Securities Summary Fall 2014

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# Securities Basics

Securities markets is one of 3 pillars of Canadian capital markets:

1. Securities 🡪 prov juris
2. Banking 🡪federal juris: prudential regulation
3. Insurance regulation 🡪prov juris

### Purpose of Securities regulation

1. **Investor protection.** Access to honest info is paramount, ensure investors aware of risks = **full true & plain disclosure \***2. Fair/efficient/transparent capital markets
3. Reduce systemic risk

**Systemic Risk:** risk of breakdown among institutions + other market participants in a chain like fashion that has potential to affect entire financial system negatively.

Ideals of Securities Reg:

1. Reg should reduce risk of failure of issuers & market intermediaries
2. Reg strive to minimize disruption + losses to stakeholders in even of failure
3. Cooperate internationally – share info foster stability.
4. Garner public confidence: publicize enforcement, increase trust in securities markets, divert $ from socially unproductive activities like gambling, info disclosure

**Techniques of Securities Regulation:**

Registration of Persons involved in securities + SROs
Registration of Issuers & Securities: SEDAR + cont’d disclosure
Anti Fraud measures: preventative measures

### Types of Securities

Corporations issue securities to raise capital and finance their business activities.
1.Debt 2.Equity 3.Derivative Securities

#### Debt Securities: borrow $ from investors

Bonds 🡪 often secured (but not if issued by gov’t)
Debenture 🡪 not secured, company is highly reliable
Commercial Paper (IOU) 🡪 fixed amount to be paid in future + interest, unsecured (normally large profitable co.) 270 days

D + Bs carry face value ($100) + maturity date (10yrs) and interest rate (10% per annum). Each yr receive $10 as interest and end of maturity date, get back $100.

#### Equity Securities: sell right in companies’ future profits

**Share:** bundle of intangible rights. Right to net profits (subtract interest payable on outstanding debt of co.) when dividends declared, and upon dissolution the net proceeds (less outstanding debts of co.)

Common shares 🡪 voting rights
Restricted shares 🡪 restricted voting rights
Preferred🡪 non-voting, carry other rights

#### Derivative Securities: equity or debt, derives value from reference share

Stock option: K entitles rts holder to either buy/sell a sec on a date at certain price, this way can hedge against drop in value of price of security. Value of option is fixed/referenced.
eg. **swap:** sell the risk associated with the possibility of the company from whom you were issued IOU (commercial paper)

## Scope of Securities Regulation: Security, Trade, Distribution

Scope is broad and ambiguous. A tranx must be made up of 3 fundamental concepts: security, trade, distribution = will be regulated.

Overbroad allows regulators to capture tranx then exclude rather than people devising tranx to escape regulation: **catch-then-exclude** (we build exceptions after)

2 interpretations guide definition of securities:
1) Sec Reg is protective, remedial, prospective, and preventative, not punitive, therefore broad interpretation is appropriate.
2)Substance over form – look at general economic effects of the tranx – flexible, attuned to inves protection. 8 most important categories from prov statutes securities definitions are:

##### 1. A document, instrument, or writing commonly known as security: BCSA, s. 1, security (a)

Need to determine the common knowledge among securities professionals, not lay persons.
eg. ponzi scheme is a sec tranx – expectation of return on their investment
***Glen W Turner Enterprises***, (ponzi scheme case) common knowledge definition of security is to ensure that “security was interpreted in a broad, flexible and liberal manner, however, it need not be commonly known to the man in the street as a security because security is a technical concept used predominantly by the financial and legal communities.

##### 2. A document evidencing title to, or an interest in, the capital, assets, property, profits, earnings or royalties of a person or company: BCSA, s. 1, security (b)

Ask is there an investment? **Speculation**? Aim to protect investing public.
eg. title doc to ½ interest in breeding chinchillas to share in profits = sec.
eg. scotch whiskey receipts, bought whisky w/ view that price increase w/ age & resold to others = sec.
eg. 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.
eg. co. solicited people w/ inventions and would help ppl with their patent application + marketing in return for 20% interest in investion = NOT sec, inventors still in complete control, payment to co. not deemed as investment🡪 ***Raymond Lee***
eg. a document need not even exist !

##### 3. An Option, a Subscription, or a Right: BCSA, s. 1, security (c)

 **Option:** put entitles holder to sell security, a call option entitles holder to buy a sec.
**Subscriptions:** sign up forms for purchasing sec upon IPO going through for example
**Rights:** corp raise $ quickly w/ fewer reg reqmts by granting existing shlders right to buy a specific # of additional shares for a specific price w/in specific time, can be traded among shlders.
**Warrants:** attached to bonds, give warrant holder right to buy a specific # of corp’s equity sec at specific price & during specific time period (referenced like an option)

##### 4. Debt Security: a bond, debenture, note or other evidence of indebtedness, share, stock, unit, unit certificate, etc BCSA, s. 1, security (d)

***BC Sec Com v. Gill***– 2 individuals gave large amounts of $ to Gill for his investment co., he then gave them receipts. Were these debt securities? **YES.** Court applied legal test – there is a rebuttable presumption that certain types of notes (like receipts) are securities. Look at intention of doc.

**Family Resemblance Test:** 4 factors relevant to determine whether presumption been rebutted.
a) is motivation of buyer to invest & get return? Is seller’s motivation to raise capital?
b) can instrument be distributed/traded among investors like debentures, derivates, corporate bonds: common trading for speculation or investment?
c) what are the reasonable expectations of the investing public?
d) is there another regulatory scheme that regulates instrument?

##### 5. Investment Contract: BCSA, s. 1, security, clause (l) “catch all” term

*QSA* defines it as:

An investment contract is a contract whereby a person, having been led to expect profits, undertakes to participate in the risk of a venture by a contribution of capital or loan, without having the required knowledge to carry on the venture or without obtaining the right to participate directly in decisions concerning the carrying on of the venture.

2 tests to determine whether there is an investment K from caselaw:

**Common Enterprise Test:** In ***Howey****,* the US Supreme Court defined “investment contract” as “a contract, transaction or scheme whereby a person invests his money in a
1) common enterprise and is led to
2) expect profits solely from the efforts of the promoter or a third party”. *Howey* involved contracts for the sale of units in a citrus grove development and contracts for the cultivation of those groves and remittance of net proceeds to the investor.

**The Court noted:** “Such persons [the investors] have no desire to occupy the land or to develop it themselves; they are attracted solely by the prospects of a return on their investment. […] The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors’ interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed.”

In ***Hawaii Market Center,*** the Hawaii Supreme Court expanded the *Howey* test for an investment contract. *Hawaii Market Center* involved a retail store membership program whereby “founder-members” could earn income if they recruited new members and distributed membership cards, i.e. store was not expecting profits “solely from the efforts of the promoter or a third party”. Court found an investment K.

