just focused on issuer

No prospectus if (NI 45-106, s.2.10(2)):

* Person is not an individual (corporation or trust)
* Person purchasing as principal (not agent)
* Acquisition cost not less than $150,000, and purchaser pays in cash
  + Full payment @ a later date (such as a vendor take-back loan or promissory note) would not fit w/in this exemption.
  + If an investment exceeds $150,000, only the first $150,000 needs to be paid in cash.
* Security of a single issuer
  + Can be diff securities, but have to be securities of a single issuer

Can’t be through an entity that has been set up primary for the purpose of taking advantage of the exemption (NI 45-106, s.2.10(3)). The issuer must report the distribution w/in 10 days to the relevant Commission in Form 45-106F1, or, in BC, the somewhat more extensive Form 45-106F6. There are two rationales for this exemption: (1) if you can invest this much money, then you probably can afford to lose; (2) this is a lot of money and for someone who can’t afford to lose it, they’ll probably get advice. Individuals might feel pressured to invest. As a result, the exemption was limited 2-yrs ago and individuals can no longer use it; only available to corporations, partnerships, etc. Benefit for purchasers: issued at discount, so pricing advantage

## No need to know: purchaser is already familiar w/ the issuer or securities

**(8) Rights offering exemption** (p. 307)

* Set out in NI 45-106 s.2.1
* A **Right** is a form of security that grants the purchaser of the rights the ability to acquire additional securities of that company.
* It's a way of tapping your already existing investor base by issuing rights
* **Restrictions** (they are more onerous than the existing security holder exemption)
* Required the preparation and filing of a **disclosure document** (a rights offering circular)
  + This had to be accepted by the securities regulators
  + Most companies using it were already public, meaning listed on an exchange. The stock exchange had their own review of the rights circular.
  + Between the commissions coordinating their reviews and the exchange, it was more onerous than doing a prospectus. So, not used.
* The rules amended in 2015 to streamline this exemption and be more flexible, and the stock exchanges have amended their policies.
  + Textbook not up to date
* It was considered as a last resort
  + They are not certain, not quick
  + Have to be open for a min period of 21 days. Unlike a private placement, can't be closed right away, and there's a risk that people don't buy. There is reputation & market damage if it doesn’t complete.
  + Only circumstance where it was used not as a last resort was when company stocks depressed significantly and the directors were worried about doing a private placement for fear of receiving criticism from SHs for diluting them. So, would couple a private placement w/ a rights offering.

**(9) Dividend distributions & reinvestment plans**

A **distribution of a dividend** in the form of the issuer’s own securities or the securities of a reporting issuer is an exempt distribution (NI 45-106, s.2.31).

* Basically issuer issues securities instead of paying out cash (p.308)

A **reinvestment plan** is an agreement b/w an issuer and its security holders, under which the security holders choose to reinvest their cash dividends automatically; that is, to purchase more of the issuer’s securities. A distribution pursuant to an investment plan is an exempt distribution where the distribution meets several conditions.

**(11) Conversion, exchange or exercise**

* P.309
* stock options & other convertible securities set out in s.2.42

**(3) Family, friends and business associates exemption** (p.310)

NI 45-106 s.2.5 sets out the required elements. **Applies to any distribution of security to**

(1) close personal friend

(2) close biz associate

(3) spouse, parent, grandparent, sibling, child, grandchild

**of a director, an executive officer, or control person of the issuer or an affiliate of the issuer or a holding company or trust of one of these categories of people.**

* Has to be a close enough relationship – just b/c you go to the same church or are member of the same golf club is not enough

There can’t be any commission or finder’s fee paid to rely on this exemption. There are additional requirements for some jurisdictions.

**Affiliate exemption**

* A distribution to an “affiliate” of an issuer
* P.312

**(12) Employee, executive officer, director & consultant**

* P.313
* Issue shares to employees under a compensation plan or stock options – set out in NI 45-106, s2.24

**Investment fund exemptions**

* Available to issuers that are investment funds
* P. 313

**(4) Private issuer exemption** (p.314)

Available to anyone selling shares if that sale is a distribution provided that the requirements are met. So, available to SHs who are reselling securities under deemed distribution.

Key requirement is that the securities be securities of a private issuer (defined in NI 45-106 s.2.4) – criteria:

1. issuer must not be a reporting issuer or an investment fund
2. equity securities other than none-convertible debt must be subject to restrictions on transfer that are in issuer’s constating documents or SH agreement.
   1. **Constating documents** are foundational docs: for a BC company its articles and notice of articles; for Federal company its certificate of incorporation, articles, bylaws.
3. equity type securities **must not be held beneficially by more than 50 persons**, excluding employees and those who were employees when they acquired the securities
4. issuer has distributed securities only to specified categories of person
   1. List includes people with a (1) **close affiliation** w/ the company such as directors, officers, existing security holders; (2) **accredited investors**; (3) **Catchall**: a person who is not a member of the public - i.e. people who have such a close relationship to the directors/officers that they don't need any more information to assess the company - need to establish that they are sufficiently close
      1. Look @ the list

**(7) Existing security holder exemption** (p.315)

* Adopted in 2014 by most Canadian jurisdictions; Ontario joined Feb 2015
* Designed to provide an exemption to reporting issuers that are listed on the TSX and issuing securities to people who already own their securities to facilitate the capital raising process from the existing investor base.
* Set out in MI CSA Notice 45-313; OSC rule 45-501
* Conditions
  + Have to be a reporting issuer
  + Have securities listed on at least one exchange, includes TSX, TSX venture exchange, the Canadian Stock Exchange
  + Issuer must be current w/ its continuous disclosure requirements
  + Can only offer securities that are already trading on the exchange
  + The distribution can't result in distrib of more than 100% of the listed securities of the same class
  + Need to issue news release disclosing the offering – disclose that you are proposing to rely on this exemption, pricing, number of securities,
  + The offering must be made available to all existing security holders w/ the same type of listed security.
  + Can only invest up to $15,000 per issuer in a 12-month period under the exemption, unless the investor has obtained suitability advice from a registered investment dealer.
  + An exempt distribution report must be filed
* Investors have a right of action against the issuer for misrepresentation in any of the continuing disclosure obligations
* Any securities issued under this exemption is subject to a 4 month holding period before the securities are released on the market
* Theoretically, another way for listed issuers to tap existing investor base. There are 2 problems: (1) it limits the amount that investors can invest ($15,000 unless has suitability advice); (2) the only way to invest more than $15,000 is to get suitability advice, which has to come from a broker. But there is still no model for the broker to get rewarded, so brokers are not pushing the use of this exemption.

## Cost/benefit analysis: ensuring smaller issuers & not-for-profits can access capital markets

**(5) Offering memorandum (OM) exemption** (p.322)

The OM exemption in s.2.9 of NI 15-106 allows issuers to sell to anyone regardless of their income, net worth, investment amount, or relationship to the principles of the issuer. Everyone an issuer could solicit in Canada w/ a fully registered prospectus may be solicited using an OM prepared in the required form under the OM exemption. To rely on the OM exemption, issuers must prepare and deliver an OM in the required form as set out in NI 45-106 s.2.9. It’s a short form disclosure document that includes audited financial statements (so more expensive than other exemption) and risk acknowledgment in the prescribed form. OMs are not reviewed or receipted (don’t need a receipt) by the commission in advance. However, OM misrepresentations do attract liability. Also, don’t need an UW – easier and cheaper than prospectus.

There are two groups where this exemption is available:

* BC, parts of New Brunswick, Nova Scotia, Newfoundland: can use OM exemption anytime w/out any limit on the size of the investment and for an investment plan (so can sell hedge fund to anyone you want to)
* Alberta, Manitoba, Northwest Territories, Nunavut, PEI, Quebec, Saskatchewan, Yukon, Ontario: OM exemption less widely available; can’t invest more than $10,000 unless you are an “eligible investor” (includes an accredited investor) – net asset must exceed $400,000, net income exceeding $75,000, or net income w/ spouse exceeding $125,000
  + Ontario builds certain things into their own act instead of adopting the national instrument
  + Not available to investment funds

**Why would you ever do a prospectus in BC?** When you do a prospectus you become a reporting issuer. Once you become a reporting issuer, your stock becomes freely traded. To have a listing on a stock exchange need a prospectus.

**Isolated distribution**

* P.325

**Asset acquisition**

* A distribution made as consideration for the acquisition of assets owned by the purchaser, if those assets have a fair value of at least $150,000 is an exempt distribution.
* P.325-326

**Not-for-profit issuers**

* P.326

**(6) Crowd funding exemption** (startup exemption) (p.326)

Two relatively new exemptions allowing early stage companies to access capital.

* Alberta is not listed under either of these; North West Territories thinking of starting a 3rd crowd funding exemption
* The two that couldn’t agree were Ontario and BC

MI 45-316: **the start-up crowd funding exemption**

* available in BC, Saskatchewan, Manitoba, Quebec, NB, Nova Scotia – but not Ontario
* have to be a private company (can’t be a reporting issuer)
* have to distribute securities through funding portals (ex. FrontFundr)
  + These funding portals act in furtherance of trade (which triggers registration requirement) so they can be either a registered dealer or rely on the registration exemption for funding portals.
* Total distribution must be limited to $250,000; each individual investor limited to max investment of $1,500 per distribution
* Distribution period may remain open only for 90 days
* Have to prepare a short form offering document
* have a withdrawal right (cancel purchase) – w/in 48hrs of receiving short offering doc
* b/c of the small amount, the investor protection rational doesn’t apply and can rely on the exemption. The other side of the argument is that people could lose $1,500. regulators relying on balancing efficiency, it is important for the economy, entrepreneurship.

MI 45-108: **crowd funding exemption** – available to both reporting issuer and private

* Available in Manitoba, Quebec, Ontario, NB, Nova Scotia – but not in BC
* Available to reporting and not reporting issuers
* Each investor can invest a max of $2,500 in a single investment
* In Ontario, also limited to total annual investment limit of $10,000
* If accredited investor, limit is $25,000; Ontario total limit is $50,000
* Total amount that an issuer can raise is $1.5M in a 12-month period
* This version has more onerous disclosure requirements
  + Reporting issuer must be in compliance w/ continuous disclosure obligations – rational is that you already have the info in the market
  + If not reporting, required to prepare and disclose financial statements, notice of use of proceeds (what are you going to do w/ the money), subject to some ongoing disclosure requirements but not as onerous as a reporting issuer

## Redundancy or dual regulation: info available from another source or required by another regulator

**(13)** **Issuance of mortgages**set out in NI 45-106, s2.36

* If you're licensed to sell mortgages, there's an exemption for sale of mortgages

(14) available to **banks and corporate association** where there's evidence of **deposits** NI 45-106, s2.41

**Take-over bid & issuer bid**

* P.320

**(10) Biz combinations & reorganizations**

* NI 45-106 s.2.11
* If 2 companies merge and one of them issues securities of their company to the security holders of the other company
* Merger, amalgamation, plan of arrangement pursuant to statutory procedure
* P.320

**Acting as an UW**

* No need for prospectus level disclosure b/w an issuer & its UW – but an UW would need to prepare a prospectus or use an exemption to fulfill its function as an UW
* P.321

## Failure to comply

**If an issuer or restricted security holder improperly relies on an exemption from the prospectus requirement, the consequences are potentially significant. In Jones (Ontario case), the Court held that a failure to file a prospectus renders the contracts of purchase and sale void, and that no limitation period applies.**

What happens if you have not complied w/ an exemption, you are subject to prospectus requirement – what happens if you have not prepared a prospectus? Is this a valid transaction? Does the issuer have risks or exposure? Does the investor have any remedies?

* Unlimited withdrawal rights – if subject to a prospectus requirement, you have a withdrawal right which is triggered by delivery (2 days after delivery).
* Satisfying the conditions is important b/c the claims have no limitation period

**Jones** (Ontario): dealer sold security under exemption, except they did not satisfy the exemption. Investment went south and the investor argued that K void. Dealer argued that there is not such right or remedy under Ontario legislation.

* Investor arguing that issuer breached prospectus requirement and it was illegal and therefore it should be void. And, the remedy should be return as it would be for rescission.
* Remedies under the Act were statute barred, so investor argued that not relying on statutory remedies and relying on the principle that the legal K is void – many yrs after the K.
* H: K void! YAY for investor.
* Satisfying the conditions is very important. Issuers have to be super careful b/c can be exposed beyond the limitation period.

Criticisms of exemptions

* Focussed on institutional investors and individuals/retail investors have been left out
* But there's a pricing advantage for investors for the risk of not getting all the data, and the lack of liquidity

## Resale rules

If an investor purchased securities in the exempt market and now wants to sell those securities, the investor must either (a) find a purchaser who qualifies for an exemption, keeping the securities in the exempt market, or (b) satisfy the resale rules set out in NI 45-102 in order to sell the securities in the public market. The resale rules bridge the gap between the exempt market and the public market.

**Is the investor a control person, or not?**

**Section 1 of the BCSA defines “control person” as:**

* **a person** who holds a sufficient number of voting rights attached to all outstanding voting securities of the issuer to affect materially the control of the issuer, OR
* **a group of people, acting in concert**,which together holds a sufficient number of voting rights attached to all outstanding voting securities of the issuer to affect materially the control of the issuer.

**If a person or group of people hold more than 20% of the voting rights attached to all outstanding voting securities of the issuer, they are deemed to be a control person** (in the absence of evidence to the contrary).

**Restricted & seasoning period for a person who is not a control person** (p.330)

**ID the exemption under which the restricted securities were issued!**

The resale rules impose hold periods which keep securities distributed under an exemption from being traded freely for a period of time. NI 45-102 imposes either a restricted period or a seasoning period for each of the exemptions in NI-106 (except for those indicated to have no hold period at all).

**Restricted Period 🡪 hold period**

NI 45-102, s.2.3 If a security was distributed under any of the provisions listed in **Appendix D,** the first trade of that security is subject to section 2.5

* Accredited Investor Exemption
* Family, Friends, Business Associates Exemption
* Affiliates Exemption
* Offering Memorandum Exemption
* Minimum Amount Investment Exemption
* Asset Acquisition Investment
* Petroleum, Natural Gas, Mining Exemption

**Hold period:** restrictions are set out ins. 2.5 of NI 45-102.The conditions that must be met to satisfy this resale rule and transform the restricted securities into free-trading securities are listed in s.2.5(2) as follows:

1. **Seasoning period:** The **issuer is and has been a reporting issuer** in a jurisdiction of Canada **for the four months immediately preceding the trade**.

* Purpose: requires the issuer be or become a reporting issuer, which requires a prospectus on file and subject to continuous disclosure requirements for min 4-months

2. **Restrictive period: At least 4 months have elapsed from the distribution date.**

* Securities have been held for 4-month + 1 day from the initial distribution
* If buying from a non-reporting issuer, the 4-month hold period will expire before the seasoning period.
* Buy on Feb 1; issuer becomes reporting on June 1 – can’t sell on July 1 (restrictive period satisfied, but not the seasoning period) // but if already a reporting issuer since Nov of prior yr – then the seasoning requirement would be satisfied on April 1, but can’t sell b/c restrictive period requirement not met yet.

3. **legend requirement:** the certificate representing the security must include a legend that sets out when the initial distribution date was and earliest date for resale. If the distribution date is on or after March 30, 2004, or, in Québec, on or after September 14, 2005, and either of the following apply:

(i) **if the issuer was a reporting issuer on the distribution date,** the certificate representing the security, if any, carries a legend stating: Unless permitted under securities legislation, the holder of this security must not trade the security before [insert the date that is 4 months and a day after the distribution date]”;

(ii) **if the issuer was not a reporting issuer on the distribution date,** the certificate representing the security, if any, carries a legend stating: Unless permitted under securities legislation, the holder of this security must not trade the security before the date that is 4 months and a day after the later of (i) [insert the distribution date], and (ii) the date the issuer became a reporting issuer in any province or territory.

3.1 If the security is entered into a direct registration or other electronic book-entry system, or if the purchaser did not directly receive a certificate representing the security, the purchaser received written notice containing the legend restriction notation set out in subparagraphs (i) or (ii) of item 3.

* If electronic, then notice has to be given – usually included in the subscription

4. The trade is not a control distribution. i.e. the security holder must not be a control person!

5. **No unusual effort is made to prepare the market or to create a demand for the security that is the subject of the trade.** Ex. no advertising

6. **No extraordinary commission or consideration** is paid to a person or company in respect of the trade. Normal commissions allowed

7. **If the selling security holder is an insider or officer of the issuer,** the selling security holder has no reasonable grounds to believe that the issuer is in default of securities legislation.

* Can’t have knowledge of any default by the issuer under the securities legislation

2.5(3) Items 3 and 3.1 of subsection (2) do not apply to a trade of an underlying security if the underlying security is issued at least four months after the later of (a) the distribution date, and (b) the date the issuer became a reporting issuer in any jurisdiction of Canada.

**If all of these conditions are met, these formerly restricted securities may be resold in the public market.**

**If these conditions are not met, the resale is deemed to be a distribution and the prospectus requirement is triggered per** s. 2.5(1) of NI 45-102.

Seasoning period

NI 45-102, s.2.4 If a security was distributed under any of the provisions listed in **Appendix E,** the first trade of that security is subject to section 2.6.

* Private Issuer Exemption
* Dividends Exemption
* Rights Offering Exemption
* Business Combination & Reorg Exemption
* Takeover Bid Exemption
* Shares to Employees Exemption

**The resale rule in** s. 2.6 of NI 45-102 **provides for a “seasoning period”.** The conditions that must be met to satisfy this resale rule and transform the restricted securities into free-trading securities are listed in s.2.6(3) as follows:

1. **Seasoning period:** The issuer is and has been a reporting issuer in a jurisdiction of Canada for the **four months immediately preceding the trade**.

* Purpose: requires the issuer be or become a reporting issuer, which requires a prospectus on file and subject to continuous disclosure requirements for min 4-months

2. The trade is not a control distribution. i.e. the security holder must not be a control person!

3. No unusual effort is made to prepare the market or to create a demand for the security that is the subject of the trade. Ex. no advertising

4. No extraordinary commission or consideration is paid to a person or company in respect of the trade. Normal commissions allowed

5. If the selling security holder is an insider or officer of the issuer, the selling security holder has no reasonable grounds to believe that the issuer is in default of securities legislation.

* Can’t have knowledge of any default by the issuer under the securities legislation

2.6(2) The first trade of securities issued by a **private company** or private issuer made after the issuer has ceased to be a private company or private issuer is a distribution unless the conditions in subsection (3) are satisfied.

**If all of these conditions are met, these formerly restricted securities may be resold in the public market.**

**If these conditions are not met, the resale is deemed to be a distribution and the prospectus requirement is triggered per** s. 2.6(1) of NI 45-102.

Comparing the two:

* They are both the same except for the restricted period and the legend requirement. The seasoning period does not require that 4-months have passed since the initial distribution, and it does not require that the securities certificate be legended (p.333).
* If distribution is made by a non-reporting, the running clock is the seasoning clock. If reporting, 4 months is going to be the holding period.
  + If you are a reporting issuer, then you would be better off if the distribution falls w/in 2.6 instead of 2.5. But if non-reporting issuer making a distribution, it doesn’t matter which section you fall under.

**Why do some exemptions fall under s.2.5 and others under s.2.6?** b/c of the nature of the exemptions

* Exemptions listed under s.2.5 are the exemptions that can be most easily abused.
* Exemptions under s.2.6 are less likely to be used to circumvent the prospectus requirement.
* Concern is that w/out a hold period people would use those exemptions and the stock would raise immediately and nobody would do a prospectus anymore.
  + w/ the hold period, market is going to have time to absorb the impact
  + prevent backdoor UW
  + to preserve the integrity of the system

**Example**

**Private company becomes reporting issue on Jan.1.** why do we need prospectus or exemption? Sale of a security distributed pursuant to a prospectus exemption is deemed to be a distribution.

* s.2.5 deems accredited investors trade to be a distribution – 3 options
  + (1) prepare prospectus
  + (2) another exemption
    - if selling under an exemption, then you would still w/in the closed system and have to sell at a discount. SO you want it to be outside of this.
  + (3) satisfy resale rule conditions

Accredited investor bought on Nov.1. (buying from private issuer)

* When can you sell? 4 months after becoming a reporting issuer – May 1

Accredited investor buys on Mar.1. (buying from reporting issuer)

* Subject to s.2.5
* When can I sell? July 1

Employee awarded shares on Nov.1 under s.2.24; company becomes reporting issuer on Jan 1

* When can I sell? May 1
* s.2.4, tells that s.2.6 applies
* If awarded on June 1, can sell on June 1 – there is no holding period

What happens if resale under an exemption before the hold period has expired?

* Buy shares of public company on Jan 1 & sell on March 1 – Buyer has 2 months left on hold period but by May 1 can be freely traded
* Hold period runs from the date of initial distribution; it does not start again when you sell restricted shares pursuant to an exemption

**Resales by control people**

When they resell securities, it is distribution. They can either qualify the sale of shares by prospectus (secondary offering), find a buyer that fits under an exemption (have to sell at a discount since still w/in the closed market), apply for a discretionary exemption under s.76 of BCSA (though unlikely that one will be granted), or satisfy s.2.8 of NI 45-102.

2.8 **Exemption for a Trade by a Control Person**

(1) The prospectus requirement does not apply to a control distribution, or a distribution by a lender, pledgee, mortgagee or other encumbrancer for the purpose of liquidating a debt made in good faith by selling or offering for sale a security pledged, mortgaged or otherwise encumbered in good faith as collateral for the debt if the security was acquired by the lender, pledgee, mortgagee or other encumbrancer in a control distribution, if the conditions in subsection (2) are satisfied.

(2) For the purposes of subsection (1), the **conditions are:**

1. **Seasoning requirement:** The **issuer** is and has been a reporting issuer in a jurisdiction of Canada **for the four months immediately preceding the trade.**

2. **Restricted period:** The selling security holder, or the lender, pledgee, mortgagee or other encumbrancer if the distribution is for the purpose of liquidating a debt, has **held the securities for at least four months.**

3. No unusual effort is made to prepare the market or to create a demand for the security that is the subject of the trade.

4. **No extraordinary commission** **or consideration** is paid to a person or company in respect of the trade.

5. The selling security holder has **no reasonable grounds to believe that the issuer is in default of securities legislation.**

In addition to meeting the 5 conditions for a control distribution set out in s.2.8(2) of NI 45-102, the control person must also:

Why didn’t they just let control person use s.2.5? B/c control person must complete & sign **Form 45-102F1** which declares that the control person has no knowledge of any material fact or change of the issuer that has not been publicly disclosed (b/c presumed that he might have knowledge that other SHs don’t). Then, form has to be filed at least 7 days before control person engages in any trade (sends a signal to the market – more supply in the market might cause downward pressure on price; maybe bought b/c X was control person and now want to sell too). Notice is valid for 30 days. If they haven’t sold w/in that period, then have to keep renewing to keep it valid. Control person, who is going to be an insider, has to file insider report w/in 3 days – accelerated filing (b/c market should have knowledge on a timely basis).

(3) The selling security holder, or the lender, pledgee, mortgagee or other encumbrancer if the distribution is for the purpose of liquidating a debt, under subsection (2) **must**

(a) **complete and sign a Form 45-102F1** no earlier than one business day before the Form 45-102F1 is filed;

(b) **file** the completed and signed Form 45-102F1 **on SEDAR at least seven days before the first trade** of the securities that is part of the distribution; and

(c) **file, within** **three days** after the completion of any trade, **an insider report prepared in accordance with either Form 55-102F2 or Form 55-102F6** under National Instrument 55-102 System for Electronic Disclosure by Insiders (SEDI).

(4) A Form 45-102F1 filed under subsection (3) expires on the earlier of

(a) **thirty days** after the date the Form 45-102F1 was filed, and

(b) the date the selling security holder, or the lender, pledgee, mortgagee or other encumbrancer, files the last of the insider reports reflecting the sale of all securities referred to in the Form 45-102F1.

(5) A selling security holder, or the lender, pledgee, mortgagee or other encumbrancer must not file a new Form 45-102F1 in respect of a class of securities of a reporting issuer until the Form 45-102F1 in respect of that class of securities previously filed by that person or company has expired.

Control persons are subject to more onerous resale rules when selling securities in the public market. **Rationale:** regulators are concerned with information asymmetry and the possibility that control persons may be selling into the marketplace on the basis of information not generally available to investors.

## Exempt distribution reports

You need to tell the regulator that you have done a private exemption w/in 10 days of the distribution & you pay a fee based on the amount of money that you have raised. Commission staff reviews exempt distribution reports.

* Form 45-106 F1; book refers to F6 for BC, this is gone now!
* If you claim an exemption and the Commission thinks the requirements aren’t met, the staff will review
* The reports are reviewed only after you file them

**Random comments at the end of class**

Private placements are the most common types of funding. Most of them rely on the private issuer exemption.

If a company is reporting, it is probs listed on the stock exchange. In addition to securities regulation, there are the stock exchange rules.

* TSC has a company manual that has rules on private placements, dictating pricing, when SH approval is required, requiring TSX approval before share is issued.
* If listed on venture exchange, they have a corporate finance manual (manual policy 46.5 sets out the private placement rules – prescribed forms that are used to file; periods of time for review; docs to be filed)
* Subscription agreement contains representations and warranties

# Continuous disclosure

**Is entity a reporting issuer? If yes, then it is subject to continuous disclosure requirements.**

* venture issuer or non-venture issuer?
  + A venture issuer (defined term in s.1) is a reporting issuer not listed or quoted on the TSX or a non-Canadian marketplace during the relevant time period. Either not listed or listed on TSX Venture.

**WHAT?** A set of ongoing disclosure requirements that apply to reporting issuers in Canada that ensure the information that is set out in the prospectus is kept current

* Prospectus: point in time snapshot
* Once a company becomes a reporting issuer, then they're subject to ongoing disclosure requirements
* Set out in Part 5 of the Instruments
* NI 51-102 **- very important** **-** Brings together many of the ongoing disclosure requirements
  + Previously, these requirements were scattered in many different policies
  + Applies nationally - there are minimal variations between provinces

**Reasons for requiring continuous disclosure** (p.249)

* To keep info in prospectus current
* CD is designed to create a “level playing field” where all investors have access to the same info and all pricing and investment decision are made from the same starting point.
* Minimizes risk of insider trading
  + Where a party has knowledge of the issuer that the public doesn't
* Creates a foundation for the streamlined alternative forms of prospectus – since issuers are permitted to distribute securities w/ a modified prospectus if they meet certain operational and CD standards
  + Short form, Shelf prospectuses
    - Most commonly used alternatives by already reporting issuers
    - Key basis is the public disclosure record that is current
  + Allows for quicker access to the capital markets
* Disclosure is used as a **way of changing corporate behaviour**
  + Regulators have adopted a **comply or explain approach** to introducing behavioural changes
    - i.e. if you don't have a majority of independent directors, you have to make certain disclosures about it - how do you ensure that directors are making decisions on an independent basis?
    - Shaming the company

**Changes in CD requirements**

* Evolution of CD – pp.246 to 248
* Before 1965, only financial statements for at the time of IPO was required
* In 1965, the Kimber report saw this as a flaw b/c the bulk of trading happens on the secondary market
  + CD was the Kimber Committee’s most important reform
* By mid 70's ad hoc regimes in different jurisdictions in corporate legislation
* Big boost recently came as a result of a series of crises
  + Enron (Sarbanes Oxley in USA)
    - Required officer certification
  + Series of Canadian scandals (Bre-X: company had no resources and was a massive fraud)
    - Got NI 43-101 from this: technical reports for companies with mineral resources
  + 2008/09 Financial crisis
    - USA: Dodd-Frank
  + 2011 Sino Forest
    - Canadian public company claimed to have forest tenures in China
  + Regulators in Ontario initiated greater disclosure and governance requirements re: emerging market issuers
    - Canadian companies that have businesses in emerging markets

BCSA s.85 A reporting issuer must, in accordance with the regulations,

(a) provide prescribed **periodic disclosure** about its business and affairs,

(b) provide disclosure of a **material change**, and

(c) provide other prescribed disclosure.

## (1) Periodic disclosure

Triggered by time periods or specific events

A reporting issuer must comply with four periodic disclosure requirements:

1. Quarterly and annual **financial statements**;
2. **Management Discussion and Analysis (MD&A)** to accompany quarterly and annual financial statements;
3. **Annual Information Form (AIFs)**;
4. **Information Circulars** and **Proxy Solicitation** before shareholder meetings.

**(1)** **Financial Disclosure**

NI 51-102 requires reporting issuers to prepare and file financial statements on SEDAR.

* Statements include notes

**Accounting Standards:** Reporting Issuer’s financial statements must be prepared according to International Financial Report Standards (IFRS) (this is principles-based accounting and less rules-based) NI 52-107, s.3.2(1) – US has not adopted IFRS yet

* Replaced Canadian GAAP
* Prescribes audit standards
* Must consist of statement of profit & loss, income statement, statement of financial position, balance sheet, statement of cash flows, statement of change in financial position
* They have to be comparative – annuals compare 3-yr periods // interims compare on a 2-yr period

**ANNUAL Financial Statements**

* N**on-ventures** RI must file **audited annual financial statements** on SEDAR within 90 days of financial year-end (NI 51-102 s.4.2). It must compare the current year’s results to the previous year’s
* V**enture issuers** must fileaudited annual financial statements w/in 120 days
  + **“Venture Issuer”** defined inNI 51-102 s.1(1) **-** RI that did not have any of its securities listed or quoted on at of the TSX or other any other exchanges outside Canada (like NASDAQ).
* **Contents:** a statement of comprehensive income, statement of changes in equity and a statement of cash flows for the financial year, statement of financial position as at the end of the financial year, and notes to the annual financial statements must be filed NI 51-102 s.4.1

**INTERIM Financial Statements**

* Quarterly, except for the last quarter – so for the first 3 quarters interim FS
* **Non-ventures** issuer must file w/in 45 days after the end of the interim periodNI 51-102 s.4.4
  + **Info Included:** Same info as annual statements (above). **Don’t need to be audited, but need to be reviewed by independent accounts.**
    - If an auditor has not performed a review of an interim financial report the interim financial report must be **accompanied by a notice** indicating that the interim financial report has not been reviewed by an auditor and disclose why not s.4.3(3)(a)
      * Report or explain – shames companies into doing it
        + Ex. didn’t have enough $
* **Venture issuers** must file w/in 60 days of the end of the interim period NI 51-102 s.4.4
  + Review of interim statements doesn’t apply to venture issuers

If the issuer misses the filing deadlines, the Commission may issue a cease-trade order – might not be a blanket cease trade order for all the securities.

* Theoretically possible to get extensions, but not practically

**(2) Management Discussion & Analysis (MD&A)**

Under s. 5.1 of NI 51-102, all reporting issuers must prepare and file a Management Discussion and Analysis in Form 51-102F1 to accompany its quarterly and annual financial statements. The MD&A should analyze the financial statements (i.e. explanation of changes), discuss the dynamics of the business, discuss current or pending obligations and liabilities, and provide management’s insight on how the issuer is likely to perform in the future.

* Contents set out in Form 51-102F1
* Lawyers review the MD&A
* Tends to be boiler plate
* Since 2015, **venture issuers** are exempted from some of the MD&A requirements for their interim MD&A
* Historical, where things are at right now, also looking at **risks, uncertainness and trends** that might impact future performance
  + **Forward looking information** falls into 3 general categories:
    - **narrative** description
    - **forward looking financial information (FIFO)** – KEY to describe as uncertain –2 subcategories
      * **projections and forecasts:** forward looking information presented on a historic format
      * **outlook:** earnings forecasts/outlooks

**Forecasts** (p.256-257) 🡪 reading notes

While not required to do so, issuers often provide forecasts in their continuous disclosure. NI 51-102 divides predictions about the future into three categories.

* **Forward-looking information** is the broadest term, and covers all disclosure regarding possible events, conditions or financial performance that is based on assumptions about future economic conditions and courses of action.
* **Future-oriented financial information (“FIFO”) &** **Financial outlook** are types of forward-looking information about prospective financial performance, financial position or cash flows, based on assumptions about future economic conditions and courses of action. This info is FIFO when presented in the format of a historical statement of financial position, statement of comprehensive income or statement of cash flows. When presented in any other forms, it is a financial outlook.

NI 51-102 Contains a “safe harbour” that offers some protection to issuers who produce FIFO or financial outlook. When an issuer makes such disclosure, it must state the date on which management approved the FIFO or financial outlook, explain its purpose and caution investors that the info may not be appropriate for other purposes – s.4B.3

**(3) Annual Information Forms (AIFs)**

* Contents set out in Form 51-102F2
* Mandatory for **non-venture issuers** to prepare and file within 90 days of fiscal year end NI 51-102 ss.6.1, 6.2
* Not mandatory for **venture issuers**, but venture issuers that want to access the short or shelf prospectus need to have AIF
* Portions of them get reviewed by regulators
* Similar to a prospectus w/out the offering stuff

**(4) Information Circulars**

They are documents that are required in connection with the solicitation of proxies. Every reporting issuer calling a meeting at which securities will be voted has to solicit proxies (send proxy form out - give securityholders the right to use it). When the issuer sends out the proxy, it is required to send an information circular NI 51-201 s.9.1. Anybody other than an issuer who wishes to solicit a proxy must prepare and send out an information circular.

* Ex. Non-management solicitations: groups of shareholders who don't like what management is doing - they have to solicit their own proxies.
  + Main exception – if person soliciting proxies from 15 or fewer SHs
* **What is a proxy?**A proxy is an agent (not a piece of paper)
  + Corporate legislation dictates who gets to vote, and when meetings have to be held. If a meeting is required at which SHs are going to vote, NI 51-201 says that the reporting issuer must send to security holders a form of proxy along with the notice of the meeting. **Form of proxy** is a one-page document; an instrument by which the registered shareholder (can hold any type of security) can appoint someone else to attend SH’s meeting and vote on their behalf (the person appointed is the proxy). Proxy has to follow the wishes of the principal to the extent that they are made known to the proxy.

Information circulars are required because securities legislation wants to make sure that shareholders who can’t attend a SH meeting are able to appoint an agent, and that they are **given enough information on what they're going to vote on so they can exercise reasonable judgement.** So has to provide sufficient information.

**Form of Information Circular**

* Form 51-102F5 – Contains 16 items of disclosure, including the number of shares of issuer that are outstanding, any holders of more than 10%, etc.
  + Under F5 - prospectus level disclosure is required (for the entity whose shares are being issued) if the transaction being approved at the meeting is for acquisition of/by another company – Ex. A corp (junior mining company) calls a special meeting, puts together an info circular, then needs to provide prospectus level disclosure on B Corp (large mining company that wants to buy A corp)
* **Executive compensation requirements set out in** Form 51-102F6: **Named executive officers**(p.270)
  + **Non-venture:** CEO, CFO, and other top 3 paid executives who make more than $150k/year
    - For CEO and CFO, have to disclose regardless of amount they make
    - Next 3, only if they make more than 150
  + **Venture:** CEO, CFO, and one other named executive officer (sometimes referred to as NEOs)
  + Executive compensation broadly defined includes all forms of compensation – stocks, options, benefits

## (2) Timely disclosure

The second category of CD obligation is timely disclosure, triggered by a material change in the issuer’s affairs.

**(1) Disclosure of Significant Acquisition**

When a reporting issuer completes a **significant acquisition**, it must file a Business Acquisition Report (BAR) w/in 75 days after the acquisition date NI 51-102, s.8.2(1)

* Despite subsection (1), if the most recently completed financial year of the acquired business ended 45 days or less before the acquisition date, a **reporting issuer** must file a business acquisition report (a) within 90 days after the acquisition date, in the case of an issuer other than a venture issuer, or (b) within 120 days after the acquisition date, in the case of a **venture issuer**.
* **Determination of significance –** s.8.3(2) sets out several significance tests re: what is a significant acquisition
  + **The Asset Test**
    - **Non-venture issuer:** the acquisition is significant if the acquired assets exceed 20% of the issuer’s total assets after the acquisition
    - **Venture issuer:** threshold is 100% // used to be 40%
  + **The Investment Test** 
    - **Non-venture issuer:** the acquisition is significant if the issuer’s investments in and advances to the acquires business, as of the date of the acquisition, exceed 20% of the issuer’s assets as of the last day of its most recently completed financial year.
    - **Venture issuer:** threshold is 100% // used to be 40%
  + **The Profit or Loss Test** 
    - **Non-venture issuer/ Venture issuer:** the acquisition is significant if the profit or loss (i.e. income) over the last completed financial year of the acquired businesses exceeds 20% of the profit or loss of the issuer over the last completed financial year.

The BAR has to provide a detailed description of the transaction, audited annual financial statements, and in some cases interim financials for the business being acquired.

* **For non-venture issuers,** the BAR must include a pro forma statement of financial position of the reporting issuer. New financial statement, income, balance sheet for reporting issuer as if business acquired had been part of the issuer's business for the past year.

**(2) Material Change Reports (MCRs)**

Triggered by material change in the issuer’s affairs!

Under s. 7.1 of NI 51-102, a reporting issuer also has **an ongoing obligation to make timely and accurate disclosure of material changes that affect the reporting issuer**. When a material change occurs, the reporting issuer must:

* Immediately issue and file a **news release** disclosing the nature and substance of the material change; and,
  + Must be filed on SEDAR and disseminated (usually news coverage)
* As soon as practicable, or w/in 10 days of material change occurring, file a **Material Change Report** on SEDAR, Form 51-102F3.
  + If you file the material change report promptly, then you are relieved from the requirement to do a news release
* IF the public disclosure of the change would be prejudicial to the issuer, you can confidentially file the change: **Confidential material change report**
  + Confidentiality is only good for 10 days, then you need to resubmit, claiming why you need to extend this
  + Very rare - the staff of the Commission has the power to review at any time after filing, and can revoke the confidentiality
  + Then they'll have to issue the news release

**Best Disclosure Practices** (4 steps) NP 51-201, Part 6

* Issue news release through widely circulated news or wire service
* Advance public notice before conference call to discuss info
* Hold conference call in open manner eg. web casting
* Provide dial-in and/or web replay or make transcripts of the call available for a reasonable period of time.

In addition to 51-102 for News reports and material change reports, there's **stock exchange** requirements. Stock exchanges require disclosure of **material information** (includes **material facts and changes**). B/c material facts require a broader view, the stock exchange cuts a bit more slack and provides for a confidentiality process that is more workable than the confidential change report.