**Risk Capital Test:** The Court developed the following test for the existence of an investment contract:

1. An offeree furnishes initial value to the offeror [*members required to contribute $320 or $820 > not simple purchase of sewing machine, cookware, b/c these amounts far exceeded their wholesale value*];
2. A portion of this initial value is subject to the risks of the enterprise [*members’ ability to recoup initial investment and earn income inextricably bound to success of the Hawaii Market Center enterprise*];
3. The furnishing of the initial value is induced by the offeror’s promises or representations that the offeree will gain some benefit, over and above the initial value, as a result of the enterprise’s operation [*members were promised “commissions”/fixed returns*]; and,
4. The offeree does not receive the right to exercise practical or actual control over the managerial decisions of the enterprise [*members arguably participated in a minor way in operating the enterprise, but Crt focused on the “quality” of participation, not the “quantity*].

**Broadest concept of Invest K:** In ***Pacific Coast****,* the Supreme Court of Canada set out the Canadian version of the *Howey* and *Hawaii Market Center* tests. *Pacific Coin* involved the sale of bags of silver coins on margin (the purchaser paid a deposit, and then at a later time could either complete the transaction by paying the remaining amount or selling the bag back to Coin Exchange. **Future Contracts are securities!**

The majority set out the *Howey* test in two questions:

1. Is there a common enterprise? [*the Crt said a common enterprise exists where an investor advances money and the promoter has managerial control over the success of the enterprise*]
2. Are the profits to come solely from the efforts of others? [*the Crt construed “solely” broadly, as in Hawaii Market; if Pacific did not invest the purchaser’s deposit properly, the purchaser would be unable to obtain a return on his or her investment regardless of the market price of silver, they were buying futures contracts to hedge against risk that market value of silver would decline; also, purchasers on margin did not have the bags of silver*]

Held: The form of the investment contract being silver coins is not relevant; this is about speculating the price in the silver market rather than buying coins. Affirmed common enterprise test minus the “solely” part and replaced with undefinably significant efforts. You can have a vertical common enterprise, you don’t need a horizontal common enterprise amongst the investors

Note: Laskin CJ in dissent said purchase of coins on margin was not an investment K b/c profits from the enterprise only depended on the market price of silver, not on the actions of the Coin Exchange; also, the Exchange had no control over the investment (investors decided when to buy, sell).

Distinguish ***Pacific Coast*** with ***Lazerman*:** in Lazerman, the BCCA found that the contracts were not investment contracts (factual distinctions from Pacific: silver bars instead of silver coins, and Lazerman segregated purchasers’ funds instead of **commingling with its own**). The purchasers’ profits did not depend on Lazerman’s actions; they depended on the market price of silver. **Segregating the funds meant that there was no sharing of each other’s profits or losses and were not engaged in a common enterprise.**

**Return to rationale for securities regulation: protection of the investors, and promote a fair and efficient transaction in the capital market; reducing systemic risk (ICSC)**

Investment contracts definition by ASC in ***Kustom Design*: an investment of money in a common enterprise with expected profits arising significantly from the efforts of others.** Investors bought units in small, privately held businesses. Investors would participate in positive or negative earnings, the latter were expected, which would result in tax advantages for investors = financial benefit through efforts of others + share in each others’ gains & losses= invest K

|  |
| --- |
| 6. A certificate of interest in an oil, natural gas or mining lease, claim or royalty voting trust certif. BCSA, s. 1, clause (h) |
| **7. A profit sharing agreement or certificate** BCSA, s. 1, clause (g)[considered redundant b/c of “investment contract” clause] |
| **8. A proportionate Interest in a Portfolio of Assets** units/shares in a specified investment fund, which then in turn invests your money in various securities eg. mutual fund |

### What is a trade?

We place disclosure obligations on seller, not purchaser!

**BCSA: "trade"** includes

1. a disposition of a security for valuable consideration whether the terms of payment be on margin, installment or otherwise, but does not include a purchase of a security or a transfer, pledge, mortgage or other encumbrance of a security for the purpose of giving collateral for a debt,

\*note

(a.1) entering into a futures contract,

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

(c) participation as a trader in a transaction in a security or exchange contract made on or through the facilities of an exchange or reported through the facilities of a quotation and trade reporting system,

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

(e) a transfer of beneficial ownership of a security to a transferee, pledgee, mortgagee or other encumbrancer under a realization on collateral given for a debt, and

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

##### A disposition of a security for valuable consideration BCSA, s. 1 (1), trade, (a)

Focus is on SELLING, does **NOT** include purchase/pledge/transfer /or encumbrance of a sec for purpose of giving collateral for a bona fide debt (unless control person giving collateral). You are not disposing of it, will get it back. Consideration need not even be money. If you default on loan, and your securities are seized 🡪 becomes a trade.

Eg. Exercising option is NOT a trade, but original sale of option is a trade.

##### Entering into or Disposing of a Derivative: assigning, selling, acquiring, BCSA, s. 1, trade, (a.1) + (b)

No need for disposition to be for valuable consideration. Known as futures contract eg. Trading in futures market like in ***Pacific Coast***

A future is a contract to sell a specified asset on a stated date in the future at a state price. Futures can be written against a variety of underlying interests, e.g. currencies, commodities, indexes, interest rates.

Although futures contracts are “securities” within the meaning of Canadian securities legislation, publicly traded **commodity** futures contracts are not subject to securities regulation; subject to special reg.

##### An Act Performed by a Trader through a Marketplace BCSA, s. 1 (1), trade, (c)

Eg. Broker executing securities trades through any stock exchange

##### A receipt by a dealer of an order BCSA, s. 1 (1), trade, (d)

Trade occurs when broker receives order, not when completed. Dealer must be registered as per **NI 31-103.**

##### A transfer or pledge of securities from a control person’s holdings for the purpose of giving collateral for a debt BCSA, s. 1 (1), trade, (e)

Control person holds sufficient number of voting rights to materially affect the control of issuer. They hold more than 20% (relative #, it depends) of an issuer’s voting rights, could also be group acting in concert (definition of CP under BCSA s. 1(1).

Eg. You would not be control person if someone else held 80% of shares.

##### An Act in Furtherance of a Trade BCSA, s. 1 (1), trade, (f)

No actual trade need occur, no disposition of security. Look for sufficient connection test (fact based test whether advancing sec to trade.
eg. Arranging a meeting to promote sale/disposition of sec, as opposed to only informational purpose. We care about indirect acts!
eg. Supplying a list of prospective clients to a broker = trade
eg. Advertising before/after incorporation = deemed trade
eg. Sending letters to potential investors = deemed trade
eg. Offer to sell = trade
eg. Providing investors with subscription agreements = trade
eg. Distributing promotional material = trade
eg. Offer to purchase or act in furtherance of purchase is **NOT** a trade.
eg. Gift of sec to charity is **NOT** a trade nor is inheritance (no risk)
eg. Receiving dividends (issuer already fulfilled discl obligations), **NOT** a trade.

##### Geographic Limitation – Securities Commissions Jurisdiction over ‘Trades’

If seller and buyer are in different provinces, we normally allow the Sec. Com of the buyer to govern, want to protect the investor. Either way, Sec. Coms have concurrent jurisdicition, parallel proceedings can occur. If cross border and seller in BC, BC Sec. Com will have juris + cooperate with USA authorities. **Basic rule: where is the investor? 🡪** that is where the trade occurred.