* If it isn't ready for disclosure, the stock exchange for confidentiality would include bringing the matter to the attention of the market surveillance branch to keep them apprised

TSX-Venture provides list of material changes

* Significant litigation, significant change in management …
* 3.3 of the Corporate Finance Manual lists many as well
* But TSX doesn't give a list - because junior issuers need more guidance

**Rationale:** MCRs are supposed to ensure that all investors have access to the most current information about all reporting issuers – both favorable and unfavorable. It is a cornerstone principle of securities regulation that all persons investing in securities have equal access to information that may affect their investment decision. Public confidence in the integrity of the securities markets requires that all investors be on an equal footing through timely disclosure of material info concerning the business and affairs of reporting issuers and of companies whose securities trade in secondary market. In other words, it prevents insiders from taking advantage of their special position. Furthermore, it ensures markets perform their pricing and evaluation functions in the most prompt and efficient manner.

**What is a material change?**

**Material change is defined in the** BCSA s.1(1) **as follows:**

**"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 // *In Danier, a change of forecasted results was not a material change*

(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

**A number of cases have considered the definition of material change:**

In **Pezim***,* the SCC held that the definition of “material change” had three elements. The change must be: (a) in relation to the affairs of the issuer, (b) in the business, operations, assets or ownership of the issuer and (c) material, i.e. would reasonably be expected to have a significant effect on the market price or value of the securities of the issuer.

The SCC concluded that Pezim’s assay and drilling results, which doubled reserves, amounted to a material change because it was a change in assets. Senior management were granted options and there should have been timely disclosure of results. The problem was compounded by trading in the interim before disclosure took place and sanctions were imposed.

* Their defence was that they were still assessing assay results and that they set up a wall to contain the information
* Court said the company should have released the results; didn't matter that they had a wall or not
  + Importance is to keep the playing field level

In **Danier Leather**, the SCC distinguished between material facts (which need not be disclosed on a continuing basis, except for TSX-listed reporting issuers who must disclose changes to “material information”), and material changes. The SCC said that “material change” is limited to a change in the business, operations or capital of the reporting issuer, that this this limitation is a *deliberate, policy-based* “attempt to relieve reporting issuers of the obligation to continually interpret external political, economic and social developments 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”.

The SCC concluded that unseasonably warm weather (an external factor) was a “material fact”, but not a “material change”, and so Danier’s failure to disclose this fact did not amount to a breach of its continuous disclosure obligations.

In **AiT***,* the OSC held that the determination of whether a material change has occurred is not a “bright-line” test b/c the determination of a material change is a question of mixed fact and law. The OSC held that, in the context of a proposed merger and acquisition, whether or not this proposed transaction constitutes a material change depends on whether a “decision to implement” the transaction has taken place (even though tsx itself has not yet occurred; definitive agreement not signed). The OSC said: “where the proposed transaction is speculative, contingent and surrounded by uncertainties, a commitment from one party to proceed will not be sufficient to constitute a material change”. The OSC concluded that AiT should have disclosed the potential acquisition by Motorola as soon as the decision to proceed was made, and should not have waited until final acquisition agreement was signed (breach of *timely* disclosure obligation).

### Probability-magnitude test

**Definition: The materiality of a potential future event depends on (a) an assessment of the probability that the event will occur** having regard to all the known or ascertainable facts, **and (b) an assessment of the magnitude or significance of the change,** in terms of whether the information would be viewed by reasonable investors as important information for making a decision to buy, sell, or continue to hold their securities. – **and weighing the two to determine whether material change or not**

The greater the significance or magnitude of a change when it occurs, the lower the probability needed before it must be disclosed. Conversely, the less the magnitude/importance of the change, the greater the probability needed before disclosure. It is not a legally defined approach; a tool employed by some regulators & courts.

* This can be seen as a supply/demand curve
* Came from US law
* Applied in YBM Magnex

**Application:** when advising clients about the materiality of an uncertain event w/ a high probability (e.g. a pending merger, or a pending lawsuit), it is important to look at the **probability-magnitude test**

* Whether disclosure is necessary or not

In **YBM Magnex***,* the OSC applied the **probability-magnitude test** to determine whether a contingent future event had become sufficiently crystallized such that YBM had to disclose this possibility as a material change. The **issue** in YBM Magnex was whether YBM’s potential inability to file its audited statements by the May 20 deadline (and therefore face a cease trade order) after its audit was suspended on April 20 constituted a material change. **H:** The OSC found that this was a material change: the magnitude of the potential cease trade order was “self-evident”, and that it was sufficiently probable that YBM would be unable to obtain an audit opinion in time to make its May 20 deadline. YBM only disclosed the audit suspension 18 days after it occurred. The OSC found that YBM failed to disclose the material change forthwith/as soon as practicable.

## (3) Selective disclosure

Where general disclosure had not been made of material information, but some investors/ shareholders have been given the disclosure ahead of general disclosure (look @ p.286)

* A major concern in the USA
* In Canada addressed in **National Policy 51-201**
  + Deals with best practices in disclosure and specifically with how to avoid selective disclosure
    - Arises when companies talk to analysts doing research, institutional investors
    - Now, a lot of conference calls just open to analysts have been publicized through news releases and allowing people to call in
* Other things in this Policy: if companies post analyst reports, they post them all, and not just the favourable ones
  + Makes sure that analysts are at arm's length too
* Where it's less clear
  + If the information itself is not material, but taken with information out there it becomes material by connecting the dots

# Proxies

When summoned to vote as a SH at a meeting, SH can appoint someone as a proxy to vote at the meeting on their behalf – typically an officer of the company.

## Poxy solicitation

**What does a transfer agent do?** Incorporated companies have to keep a list of registered shares issued and the shareholders.

* + for a private company, this isn’t too hard
* but for a public company, certain trust companies can provide these services – They maintain a register of registered shareholders and every time a registered share is transferred, their records will change
* Basically, takes care of maintaining the central securities register and helps w/ handling proxies. Ex. Computershare

BCSA s.116: In this Part:

* **"form of proxy"** means a written or printed form that, on completion and execution by or on behalf of a security holder, becomes a proxy;
* **"proxy"** means a completed and executed form of proxy by which a security holder 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 security holders;
  + **s.1.1 of NI 51-102** includes an identical definition of “proxy.”
* **"security holder"** means a holder in British Columbia of a voting security of a reporting issuer.

**When do you need proxies?**

Under s. 9.1(1) of NI 51-102, if management of a reporting issuer 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**. Under s. 9.1(2), this proxy must be accompanied by an **information circular**. **When management solicits proxies, an information circular is ALWAYS required!!!**

This requirement to send an information circular along with a proxy solicitation **does not apply to non-management if:** (a) under s. 9.2(2), the total number of shareholders who proxies are being solicited is no morethan 15(rationale: recognizes the opportunity for one-on-one discussion between 15 or fewer people); or, (b) under s. 9.2(4), the solicitation is made to the public by broadcast, speech, or publication, and the person has filed info. The content requirements for a non-management information circular are also less onerous than the content requirements for a management info circular; however, all info circulars must contain enough info to allow a reasonable shareholder to make an informed decision.

Finally, the shareholder may rely on **Notice-an-Access**, set out in s. 9.1.1 of NI 51-102. This is a relatively new regime whereby can send out a notice-and-access note to SHs instead of mailing the entire thing to save on costs (ex. printing costs). It provides information about date, time, what’s being voted on, website for SEDAR to get access to information circular, reminder to review, and a copy of the proxy.

* For contested meetings, this isn’t used too often
* Usually, they’ll opt to deliver the IC instead

**Intermediaries:** NI 51-102 sets out the requirement to deliver proxy and IC to registered voters. However, most retail investors probably hold their shares through an **intermediary** (ex. broker – registered SH would be broker; ex. RBC and would say that you are beneficially entitled). Another form of intermediary (the highest level) is the **CDS**, which provides a global system that allows shares to be registered to CDS, and all participating brokers can then have shares allocated by CDS. Transfers between brokers under the CDS will not have to be registered.

* CDS 🡪 brokers 🡪 beneficial SHs 🡪 NOBOs & OBOs
* For most reporting issuers, there are few registered SHs

**Proxy solicitation under NI 54-101** (diagram Feb.14)

**Communication w/ Beneficial Owners of Securities:** NI 54-101 sets out the delivery requirements for getting materials in the hands of beneficial SHs knowns as NOBO’s (none objecting beneficial owner); OBO’s (objecting beneficial owners; can direct whether they want to receive materials or not)

* Broadridge appointed by brokers to handle communication w/ beneficial SHs
  + If want a list, contact Broadridge directly
* Brokers get small fee under NI 54-101, so the bulk is contracted to Broadridge

Step 1: NI 54-101 s.2.1 A reporting issuer that is required to give notice of a meeting to registered holders of any of its securities shall fix

* **a date for the meeting;**
* **a record date** for notice of the meeting, which shall be no fewer than 30 and no more than 60 days before the meeting date; and
  + *fix record date to establish the SHs entitled to receive notice of SH’s meeting*
* if required or permitted by corporate law, a record date for voting at the meeting.

Step 2: NI 54-101 s.2.2 at least 25 days before the record date for notice of a meeting, the reporting issuer shall send a notification of meeting and record dates to (a) all depositories; (b) the securities regulatory authority; and (c) each exchange in Canada on which securities of the reporting issuer are listed.

* *Why? to allow transfer agent to notify others*

NI 54-101 s.2.3 at the same time that reporting issuer sends notification, it shall send intermediary search request to depository.

**Step 3:** NI 54-101 s.5.3 w/in 2 biz days of receiving an intermediary search request from a RI, a depository shall send to RI a report containing # of shares, participants & nominee list.

NI 54-101 s.5.2 Also CDS publishes meeting list

**Step 4:** NI 54-101 s.2.5 at least 20 days before the record date for notice of a meeting, the reporting issuer must send request for beneficial ownership info to depository and intermediary

* Broadridge handles all the mailing to OBOs after this
* The transfer agent is able to handle NOBOs

**Step 5:** figure out if the RI is going to send directly to NOBOs or not // probably not (the transfer agent would be doing it for the reporting issuer)

**Step 6:** NI 54-101 s.4.1(a) intermediary must send search response w/ estimated number of sets to RI w/in 3 biz days of receiving the request.

**Step 7:** now, the record date is past & we know who we need to send the materials to

* Record date has 2 applications
  + Who is entitled to receive the materials? The SHs who own those shares or is the beneficial owner as of the record date
  + Who is entitled to vote? Usually same as above
    - Have to pick a date when someone is entitled to vote – usually the notice date
* If you buy shares after the record date, unless you get a proxy from the seller, you won’t be able to vote b/c the seller will still be the beneficial holder!!!

**Step 8:** w/in 2 days after the record date, the depository (CDS) sends to RI Form 54-101F3 – an omnibus proxy.

* CDS gives instructions on how to vote, and will be voted based on the instructions of the beneficial holders
* Before, only registered SHs could vote (i.e. they’ve sold or holding in trust), and beneficial owner wasn’t entitled to vote

At the same time, the depository will send confirmation to each of the participants named in an omnibus proxy.

**Step 9:** now that we know who we’re mailing to, the NOBOs and OBOs is sent a voting instruction form

**RI not sending to NOBOs**

* RI sends to intermediary proxy material for OBOs & NOBOs – minimum 21 days plus 3 biz days before the meeting
  + *Why 3 days earlier? To give them time to collect materials, figure out who to send it to etc.*
  + 21 days is clear days – based on BC Interpretation Act; basically ends up being 23 days
* Intermediary sends proxy material to NOBOs & OBOs 21 days prior to the meeting

**RI sending to NOBOs**

* 4.1(1)(b)(c)Intermediary sends to RI search response, Form 54-101F4 proxy and NOBO list w/in 3 biz days after the record date
* 2.12 RI sends to intermediary proxy material for OBOs – minimum 21 days plus 3 biz days before the meeting
* 2.9 RI sends proxy materials to NOBOs // 4.2 Intermediary sends proxy materials to OBOs – minimum 21 days before the meeting

**Step 10:** The voting instruction is then tabulated, and the information can complete the omnibus proxy so that it votes the way the beneficial holders indicate

**Fixing a date for the deposit of proxies:**

* Most of the time, issuers fix a date for the deposit of proxies – But this might not be suitable for public companies, because of quorum requirements, do not know how things will be voted on etc.
* Companies are entitled to fix a deposit deadline not more than 48 hours in advance of the meeting time
* This way, you can get a final report from the transfer agent 2 days before the meeting - if the company doesn't like the results, they can take action
* Proxies are not votes: they're predictive of votes, but they're like agencies. There's limited discretion though
* Proxies solicited by management must provide SHs w/ a choice on how they wish to vote – Except for 2 matters where they can't vote against:
  + You can't vote against the nomination of a director - can only abstain
  + You can't vote against the appointment of auditors
  + Other matters you can vote for/against
* Registered shareholders can just show up and vote, but proxies are scrutinized

## Securities lending

Broker lends security out, guy who bought security might have an interest in voting (but so does technically the beneficial owner). Who gets to vote? How do we reconcile whose vote matters when? The system is not set up to deal w/ this, so it’s a problem

* Leads to interesting examples of contested meetings: leads to **empty voting** – where financial interest and beneficial interest in the shares are decoupled
* i.e. buy 20% of company, and lend all of it out - you have no financial interest in the company, but you have 20% voting control of the company
* Activist investors can use these type of strategies to exercise a large voting power without any economic exposure
* **Telus** once threw these shareholders out and the SHs sued. Because of no economic interest, Telus won!
* Arbitrage strategies

## Proxy contests – options for a dissatisfied SH

Comes up in the exam very often!

Situations that arise where SH and management don’t see eye to eye on a particular matter (such as approval of a merger, election of directors). proxy contests are expensive

* Proxies can be used to change the board, or to constrain the board, or to provide influence over the board
* If want to change CEO have to change board

**What are the options of a SH who is unhappy w/ management?**

1. **Sell shares** – small SHs will usually do this
2. Can wait until the annual meeting & vote at the annual meeting using the proxy machinery
   * On election of directors, they'll get to withhold - but nothing will really come of this
3. Most corporate legislation (not securities) provides that shareholders that hold a minimum number of shares for a certain period of time **can make shareholder proposals**. In BC,the proposal must be signed by SHs (or a single SH) holding at least 1% of the issued and outstanding shares of the company for at least 1-yr.
   * Must be made on a timely basis, and the company must disclose it on the IC
   * If the proposal is for a certain member to be put on the board, the board is not obligated to nominate the person, but they'll put the name in the IC
     + In BC to nominate, it's 5%
4. Wait until annual meeting - if they have enough shares, they could vote the shares and see how it goes
   * See if they can outvote management
   * At the meeting, they can nominate whoever they want to be a director
   * If they don't own enough shares to win the vote at the meeting, he can do a dissident proxy solicitation
   * Dissident because he's not management
   * They can pass out a concerned shareholder Information Circular, alongside the management's circular
   * This is expensive
   * Still have to wait for mgmt to call the meeting - corporate legislation mandates regular meetings though
   * But management has options to apply for extensions
5. **Full blown proxy solicitation by requisitioning a SH meeting:** under the CBCA and BCBA, a meeting can be requisitioned by a SH, or a group of SHs, holding at least 5% of the voting shares of the company.
6. Meet with management or an independent director
   * Make it clear that you're not going away, but want to work cooperatively
   * Sometimes there are very few independent directors and lots of related party transactions
7. **Launch a TOB** – if acquire over 51% of the shares, then have enough shares to kick out the existing board of directors

**Acting for dissidents**

Do a dissident proxy solicitation if not management – ex. concerned SH

* Prof: it is much better to act for management

If negotiations fail, under s. 9.1(2) of NI 51-102, a dissident shareholder (or any other party, other than management) may solicit proxies from other shareholders. The proxy must typically be accompanied by an **information circular**. **The definition of “solicitation”** is key to determining whether the information circular requirement applies to a dissident shareholder. Section 1.1 of NI 51-102 defines “solicit, in connection with a proxy” as including any request for a proxy, any request not to execute a proxy form or to revoke a proxy, and any communication with a shareholder that a reasonable person would relate to giving, withholding, or revoking a proxy.

**Obtain SH info:** get a list of registered SHs from transfer agent; get a list of beneficial SHs from Broadridge

**Dissent Info Circular:** Dissident shareholders (i.e., not management of a public company) wishing to challenge management business at a shareholder meeting in a “full blown” proxy context are also subject to proxy solicitation rules. A dissident shareholder that solicits proxies from registered securityholders of a public company must, concurrently with or before such solicitation, send a dissident information circular in the prescribed form to each registered securityholder whose proxy is solicited.

Need to have convincing reasons – stock price performance is often relative, related party contracts, management compensation, lack of disclosure, independence, corporate governance practices. It is critical that the disclosure about the slate/reasons/things you say about management are **factually based** – otherwise, the chair of the meeting has the power to rule on the validity of proxies. If the dissident circular contains misrepresentation, then the proxies that have rallied around the dissident may be voided

**Exemption:** Dissident shareholders who solicit proxies from not more than 15 securityholders are not required to prepare a dissident information circular. Dissident shareholders are only required to file (not mail) a document on SEDAR at the time of the solicitation containing applicable information, and only if the dissident solicitation relates to a significant acquisition or restructuring transaction or the nomination of any individual for election as a director. The management might not become aware of the proxy contest until proxies are filed at cut-off time, typically 48 hours in advance of the meeting, which may be too later for management to react.

**Requisition a meeting:**

* Who can requisition a meeting? SH must hold at least 5% of the issuer shares of the company to requisition a SH’s meeting
* Timing of board response to requisition: If shareholders requisition a meeting, management has 21 days to call it, but can call within 120 days of the requisition - can stretch it out

**Delivery of proxies:** various ways proxies can be delivered: mail, fax, email, usually computerized voting now (assigned controlled numbers)

* When you act for the dissident, you want to monitor

**If you get to the requisitioned meeting**

* News releases are issued responding to the dissident slate to deal with the proxy contest
* 48 hours before the meeting - the cutoff, you know what your vote is, and can usually figure out what the company's votes are
* Arrange a pre-meeting with company and transfer agent and proxy solicitor - review proxies and see which ones are going to be rejected
  + Can make appeals and try to sort things out
* Have to realize that the cards are against them (dissidents)

**Chair of meeting:** The chair rules on everything (i.e. whether the circular was proper disclosure or not). Chair's duties at the meeting are to act fairly and in a reasonable manner, but not to act judicially. If it's clear that the Chair will not act fairly before the meeting, you can start an oppression action with the courts and get an independent Chair at the meeting. Court will not grant an order appointing an independent chair w/o evidence indicating that the Chair will be biased. If acting for dissonant, want to create a case where the chair has done something that indicates that they won’t act fairly. Absent manifest error, the court will defer to the Chair's. In **Mosquito Consolidated,** the court ordered a new meeting after dissidents started an oppression action.

**What can management do when they see that there’s going to be overwhelming votes against them?**

* They can postpone or cancel the meeting. Directors might find themselves getting sued for doing this without good reason.
* Example reasons: Dissidents' disclosure was defective, give shareholders more time to figure out their slate
* Last resort is diluting the SHs

**Advance Notice Policies/By-laws**

* in the case of BC companies, if anyone other than management wants to nominate a director, advance notice of nomination must be provided to the company not less than 30 and not more than 60 days before the meeting
  + info about SH posing the nomination must be provided
  + this gives the management a heads up
* **Orange Capital Case:**Advanced notice policies interpreted as protective of shareholders rather than management
* A lot of companies are now adopting these
* Before Advanced Notice, you could show up at the meeting and propose a slate of directors 🡪 Could ambush
* Potential effects on corporations
  + Could see more proxy contests as a mechanism to acquire not only control of the company, but also ownership - put in place a friendly board
  + We see proxy contests among companies that are junior in Canada, but have attracted interest in mainland China investors
    - They soon realized that they would need to take control of the board

# Corporate governance

Corporate governance scandals

* Enron Corporation’s cataclysmic bankruptcy

2 broad themes that have risen in importance over the past decade:

* (1) Increased corporate transparency & accountability
  + (A) Post-scandal reforms
    - Unlike other provinces, BCSCn preferred a principles-based approach to corporate governance.
    - Commissions follow the corporate governance regime set out in NI 58-101, NP 58-201 and NI 52-110
  + (B) Corporate governance disclosure
  + (C) Director independence:
  + (D) Director and officer certification requirements
  + (E) SH meetings and voting rights
    - dual class share structures
    - plurality and majority voting
    - say-on-pay
* (2) Evolving understanding of the public corporation’s role in society
  + (A) Intro: “SH primacy model”; “stakeholder theory”
  + (B) BCE Inc. v 1976 Debentureholders
  + (C) Gender equity and board diversity
  + (D) Corporate social responsibility (CSR): refers to the way in which a company integrates social and environmental goals into its biz operations, while still addressing SH and stakeholder expectations.

**Corporate Governance Disclosure Requirement**

Historically, no mandated disclosure and the rational was that pple invest in companies that perform well (if bad corp governance pple won’t invest in). This failed in 2011 w/ Enron’s bankruptcy (worst one in US’s history – fraudulent accounting practices; serious lack of independence) – as a result of which the Sarbanes Oxley Act was implemented.

Canada has adopted a comply or explain methodology – whereby issuers need to adopt practices; and if they don’t, they need to tell people why you don’t

* BC wanted to adopt principled approach, but ultimately explain-and-comply won!

NI 58-101 sets out a series of disclosure requirements w/r/t corporate governance.

**Director Independence Requirements**

Most important function of independent directors is overseeing and scrutinizing the activities of management.

NI 58-101 s.2.1 IF management of a **venture issuer** solicits a proxy from a security holder for purposes of electing a director, the issuer must include in its management info circular the disclosure required by **Form 58-101F1.**

NP 58-201 provides guidance: s.3.1 the board must have a majority of independent directors.

* NI 58-101 s.1.2 Independence means what it means in the Audit Committee Requirement (NI 52-110)
  + NI 52-110 s.1.4 member is independent if he has **no direct or indirect material relationship w/ the issuer**. A “material relationship” is defined as a relationship which could, in the view of the issuer’s board of directors, be reasonably expected to interfere w/ the exercise of the member’s independent judgment.
    - Specific relationships that are expressly considered “material”: an individual who has been an employee or executive officer of the issuer in the last 3 yrs; or their family members (p.721) 🡪 Ex. CEO won’t be viewed as independent

Form 58-101F1

* **Disclose identity of non-independent directors**
* **Disclose proportion of non-indep/indep directors**
* If they don't have majority independent, they have to explain (the shaming method)
  + P.724
* Provide copy of board's written mandate – schedule B
  + Sets out roles and responsibilities
* Talk about orientation and continuing education
* Disclose whether or not the board has adopted a written code of conduct for directors and employees
  + If yes, how to get a copy of it
* Identify how board identifies new candidates to board
* How board is compensated
* The committees of the boards
* The assessment process for members of the board & term limits

**Board Diversity Requirements**

**Policies regarding the representation of women on the Board** – item 11

* Survey of gender diversity conducted by OSC in 2013
  + Banking /RE- about 34% of board members were women
  + Industrial/communication/media were okay
  + Mining/Oil and Gas/ tech - very dominated by men
* Based on this, jurisdictions in Canada adopted disclosure requirements on gender diversity at the board/officer level
* Identify whether policies have been adopted relating to the ID and nomination of female directors
  + Must explain if haven't done so
* Goes to nomination process - what steps re: nomination of women to board
* Same thing for women in officer appointments
* Company's targets re: representation of women on board and officer positions
* BC hasn't adopted any of these
  + Didn't think gender issues should be the only kind of diversity addressed
* There is speculation that mandatory targets will come to Canada

**Director and Officer Certification Requirements**

NI 52-109 deals w/ certification of financial statements

* CEO and CFO have to certify that accounting statements fairly represent company
* Requires controls that the final position is fairly represented

**Audit Committee Requirements** Audit committee is good for exam question

This is the one committee that's mandatory – Every issuer must have an audit committee that complies with the requirements of the Instrument. NI 52-110 s.2.1! Other ones such as compensation committee are only recommended!

**Composition of audit committee:** NI 52-110 s.3.1 (1) An audit committee must be composed of a minimum of three members. (2) Every audit committee member must be a director of the issuer. (3) Subject to sections 3.2, 3.3, 3.4, 3.5 and 3.6, every audit committee member must be independent. (4) Subject to sections 3.5 and 3.8, every audit committee member must be financially literate.

* Ensures there's not COI
* Audit committee meant to be a body between management and the auditors

The auditor has a duty to shareholders - management can't fire, but shareholders can

* They get approved by shareholders, but work closely with CEO and management, so this can get tricky - recent laws limit how they can get involved

**Majority voting policy**

**TSX Company Manual** requires that each director of a TSX-listed issuer (other than directors of a majority-controlled listed issuer) be elected by majority of the votes cast at any SHs’ meeting other than a contested meeting. A majority voting policy is a written policy adopted by a resolution of the board of directors of the issuer – but TSX prescribes the parameters. Issuer doesn’t have to adopt a formal majority voting policy if it otherwise satisfies the majority voting requirement of the TSX – ex. if its articles or by-laws include majority voting provisions.

Majority voting provisions must provide that **a director immediately tender his resignation if he is not elected by at least a majority of the votes cast** (i.e. doesn’t get 50.1% // treat withhold as votes cast), other than in the context of a contested meeting. A "contested meeting" is defined as a meeting at which the number of directors nominated for election is greater than the number of board seats available as fixed by the issuer before the meeting. The majority voting provisions must also provide that **the board of directors accept or refuse (but only in exceptional circumstances) a tendered resignation within 90 days of the relevant meeting.** Promptly after the board’s decision, an issuer is required to issue a news release communicating the directors’ decision and, if the directors refuse to accept a resignation, the news release must fully state their reasons.

* When shareholders vote, they vote for or withhold
  + Can end up w/ none getting elected
* CBCA is currently under **proposed amendment**
  + Amendments have mandatory majority voting

**Class shares** (p.728)

* i.e. voting/non-voting
* Voting might not trade and held by the founder, and the non-voting ones matter very little
* Idea is that the company's success depends on the founder i.e. facebook
* These are allowed in Canada, but there are particular disclosure requirements for these
* Canadian Coalition for Good Governance
  + Gives recommendations for corporate governance
  + They don't like dual class shares, but they see their purpose
* Dual class companies have out-performed
* TSX allows dual class

**Say on pay (not binding)**

* Say on pay is a vote that arises by companies adopting a policy that allows a vote on executive compensation. SHs have an “advisory vote” (not compulsory) on the issuer’s approach to executive compensation in the yr prior.
  + Many companies have adopted this - some exchanges in USA make this mandatory

**Proxy access (proposal mechanism)**

* Different from proxy contests
* Proxy access mechanism allows SHs to nominate directors and have those nominees listed in the company’s proxy statement and on the company’s proxy card.
  + Big in USA: Brought in as part of Dodd-Frank
  + Shareholders had access to corporate proxy machinery - better access

# Insider trading (IT)

Insider trading is not forbidden per se; only specified abuses are forbidden.

There are 2 types of IT: legal and illegal. The distinction between the two turns on the insider’s state of knowledge at the time of the impugned activity.

Background

* Started caring in 1965 following the Kimber Report, which suggested that legislative provisions were necessary
* Common law afforded insufficient protection to SHs
* Investor protection & efficient capital markets
* P. 341 quote: "the ideal securities market should be a free and open market with full knowledge of the facts. Anything else lessens the confidence of the public in the market place…"

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”.

Why do we care?

* There are arguments that IT should not be regulated
  + Victimless crime – if selling securities, I was going to sell it anyway – would I rly be a victim if selling to someone who has insider info
  + allowing insiders to trade gives them incentive
  + trading info will ultimately be reflected in the market
* Argument for protection
  + Eroding confidence in capital market, which erodes efficiency – if pple think that it is not a leveled Plainfield, then they don’t want to play
    - Less people invest, so less capital available for business in Canada
  + Encourages timely disclosure

## Reporting issuer

A reporting issuer is an issuer that has issued securities through a prospectus or take-over bid, or that is listed on a stock exchange. The ITR requirement applies only to reporting insiders of reporting issuers. The admin prohibitions against IT and tipping also apply only to reporting issuers.

* Public companies
  + Securities trading; not a reporting issuer in Canada (ex. a company from US) – subject to IT regulation
  + In Ontario legislation does not apply to non-reporting, but in BC it does
    - In BC, not just reporting issuers
* Corporate law rules apply to private companies

## Legislation: insider trading, tipping, and recommending

57.2(1) In this section, **"issuer"** means

(a) a reporting issuer, or

(b) any other issuer whose securities are publicly traded.

* *Not a reporting issuer, but securities are trading i.e. a company that has a listing in the USA or UK - not reporting issuer in Canada, but effectively a public company*

Insider trading: 57.2(2) A person **must not enter into a transaction** involving a security of an issuer, or a related financial instrument of a security of an issuer, if the person

(a) is in a **special relationship with the issuer**, and

(b) **knows** of a material fact or material change with respect to the issuer, which material fact or material change **has not been generally disclosed.**

* It says knowledge not use – use is harder to show than knowledge

Insider tipping: 57.2 (3) An issuer or a person in a special relationship with an issuer **must not inform** another person of a material fact or material change with respect to the issuer **unless**

(a) **the material fact or material change has been generally disclosed, or**

* 51-102 disclosure standards; selective disclosure

(b) informing the person is **necessary in the course of business** of the issuer or of the person in the special relationship with the issuer.

* Prohibition on tipping

Takeover/biz combo: 57.2 (4) A person who proposes to

(a) make a takeover bid, as defined in section 92, for the securities of an issuer,

(b) become a party to a reorganization, amalgamation, merger, arrangement or similar business combination with an issuer, or

(c) acquire a substantial portion of the property of an issuer,

must not inform another person of a material fact or material change with respect to the issuer unless

(d) the material fact or material change has been generally disclosed, or

(e) informing the person is necessary to effect the takeover bid, business combination or acquisition.

Recommending: 57.2 (5) If a material fact or material change with respect to an issuer has not been generally disclosed, the issuer, or a person in a special relationship with the issuer with knowledge of the material fact or material change, **must not recommend or encourage another person to enter** into a transaction involving a security of the issuer or a related financial instrument of a security of the issuer.

* This covers situations in which there is effectively a “tip”, but w/ no material non-public info being passed on.
* There is considerable uncertainty as to what constitutes recommending or encouraging. Could a wink constitute encouragement? Could silence, in response to a question, constitute a recommendation?
* Unlike w/ tipping, a person who trades after having been (illegally) encouraged to do so by a special relationship person is not liable for illegal IT b/c the former would not be trading while in possession of material non-public info (p.359).

## Legal insider trading

**Criteria: (1)** person is an insider + **(2)** does not have material non-public info + **(3)** if a reporting insider, files an insider trading report

Where a special relationship person does not know any material non-public information about the reporting issuer, the person may trade freely in the reporting issuer’s securities. However, if the person is a **“reporting insider”** of a reporting issuer, the reporting insider must file an insider trading report (ITR) in certain circumstances, unless an exemption is available.

* There is a subset of insiders that is a reporting insider
* Not all insiders have to file a report, only a subset of the insiders have to file

### Definition of “insider”

Section 1(1) **of the BCSA defines “insider” as:**

(a) a **director or officer of an issuer**

* “director” and “officer” are defined terms that include persons who lack the formal title but act in a similar capacity.

(b) a director or an officer of a person that is itself an insider or subsidiary of an issuer

* a corporation that is an insider of the issuer and you are the director

(c) a person that has

(i) beneficial **ownership of, or control or direction over,** directly or indirectly, or

(ii) a combination of beneficial ownership, 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
* up to the decision-makers to interpret what compromises “direct or indirect” beneficial ownership (footnote 39, p.345)
* “control or direction” must mean more than merely legal ownership (p.346)
* securities held by UWs during a distribution are excluded from this definition as their inclusion will unnecessarily complicate distributions

(d) 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

* don’t worry about this one too much

(e) a person **designated as an insider** in an order made under section 3.2, or

* commission has discretion to designate a person as an insider

(f) a person that is in a **prescribed class of persons**

**Who is a reporting insider?**

First make sure an insider! Then see if a reporting issuer!

Definition of reporting insider is set out in NI 55-104 s.1.1(1)

* 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/revenue of the reporting issuer
  + directors of non-public company, but subsidiary of public company are still insiders
* A **significant SH** of the reporting issuer
  + One w/ direct or indirect beneficial ownership of, or control or direction over (or some combination thereof) more than 10% of an issuer’s voting securities.
* A person “responsible for a principal business unit, division or function of the reporting issuer”
  + Ex. a vice-president of a significant division (VP of finance)
* 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
* An insider that 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

**What does an insider have to do to trade legally?** (p.351)

**Profiles**

NI 55-102 requires **reporting insiders** and reporting issuers to file “insider profiles” and “issuer profile supplements”, respectively (ss. 2.1(2), 2.3(1)).

* An insider profile must conform to Form 55-102F1 and contain info about the insider’s relationship to the reporting issuer, including the date on which the insider became an insider (and ceased to be an insider, if applicable). The profile must also list info such as the insider’s address, telephone and email address.
* Reporting issuers must file “supplements”

**Reports**

Under NI 55-104 s.3.2 a person must file an ITR on SEDI (national database of reporting insiders) w/in 10 days of first becoming a **reporting insider**, disclosing **(i)** the reporting insider’s “beneficial ownership of, or control or direction over”, the reporting issuer’s securities; and **(ii)** the reporting insider’s “interest in, or right or obligation associated w/, a related financial instrument involving” the reporting issuer’s securities (i.e. a derivative).

* If a company acquires more than 10% of another company, they also have to file a report

Subsequently, the reporting insider must file an ITR w/in 5 days of any change to either of those positions (s.3.3).

* Disclosing any change of ownership
* Ex. CEO buys securities, must file report w/in 5-days to show new ownership info

ITRs must include the info required by Form 55-102F2. Insider must disclose the nature of its ownership and other info including, the date of the transaction and the closing balance of the securities held by the insider.

**Rationale:** If you are a reporting insider, the fact that you're trading is information the public might want

**Exemptions from the ITR filing requirement** (p.352)

These exemptions prevent the ITR requirement from unduly undermining capital market efficiency. Sometimes the costs of ITRs outweigh their benefits.

NI 55-101 sets out insider reporting exemptions – some relieve the insider of the obligation to file, and others permit insider to delay its report.

Issuer’s events // Issuer grant as compensation // Normal course issuer bids and publicly disclosed transactions // Insiders of US issuers

Automatic securities purchase plans

* Reporting exemption for a director or officer who acquires securities through an “automatic securities purchase plan”

General exemptions

* Director/officer of a subsidiary that is not a major one
* If a RI has no beneficial ownership, or control or direction over, any security of the issuer, or any interest in a related financial instrument, that RI has not filing obligation

Discretionary exemptions

* Reporting insiders may apply to the Commission for a discretionary exemption from the insider reporting requirements. Under s.91 of the BCSA, the regulator may grant a discretionary exemption to insiders where it would not be prejudicial to the public interest to do so.

**Consequences of failure to file insider reports**

Under BCSA s. 155(1), if an insider fails to file a required insider trading report, that issuer has committed an offence and may be liable, under s. 155(2), to a fine of not more than $3 million, or to no more than 3-years imprisonment, or both. The regulator may also make an order for compliance under s. 157(1), or an enforcement order, including a cease trade order, under s. 161.

**Halt order**

BCSA 89(1):If the commission thinks there is something sketchy going on, b/c of insider trading, they can cease trade securities. Can do so on emergency basis w/o opportunity to be heard and hold it for 15 days.

## Illegal insider trading

There will be an exam Q!

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 OR tip others. Prohibitions on illegal IT are found in provincial securities legislation and the Criminal Code. Prohibitions apply to all special relationship persons (not only insiders); and apply to both purchases and sales (not only sales under the definition of “trade”).

* Hard to prosecute – exceptionally high burden of proof from a criminal perspective
* KPMG guy left a bad trail to get caught – easy example to prosecute

The principle of holding persons in a special relationship liable for purchases and sales they make while in possession of material non-public info is based both on investor protection and a general ideal of fairness (p.356).

Can attract administrative or criminal liability or lead to a civil action for damages.

* Admin proceedings (proof: BOP) before securities commission is easier than criminal (proof: BARD)
* Finkelstein was circumstantial; his friends didn’t turn on him
* Rankin tried arguing that didn’t tell info so he can trade – takeaway: don’t share info

**\*What are the elements of administrative liability?\***

For there to be a claim against X for illegal insider trading under **s. 57.2** of the BCSA, three elements must be met:

* **Special relationship:** X must be in a special relationship with the reporting issuer;
* **Material information:** the knowledge on which X purchased or sold the reporting issuer’s securities must meet the materiality threshold (i.e. it 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.
* Onus of proving the offence is on the Crown/Securities authority

Prohibition against illegal insider trading (BCSA s.57.2(2))

The elements of illegal insider trading are the following:

* (1) a person in a special relationship w/ a reporting issuer
* (2) **trades** in the issuer’s securities (or, effectively, a derivative)
* (3) w/ knowledge of a material fact or change
  1. not “use of” b/c that’s rly hard to prove - knowledge is easier to prove
* (4) that has not generally been disclosed

Prohibition against tipping (BCSA s.57.2(3))

The elements of illegal tipping are the following:

* (1) a person in a special relationship w/ a reporting issuer
* (2) w/ knowledge of a material fact or change
* (3) that has not generally been disclosed
* (4) **informs** another person of that information, **other than necessary course of business**
* this is an offence irrespective of whether a trade occurs by the tippee
* ex. sharing w/ friend

Encouraging or recommending a trade ((BCSA s.57.2(5))

* If you're in a special relationship and you don't pass any material facts along, but **recommend** a trade
* You're not tipping, but there's a penalty for this too

**Element 1: X must be in a SPECIAL RELATIONSHIP with the reporting issuer**

Under s. 3 of the BCSA, for X to be in a “special relationship” with the reporting issuer, X must be:

For the purposes of sections 57.2 and 136, **a person is in a special relationship with an issuer if the person**

(a) is an **insider**, **affiliate** or **associate** of – *defined terms*

(i) the **issuer,**

(ii) a **person** that is **proposing to make a takeover bid,** as defined in section 92, for the securities of the issuer, or

(iii) a **person that is proposing**

(A) to become a party to a reorganization, amalgamation**, merger,** arrangement or similar business combination with the issuer, or

(B) to acquire a substantial portion of the property of the issuer,

|  |
| --- |
| **Definition of “insider”**  Insiders are one small branch of those in a special relationship.  Section 1(1) **of the BCSA defines “insider” as:**  (a) a **director or officer of an issuer**   * “director” and “officer” are defined terms that include persons who lack the formal title but act in a similar capacity.   (b) a director or an officer of a person that is itself an insider or subsidiary of an issuer   * a corporation that is an insider of the issuer and you are the director   (c) a person that has  (i) beneficial **ownership of, or control or direction over,** directly or indirectly, or  (ii) a combination of beneficial ownership, 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 * up to the decision-makers to interpret what compromises “direct or indirect” beneficial ownership (footnote 39, p.345) * “control or direction” must mean more than merely legal ownership (p.346) * securities held by UWs during a distribution are excluded from this definition as their inclusion will unnecessarily complicate distributions   (d) 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   * don’t worry about this one too much   (e) a person **designated as an insider** in an order made under section 3.2, or   * commission has discretion to designate a person as an insider   (f) a person that is in a **prescribed class of persons**  Summary of important ones   * Director/officer of an issuer or a subsidiary of an issuer * 10% SH of the issuer * Director/officer of 10% SH   **Definition of “affiliate”**  1(2) For the purposes of this Act, an issuer is **affiliated** with another issuer if  (a) one of them is the subsidiary of the other, or  (b) each of them is controlled by the same person.  *This is not a control person.*  *Ex. parent company is an affiliate. If parent owns another subsidiary, they are also affiliates.*  **Definition of “associate”**  There is an associate relationship b/w two persons if they are …  1(1) **"associate"** means, if used to indicate a relationship with any person,  (a) a **partner**, other than a limited partner, of that person,  (b) a trust or estate in which that person has **a substantial beneficial interest** or for which that person serves as **trustee** or in a similar capacity,  (c) an issuer in respect of which that person **beneficially owns or controls, directly or indirectly, voting securities carrying more than 10% of the voting rights** attached to all outstanding voting securities of the issuer, or  (d) a **relative**, including the spouse, of that person or a relative of that person's spouse, if the relative has the **same home as that person**; |

(b) is **engaging in or is proposing to engage in any business or professional activity** **with or on behalf of the issuer** or with or on behalf of a person described in paragraph (a) (ii) or (iii),

* These persons are included b/c they may learn confidential info through their relationship – Re Greenway (footnote 50, p.347)
* Suppliers, bankers, lawyers, accountants, UWs, and expert consultants such as geologists all fall into this category (footnote 51, p.347)
* Securities dealers and advisers are not included as they are targeted by registration requirements and subject to ongoing obligations as registrants.