What about online? **NP 47-201** *Trading in Securities Using the Internet and Other Electronic Means* says that someone trades in a local juris if post online a document offering or soliciting trades and that doc can be accessed by people in that province. Avoid this by placing disclaimer that sets out jurisdiction to which the trade applies, it is not the local juris.

### Scope of Distribution

Occurs only 1x, when issuer sells security to raise capital to the public = primary market.

Only an issuance of securities from an issuer itself constitutes a “distribution” under the relevant statutory definitions. Essential components are:

**BCSA s. 1(1) “distribution”**

1. a trade in securities that have not previously been issued (i.e. new to the market)

2. a trade by the issuer in its own previously issued securities (i.e. securities previously issued but returned to the issuer, eg. Redeem, purchased or donated shares)

3. resale by a “control block” person: (a “control person” is a person with more than 20% of the issuer’s outstanding voting securities is deemed a control person, however, a lower percentage than 20 may constitute control – each case must be evaluated on its particular circumstances); when a control person trades securities, those securities must be qualified with a prospectus

Rationale: this distribution may effect price + CP may have info others do not. Others may think something wrong, could depress price

4. an underwriter’s trade in securities it acquired before the effective date of the closed system;

5. any trade that is a distribution under the regulations eg. Resale of previously exempted securities, but unless another exemption does not catch the 2nd distribution, must file prospectus.

6. any transaction involving a purchase and sale or a repurchase and resale during distribution or incidental to distribution: this includes securities purchased by an underwriter during a distribution, where the underwriter plans to resell the securities.

**Residual discretion of Sec. Com. Senior staff to deem a distribution and force disclos. BCSA(e)(i)**

**2 Tests that underlie when Sec. Coms will view a distribution “to the public” and when will be exempted.**

1. The need to know test (whether offeree had sufficient info about the issuer and sufficient sophistication so as not to need protection).
2. The close friend or associate test (whether the relationship between the issuer and the offeree meant that the latter did not need protection).

### The Functional Framework of Distribution: Under Writing

Where a company wants to distribute to the public, do it either 1) **direct issue** or may 2) **hire underwriter** (UW) (**main route).** This company is called an **issuer.**

BCSA defines“**issuer**” **as a person who has a security outstanding, is issuing a security, or proposes to issue a security, and “reporting issuer” as an issuer who has filed a prospectus or whose securities have, at any time, been listed on a recognized stock exchange.**

Whether or not an issuer is required to continually disclose information to the markets and investors depends on whether it is a reporting issuer or a non-reporting issuer. An issuer that has filed and obtained a receipt for final prospectus is a reporting issuer even closing/distribution of the securities did not take place.

**Direct Issues** are hardly ever done directly to diverse large group (public), often to small group. Eg. Rights offering or through exempt offering w/ institutional purchasers, crowd funding (owners/entrepreneurs advertise details of their b. venture online & solicit funding.

**Underwriting**

They assist issuers by:

🡪advise issuer on financial situation/how to structure the tranx
🡪assist in distribution of their sec by finding investors & conducting tranx w/ them
🡪perform risk-bearing function wn they execute a **firm commitment** or **bought deal** by purchasing the issuers’ sec that they will then resell.
🡪give issuer seal of approval on IPOs – solidifies company’s value to prospective investors.
 **Quiet Period:** wn issuer decides to proceed w/ IPO by signing engagement letter: during that time, particpants need to control info disseminated about company so that it is consistent with disclosure prospectus, avoid any acts in furtherance of a trade.

##### 4 Range of Underwriting Arrangements

Continuum of Risk Taken by UW:

**Full Risk: Bought Deal Offering 🡪** UW buys entire issue at set price before preparing prospectus or canvassing interest among investors. UW takes loss, if cannot sell sec, while Issuer gets its profit.

**Medium Risk: Marketed Deal Offering 🡪** UW does not commit to purchase the issuers’ sec. until it has had chance to assess the market demand before final prospectus & UW agreement signed. The set price will btw the UW & Issuer will reflect the market conditions.

**In both Bought Deal + Marketed Deal 🡪 UW hopes to sell at higher price to make profit: “The Spread”.**

**Medium – Low Risk: Standby offering:** UW commits only to purchase sec that are not sold to investors at a certain price –guarantees issuer, a minimum amount of total proceeds.

**Low Risk: Best Efforts agency agreement:** UW does its best to sell sec on issuers behalf. Market risk & ownership remains w/ issuer. UW’s profit is a commission (fixed % from sale of each security).

##### Risk Strategies for UWs: Market Out Clauses + Spreading Risk

UW generally take on bought deals, so must manage the risk that comes w/ it.

**1, They use ‘market out clauses’:**

Eg. If state of financial markets turn bad that sec cannot be marketed profitably 🡪 the market referred to is the market in which sec to be offered rather than in broad financial market (*BCSC case in a best efforts agency agreement)*

NB: In ONSCJ ***Stetson Oil*** *(engagement letter in private placement found binding):* court held that the above market out clause can never be in a bought deal b/c the whole point in a BD is that the UW takes the risk of being able to sell sec profitably and MAC clauses should not be construed as providing UW an out under the above scenario but under different name (case not binding in BC)

Disaster out clause – if event seriously affects market as a whole
 ‘material adverse change out’ clause MAC, which would have significant adverse effect on sec’ market price/value
Due diligence out
Regulations proceedings out
Tax changes out

NB: UW will NOT sign the UW agreement until days before **final props receipt issued and** distribution period opens, so will do months of work based on a bid letter or engagement letter (use market out clauses in these + UW agrnts).

**2.** **In bought deal:** **Spread the risk** by inviting other investment dealers into deal. Lead bank forms a banking group or UW syndicate. UW contracts w/ other investment dealers, each agrees to take a fixed % of issue from lead UW. So they share in the spread at different percentages. Or create a selling group 🡪 widens distribution offering, but no risk w/ unsold sec and do not share in residual profits (members of the selling group) **Lead UW 🡪 UW Syndicate 🡪 Selling Group**

##### Types of Secondary Markets

1. TSX/TSX-V: must meet & maintain their requirements
2. OTC or unlisted market: includes many debt securities & OTC derivatives
3. Upstairs Market (face to face) btw institutional investors (less liquid/transparent/smaller) w/ assistance of dealers
4. Upstairs Market w/o dealers
5. Money Market: short term deb sec (eg. Commercial paper, debt of gov & corp – companies have strong credit ratings eg. Bank of Canada

## Materiality

Concept is relevant for various issues in Securities regulation.

### Material Facts and Material Change

Section 1 of the BCSA defines:

**“material change”**
(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

Immaterial if mgmt never implements change or plan, must still disclose.