(c) is a **director, officer or employee** of the issuer or of a person described in paragraph (a) (ii) or (iii) or (b),

(d) knows of a material fact or of a material change with respect to the issuer, having acquired the knowledge while in a relationship described in paragraph (a), (b) or (c) with the issuer, or

* **Persons w/ a past relationship** – someone who has resigned from the company is captured
* This branch of the def ensures that persons in a special relationship w/ a reporting issuer cannot avoid liability for trading w/ material non-public info simply by removing themselves from the situation in which the relationship arose (as if to terminate the special relationship).

(e) knows of a material fact or of a material change with respect to the issuer, having acquired the knowledge from another person at a time when

(i) that other person was in a special relationship with the issuer, whether under this paragraph or any of paragraphs (a) to (d), and

(ii) the **person that acquired knowledge** of the material fact or material change from that other person **knew or reasonably ought to have known** of the special relationship referred to in subparagraph (i).

* A person who learns of a material fact or material change from a person in a special relationship w/ the issuer is a **“tippee”**
* (ii) provides a potential defence for the tippee
* a person who learns of a material fact or material change from a tippee is also a tippee and may also fall under this branch

**Note:** this defn is a lot broader than the defn of “insider”! Includes: employees, lawyers, accountants, some third parties….

**KPMG accountant overhearing info:** accountant acquired info from partner, who was engaged in professional activity on behalf of the issuer (so in a special relationship under sub(b)) 🡪 Now, accountant is in a special relationship under sub(e).

Accountant tells his dad & dad buys shares. I: is his dad in a special relationship? Whether the accountant’s dad is in a special relationship or not depends on the reasonableness of the dad knowing that his son was in a special relationship w/ the issuer. Exam answ could go either way!

**Element 2: X traded based on knowledge of MATERIAL non-public INFORMATION (material facts or change)**

**(A) Materiality**

**IF accused of illegal IT,** argue that info at issue was not material, or that they reasonably believed the info was not material (p.359).

Section 1(1) of the BCSA defines:

* **material change** as “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**”.
* **material fact** as **“**a fact that would **reasonably be expected to have a significant effect on market price or value of securities**”, or a decision to implement such a change
  + unseasonably warm weather in *Danier Leather*;
* this is the market impact test!

Timing may be important – look @ *Kapusta* on p.360

***Re Donnini*** (p.361; footnote 122)

* F: Donnini was a director and large SH of the parent company of Yorkton Securities, which was negotiating w/ KCA, a mining company, about a warrants financing.
* I: whether Donnini knew material non-public facts when he engaged in certain trades?
* OSC found that Donnini knew from speaking w/ a # of colleagues at Yorkton that the deal was likely to be completed at $6.75 per share, and that counted as knowledge of a “material fact” even though the deal was not certain to occur. This finding was confirmed by his trading pattern
  + Commission considered the probability that financing might go through as relevant
* Concealing ID of firm – not good
* **Probability/Magnitude Test**
  + Likelihood of occurrence and impact on the market price
* H: guilty of insider trading

**(B) The material information relied on by X to trade was NOT GENERALLY DISCLOSED**

There are two parts to making info public (p.361-363):

* disclosure (releasing the info) and
  + accomplished through continuous disclosure methods
* dissemination (ensuring the info is distributed broadly enough).

***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

National Policy 51-201

* Recommendations on how to disclose and when to disclose material change
* Also addresses selective disclosure & recommends some steps to be taken to minimize selective disclosure
* Tipping is selective disclosure, so

**Evidentiary issues**

Commission Staff must prove each element of the an illegal IT allegation on a BOP.

*Re Suman* (p.364-367)

* Can draw inferences as long as done properly
* Two sorts of inferences are impermissible: those that assume facts that have not been proved; and those linked only speculatively to the facts that have been proven

*Holtby*

* Specific instances where inferences could be useful – circumstantial evidence as to a certain habit/practice; circumstantial evidence of after-the-fact conduct that could reflect consciousness of guild

### Defences to liability for illegal insider trading & tipping

If all the elements are proved, the onus shifts to the respondent to prove one or more available defences (if the respondent wishes to do so).

**(A) Statutory defences**

BCSA s.57.4 provides defences to the abovementioned offences, including:

**(1) Reasonable belief in specific disclosure:**

* s.57.4(1) a person does not contravene s.57.2(2)[insider trading]where one reasonably believes that the other party knew the material fact or material change
* s.57.4(2) a person does not contravene57.2(3) [insider tipping] or (4) [takeover/biz combo]where one reasonably believes that the other party knew the material fact or material change

(2) Acting w/out using the info:

* s.57.4(3) a person does not contravenes.57.2(2)[insider trading] 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
* s.57.4(4) a person does not contravene s.57.2(2)[insider trading] 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

(3) No knowledge:

* s.57.4(5) **corporate persons** do not contravene s.57.2(2)[insider trading] or s.57.2(5)[recommending] if no individual involved has knowledge of material fact/change or material order information **and** is acting on recommendation/ encouragement of someone who does
  + Important for the company to prove that it has implemented policies and procedures to prevent material non-public info from being passed around insider the company. This is called a “Chinese Wall” or an “ethical wall”. It is neither necessary nor sufficient for this defence, buts its presence helps and its absence hurts (p.369).

**(4) Reasonable belief in general disclosure:**

* a special relationship person will not be found liable for trading or tipping under securities legislation if that person can prove a reasonable belief that the material info have been generally disclosed (BCSA s.57.4(1)(2))
* An honest but unreasonable belief is not sufficient (Re Gorrie) (p.367)
* **Re Conner:** meeting went late and news release issued in the morning and disseminated after Conner purchased securities; he argued that he had a reasonable belief b/c of the past practices that general disclosure had happened. **2 components to general disclosure: (1)** company has disseminated the material info – i.e. issued a news release; not good enough putting on SEDAR or @ SH meeting; **(2)** trading public must have the info long enough to allow it to digest, so it can understand (at least 1 day) // H: the belief that it was generally disclosed was not reasonable
* DD defence: s.136.2provides 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
  + didn’t cover this provision in class

|  |
| --- |
| 57.4(1) A person does not contravene section 57.2 (2) if, at the time the person enters into the transaction involving the security, exchange contract or related financial instrument, the person **reasonably believes that the other party to the transaction knows** of the material fact or material change.  (2) A person does not contravene section 57.2 (3) or (4) if, at the time the person informs the other person of the material fact or material change, **the person reasonably believes that the other person knows** of the material fact or material change. |
| (3) A person does not contravene section 57.2 (2) or 57.3 (3) if the person  (a) enters into the transaction under a written automatic dividend reinvestment plan, written automatic purchase plan or other similar written automatic plan, in which the person agreed to participate before obtaining knowledge of the material fact, material change or material order information, or  (b) enters into the transaction as a result of a written legal obligation  (i) imposed on the person, or  (ii) that the person entered into before obtaining knowledge of the material fact, material change or material order information. |
| (4) A person does not contravene section 57.2 (2) or 57.3 (3) if the person entered into the transaction  (a) as agent under the specific unsolicited instructions of the principal,  (b) as agent under specific instructions that the agent solicited from the principal before obtaining knowledge of the material fact, material change or material order information,  (c) as agent or trustee for another person because of that other person's participation in a written automatic dividend reinvestment plan, written automatic purchase plan or other similar written automatic plan, or  (d) as agent or trustee for another person to fulfill a written legal obligation of the other person. |
| s.57.4(5) **A person that is not an individual** does not contravene section 57.2 (2) or (5) or 57.3 (3) or (5) if no individual involved in making the decision to enter into the transaction or make the recommendation on behalf of the person  (a) has knowledge of the material fact, material change or material order information, **and**  (b) is acting on the recommendation or encouragement of an individual who has that information. |
| (6) A person does not contravene section 57.3 (3) if, at the time the person enters into the transaction, the person reasonably believes that  (a) the investor has consented to the person entering into the transaction, and  (b) the other party to the transaction knows of the material order information. |
| (7) A person does not contravene section 57.3 (4) if, at the time the person informs the other person of the material order information,  (a) the person reasonably believes that the investor has consented to the person informing the other person, and  (b) the person informs the other person that both the person and the other person are connected to the investor for the purposes of section 57.3. |
| (8) A person does not contravene section 57.3 (5) if, at the time the person recommends or encourages the other person to enter into a transaction,  (a) the person reasonably believes that the investor has consented to the person recommending or encouraging, and  (b) the person informs the other person  (i) of the material order information, and  (ii) that both the person and the other person are connected to the investor for the purposes of section 57.3. |
| **Due diligence defence for insider trading**  136.2 A person is not liable under section 136 or 136.1 (1) if, after a reasonable investigation occurring before the person  (a) entered into the transaction,  (b) informed another person of the material fact or material change, or  (c) recommended or encouraged a transaction,  the person had no reasonable grounds to believe that the material fact or material change had not been generally disclosed. |

**(B) Common Law Defences**

**(1) Tipping in the necessary course of biz**

NP 51-201, s.3.3:The “tipping” provision [s.57.2 (3)] allows a company to make a selective disclosure if doing so is in the “necessary course of business”. The question of whether a particular disclosure is being made in the necessary course of business is a mixed question of law and fact that must be determined in each case and in light of the policy reasons for the tipping provisions. Tipping is prohibited so that everyone in the market has equal access to, and opportunity to act upon, material information. Insider trading and tipping prohibitions are designed to ensure that anyone who has access to material undisclosed information does not trade or assist others in trading to the disadvantage of investors generally.

NP 51-201, s.3.3(2) provides a list of communications that are generally covered by the necessary course of biz exemption: **(a)** Vendors, suppliers, **(b)** EE, OFRs, and board members, **(c)** lenders, legal counsel, auditors, UW’s, financial and other professionals **(d)** parties to negotiations **(e)** labour unions and industry associates, **(f)** Government agencies and non-gov’t regulators **(g)** Credit rating agencies (provided that the info is disclosed for purpose of rating debt securities)

NP 51-201, s.3.3(5) BUT not analysts, institutional investors or other securities market professionals.

Per NP 51-201, s.3.4, good to make them sign a confidentiality agreement.

**Royal Trust Co:** disclosure of information to a SH as part of an attempt to defend against a takeover bid was not held to be in the necessary course of biz. (p.370)

Re George:Sharing biz of the firm with analysts to tell others in the industry is not in the necessary course of biz. (footnote 176, p.372)

**(2) Reasonable mistake of fact regarding materiality**

**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 if 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

**Harpor**

* Drilling results disclosed
* Negative results and he thought that they were wrong, so did not disclose
* By the time disclosed, price down and by that time Mr.P had sold his shares
* Mr.P argued reasonable mistake of fact – he had a reasonable basis that the geologist was wrong
* H: his belief of geologist findings was not significant was not reasonable

**(3) Tippee unaware that tipper was a special relationship person**

* **Tippee** cannot be liable either for illegal IT or tipping another person, if the **original tipee** did not know and could not have reasonably known that the **original tipper** was a special relationship person. But the original tipper would still be liable. (p.372)

**\*Criminal Liability\***

important differences: extension to all issuers, not just reporting issuers; importation of mens rea

* elements of criminal provision are hard to prove
* pp. 373-375

## Sanctions for illegal IT

The following sanctions may apply if X is found guilty of illegal insider trading or tipping in contravention of BCSA s. 57.2.

1. **Administrative Sanctions under the BCSA** (most common): X may face administrative sanctions under the BCSA. Under s. 161, the regulator may make various **enforcement orders** when it is in the public interest to do so. For example, the regulator may suspend, restrict or terminate the X’s registration, exclude X from trading in BC markets, remove X or prohibit X from acting as a director or officer of an issuer, or reprimand X. Under s. 162, the regulator may impose fines up to $1 million for each contravention of the Act if it determines that doing so is in the public interest. For example, Donnini was subject to a 15 year suspension for illegal insider trading.
2. **Criminal Sanctions under the Criminal Code:** X may be prosecuted under the s. 382.1 of the *Criminal Code.*  Prohibited insider trading under s. 382.1(1) is an indictable offence, and the offender may be liable to imprisonment for a term not exceeding 10 years. Tipping under s. 382.1(2) is a hybrid offence for which the offender may be liable to imprisonment for a term not exceeding 5 years. The prosecution must establish that the accused *knowingly* used or passed on undisclosed material information.
3. **Quasi-Criminal Sanctions under the BCSA:** X may be prosecuted under the quasi-criminal provisions set out in s. 155 of the BCSA. Under s. 155(5), the maximum penalty for a contravention of s. 57.2 is a fine not more than the greater of $3 million and an amount equal to triple any profit made by X thanks to the contravention, or imprisonment for not more than 3 years, or both.
4. **Civil Court Proceedings:** X may face civil court proceedings initiated by the regulator if it determines that it is in the public interest to do so. Under s. 157 of the BCSA, the regulator may apply to the BC Supreme Court for an order that X has contravened a provision in the act, an order that X pay the regulator any amount obtained, directly or indirectly, as a result of the contravention, an order setting aside a trade, or an on order that X otherwise rectify the contravention to the extent that rectification is possible.
5. **Statutory Civil Liability:** X may face civil liability. Section 136 of the BCSA provides that a plaintiff may recover losses against X. The amount payable by X would be the less of the losses incurred by the plaintiff or an amount determined in accordance to the regulation (but a change in market price *unrelated* to the material information is not attributable to damages).

## Criticisms of & emerging issues relating to illegal IT

Desirability of IT regulation

* Advocates of eliminating IT regulation advance 3 arguments (P.377)

Investigation & enforcement techniques

* P.379

Imperial evidence the IT regime is imperfect

* P.380

## How can an issuer minimize the potential for insider trading?

**Best Practices for Countering Insider Trading**

**(1) Disclosure policy**

* Reasonable guidelines on who can speak publicly on behalf of the issuer

**(2) Cease trade order** if aware of material info that has not been disclosed to the market

**(3) Regular Blackout periods for insiders:** periods during which insiders are not allowed to trade in the security – 2 types: automatic and discretionary

* **Automatic ones** will generally be around periodic disclosure
  + Sometime between period end, and 1 or 2 days after the release of financial statements
* **Voluntary blackouts**can be instituted by a designated trading officer (often CFO) when the issuer is expecting to have material information
  + i.e. for biotech, they're close to completing clinical trials
* A case like Connor would not have happened if they had a trading policy and blackouts
  + i.e. you don't trade until a full day after a board meeting

**(4) 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

# Take-over bids (TOB)

Once you have an offer to acquire more than 20% and don’t fall under an exemption, then have to comply w/ the regulation.

* Occur when a **bidder (“Offeror”)** corp makes an offer to purchase (some or all) outstanding shares of **target** corporation **(“Offeree”)** (note: target doesn’t need to be a reporting issuer)
  + **Hostile bids** occur when target mgmt/DIRs do not invite and are not generally in favour of the bid; may lead to defensive tactics
  + **Friendly bids** occur when target mgmt. approves of the takeover and cooperates with the bidder in selling the bid to target shareholders
    - Negotiate on a confidential basis until they reach an agreement
    - Advantages: Acquirer can do DD; opportunity to structure the bid;
* **Takeover bid occurs with making of an offer, not with completion of transaction**
* Major focus of 1965 Kimber Report (p.383); significant reforms followed the 1983 Report of the Securities Industry Committee on Take-Over Bids.
* Other legal regimes that may also be triggered: *Competition Act* and *Investment Canada Act*

Policy: NP 62-202 1.1(1) The Canadian securities regulatory authorities recognize that take-over bids **play an important role in the economy** by acting as a **discipline on corporate management** and as a means of **reallocating economic resources to their best uses.** In considering the merits of a take-over bid, there is a possibility that the interests of management of the target company will differ from those of its shareholders.

* 2 notions of efficiencies
  + efficient capital market allows investors to allocate savings to the most productive firms
  + managerial efficiency: one mechanism to ensure most capable management in charge
    - If a firm is underperforming they will be less profitable, and their stock price will suffer. This creates an arbitrage opportunity by allowing someone to acquire control and insert new management to insert new management

Although regulators want to facilitate takeover bids, they have the following concerns.

* They would be used **coercively** – SHs not treated equally (offer better price to some SHs), not giving enough info/time to make an informed decision.
* **Management entrenchment** – in considering merits of TBs there is a possibility that management and SH interests diverge. For instance, management could look @ take-over bids negatively – they’ll lose their jobs, but SHs could benefit from increased stock price. There is a concern that management of target companies will use defensive tactics.
  + Historically, Canada has been one of the friendliest regimes for take-over bids

### Control premium

* **Control premium** is an amount that a buyer is willing to pay over the current market price of a publicly traded company to acquire a controlling share in that company.
* **Legal control:** when you own 50% + 1
* **Factual control:** 20% - own less than 50%, but effectively control the company
* One of the fundamental principles built in our bid regime is that control premium should be shared equally among all shareholders.
  + It is not something that an individual can sell; it is a corporate asset that must be shared among all individuals.

## Purpose of TOB Regs: Protecting SHs

NP 62-203, s.2.1: The Bid Regime is designed to establish a clear and predictable framework for the conduct of bids in a manner that achieves **three primary objectives:**

* **equal treatment of** offeree issuer security holders,
* provision of **adequate information** to offeree issuer security holders, and
* an open and even-handed bid process.