(meant to guard against insider trading)

**“material fact”** as “a fact that would **reasonably** be expected to have a significant **effect on the market price or value** of securities (when it arises, not delayed effect) 🡪 broader than MC 🡪 only relate to securities issued at time of prospectus IPO!

**NI 41-101 General Prospectus Requirements requires material facts disclosed**

Issuer must file prospectus containing, “**full, fair, plain” disclosure of material facts** (snap shot + static), thereafter continuous disclosure by reporting issuer of any **material changes** to business/operations / or capital of issuer (dynamic, ongoing, overtime). 🡪narrower than MF b/c must relate to business/operations or capital of issuer, but applies to *any* securities of reporting issuer (*Pezim*).

MF could include MC, but could have MC that is not MF

### NP 51-201 Disclosure Standards – Part IV Guidance on Materiality

 **Overarching principle of materiality**: the nature, timing of the information; what does the market look like, how big is the issuer, something could be material for one company and not material for another; but when in doubt, disclose. For example: changes in financial result, credit arrangements, acquisition and disposition

6 Broad Categories of events according to NP 51-201 that may give rise to **material change:**

1. Changes in corporate structure, such as TOB, mergers, changes in share ownership that may affect control of corp.
2. Changes in capital structure (classes of shares)
3. Changes in financial results, such as significant increase or decrease in earnings projections, changes in assets or changes in accounting policy
4. Changes in business and operations; for example a significant change in corporate objectives, the loss **or gain of significant contracts,** or significant resource discoveries
5. Acquisitions and dispositions and
6. Changes in credit arrangements eg. ***Coventree* case**

**External Event:** has to affect the business, operations or capital of issuer in a particular way, different than effect on others in its industry (perhaps b/c issuers’ material Ks or assets are particularly affected**.**

#### Caselaw on Materiality

##### Pezim v. BC (Superintendent of Brokers) 1994 SCC Material Change + Assay Results

🡪change to value of asset must be disclosed

Reporting issuer is a mining exp/deve comp. Would release results of its mineral searches (assay results) in periodic releases rather than all at once. In between release of results it would engage in sec tranx: private placement, options for mgmt. (exempted from disclosure). First interval of results = lots of gold supposedly found. Pezim sells shares in the co. Second interval of results = not so much gold. (insider trading)

BCSC finds that Pezim failed to disclose material change stemming from mineral search findings in timely way, had to disclose as soon as practicable, and BEFORE engaging in sec tranx. If they did not engage in sec tranx, would have been fine for them to disclose in intervals.

From the point of view of an investor, any changes to mining property, **which is an asset bears significantly on the question of that property’s value; therefore capable of affecting the business, operations, and capital of the issuer. = material change.** BCSec Com penalized Pezim under its public interest powers **s. 27** for failure to make **continuous disclosure**, because it failed on its insider trading charge.

NB: industry standard is any change that amounts to 10% increase or decrease = disclose

##### Re Siddiqi 2005 BC S. Cn. Material Change in context of contemplated tranx

Materiality in the context of contemplated tranx to help raise funds that never fully realized. Disclosure will depend on if the existence of negotiations could **reasonably be expected to affect sec’s price** then fact of negotiations is **material change** only if completed tranx itself would constitute a material change.

As soon as there was sufficient degree of certainty that tranx would be completed = making informal handshake deal, even though not legally binding = must disclose as part of continuous disclosure obligations as a reporting issuer. Can’t just be speculative, filled w/ opinion.

Report out of abundance of caution! Should have commitment from both parties.

##### Kerr v. Danier Leather 2007 SCC FOFI as material change/fact

Can future oriented financial information (forecast on RI’s financial performance) give rise to material change?

Danier going public, issues prospectus, which must contain full, true, and plain disclosure of all **material facts** as of the date receipted by Sec. Com. If any **material change** occurs between date of receipt and date that distribution closes, must file amendment. D’s prospectus included forecasts for revenue & earnings show X, but internal company analysis showed that the Co. may not meet target. So was this a **material change** that had to be disclosed via an amendment?

SCC:

If a forecast has or may reasonably be expected to have an effect on the market price or value of the issuers’ sec, the forecast is material & implied assertions of fact within it are material facts. When you make forecast, there is always an implied representation that your assumptions in forecast are reasonable. People will rely on these. You cannot hide behind the business judgment rule to say that forecast is subjective (can’t use this as excuse under material change disclosure either). There was an implied representation that the forecast was objectively reasonable. But the intra quarterly results that showed that they may not meet target NOT mat. change, no change to business, **operations** or capital of issuer.
Additional points:
🡪only material changes need be disclosed btw final prospectus receipt date & distribution date
🡪implied representation made only up to receipt date, Danier need not disclose of mat facts thereafter

##### Re Coventree Inc. 2011 OSC Market Impact Test – Reasonable Investor Test

Prior to filing prospectus Coventree learns that the DBRS is adopting more restrictive practices in its credit rating standards for asset backed commercial paper. Selling ABCP is part of Cov’s business. Was this a material fact that they failed to exclude in prospectus? (NO)

Post-prospectus, DBRS tells Cov that they are not going to rate ABCPs anymore (market falling apart), which meant that DBRS cannot sell ABCP anymore, obviously going to affect their business, operations, capital. OSC says pre-prospectus DBRS policy change NOT a material fact that needed to be disclosed. However, they had to disclose DBRS change post-prospectus = material change.

Take aways: Mention both tests !

**Market Impact Test:** Info is material if it is reasonable to expect that the release of that information would impact the market price of the security. This is objective inquiry.

**Prof favours Reasonable Investor Test:** is this info that a reasonable investor would consider the important to an investment decision. This is a lower threshold than market impact test for materiality = investor protection!

**Beaware of Hindsight Bias!**

🡪fact that Cov’s share price didn’t drop after disclosure is irrelevant to materiality
🡪even if you alert an investor about some risk in prospectus, then risk factor occurs you must disclose it when it materializes.

##### Re Kapusta 2011 ASC No to Hindsight Bias, Expectation over outcome

President/CEO of AB oil gas co. buys securities on insider information. ASC: “it is not what eventually did happen, but rather what, beforehand, would reasonably have been expected to transpire. Hindsight must be avoided!” However, subsequent events can have **corroborative value** with the reasonableness analysis of an earlier expectation. The test results had been sufficiently certain to give rise to a material change. Months later when new pool of oil found and led to price increase is NOT weighty evidence.

For **procedure** in filing a material change, see later notes.

## Machinery of Securities Commissions

##### Administrative Structure – 2 Tier

Part Two of BCSA provide for two separate levels in the structure of the commission.

**First Level – Commissioners**

Section 4 of the Securities Act describes the first level of the commission which consists of up to 11 members

who are appointed by the Lieutenant Governor in Council after a merit based process. One member is

designated as the chair and chief executive officer, and one or more members may also be designated as vice

chairs.

**Second Level - Staff**

Section 8 states that the commission must appoint a person to be the executive director and chief administrative officer. The executive director is the head of the second level of the commission, the staff, who are employed.

🡪there is a **separation of advocate + Judge**

**Powers**

🡪investigate, examine
🡪supervise registrants, trading in general, prospectus, distributions, const’d disclosure, proxies, TOB, insider trading, self dealing
🡪enforce legislation & impose sanctions
🡪delegate front line responsibility to SROs

**Rule Making Capabilities:** In response to *Ainsley Corp* decision (which said OSC didn’t have rule making power), sec com throughout Canada were given such powers through legislatures. Commissions follow notice and comment rule making.

##### National Instruments & Policies – incorporated by reference under s. 184(2)(d)

Canadian Securities Administrators (CSA) issue NPs, NIs, MIs. NPs not law, set out principles or criteria to exercise of discretion by sec com, interpretative guides for statutes, and general practice recommendations. NIs, MIs, and companion policies are central method of Cdn harmonization.

##### Passport System – Created in 2004 (ON opted out) : MI 11-102 Passport System

Market participants need only comply with the securities laws (prospectus & cont’ discl, exemptions) of 1 principal regulator (typically where headoffice is at MI 11-102) & Ontario Sec Com, if they want nationwide access. Your non-principal regulators called host regulators. You file single paper with all the juris in which you want to issue prospectus & pay a fee to them (even though non-principal regs do nothing). Under PS, issuer obtains decision on its prospectus (or exemption from), and upon receiving dsn, they can rely on this for all other juris (except for ON).

##### Enforcement Procedures: Compliance, Investigatory, and enforcement powers

**Investigation**

Compliant or commission initiated.

Informal stage: rely on voluntary cooperation of parties, no compelling to give info

Formal stage: Com may initiate formal investigation. The com has broad + discretionary powers to investigate all done in the pubic interest: force attendance, inspect docs, compel production of docs, search/seizure w/ ex parte court order.

**Hearings to protect public interest**

Could be electronic, written, oral.
Disclosure:

Notice of hearing is issued with allegations against the respondents. Com should disclose all non-priv info, make full answer and defence. Violation of could be grounds for abuse of process. Normal evi rules do not necessarily apply.

**Regulatory & Internal Reviews**

Comm tribunal can review decisions of its Exec D, one is entitled if directly affected by decsion of ED to review by tribunal or appeal to them. A decision of ED or com to grant or not to grant exemtion from registration or prospec reqm cannot be appealed.

**Review of SRO or Exchange Decisions by Comm.** Can occur! If...(for example)
🡪proceeded on incorrect principles
🡪erred in law

##### Appeal Procedures

Statutory right to appeal under the relevant section 167(1) under the Securities Act of British Columbia (BCSA): “A person directly affected by a **decision of the commission (including its review of Exec Dire’ or SRO/Exchange’s decisions)** may appeal to the **Court of Appeal** with leave of a justice of that court.”1 A “person directly affected” includes corporations as per definition of “person” under the BCSA.

To get a leave to appeal, the BCCA set out six factors of consideration (*Walker v. BCSCn)*:

• Whether the tribunal’s jurisdiction is at issue

• **Whether there are questions of law**, concerning statutory application, statutory

interpretation important to the parties or interpretation of standard statutory

wording, engaged for the appeal

• Whether previous rulings show evident differences of opinion

• Whether there is a potential for a successful appeal

• Whether there is a benefit that would be derived from a successful appeal

• Whether several appellate bodies have considered the issue

= give lots of deference!

Standard of Review: reasonableness

**SROs: IIROC** (Investment Industry Regulatory Org of Canada): National Self Reg Org. IROC carries out its regulatory responsibilities through setting and enforcing rules regarding the proficiency, business and financial conduct of dealer firms and their registered employees and through setting and enforcing market integrity rules regarding trading activity on Canadian equity marketplaces.

**Mutual Fund Dealers of Canada (MFDA)** national self-regulatory organization (SRO) for the distribution side of the Canadian mutual fund industry. The MFDA is structured as a not-for-profit corporation and its Members are mutual fund dealers that are licensed with provincial securities commissions.

Prov sec com delegate various roles to these entities. Aka Recognized Entities.

### A New Regime? Cooperative Capital Markets

Cooperative Capital Markets Regulator Initiative: Feds/ON/BC/SK/NB/PEI. Canada only country w/o national regulator, but Cdn companies not valued enough b/c our fragmented system seems like less enforcement, more vulnerable to fraud (relationship btw com and RCMP).

These five governments released a Memorandum of Agreement (MOA) on September 8, 2014 setting out the terms and conditions to establish the Cooperative System. They also released draft uniform provincial capital markets legislation and complementary federal legislation for public comment. Open invitation remains for others to join.

##### Systemic Risk

Risks that occasion a domino effect whereby the risk of default by one market participant will impact ability of other to fulfill their legal obligations, setting off a chain of negative economic consequences that pervade entire financial system. It can be a function of 3 criteria to help identify the systemic importance of an institution, market or instrument:

🡪size (volume of financial services provided by individual component of the fin system)
🡪substitutionality (extent to which other components can provide that service in event of failure
🡪interconnectedness (linkages w/ other components of that system)

##### Reference Re Securities Act

To have a federal securities regulator would be unconstitutional under the federal government’s **general trade & commerce power (s. 91(2) of Constitution Act)**, but they could have jurisdiction over “**mgmt of systemic risk”** + “**international data collection”** (these are national in scope). Feds cannot have power over day to day affairs of sec, that is under prov property & civil rights 92(13).

#### The Cooperative Capital Markets Regulatory System

See class handouts

### The Prospectus Process NI 41-101 General Prospectus Requirements & NI 41-101F1 Required Info

**Once you have security, trade, distribution = must file prospectus if distribution to primary market to public. Make full true and plain disclosure of all material facts.**

#### Prospectus required

**61**  (1) Unless exempted under this Act, a person must NOT distribute a security unless

(a) a preliminary prospectus and a (FINAL) prospectus respecting the security have been filed with the executive director, and

(b) the executive director has issued receipts for the preliminary prospectus and prospectus.

(2) A preliminary prospectus and a prospectus must be in the required form.

#### Voluntary filing of prospectus

**62**  Even though a person is not distributing securities, a preliminary prospectus and a prospectus that are in the required form may be filed for

(a) the purpose of enabling the issuer to become a reporting issuer, or

(b) any other prescribed purpose.

#### Contents of prospectus

**63**  (1) A prospectus must provide **full, true and plain disclosure of all material facts** relating to the securities issued or proposed to be distributed.

(2) A preliminary prospectus must substantially comply with the requirements of this Act and the regulations respecting the content of a prospectus.

**Reporting Issuer:** issuer that filed prospectus, gone IPO.

**Full True & Plain Disclosure:** sufficient info for investors to make their decisions, cannot omit info!, plain understandable language.