**#1 Equal Treatment**

**What is involved in this obligation of equality?**

* **Basic concepts:** governs the bidder’s behaviour b/c designed to protect the target shareholders
* *Report of the Committee To Review the Provisions of the Securities Act (ON) Relating to Take-Over Bids and Issuer Bids* – goal of even-handed treatment of shareholders
* **Pro rata take up:** A bidder may offer to acquire less than 100% of the shares and then more than the desired number are actually tendered. Then the bidder purchases the same proportion of shares from all tendering SHs according to the number of shares that each SH tendered (rather than first-come, first-serve on tendered shares) (MI 62-104, s.2.26(1)).
* **Identical consideration:** all holders of the target’s securities shall receive identical consideration.
  + **Collateral benefit prohibition:** 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.
  + **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
  + **Acquisitions before the take-over bid:** 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

**#2 Sufficient Information** *goes to the disclosure that’s required in the bidder’s circular*

**What disclosure obligations are on the target board and the bidder?**

* **Basic concept:** ensure that shareholders have full information about the bid and 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 62-104provides 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 to all shareholders of the target, after receiving a list of said SHs.
* s.2.12(1) of MI 62-104provides 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 62-104provides 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, s**hould 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 system: any person who acquires control of 10% or more of the voting/equity securities of an issuer must issue and file a press release identifying the purchaser and the extent of their control in aggregate – every subsequent 2% increase/decrease requires a further press release.
  + **Policy:** gives the target board a heads up re: creeping takeover bids + lets SHs get in touch with each other

**#3 Ensuring Adequate Time to Make Decisions** *(the minimum deposit period)*

**What timing requirements are in place to protect target shareholders?**

* s.2.28.1 of MI 62-104provides that an offeror must allow securities to be deposited under a take-over bid for an initial deposit period of at least **105 days** from the date of the bid.
* s.2.30(1) of MI 62-104 a security holder **may withdraw** securities deposited under a take-over bid or an issuer bid (a) at any time before the securities have been taken up by the offeror, (b) at any time before the expiration of 10 days from the date of a notice of change under section 2.11 or a notice of variation under section 2.12, or (c) if the securities have not been paid for by the offeror within 3 business days after the securities have been taken up.
* Offeree does not have withdrawal rights in 3 circumstances (p.406):
  + The offeror has already taken up the offeree’s securities by the date the offeror gives notice of a variation
  + The only variation is an increase in consideration and the extension is not more than 10 days
  + The consideration is cash, and the only variation is the waiver of a condition in the TOB
* Min deposit period

#4 Right to reconsider or withdraw

## Definition

**Does what we are doing fall w/in the definition of takeover bid?**

In Ontario, def is w/in the OSA. In all other jurisdictions, the definition is located partly w/in the legislation and partly w/in NI 62-104.

**“Takeover Bid” (**BCSA 92**) –** Direct or indirect offer to acquire a security that is (a) made by a person other than the issuer of the security, and (b) within a **prescribed class of offers** to acquire.

**If this def met, then have to make a formal bid in accordance w/ the takeover bid regime, unless you can rely on an exemption. In BC, takeover bids are governed by MI 62-104 (takeover bid rules that apply to all jurisdictions except ON), NP 62-203 (policy related to the interpretation of the Bid Regime), NP 62-202 (defensive tactics for target company), NI 62-104 (early warning system).**

NI 62-104 s.1.1: **“take-over bid” means an offer to acquire** outstanding voting securities or equity securities (i.e. not debt securities) of a class made to one or more persons, any of whom is in the local jurisdiction (any jurisdiction in Canada) or whose last address as shows on the books of the offeree issuers 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 of that class of securities** at the date of the offer (and securities convertible into securities of the class). **but 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**

* Anything subject to SH vote under corporate law is not a takeover bid b/c already regulated by corporate legislation
* Has to be equity (participate in residual income or assets of company) or voting, not both
* Examples of a takeover bid
  + If own 10% of company and buy another 10%
  + If own 19% and make an offer to acquire an additional 2%
* Does not matter whether you succeed or not, simply if offering to acquire enough securities to get to 20%.
* An offer to purchase the target’s assets will never be a TOB.
* If the requirement were 20% of the total equity or voting securities, the offeree could conceivably gain control of one or more classes w/out triggering the TOB requirements (p.389).
* **Offer:** can be both direct and indirect (tries to prevent the application of TOB regs by the use of intermediaries) (p.390)
* **20% threshold may be met by the aggregate holdings of multiple parties acting “jointly and in concert”**
  + **Acting “Jointly & in Concert”** (s.1.9(1) of NI 62-104): It is a **question of fact** as to whether a person is acting jointly with an offeror. Includes making a formal or informal agreement, commitment or understanding by **(a)** **acquiring or offering to acquire securities of the same class** as those under the TOB; or **(b)** **intending to exercise voting rights attached to the target’s securitie*s*** jointly or in concert with the offeror (or anyone acting jointly or in concert with offeror) (***Re Arthur-Jones:*** *EEs gave a proxy and right of first refusal over their securities to the controlling securityholder; EEs were deemed to be acting jointly and in concert w/ that security holder*).
    - Trigger counting shares together for triggering TOB regulation
    - Early warning?
* Local jurisdiction: an offer to someone who is offshore is not a takeover bid

**Deemed Beneficial Ownership – defined in s.1.8**

* include convertible securities
* an option – if not vested right now, but will vest 30-days from now, it gets accounted; but if vesting day is 61 days out, it doesn’t count (threshold is 60 days); if vested right now, counts
* an agreement to purchase securities if the agreement is intended to close w/in 60 fays is an acquisition of beneficial ownership
  + client signs agreement to buy securities from another party – even though subject to conditions, this is deemed to be beneficial ownership if it provides for closing w/in 60-days

**Plan of arrangement** is the way to go if there is no opposition.

* Xon buyer – plan of arrangement not approved on the basis that there were irregularities in the process
* Provide a venue to dissonant SHs to attack
* Always consider the potential for opposition

## Exemptions from TOB Regulation

**When is one exempt from the takeover bid requirements?** If yes, then exempt from Part 2 (preparing a bid circular etc.)

A TOB is exempt from the TOB requirements in 5 specified situations. In addition, the commission may grant exemptions. As w/ distribution requirements, the TOB regime operates on a “catch-then-exclude” basis. Every TOB will be caught unless it falls w/in a specified or discretionary exemption (p.300).

The first two are the useful ones! These are the ones that can rely on to go over 20% without triggering a TOB regime.

**[1] Normal Course Purchase Exemption** s.4.1 of NI 62-104Offeror may acquire up to 5% (counting securities held by joint actors) of the outstanding securities of a given class over a 12-month period w/o triggering TOB regulation. Also:

* 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 (plus reasonable brokerage fees)
  + **Market Price =**simple average of the closing price over the past 20 biz days (s.1.11(1))

**[2] Private agreement exemption** s.4.2 of NI 62-104Whereby purchaser may enter single or separate agreements with up to 5 vendors (5 or less) – cannot be made to security holders generally and value of consideration paid may not exceed 115%, incl broker fees and commissions, of market price at date of bid (e.g. 5 target SH’s may control 80% of shares)

* Often used to purchase securities from a control block person
* Provides loophole which allows private purchase sale agreements – ex. you have 19% and there’s 5 pple that hold 10% each 🡪 this is exempt even though you hold 29% now
* One of the limitations is that you are limited in the amount of premium that you are allowed to pay

**[3] Non-reporting Issuer Exemption** s.4.3 of NI 62-104TOB exempt **if target** **(1)** Is not a reporting issuer **(2)** No published market for its securities **(3)** Max of 50 securityholders in the class (excluding former and current employees).

* Exemption that most non-reporting target companies fall under
* **For TOB non-reporting must report too**
* The 3rd requirement is problematic
* One way around it is a plan of arrangement, which is more of a corporate procedure

**[4] Foreign take-over bid exemption** s.4.4 of NI 62-104where target securities are primarily traded on foreign exchange and less than 10% of SHs listed in Canada.

**[5] De Minimis Exemption** s.4.5 of NI 62-104TOB is exempt from regulation w/in a jurisdiction (i.e. a province or territory) if only a minimal portion of the bid occurs in the jurisdiction. **Factors:**

* 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.

**[6] Discretionary Exemption (**BCSA 114**):** On application of an interested person or on own motion, may be exempt from TOB req’s if not prejudicial to the public interest.

## TOB Procedures

A person must not make a takeover bid, whether alone or acting jointly or in concert with one or more persons, except in accordance with the regulations (BCSA 98)

* ***BCE decision*** – there is a fiduciary obligation to consider best interests of the corp **BUT under** NI 62-202 what is supposed to be considered is the *bone fide* interests of the shareholders of the target company **🡪** **This is an unresolved problem b/w securities regulation and corporate law.**

**Early Warning Reporting System**

**The early warning reporting regime generally requires disclosure of security holdings of a reporting issuer when the ownership threshold of a security holder exceeds 10%.**

Under s. 5.2(1) of NI 62-104,an acquiror who acquires beneficial ownership (*includes options, agreements to buy*) of, or control or direction over, **voting or equity securities of any class** of a reporting issuer, or securities convertible into voting or equity securities of any class of a reporting issuer, that, together with the acquiror’s securities of that class, **constitute 10% or more** of the outstanding securities of that class, must

(a) **promptly**, and, in any event, **no later than the opening of trading on the business day following the acquisition,** **issue and file a news release** containing the information required by section 3.1 of National Instrument 62-103, and

* 62-103F1 – news release // there are 9 items: date the triggering event occurred, whether joint actors, % acquirer has acquired, consideration paid, why did the buyer purchased the securities in the first place

(b) **promptly**, and, in any event, **no later than 2 business days from the date of the acquisition, file a report** containing the information required by section 3.1 of National Instrument 62-103

D1: 10% (trigger) --- D2: before opening news release --- D3 EWR --- D4 Resume trading

* The person is restricted from trading in securities of the class while the info is being disclosed and disseminated – section????

(1) decreases in ownership of, or control or direction over, 2% or more; (2) increases of 2% or more; (3) a change in a material fact contained in a previous report need to be disclosed.

(2) **For every 2% increase or decrease,** another report and news release must be filed (only if still above 10%). **Rationale:** this disclosure provides targets with a heads up about potential takeovers (aka “creeping takeover bids” – potential bidder slowly approaches 20% threshold).

Also must disclose any change in any material fact set out in a previous report *(ex. An agreement to how we wanted to vote our shares came to an end)*

**Disclosure when ownership, control or direction falls below the 10% threshold.**

(3) An **acquiror must issue and file a news release and file a report** in accordance with subsection (1) **if beneficial ownership of, or control or direction** over, the outstanding securities of the class of securities that was the subject of the most recent report required to be filed by the acquiror under this section **decreases to less than 10%.**

* So if 10 and fall to 8 you have to report, but after that you don’t

**Definitions and Interpretation** 5.1(1) In this Part,

**“acquiror”** means a person who acquires a security, other than by way of a take-over bid or an issuer bid made in compliance with Part 2;

**“acquiror’s securities”** means securities of an issuer beneficially owned, or over which control or direction is exercised, on the date of the acquisition or disposition, by an acquiror or any person acting jointly or in concert with the acquiror;

def of offer???

**These reports don’t substitute for insider trade reports!!!**

**Four major exemptions from Early Warning:**

* **Passive Investors -** Mutual funds or other “eligible institutional investors” who make use of **an alternative monthly reporting system** (NI 62-103 ss 3.3, 4.1-4.8).;
* When share redemptions or distributions from the treasury change a person’s security holdings (62-103 ss.6.1);
* An UW who owns the securities only as an UW and has made certain disclosure by new release (62-103, 7.1);
* Commissions have the discretion to grant exemptions (**“Public Interest”)** (62-103, 11.1).

Case: Issuer reporting in the US, but incorporated in Canada

* Proxy contest
* Dissonant SHs won’t be able to vote b/c had not filed anything in Canada
* So early warning is important

**The Offer**

Written offer for acquiring 20% or more must be made in an information circular before TB legislation is triggered. Also, a letter from the bidder to the target company SHs – letter of transmittal (this letter is not mandated by the legislation, but it is the method by which SH that receives offer accepts)

**(1) To Whom:** A TOB must be made to all in the class in the jurisdiction(62-104, 2.8).

* **50% Minimum Tender Requirement:** a minimum of more than 50% of all outstanding target securities owned or held by persons other than the bidder and its joint actors be tendered and not withdrawn before the bidder can take up any securities under the bid 62-104, s. 2.29.1
  + this requirement allows for collective action by securityholders – in effect a “shareholder vote” on the bid (i.e. a majority of securityholders must show they are in favour of the bid by tendering).
* **10-Day Extension Period:** if the minimum tender condition is met, and all other terms and conditions of the bid have been complied w/ or waived, the bid must be extended for an additional 10 days. The extension requirement allows other SHs to tender once they know that a majority of security holders are in favor of the bid. It also alleviates the concern of regulators that security holders may otherwise have felt “pressure to tender” to a bid for fear of being “left behind” if the bidder received sufficient tenders from other security holders.

**(2) Commence the Bid in one of two ways:**

* Publishing an ad with a brief summary of the bid in a “major daily newspaper of general and regular paid circulation” in each jurisdiction in which offerees reside (2.9(1)(a)) 🡪 will likely do this if hostile
  + Circular & offer have to be filed on SEDAR at the same time the newspaper is issued, and given to target company.
  + Why start by a newspaper announcement? Look @ class notes
* Request a copy of the SH list from the target company and send a copy of the bid circular to the security holders (62-104, 2.9(1)(b)) 🡪 will likely do this if friendly
  + Also need to send the circular 2.10
  + Now have to file on SEDAR
  + Starts the clock on the initial deposit period

**Offeror’s TOB Circular** (p.399-400):

* Offeror must prepare and send a TOB circular.
* TOB circular must be concurrent with the bid (62-104, 2.10(1)(a)). BCSA 98 – must not make a bid except in accordance w/ regs.
* **Info needed to be included (**62-104F1**):** Name/description of usual activities **//** Class/number of section subject to TOB **//** Dates on which TOB will commence & expire **//** Offeree’s withdrawal rights **//** Purpose of TOB **//** Material facts that would impact offeree’s decision **//** Signed certificate that circular contains no untrue statement of material fact/omission.
* **Change in Info:** Must keep offerees informed of any info that “would reasonably be expected to affect” their decisions (62-104, 2.11(1)).
* **Variations:** The offeror must promptly inform offerees of any variations in the TOB terms (s.2.12)
* **A TOB cannot expire before 10 days after the date of the variation notice** (s.2.12(3)(4))
* **File:** Must be filed with the Commission, but does not need to be vetted (62-104, 2.10(4)).
* If all cash, simpler form of TOB circular. If including securities of your company as part of the consideration, need to include prospectus level disclosure.

2.10 (1) An offeror making a take-over bid or an issuer bid must prepare and send, either as part of the bid or together with the bid, a take-over bid circular or an issuer bid circular, as the case may be, in the following form: (a) Form 62-104F1 Take-Over Bid Circular, for a take-over bid; or (b) Form 62-104F2 Issuer Bid Circular, for an issuer bid.

(2) An offeror commencing a take-over bid under paragraph 2.9(1)(a) must, 13 (a) on or before the date of first publication of the advertisement, (i) deliver the bid and the bid circular to the offeree issuer’s principal office, (ii) file the bid, the bid circular and the advertisement, (iii) request from the offeree issuer a list of security holders described in section 2.8, and (b) not later than 2 business days after receipt of the list of security holders referred to in subparagraph (a)(iii), send the bid and the bid circular to those security holders.

(3) An offeror commencing a take-over bid under paragraph 2.9(1)(b) must file the bid and the bid circular and deliver them to the offeree issuer’s principal office on the day the bid is sent, or as soon as practicable after that.

(4) An offeror making an issuer bid must file the bid and the bid circular on the day the bid is sent, or as soon as practicable after that.

**(3) Minimum Deposit Period:** An offeror must allow securities to be deposited under a take-over bid for an initial deposit period of **at least 105 days** from the date of the bid 62-104, 2.28.1

* **Exceptions:**
  + 2.28.2:target issuer’s board of directors may issue a “deposit period news release” in respect of a proposed or commenced take-over bid providing for an initial bid period that is shorter than 105 days but not less than 35 days. The reduced period will apply to all outstanding bids (if the bidder files a notice of variation) and all subsequent bids.
    - what if friendly? Shorten deposit period – putting out a news release that shortening period and saying have support of management
  + 2.28.3:if thetarget company, by news release, announces that it will effect an **“alternative transaction”** (generally a transaction that requires a vote of security holders, such as a plan of arrangement) the minimum period for all outstanding bids (if the bidder files a notice of variation) and subsequent bids will be 35 days.

Concern w/ old rules

* 35 days not long enough 🡪 extended initial depository to 105; NI62-104 s. 2.28
  + Need at least 50% of that class tendered
  + 10 day exertion period - ?
* If our rules are too relax in comparison to our neighbors – then an imbalance that will not favor Canada

**(4) Consideration:**

Under the pre-bid integration rule (62-104, 2.4(1)), if a bidder buys shares in the target under a private placement (not on the exchange) during the 90 days before making a bid:

* The bid price must be at least equal to the highest consideration paid.
* The bid must be for at least the highest percentage of target shares purchased from the holdings of any seller.

**Equal treatment is fundamental to takeover bids!**

Consideration can be cash, securities, other (ex. deposit receipts), or a combo – if cash, must be ready to go **(**62-104, 2.27(1)

* Cash is the easiest and cheapest circular to put together
* A private issuer can become a reporting issuer if there is share for share bid // a back door way of becoming a reporting issuer

**A class must receive identical consideration** (2.23(1)) – even if buys some then ups the offer, must reimburse all – this includes up to 90 days before the TOB.

* **Exemption**: Normal course trades in a published market, as long as no unreasonable fee or commission, nor any solicitation by the seller or purchaser (s.2.6)
* If a partial offer, then have to buy on a pro-rata basis

**Prohibition Against Collateral Agreements (**2.24**) -** If a person makes or intends to make a take-over bid, the person or any person acting jointly or in concert with that person 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**.

* **Exception (**2.25**) –** 2.24 does not apply to employment compensation arrangement, severance arrangement or other employment benefit if certain conditions are met.

**Director’s Circular (issued by DIR’s of Target)** (p.401-405):

The target board of directors must prepare and send a DIRs’ circular to SHs no **more than 15 days after the date of the bid** (and TOB Circular) per NI 62-104 s.2.17)

* Sometimes they can postpone announcement, bet have to send follow-up circular and announcement no later than 7-days before the expiry. ???

**MUST MAKE: 1)** **Recommendation to securityholders to accept or reject the bid**, together with reasons for that recommendation; **2)** Advise they cannot make recommendation with reasons; **3)** Advise they are still considering but will advise later.

* **E.g. of Required Information (**62-104F3**):** Names of offeror and target DIR’s **//** The interests of the target’s DIRs and OFRs in any material transactions w/ offeror **//** A signed certificate stating the circular contains no untrue statement of material fact or omission of material fact.

**Best practice**: is to set up a special committee of independent DIRs, and they have a job to figure out whether or not it is in the best interest of the corp to be taken over and its SHs. They hire their own counsel, accountants, and have access to all the needed info to determine if the bid is good or not.They may appoint a non-independent dir who knows the company well to negotiate w/ the offeror, but shouldn’t be involved in making the recommendation. Usually, the first DIR’s circular just states a special committee is made, and then after will recommend if bid should be expected or not. **If there are particular DIR’s that disagree, they can issue their own information circular! (should do this for liability reasons).** Officers can make an individual recommendation as well.

BCSA 99 **– DIRs MUST** (a)determine to recommend acceptance or rejection of the TOB or determine not to make a recommendation, and (b) make the **recommendation, or a statement that they are not making a recommendation**.

* **Accept =** Friendly; **Reject =** Hostile.

**Contemporaneous Acquisitions**

During the time that the bid is outstanding, there are restrictions on buying/selling the company

* The buyer cannot buy any shares of the company other than up to 5% on the market
* Restrictions on third parties acquiring more than 5%

**Variations**

* When an offeror varies the terms of a TOB, it must promptly issue and file a news release and send notice of the variation to all those entitled to receive the TOB circular whose securities have not yet been taken up. NI 62-104, s.2.12
* There must be at least 10 days b/w the notice and the end of the deposit period (that is, an extension may be needed)
  + Look @ exception on p.407

NI 62-104, s.2.12 (1) If there is a variation in the terms of a take-over bid or an issuer bid, including any reduction of the period during which securities may be deposited under the bid pursuant to section 2.28.2 or section 2.28.3, or any extension of the period during which securities may be deposited under the bid, and whether or not that variation results from the exercise of any right contained in the bid, the offeror must promptly

(a) issue and file a news release, and

(b) send a notice of variation to every person to whom the bid was required to be sent under section 2.8 and whose securities were not taken up before the date of the variation.

**Withdrawal Rights**

NI 62-104, s.2.30 (1) A security holder may withdraw securities deposited under a take-over bid or an issuer bid

(a) at any time before the securities have been taken up by the offeror,

(b) at any time before the expiration of 10 days from the date of a notice of change under section 2.11 or a notice of variation under section 2.12, or

(c) if the securities have not been paid

* P.406

If conditions not satisfied, then the bid fails.

Minimum tender condition – 50.1 total

* 90% which allows them to use compulsory acquisition
* 66.2% - stage 2 squeeze out
  + plan of arrangement
  + amalgamation
* either satisfy or waive conditions
* then have 10 days to take up the shares; to accept the tenders; then have 3 days to make payment
* extend the bid
* obligation to pay is 2.3(1)
* mandatory extension period 2.3(1.1)
* once bid expires there is a 20 business day cooling off period
* s.2.5

**[I] Take Up**

* Procedure
* Proportionate take up (p.407)

**[J] Post-TOB Acquisitions**

* Offeror must not acquire securities subject to the TOB for 20 business days after the TOB expires (NI 62-104, s.2.5), but per s.2.6 this does not apply to purchases made by the offeror in the normal course on a published market (subject to the 4 conditions listed) (p.408).

**[K] Other Required Filings**

* NI 62-104, s.3.2(1)
  + P.408

Case Example

* Mike: given me confidentiality and exclusivity agreement
  + Exclusivity period: so that he can’t negotiate w/ anyone else
  + Standstill: if can’t negotiate, then he can’t come back a certain period
* Garry: how much premium are you going to give me?
* Mike: 30%, but will fire you and all of the board
* Garry: will get back to you
* Garry: 10 days
* Mike: 120 days

*Garry – will call a board meeting // material even if offer is a joke*

* *Running out of cash; will have to do financing, which will dilute*

*If they were to do it friendly, then would negotiate a framework.*

*I am launching a TOB, unless we can negotiate over the weekend (this would probably be a friendly plan of arrangement)*

* *G will call a board meeting and if any conflicts of interest, he will strike a committee*
* *Might strike one anyway if big – ideally all independent director (CEO not an indep director)*
* *Special committee might retain separate counsel*
* *Special committee will obtain a financial advisor to advise on potential bids*

*Formally commenced bid*

* *G has 105 days to find another bid*
* *Send copy of circular*
* *RIM v Cirticum –* 
  + *Permitted use provision can trigger unlimited standstill*

*Leaked confidential info – G is going to start litigation*

*Announce White Knight*

* *Mike could challenge/walk away/*

## Defensive tactics to TOBs

Hostile bids lead to defensive measures!

In Canada don’t have ability to just say go away, unlike the US.

* NP 62-202(2) The primary objective of the take-over bid provisions of Canadian securities legislation is the protection of the bona fide interests of the shareholders of the target company. A secondary objective is to provide a regulatory framework within which take-over bids may proceed in an open and evenhanded environment. **The take-over bid provisions should favour neither the offeror nor the management of the target company, and should leave the shareholders of the target company free to make a fully informed decision.** The Canadian securities regulatory authorities are concerned that certain defensive measures taken by management of a target company may have the effect of denying to shareholders the

Target Company, through its DIR’s, may want to defend against a hostile TOB – there are **3 main reasons:** 1) Compensation is inadequate; 2) Don’t like the idea of the offer; 3) Selfish Reasons. Securities regulators will take appropriate action if they become aware of defensive tactic that will likely result in the targets shareholders being deprived of the ability to respond to a takeover bid or to a competing bid.

* Basic concepts: during a hostile takeover the board is in an inherent conflict of interest
  + Fiduciary duty to the corporation vs. keeping their jobs
  + Usually the board will set up a Special Committee to review terms of the bid + alternatives to make recommendations to the board
* Governed by NP 62-202 – generally regulators find tactics acceptable if the actions are intended to secure a better/offer or result for target shareholders as opposed to entrenching themselves
  + Underlying premise – given this, why should there be defences?
  + Balance conflict w/ corporate responsibilities and rights of shareholders
* s.1.1(4) – the following tactics will come under 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

**What can the target board do?**

**Once an unsolicited bid has commenced, the target will often engage in a series of defensive tactics to try to give its board of directors more time to adequately pursue all available alternatives.**

**\*Shareholders’ Rights Plan (SRP) or “Poison Pill”** – most common defensive tactic

The target company may already have a shareholder rights plan in place; if not, board may call a meeting for shareholders to approve a tactical shareholder rights plan. SRP gives target shareholders, except the bidder, the right to acquire more target shares at a reduced price. This can result in massive dilution of shares. A bidder can apply to have a shareholder rights plan set aside by the regulator (usually a matter of when, not if). Under the new rules allowing 105 days, it is likely that they will be cease traded after 105 days. The theory behind this approach is that the only legitimate purpose of a pill is to provide the target board w/ sufficient time to attempt to obtain a better bid; moreover, while it is permissible, for that purpose, to delay allowing SHs to respond to a bid, it is impermissible to deprive them from the opportunity.

* Policy: buy the target board time to find a white knight
* If do it after bid launched, it is a tactical poison pill
* Nuclear option = massive dilution

**347883 Alberta Ltd.** – when considering a ‘cease-trade application’ look to if 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

**Re Royal Host *–***  **test for cease trading**

When will an SRP be cease-traded by a Commission? There is no “holy grail” to determine when a “pill must go” (longest (before changes in law) was 120 days). Need to find balance between permitting board to fulfill fiduciary duty and protecting the rights of shareholders to tender shares as they see fit.

* Starting point for the analysis is NP 62-202, Take-Over Bids – Defensive Tactics

Factors to be considered (not exhaustive)

* whether shareholder approval (“vote”) of the rights plan was obtained (vs. s tactical decision by the board);
* when the plan was adopted (e.g. if been in place for a long time);
* 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

Examples of declining to cease-trade the SRP

* **Re Pulse Data Inc.**(p.415): 78% of securityholders voted to maintain the SRP, fully aware that it was unlikely to lead to an auction
  + Offeror offered a premium of only 3.3% when a normal premium would have been more like 10 to 15% over the market value.
* **SHs ratified plan 🡪 \*Re Neo Material Technologies Inc**(p.416): 81% of securityhoders had voted to approve the SRP; pill allowed to remain in place!
* BCSCn in \***Lions Gate** concluded that neither *Pulse* nor *Neo* should be interpreted “as representing any significant change” to the longstanding “not if but when” policy, both having been decided w/ an overreliance on the securityholder votes.
  + **Conversion of debt to equity** by management to thwart an activist SH was upheld b/c director’s had good reasons for converting debt to equity other than to fend off the bidder. It reduced their debt-equity ratio. Also, the bidder would not have been good to the company.

Examples of cease-trading the SRP

* **Re Baffinland**(p.417): OSC cease traded – b/c B had agreed not to solicit any more offers
* **Re Inmet Mining** (p.418)

**\*White Knight**

* Target’s DIR’s might try to find someone else to make a competing TOB. They have a fiduciary duty to see if anyone else is willing to pay more.
  + Under the new rules (105 day period), they have a considerable amount of time to engage in this process
* Usually have to “sweeten the deal” to induce a White Knight to takeover company.
* **Break Fee**: Promise that if the White Knight doesn’t succeed in taking over the company than the target co must pay the White Knight. This would hollow out the value of the company (if the white knight does not work) and would improve the value of the competitor (e.g. 3-5% of the value of the company).
* Usually get the Special Committee to review the alternatives as the target must canvass the market as per *Maple Leaf Foods*
* A variation is the “white squire” – an investor willing to invest enough to thwart the TOB, but w/out acquiring control
* The company will enter a support agreement w/ the white knight

**\*Sale of the Crown Jewels (key assets)**

* The target’s “crown jewels” are its most valuable assets.
* Agreement with third party to sell a significant asset to make the company a less attractive take-over target (E.g.Sell interest in land or sell a division of the company).
* As the Board of DIRs need to say, in keeping w/ Fiduciary duty, it is better to sell crown jewel than be taken over. This sale can be contested in court.
  + Biz judgement rule: courts will usually defer to the management’s decision if its not made in bad faith and was an informed decision.
* **CW Holdings** – Pre-Acquisition Agreement with the white knight contained option in favour of crown jewel, allowed by the court
  + 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
* sometimes it might be case – spend or commit the cash
* Western communication case: company entered an agreement to sell some of its key assets // transaction upheld // court will look @ whether directors were trying to entrench themselves or act according to fiduciary duty
  + Justified under the biz judgment rule, then courts will defer
* **CW Holdings v WIC:** in exchange for making a bid, Shaw and WIC entered into a pre-acquisition agreement which entitled Shaw to a (i) break fee of 30$ million in the event that the bid was unsuccessful, and (ii) an option to purchase WIC’s radio assets for $160 million (exercisable regardless of whether Shaw’s offer was successful) // H: neither break fess nor option assets were per se illegal, and the combo was not illegal either.
  + Considering expert evaluations of the assets, 160 M was not an unreasonable price

**\*Break Fees:** big enough to bring the white knight to the table, but not big enough to scare everyone off.

Agreement between white knight and target may have such a clause indicating that if the merger does not happen then the target will pay a certain fee to the white knight

* Result = adds to the acquisition cost of someone other than the white knight
* Anita Anand, “Break Fees: Loathed but Legal”
  + Regulators have no authority to interfere + strike down a contract that SHs don’t like
  + Can only assume jurisdiction via “investor protection”

**CW Holdings** – the agreement also had a break fee clause

* Not *prima facie* improper but they might be due to their quantum
* Will be acceptable 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

**\*Litigation**: Target may attempt to delay or avoid a takeover by bringing a lawsuit against the acquirer on various grounds, such as challenging the acquirer’s disclosure in its regulatory filings.

* injunctions, challenging disclosure provided in the circular etc.
* Will review all actions taken by the bidder to ensure compliance w/ applicable laws. Will also review take-over bid circular for compliance w/ disclosure requirements.
  + Where disclosure is deficient, target can make an application to have the take-over bid cease traded.
* If bidder has signed confidentiality agreement w/ target in the past, which had a permitted use clause
  + \***RIM v Certicom,** permitted use provision could trigger unlimited standstill
    - 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
* ***Re Chapters*** + ***Re Canfor*** = examples of when the ulterior motive of the application was likely delay

**\*Issuer Bid**

* launching bid by which company purchases its shares from its shareholders in competition with the hostile bidder.
* Same requirements as TOB, except exemptions don’t apply
* There is an exemption for redeemable shares
* This is a way for management to give money to SHs while allowing to retain some of their shares

**Luck-Up Option**

* Option granted to a party to acquire a large block of securities or a substantial percentage of the target’s assets if a “trigger event” – e.g. a hostile bidder acquiring 20% of the targets voting securities – occurs.

**\*Golden Parachute:** Compensation package given to senior executives that include generous severance payments or pensions that are triggered by a change in management.

**Conflicting out:** an issuer that considers it might become a potential target can take steps to “conflict out” leading law firms by giving them all some work w/ the hopes of preventing such firms from acting for a hostile bidder.

**Greenmail:** not a true take-over defence, rather a strategy adopted by certain offerors (p.412).

**\*Private placements**

* Issue privately placed shares to friendly SHs, not to hostile bidders –
  + if large enough, can deter offeror from taking up securities
* They can sometimes make take-over bids go away
* Are private placements the new poison pill? BLG handout
* **Dolly Varden Case: adopted a 2-part test: (1)** Is there any reason to think this is being used as a defensive tactic? Consider: did the private placement have a bona fide, business rational? Was there a need for financing? **(2)** whether a defensive tactic that should be interfered by regulators.
* If you put a private placement w/ no biz purpose and it’s to make a takeover bid go away, this will be looked at very poorly.

## Strategies to increase likelihood of success

Strategies and measures that can be adopted by the offeror to increase the likelihood of success of a take-over bid

* Try to avoid litigation – don’t do things that will result in litigation
  + Make sure you haven’t entered into a confidentiality agreement w/ a permitted use clause
  + Make sure circular is accurate and doesn’t include misrepresentations
* Pros and cons about going over a control position of 10% (establishing a toe-hold position)
  + Once go over 10%, dealing with MI 61-101, which could complicate things – ex. requirement of a formal evaluation 🡪 might have a better chance if stay below 10%
  + If you cross 10% threshold, the early warning requirements (need to disclose intentions; if intentions are to launch a TOB and don’t disclose then in trouble)

The offeror may acquire shares of the target prior to the commencement of the bid – this practice is referred to as acquiring **a “toe-hold” position**. If the offeror acquires beneficial ownership of securities of the class that is subject to the bid within 90 days immediately preceding the offeror’s bid, then the bid must meet certain criteria. Specifically, the bid’s terms must be at least as favourable as the most favourable terms of any of those prior transactions, both in terms of the consideration offered and the percentage of the sellers’ securities of the class for which the offer is made. // The acquisition of a “toe-hold” position in the target’s securities before initiating a bid can be advantageous to a potential bidder, since the acquisition of a significant stake may discourage competing offers and the bidder’s total acquisition cost will normally be reduced. However, the bidder may find it difficult to dispose of the shares, other than at a loss, if the bid fails.

**MI 61-101**

* Only in Ontario in Quebec
* Protection of minority shareholders
* Ensure conflicts of interests that exist in a lot of transactions don’t prejudice independent SHs
* Imposes certain procedural safeguards, including specific disclosure requirements, and where applicable, valuation and minority approval.

## Issuer bids (IBs)

An IB is an offer by an issuer to acquire or redeem its own securities from securityholders in the jurisdiction (p.421).

* Subject to greater restrictions and investor protection measures than TOBs.
* IBs encompass all non-debt securities, including debt securities that are convertible into non-debt securities.
* Not restricted to voting and equity securities.
* There is no 20% threshold – meaning that an offer by an issuer to acquire any number of its own (non-debt) securities is an IB.
* Exemptions: normal course // non-reporting issuer // foreign bid // de minimis exemptions // issuer acquisition or redemption – ex. where a security provides that its holder may require the issuer to redeem it for cash on demand, the IB requirements do not apply to those redemptions // purchases from EEs, executive officers, directors and consultants – these persons are deemed to know enough about the issuer not to need the protections of IB regulation; must meet 2 conditions (p.423)

Differences from TOB procedures

* May be initiated only by delivering the bid to the relevant securityholders
* No director’s circular is required
* Contemporaneous acquisitions (p.424)

## Commissions’ discretion

p.424-425

## Critics of the TOB regulatory framework

p.425-246

* Any gains enjoyed by target securityholders are offset by equivalent losses to the successful offeror’s securityhlders.

## Emerging issues

Derivatives can be used to uncouple legal voting rights and economic exposure.

* **“Empty voting”** refers to situations where an investor has voting rights but no net economic exposure to the shares being voted. P.426
* **“Negative voting”** refers to situations where an investor has voting rights and negative net economic exposure to the shares being voted – that is, the investor has an interest in the share price decreasing. This can help to avoid certain disclosure obligations, helping to hide a voting interest until ready.
* **Hidden ownership:** The investor has economic exposure to the shares but no voting rights. An investor might be able to convert its interest into voting rights (just in time to vote in a TOB).
  + The investor avoids disclosure obligations, concealing its economic interest in the issuer. In the context of TOBs, hidden ownership undermines the early warning regime, as the investor technically does not have ownership or control.

## Enforcement/sanctions

Statutory civil liability provisions, where investors can seek to recover damages for misrepresentation.

Administrative sanctions, where violators face such penalties as cease trading orders, denials of exemptions and prohibitions from acting as a director or officer.

Civil sanctions, where the Commission may apply to court for any order the court wishes.

Penal (also known as quasi-criminal) sanctions, where violators face imprisonment, a fine or both.

An interested person may apply to the commission/ court

# Enforcement

Division of powers

* the only way that the Feds can get involved in enforcement – if falls w/in the Corporate Law or Criminal Code
* Other than that enforcement of securities law is a matter of **provincial jurisdiction**

The Act

* 142 BCSA – exceptionally broad investigative power
* 143 sets out the scope
* 144 powers to produce documents and compel testimony
* standard of reasonableness

**4 areas of enforcement**

**Administrative:** most commonly used, most efficient, findings must be on BOP (less onerous that crim and quasi-crim) // **Awarded for breach, or non-breach if in the public’s interest to make an order** // review panel: panel of experts by BC securities commission

* **Pose sanctions on registrants** 
  + There are categories of registration for certain activities (i.e. becoming a reporting issuer)
  + If you’re in breach of conditions of your registration, they can restrict your registration, terminate it – which could affect ability to carry on biz
* **Cease-trade order** – no trading in those securities is permitted at law
  + Can be subject to this if don’t comply w/ disclosure regime
* **Management cease-trade order:** prohibits managers from trading securities of the issuer
* You rly rly need to file F/S b/c potential consequences can be severe
* **Denial of exemptions**
* **Order to provide or amend any documents** 
  + If there’s deficiency in a continuous disclosure document, the regulators can make an order to amend and refile the document
* **Prohibit you from acting as a consultant or in investor relations activities**
* **Administrative penalties**
  + They can fine you - but it's not allow to be punitive
* **Disgorgement** **of profits** 
  + an order that can be placed if you have earned a profit as a result of bad behavior

**Civil:** regulators can bring a proceeding in provincial court b/c the range of sanctions that can be issued by a court is broader than Admin – but burden of proof is higher & the process is less efficient

**Quasi-criminal sanctions:** heard in provincial court // violations of SA that have a quasi-criminal element for a range of sanctions that can include imprisonment

* serious breaches which constitute an offence
* Can have a jury panel if the total prison penalty exceeds 5 years

**Criminal:** CC – 380(1)(2); 382; 400

* 387(1) Indictable offence to defraud public through deceit or falsehood
* 380(2) offence to **effect the public price of a** stock with the intention to mislead
* 380(3) **Manipulating stock** with appearance of trading is an offence
  + If you can act on both side of the trade (i.e. as a broker) and you clear a trade amongst yourself at a different price to change the new market price - called **washtrade** - if you do this to manipulate the price, it's an offence
* 400 indictable offence to create a prospectus if the person know its false and to induce someone to become a shareholder

# Civil Liability

Can be sued for money!