##### Required Contents for Long Form Prospectus: NI 41-101 + NI 41-101F1

From Form NI 41-101F: (non financial disclosure)

🡪cover page Disclosure
🡪summary of prosp
🡪description of business
🡪use of proceeds
🡪Management’s Discussion & Analysis
🡪Description of Sec Distributed
🡪Consolidated Capitalization
🡪Options to purchase sec
🡪prior sales
🡪principal sec holders
🡪directors/exec officers
🡪exec compensation
🡪**RISK FACTORS (reasonable investor test)
🡪**legal proceedings/reg actions
🡪relationship btw issuer or selling secholder and UW
🡪material contracts
🡪Experts
🡪other material facts
🡪rights of withdrawal/recission

##### Financial Matters: Disclosure NI 41-101

Each prospectus must file **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 + recent interim financial report for most recent period.
**Credit Supporter Disclosure
Significant Acquisitions
Probable Reverse Take Over (its potential acquirer)**

Must include and file Auditor’s comfort letter (assuring financial soundness of statements) along with unsigned financial statements **in prelim prospect** and must file a new one should an amendment to a prelim prosp affect the first comfort letter. 6.3 NI 41-101

##### Information about the Future: Financial Outlook, Future Oriented Financial Information, Forward Looking Info: NI 41-101F1 + NI 41-101 PART FOUR + NI 51-102 CD

 **Forward Looking Info:** possible events, conditions or financial performance that is based on assumptions about future economic conditions and courses of action and **includes future oriented financial info (FOFI)** w/ respect to prospective fin performance, prospective financial position or prospective cash flows that is presented either as a forecast or a projection.

Requirements of NI 51-102 (4A.2 + 4A.3) Continuous Disclosure Obligations bleed into NI 41-101F1. Both require **substantive reasonableness and disclosure:**

**1.** Must have **reasonable basis** for it. Reasonableness of assumptions, plus process followed in preparing/reviewing forward looking info. There is an implied representation that the info is objectively reasonable at the time the prospectus is filed.

**2.** The Issuer should caution readers about the risk factors, limitations of that info and identify it as forward looking. Issuer should create “**safe harbour”** provision in prospectus to limit liability.

##### Issuer’s and Underwriters Certificates: NI 41-101 PART 5

**Issuer:** **CEO, CFO, and any 2 directors** (other than CEO/CFO) must certify that prosp constitutes full true and plain disclosure of all material facts. = liable for misstatements or misrepresentations.

**Underwriter:** same as above, but prefaced with “to the best of our knowledge, information and belief...”UW’s due diligence efforts weigh in its liability for misstatement/misrep.

Any expert, lawyer, engineers, auditors, etc. that helped prepare a part of the prospectus must consent to that info being used. NI 41-101. Esp auditor!

##### Regulatory Discretion BCSA s. 65

Lots of discretion in prospectus matters! For public interest protection of investors from unfair practices, and to foster fair and efficient capital markets and confidence in capital markets.

When will ED refuse to issue receipt for prospectus?
**Executive director's discretion**

**64**  (1) Before issuing a receipt for a preliminary prospectus or for a prospectus, the executive director may impose additional filing requirements and conditions if the executive director considers that it is in the public interest to do so.

**Receipts for prospectus**

**65**  (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.**

Eg. even if an officer’s past conduct might mean co wont’ operate w/ integrity, upheld this discretion in OSC

*Committee for Equal Treatment of Asbestos Min Sharehodlers* SCC 2001
🡪ED broad but not unlimited discretion to intervene
🡪pub interst is purpose behind sec acts
🡪disc prospective and preventative
🡪ED to consider public confidence and efficiencies of cap market

*Re Inland*: ED may withhold issuance of receipt on a merit basis must at least have reasonable and specific business plan.

#### Mechanics and Stages of Prospectus

Timeline:

1. Determine Principal Regulator
2. Dual Prospectual if want to sell in ON
3. Prelim Receipt
4. Waiting Period
5. Final Receipt
6. Close of Distribution period.

The prospectus and all corresponding docs filed on System for Electronic Document Analysis and Retrieval (SEDAR).

##### Pre Marketing & Marketing Restrictions: 2 Exemptions

Only registered investment dealers (IIROC) may engage in pre marketing on behalf of issuer, so employees could but would have to be registered.

Why do we restrict communication before preliminary prospectus is filed?

🡪ensure investor protection and that they have equal access to doc that contains f.t.p. disclosure of all material facts (liability attached)
🡪deter “conditioning of market” (potential investors learning, and becoming excited about offering too soon)
🡪to try and ensure level playing field for investors and prevent selective disclosure.

Pre marketing occurs when a party communicates w/ potential investors before a public offering and includes other promotional activities that occurs **before a preliminary prospectus is filed**.

**1. Short Form Prospectus and Bought Deal Exemption: NI 44 101 *Short Form Prospectus Distributions*  PART 7 :**

“solicitations of expressions of interest” for securities that would be qualified for distribution under a **short form prospectus** where issuer and UW had entered into a **bought deal:** **Part 7** allows investment dealer to engage in roadshows and provide standard term sheets and marketing materials to potential investors. Could be done by telephone, on the internet, by other electronic means.

**2. Testing the Waters IPO Exemption: NI 41-101, s. 13.4
🡪are you a company that already has UW retained and want to go public?
🡪are you non public issuer that needs to test before full commitment (have no UW)?**

Marketing of IPO deals before preliminary prospectus is filed. Applies to 2 entities: Either you are going IPO or you are a non public issuer who wants to test waters for proposed IPO before fully committed to filing long form prospectus, an investment dealer will do this on issuer’s behalf.

**Limitations on Exemption:**

🡪unavailable if any of issuers’ sec held by a control person that is a public issuer = **no subsidiaries**
🡪issuer may solicit only from “accredited investor”, either way, material must contain clause that it does not provide full disclosure and not subject to liability for misrep.
🡪**accredited investor** must confirm in writing that they will keep the info confidential, only purpose is to assess its interest in offering.
🡪must have gap of at least 15 days between last solicitation of interest and the date the IPO prelimin prospectus is filed, so cannot solicit 15 before prelimin pros is filed.
🡪41-101CP advises that investment dealers and accredited investors should not take advantage of this exemption eg. **selective disclosure,** make disclosure of material facts to investors, which do not end up in the prospectus!

##### Preliminary Prospectus NI 41-101

PR􀀃reviews􀀃preliminary􀀃and􀀃pro􀀃forma􀀃prospectuses􀀃based􀀃on􀀃its􀀃review􀀃procedures,􀀃analysis􀀃and􀀃 precedents.􀀃PR􀀃will􀀃issue􀀃preliminary􀀃receipt􀀃if:􀀃

1. Ryan􀀃has􀀃filed􀀃acceptable􀀃materials,􀀃and􀀃

2. Ryan􀀃confirms􀀃to􀀃the􀀃best􀀃of􀀃its􀀃knowledge􀀃and􀀃belief􀀃that:􀀃􀀃

􀁸 🡪materials have􀀃been􀀃filed􀀃and􀀃fees􀀃have􀀃been􀀃paid􀀃to􀀃the􀀃PR􀀃and􀀃non􀍲PR,􀀃and􀀃

􀁸🡪locally􀍲required􀀃materials􀀃have􀀃been􀀃filed,􀀃no􀀃local􀀃cease􀀃trade􀀃orders􀀃in􀀃effect,􀀃and􀀃

🡪at􀀃least􀀃one􀀃underwriter􀀃is􀀃registered/applied􀀃for􀀃registration/exempt􀀃from􀀃registration.􀀃􀀃

PR􀀃may􀀃issue􀀃comment􀀃letter(s)􀀃outlining􀀃problems􀀃in􀀃preliminary􀀃prospectus􀀃which􀀃Ryan􀀃must􀀃correct.