**Is this a primary or secondary trade?**

* **Primary trades** are out of the treasury, (so from the issuer to the investor)
* **Secondary trades** are trades between investor to investor (the huge portion of the market is here)

## Procedural matters

Can’t bring a suit as of right – have to apply to the court for leave to prevent abuses

**STANDING:** For **1)** Prospectus, **2)** Offering Memorandum, and **3)** Circular misrepresentations, the document’s recipient has standing (i.e. purchaser for first two (**BCSA, 131(1), 132.1**), any securityholder for (**BCSA, 132(1))**

* Person on **the other side of the trade** has standing against an inside trader or tipper (**BCSA 136(1)-(3)**).
* Also, a reporting issuer has standing for an accountability action.
* The Commission and other securityholders have a cause of action against the RI if it doesn’t pursue its cause of action.
* The amount lost is what you can recover.
* **For standing against a party for misrepresentations in secondary market SCL,** see 4 grounds under s.140.3 below.

## Primary market liability

Applies to certain primary trades, not all! The legislation establishes statutory civil liability for **misrepresentations** in a **prospectus, offering memorandum or circulars for a take-over bid or issuer bid, including directors’ and director’s or officer’s circulars.**

* **Prospectus liability** arises when a purchaser buys a security covered by the prospectus during the period of distribution (b/w final receipt date and the closing date), if the prospectus contained a misrepresentation, or if a misrepresentation resulted during that period from a material change that was disclosed improperly or not at all. No liability springs from events that take place after the closing date, as that is the date at which the distribution period is considered closed. 🡪 BCSA 131(1)
* **TOB document liability** is for a misrepresentation in a takeover bid circular, issuer bid circular, notice of change, or notice of variation. Triggered when such a document is sent to securityholders. 🡪 BCSA 132(1)
* **OM liability** triggered when a purchaser buys a security under an OM, if the documents contained a misrepresentation, or if a misrepresentation resulted from a material change that was not properly disclosed. 🡪 BCSA 132.1(1)

**What is a misrepresentation?**

Section 1 of BCSA defines **"misrepresentation"**as

(a) an **untrue** statement of a material fact, or

(b) an **omission** to state a material fact that is

(i) required to be stated, or

(ii) necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made;

The investor is effectively deemed to have relied on the misrepresentation 131(1)(a); 132(1); 132.1(1)(a). In other words, the plaintiff does not need to prove that they relied on the misrepresentation.

**Who can be held liable for the misrepresentation?**

**PROSPECTUS MISREP:** Prospectus investor has a right of action against:

**(1)** **The issuer or selling securityholder** **(rescission or damages)** (131(1)(b)(i)).

* can elect to exercise a **right of recession**, in which case the purchaser has no right of action for damages against the issuer 131(3)

**(2) Any UW who signed the prospectus certificate** **(rescission or damages)** (131(1)(b)(ii)).

* can elect to exercise a **right of recession**, in which case the purchaser has no right of action for damages against the issuer 131(3)

**(3) Any DIR of the issuer** when the prospectus was filed **(damages)** (131(1)(b)(iii)).

**(4) Any person who consented** to any part of the prospectus (damages – for that person’s part) (131(1)(b)(iv)).

* 3rd party experts, auditors, lawyers – but s.131(2) limits the liability to misrepresentations contained in the reports/opinions/statements that they prepared.

**(5) Any other person who signed the prospectus** **(damages)** (131(1)(b)(v)).

* CEO, CFO and the 2 directors

BCSA 131(11): The liability of all these people is **joint and several**

* Exception: each UWs’ liability is limited to the portion of the distribution underwritten by it 131(9)

**TOB DOC MISREP:** Liability arises against the following people **BCSA 132(1)**

**(a)** **The offeror** **(Rescission)**

**(b)** **(i) Anyone who signed** the document **(Damages) (ii) Every DIR** of the offeror when it was signed **(Damages) (iii) Anyone whose consent has been filed** as prescribed **(Damages) (iv) The offeror** **(Damages)**

**OFFERING MEMORANDUM MISREP:** OM investor can get rescission or damages against (**BCSA 132.1(1)**:

**(i)** the **issuer** (textbook also says selling securityholder) **(damages)**

* Per **132.1(2)**, can elect to exercise a **right of recession**, in which case the purchaser has no right of action for damages against the issuer.

**(ii)** every **DIR** of the issuer at the date of the disclosure document **(damages)**, and

**(iii)** every **person who signed** the disclosure document **(damages)**.

**What types of relief are available?** A plaintiff can seek two types of relief:

**Rescission**

* Only available if the investor still owns the securities
* If you're eligible, you get your purchase price back, and you give back the shares
* **Limitation period** for rescission is shorter - 6 months
  + 180 days from the date of the transaction **(BCSA, 140(a)**).
* **S131(3)** This is only available against the issuer, or the underwriter in the case of a bought-deal agreement (firm commitment UW)

**Damages**

* If you're beyond 6 months OR you no longer own the securities
* Compensates the investors for the value attributable to the misrepresentation
* **Limitation period** is 3 years from misrepresentation or 6 months after the investor learned of misrep, whichever is shorter
  + Others (damages) = **(1)** three years from the date of the transaction; **(2)** 180 days after the P first had knowledge of the facts underlying the cause of action (**BCSA 140(b)**).
* These are calculated based on the difference between the price paid for the securities and their value once the misrepresentation was disclosed, limited to the depreciation caused by it (**S131(10)**): ***Danier Leather***. This is limited by **S131(13)**, which states that a plaintiff can’t recover more than the price they paid for the securities.

**What are the defenses?**

**Standard of reasonableness is set out in** s.133 of BCSA. It is the standard that is required of a prudent person in the circumstances. There is no bright line test. What is needed? **Not simply accepting info given by management at face value, making independent inquiries to verify info**, engage experts (legal counsel – legal due diligence)

* In determining what is a reasonable investigation or what are reasonable grounds for belief for the purposes of sections 131 and 132, the **standard of reasonableness must be that required of a prudent person in the circumstances of the particular case.**

**Onus of Proof:** is on the party claiming the defense (i.e. defendant) **// STD of Reasonableness (BCSA 133):** The standard for determining "reasonable investigation" and "reasonable grounds" is that of "**a prudent person in the circumstances**"

|  |  |
| --- | --- |
| **Actual Knowledge** | Under s. 131(4), a defendant is not liable if the defendant establishes that **the purchaser purchased with knowledge of the misrepresentation***.* [very difficult to establish!] This is the only defence available to the issuer! |
| **No Knowledge** | Under s. 131(5)(a), a defendant is not liable if the **prospectus was filed without their knowledge**. However, to rely on this defence, upon becoming aware that the prospectus was filed, the defendant must have given reasonable general notice of their lack of knowledge.  e.g. director who didn’t sign the prospectus was out of the country when it was filed, didn’t know  e.g. expert provided info to issuer on belief it would not be published in prospectus > but published |
| **Withdrawal of Consent** | Under s. 131(5)(b), a defendant is not liable if they withdrew their consent to the prospectus upon becoming aware of any misrepresentation, and gave reasonable general notice (e.g. news release) of their withdrawal and the reason for it.  e.g. something new comes to light so the auditor withdraws their financial report |
| **Reliance on Expert** | Under s. 131(5)(c), the defendant is not liable if they **did not believe, and had no reasonable grounds to believe that the part of the prospectus related to an expert report, opinion or statement contained a misrepresentation.**  e.g. issuer, directors or officers rely on an expert, and had reasonable grounds to believe that the expert was capable of providing proper info, but it turns out expert made a misrepresentation |
| **Expert’s Defence** | Under s. 131(5)(d), a defendant who is an expertis not liable for a misrepresentation if the prospectus **did not fairly represent their report, opinion, or statement.**  For this defence to apply, the expert must have:   * had reasonable grounds to believe that the relevant part of the prospectus did fairly represent their report, opinion, or statement; OR * as soon as practicable upon becoming aware of the misrepresentation, advised the regulator and **given reasonable general notice** that they were withdrawing their expertise.   e.g. expert saw draft of prospectus, approved it, but then language was changed after the fact |
| **Forward-Looking Info** | Under s. 131(8.1) and (8.2), the defendant is not liable for a misrepresentation in **forward-looking information (FOFI)** if the defendant proves that the document contained **reasonable cautionary language**, that the material factors and assumptions underlying the FOFI were set out, and that the defendant had a **reasonable basis** for drawing such conclusions. |
| **Due Diligence**  **THE MOST  IMPORTANT DEFENCE!**  Not available to the issuer! | Under s. 131(7), a defendant (other than the issuer!) is not liable if **they believed (subjective) that there was no misrepresentation and conducted “a reasonable investigation (objective) to provide reasonable grounds for a belief that there had been no misrepresentation”**.  e.g. if director, officer, underwriter, expert performed reasonable due diligence, may not be liable!!!  **Escott v Barchris** (leading case): defendants (directors who signed the certificate) were immigrants that did not speak/read English well and said they relied on Lawyers etc. to ensure accuracy // H: liable for misrep b/c didn’t do your own DD. |

**Actions tied to delivery requirements** 🡪 There's a right of withdrawal for a failure to deliver a prospectus  // 83(3) - Agreement to purchase securities is not binding until 2 days after the prospectus is delivered // It's infinite if it's never delivered

## Secondary market

**Application**

140.2 This Part **does not apply to**

(a) the purchase of a security offered by a prospectus during the period of distribution,

* Have a whole other regime to protect you, so don’t need secondary market civil liability regime

(b) the acquisition of an issuer's security pursuant to a distribution that is exempt from section 61, unless the acquisition is within a class of prescribed acquisitions,

* Exempt distributions

(c) the acquisition or disposition of an issuer's security in connection with or pursuant to a take over bid or issuer bid, unless the acquisition or disposition is within a prescribed class of acquisitions or dispositions, or

(d) a prescribed transaction or class of transactions.

**Who is a responsible issuer?** s.140.1Responsible issuers which includes 2 categories of issuers:

* **A reporting issuer, or**
* **any other issuer w/ a real and substantial connection to British Columbia,** any securities of which are publicly traded;
  + **Abdula v Canadian Solar** (Ontario case): Company in Canada reporting on Nasdaq, but not TSX // D arguing SHs should sue in the US not Ontario // H: there is a real and substantial connection to Ontario and the court took jurisdiction // ***trade made in US made by a company not reporting in Canada***

**Secondary Market Limitation Periods 🡪** s.140.94

Damages: it is the earlier of:

* 3 years from the date the impugned conduct occurred; and
* 6 months after the issuance of a news release disclosing that the Ps have obtained leave to commence a secondary market SCL action

Remember, to pursue secondary market SCL plaintiff’s need leave of the Court under BCSA s.140.8

Note: Applying for leave suspends the 3-year limitation period (*Green v CIBC*)

**Who is an influential person?**

s.140.1 **"influential person"** means, in respect of a responsible issuer,

(a) a control person,

(b) a promoter,

(c) an insider who is not a director or officer of the responsible issuer, or

(d) an investment fund manager, if the responsible issuer is an investment fund;

**What activities trigger liability?**

**Misrepresentation in a document released on behalf of an issuer**

s.140.1**"document"** means a **written communication**, including a communication prepared and transmitted only in electronic form,

(a) that is required to be filed with the commission, or

(b) that is not required to be filed with the commission and

(i) that is filed with the commission,

(ii) that is filed or required to be filed with a government or an agency of a government under applicable securities or corporate law or with an exchange or quotation and trade reporting system under its bylaws, rules or regulations, or

(iii) that is any other communication the content of which would reasonably be expected to affect the market price or value of a security of the responsible issuer;

**140.3(1)** Liability arises when: **1)** a **“responsible issuer”** or a person with **actual, implied, or apparent authority** to act on the responsible issuer’s behalf **2)** **“Releases” a “document”** containing a misrepresentation.

**Who is Liable?**

* 140.3(1)(a) The **Responsible Issuer;**
* (b) Each **DIR of the Responsible Issuer** at the time the doc was released;
* (c) Each **OFR of the Responsible issuer** who “authorized, permitted or acquiesced” in the release;
* (d) **Each “influential person**” (and its DIRs and OFR’s) who "knowingly influenced" the responsible issuer (or the person or company with authority) to release the document (or knowingly influenced a DIR or OFR of the responsible issuer to release the document).
* (e) and each "expert", where misrepresentations from the expert's report, statement or opinion are used in the document with the

**A public oral statement made on behalf of an issuer**

s.140.1**"public oral statement"** means **an oral statement** made in circumstances in which a reasonable person would believe that information contained in the statement will become generally disclosed;

**140.3(2) 1)** A person with **actual, implied, or apparent authority** to speak on the responsible issuer’s behalf **2)** Makes **a “public oral statement”** that **relates to the business or affairs** of responsible issuer and that contains a misrepresentation.

**Who is Liable?**

* 140.3(2)(a) The responsible issuer,
* (b) The person who made the public oral statement,
* (c)Each DIR and OFR of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement,
* (d) each influential person, and each DIR and OFR of the influential person, who knowingly influenced (vague)
  + (i) the person who made the public oral statement to make the public oral statement, or
  + (ii) a DIR or OFR of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement,
* (e) each expert where
  + (i) the misrepresentation is also contained in a report, statement or opinion made by the expert,
  + (ii) the person making the public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and
  + (iii) if the public oral statement was made by a person other than the expert, the expert consented in writing to the use of the report, statement or opinion in the public oral statement.

**Influential Person** Document/Oral Misrep (140.3(3)): Liability arises when: 1) An influential person, or person with actual, implied or apparent authority to act or speak on behalf of the influential person; 2) Releases a document that relates to a responsible issuer and contains a misrepresentation OR Makes a public oral statement that relates to a responsible issuer and contains a misrepresentation.

140.3(7) – In an action under (2) or (3), if the person who made the public oral statement had apparent authority, but not implied or actual authority, to speak on behalf of the issuer, no other person is liable with respect to any of the responsible issuer's securities that were acquired or disposed of before that other person became, or should reasonably have become, aware of the misrepresentation.

**Failure to make timely disclosure of a material change when required**

s.140.1**"failure to make timely disclosure"** means a failure to disclose a material change in the manner and at the time required under this Act;

**140.3(4)** 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** (**NB:** **Timely disclosure is needed under BCSA 85(b))**

**Who is Liable:**

* 140.3(2)(a) **the responsible issuer,**
* (b) **each DIR** (Someone on Board of DIRs) **and OFR** (e.g. CEO, COO, etc) of the responsible issuer who authorized, permitted or acquiesced in the failure to make timely disclosure,
* (c) each influential person, and each DIR and OFR of an influential person, who knowingly influenced
  + (i) the responsible issuer or any person acting on behalf of the responsible issuer in the failure to make timely disclosure, or
  + (ii) a DIR or OFR of the responsible issuer to authorize, permit or acquiesce in the failure to make timely disclosure.

**What is the burden of proof?** Which can act as defences

|  |  |
| --- | --- |
| **Core Documents** | **Non-Core Documents + Public Oral Statements** |
| **Core documents include (140.1):**   * **Suing DIR or Influential Person**: Core Docs = Prospectus, OM, TOB, Issuer Bid, Periodic Disclosure Docs * **Suing Issuer or OFR:** Core Docs = all above + docs required under 85(b), press releases, and material change reports.   **The burden of proof:** is simply the existence of a misrepresentation – P doesn’t need to prove that D knew or should’ve known about it (**140.3(1)**) | **Non-core documents** **(140.1)** include new releases, investor presentations, etc.  **The burden of proof:** P must prove that the D (**except a D expert**) 1) knew of the misrepresentation; 2) deliberately avoiding discovering that there was a misrepresentation; or 3) was guilty of gross misconduct (**140.4(1)**) |

**\*Failure to Make Timely Disclosure:** Onus is on the P to prove that the D (**except a responsible issuer or an OFR of a responsible issue**): **1)** knew of the change and that it was material; **2)** deliberately avoided discerning that there was a change or that it was material; or **3)** was guilty of gross misconduct (**BCSA 140.4(3),(4))**

* **(4) –** Can’t use the “defense” if it’s an action against a responsible issuer **OR** OFR of a responsible issuer (**e.g.** CEO, COO, etc).

**What are the defences?**

|  |  |
| --- | --- |
| **Actual Knowledge** | Under s. 140.4(5), a defendant is not liable if the defendant establishes that **the plaintiff bought or sold with knowledge that the document or public oral statement contained a misrepresentation, or with knowledge of the material change**.[very difficult to establish!] |
| **Due Diligence** | Under s. 140.4(6)(a), a defendant is not liable for a misrepresentation if they prove that before the release of the document or the making of the public oral statement, the defendant **conducted or caused to be conducted “a reasonable investigation”** and at the time of the release or statement **“had no reasonable grounds to believe**” **that the document or oral statement contained a misrepresentation**.  Under s. 140.4(6)(b), a defendant is not liable for a failure to make timely disclosure if they prove that before the failure to make timely disclosure occurred, the defendant **conducted or caused to be conducted “a reasonable investigation”** and **“had no reasonable grounds to believe that a failure to make timely disclosure would occur”.**  Factors a crt will consider relevant when determining whether an investigation was reasonable  Section 140.4(7) sets out a list of factors that a court will consider in determining whether an investigation was reasonable under s. 140.4(6). These factors include:   * The knowledge, experience, and function of the defendant; * The office held by the defendant (if the defendant is an officer); * The presence or absence of another relationship w/ the responsible issuer (e.g. officer, employee, shareholder), if the defendant is a director; * The existence (if any) of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations; * The reasonableness of the defendant’s reliance on the responsible issuer’s disclosure compliance system and on the responsible issuer’s officers, employees and others whose duties would ordinarily have given them knowledge of relevant facts; * For expert reports, what professional standards are applicable to expert defendant; * In the case of misrepresentation, the role and responsibility of the defendant in preparing and releasing the document, making the public oral statement, or ascertaining the facts contained in the document or public oral statement; * In the case of failure to make timely disclosure, the role and responsibility of the defendant involved in the decision not to disclose the material change.   These factors attempt to strike a balance – in some companies it is not reasonable to assume that every director or officer is involved in disclosure decision. |

**What are the damages?**

Purpose of secondary civil liability is investor protection through deterrence – not full compensation.

**Damages for acquisition or disposal after the misrepresentation/failure to make disclosure (140.5):**

**1) Securities disposed of on/before 10 days after correction**: Damages = difference b/w average price paid and price received on disposition.

**2)** **Securities disposed of after 10th trading day**: Damages are the lesser of 🡪 The difference between average price paid and price received on disposition **OR** the difference between average price paid and the average price over the 10 trading days after public correction or disclosure.

**3) Where securities are not disposed:** Damages are difference between average price paid and average trading price over 10 days after public correction

**Note:** for disposals of security, just reverse price paid and received

**Liability is proportionate**, not joint and several (**140.6(1)**)

* (**140.6(2)**) **exception:** if a D, other than a responsible issuer, **authorized, permitted, or acquiesced, while knowing misrepresentation/failure to disclose** the whole amount may be recovered from him, and **it is joint and several** between such D’s.

|  |  |
| --- | --- |
| Limits of Damages (140.7(1)) | |
| Responsible Issuer | The greater of 5% of its market cap (the number of common shares outstanding, multiplied by the market price per share) or $1 million. |
| DIRs and OFR (or someone else who made a public oral statement) | The greater of 50% of the aggregate of D’s compensation from the issuer and its affiliates or $25,000. |
| Experts | The greater of the revenue that the expert and its affiliates earned from the issuer and its affiliates during the 12 months preceding the misrepresentation or $1 million (greater limit b/c insurance). |
| Cap does not apply to a person, other than the responsible issuer, if the P proves that the person authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure, or influenced the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure (140.7(2)) | |