File this first one with the Com and get initial feedback (w/ 10 working days) and approval on form and content. Contains everything that will be in the final prospectus except price of sec to be offered, auditors report is not included, only applies to final prospectus. Must contain notes that, no securities may be sold before final prospectus is receipted. Marketing normally won’t commence till first set of comments received.

##### Waiting Period NI 41-101 + s. 78 of BCSA

Time between when issuer receives a receipt from the Com for its prelimin prospectus, and when it receives the receipt for its final prospectus. During waiting period, there will be no sale or any acceptance of an offer to buy securities. NO gun jumping! No acts in furtherance of a trade!

What is permitted during waiting period? (whatever is done/said, better be in the prelim prosp!!)

NI 41-101 permit investment dealers on behalf of issuers to distribute a significant amount of info to all investors during waiting period:

🡪**prelim prospec notice:** info about the securities from communication which includes a source from which the prelim prosc is accessible. (written com that relates to prelim)
🡪**prelim prospc**
🡪**standard term sheet:** (NO civil liability)a summary of the prelimin prospectus (need not be filed on SEDAR) must contain cautionary language that it doesn’t contain material disclosure
🡪**marketing materials:** written communication regarding the sec under the prospc that contains material facts relating to issuer, securities or an offering. Must have some cautionary language. Must be approved by issuer and lead UW, and filed on SEDAR
🡪solicit expressions of interest from a prospective purchaser, if they were given copy of prelim pros.

**Roadshows:** (1-2 weeks)presentation to potential investors, regarding distribution of secu under a prospectus, conducted by one or more investment dealers on behalf of issuer in which one or more of the issuers’ exec officers or other rep of issuer participate in. The issuer is building its books by getting subscriptions!(solicit intentions to buy)

**Greensheet:** 10 page long summaries prepared by investment dealers intended for their representatives, summarizing main terms of prospectus during waiting period, not intended for members of public.

\*subscription agreements are NOT binding, prospective purchaser can withdraw s. 83(3)

In general, mgmt should not give interviews to media before or during waiting period. No predictions about future fin performance that is not in prospectus. Pricing discussions based on expressed interest occur after marketing.

##### Final Prospectus – reg + civil liability attaches! NI 41-101

PR􀀃will􀀃issue􀀃a􀀃final􀀃receipt􀀃if:􀀃

1. PR􀀃satisfied􀀃that􀀃Ryan􀀃has􀀃resolved􀀃all􀀃its􀀃comments,􀀃and􀀃

2.For􀀃a􀀃dual􀀃prospectus,􀀃the􀀃OSC􀀃has􀀃indicated􀀃on􀀃SEDAR􀀃that􀀃it􀀃is􀀃clear􀀃to􀀃receive􀀃final􀀃materials􀀃

or􀀃has􀀃opted􀀃out􀀃of􀀃dual􀀃review,􀀃and􀀃

3. Ryan􀀃has􀀃met􀀃all􀀃of􀀃the􀀃preliminary􀀃prospectus􀀃requirements􀀃(see􀀃above).

The approved version of PP. Must submit blacklined copy with all changes req’d by commission. Once issuer obtains receipt for final prospectus time to Distribute!!!

**Amendment to Pre Lim**: If btw prelim and final prospect (waiting period), a **material adverse change** occurs MUST file amendment **within 10 days of change:** PART 6, s. 6.5 of NI 41-101

**Amendment to Final:** If btw final and close of distribution period, a material change occurs (good or bad) MUST file amendment, **within 10 days of change**: PART 6, s. 6.6 of NI 41-101

**Amendment to Final:** distribution of securities under final prospectus not complete, want to issue sec that were not disclosed in final prospec, then final prosp must be amended to include new sec. 6.6(2). **within 10 days of change**

File them as soon as possible, dn’t rely on 10 day window. BC Sec com will then issue receipts for the amendments, deemed in passport juris, as long as you file it w/ the non-principal reg juris.

##### 2 day Cooling off period commences after final prospectus filed

Dealer who receives order must give prospective purchaser the final prospectus. They have 2 business days to allow a cooling off period so they can decide if they want to withdraw from buying.

#### Alternative Forms of Prospectus

##### Short Form Prospectus NI 44-101 Short Form Prospectus Distributions in NI 44-101F1

SFP includes basic info on particular issue and the use of proceeds. LFP unnecessary b/c previously filed with commission. LFP incorp by ref. Must have good disclosure record.

To qualify issuer must be electronic filer on SEDAR and be RI in at least one juris in Canada, must have sec listed on exchange, and cannot have ceased operations or have cash or its exchange listing as its principal asset. Must be up to speed w/ all it continuous discl obligations in every juris. Finally, must have current annual financial statements and current Annual Info Form in 51-102F2 *Annual Info Form* on file as part of its CD in at least one juris.

**Annual Info Form:**

AIF focuses on material info about issuer and business at the end of recent financial year, in context of past and

future developments, risks and other external factor that may impact issuer.

• Description of business: products and services, special skill and knowledge, competitive conditions, new products,

intangible properties, cycles, economic dependence on major Ks, patents, formulas, trade secrets, environmental

protection, employees, foreign operations, inter-corporate relations, etc.

• Includes a three year history of business, significant acquisitions in the year, dividends, legal proceedings, info on

directors and officers, conflicts of interest.

In addition to AIF, the SFP must incorp by ref current AIF, current annual fin statements, MD&A, interim financial statements, material change reports, business acquisition reports, and info circulars. Liability attaches to SFP. The filing process for a short form prospectus is similar to that for a long-form prospectus, but the waiting period is far shorter (as per NP 11-202).

##### Shelf Prospectus

**Shelf Prospectus** (\*only available to reporting issuers w/ good disclosure record)

**NI 44-102 *Shelf Distributions* sets out the requirements for filing a shelf prospectus.** Reporting issuers that are eligible for the short form prospectus process are also eligible to file shelf prospectuses. A shelf prospectus allows an issuer to file a short form-style prospectus and then leave it “on the shelf” for up to 25 months. At any point in those 25 months, the issuer can take the securities “off the shelf” and distribute them. Pros: can expedite the raising of capital, can lower the cost of making an offer > to distribute securities, the issuer only needs to prepare an information supplement, *which does not required review by regulators.* Cons: risk of “market overhang” (share price dropping in anticipation of forthcoming issuance of shares). Rationale: same as for SFPs > for reporting issuers for which there is considerable information in the market.

##### Post Receipt Pricing Prospectus

**Post-Receipt Pricing Prospectus** (\*available to all issuers, but only for specific transaction + single type of security)

**NI 44-103 *Post Receipt Pricing* sets out the requirements for filing a post-receipt pricing prospectus.** All issuers are eligible for the PREP prospectus process, but it may only be used for a specific transaction and a single type of security (in contrast to shelf prospectuses, which may be used for multiple types of securities. The PREP process allows issuers to file a base prospectus (long or short form) without including price and related information. A PREP prospectus cannot be used for a rights offering, and can be kept “on the shelf” for 90 days (far less than 25 months for shelf prospectuses). This shelf life can be extended if the issuer files a supplemental PREP prospectus. To distribute securities, the issuer must prepare an information supplement to distribute to prospective purchasers, *but this need not be reviewed by regulators.*

##### Penalties for Non Disclosure

s. 164 failure of filing requirements = Com can issue cease trade w/o hearing
s. 162 Administrative penalty:

**162**  If the commission, after a hearing,

(a) determines that a person has contravened

(i)   a provision of this Act or of the regulations, or

(ii)   a decision, whether or not the decision has been filed under section 163, and

(b) considers it to be in the public interest to make the order,

the commission may order the person to pay the commission an administrative penalty of not more than $1 million for for each contravention.

s. 161 Enforcement Orders: broad powers for public interest, no need to even breach sometimes as preventative of future harm.
s. 155. 1 Restitution to Sec Com
s. 157 Orders for Compliance in public interest

#### Passport System MI 11-102 Passport System

**MI 11-202 + NP 11-102 *Process for Prospectus Review in Multiple Jurisdictions*  sets out the passport rule for filing a prospectus in multiple jurisdictions.** The aim of the passport system is to streamline the regulator review and comments process.

Under the passport system, the issuance of a receipt for a preliminary prospectus by the primary regulator is deemed to be receipt of the preliminary prospectus in all passport jurisdictions (\*these jurisdictions must be listed in the primary regulator’s receipt). The primary regulator will provide the bulk of the comments during the waiting/review period.

However, Ontario has not signed on to MI 11-102, but agreed to coop under **NP 11-202**. If issuer files a prospectus in multiple provinces including Ontario, the **dual prospectus** system applies and there are two principal regulators (Ontario Securities Commission + other primary regulator). Both principal regulator and OSC reviews the prospectus, generally issuer will only deal with principal reg, and OSC advises princip reg of any concerns. So concerns sorted out and finally princip reg issues receipt, it is deemed in ON. ON can opt out, PR will try and resolve ON’s concerns, if not resolved, then no deemed receipt in ON. Must file w/ Ontario individually.

##### Multijurisdicitonal Disclosure System

**NI 71-101 sets out the requirements for distributions in Canada and the US.** Under the MJDS, issuers from the US and Canada can use the same disclosure forms when selling securities in each other’s markets.

## NI 51-102 + Part 12 of BCSA: Continuous Disclosure Obligations

So now you have receipt for final long form prospectus = you are a reporting issuer!

Disciplines mgmt makes them responsible, don’t want to be ousted from job. Enhance disclosure on exec comp/shareholder rights/reinforces value of transparency, perhaps better corp citizen.

### Periodic Disclosure NI 51-102

**Section 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.

#### Financial Disclosure PART 4 NI 51-102

##### Accounting Standards

Financial statements of RI must be prepared in accordance with International Financial Reporting Standards (IFRS).

##### Subject and Timing of Financial Disclosure: Annual Financial Statements + Interim Financial Statements

AFS + IFS: create level playing field, all investors have access to same info (investor protection + capital market efficiency)

**Audited Annual Financial Statements NI 51-102:** must file AFS within 90 days of year end. Auditor must be independent and exercise its due diligence when preparing report. + MD&A. Audited annual financial statement must show comprehensive income, statement of changes in equity and a statement of cash flows for the financial year, and financial position at end of financial year. Compare this year’s results to last year.

**Interim Financial Statements:** file comparative interim financials for 9, 6, and 3 months before end of RI’s financial year. Due within **45 days** of end of interim period to which they apply. (no need for auditor’s report, but subject to auditor’s review) + MD&A.

NI 51-102 - 4.3(3)(a) **If an auditor has not performed a review of an interim financial** report required to be filed under subsection (1), the interim financial report must be accompanied **by a notice** indicating that the interim financial report has not been reviewed by an auditor.

Must show comprehensive income, statement of changes in equity and a statement of cash flows for the quarter and financial position at end of quarter, and comparative financial info for corresponding interim period in the immediately preceding financial year, if any. If foreign earlier deadline applies, that must be met in Canada.

##### Auditor’s Report

All annual financial statements and any interim financials (RI chooses to have audited) must be audited as per IFRS. Their audits are intended to enable securityholders to oversee mgmt, not to assit shareholders in personal investment decisions. No fid duty to public or shareholders.

##### Predictions about the Future: forward looking info; FOFI, and financial outlook.

NI 51-102 PART 4B

3 predictions: forward looking info; FOFI, and financial outlook.

FLI: is **broadest term** and covers all disclosure regarding possible events, conditions or fin performance that is based on assumptions about future economic conditions and courses of action. It includes FOFI w/ respect to **prospective fin performance, fin position or cash flows**, presented either as a forecast or a projection.

FOFI and fin outlooks are types of forward looking info about prospective fin performance, fin position or cash flows. This info is FOFI when presented in the format of a historical statement of fin position, statement of comprehensive income or statement of cash flows, when presented in any other form it is a financial outlook.

Requirements of NI 51-102 (4A.2 + 4A.3) Continuous Disclosure Obligations. Require **substantive reasonableness and disclosure:**

**1.** Must have **reasonable basis** for it. Reasonableness of assumptions, plus process followed in preparing/reviewing forward looking info. There is an implied representation that the info is objectively reasonable at the time the prospectus is filed.

**2.** The Issuer should caution readers about the risk factors, limitations of that info and identify it as forward looking. Issuer should create “**safe harbour”** provision in prospectus to limit liability.

In *Kerr v. Danier*: FOFI implies a material fact that the forecast is objectively reasonable, which increases change that FOFI may give rise to an action for misrep.

##### Management’s Discussion & Analysis (MD&A) **Form 51-102F1** *MD &A + PART 5 NI 51-102*

MD&A must be filed with every **annual AND interim financial statement.** Narrative explanation from RI’s mgmt on most important aspects of issuer’s position and condition, help explain Annual/interim financials. Explain past performance and look to future. Add context and depth to financial info, discuss trends, risks, **material info** not reflected in fin info, any changes to business model, corp gov changes, any new levies. 🡪 high degree of disclosure!

Issuer’s board of directors or audit committee must **approve** MD&A before it can be filed + distributed to shareholders. Must be filed on same day that issuer files financial statements.

##### Annual Reports and Annual Information Forms (AIFs)

Annual Reports: NOT req’d by securities law. Glossy docs sent to securityholders summarizing past fiscal year.

Annual Information Forms FORM 51-102F2 *AIF* 18 items + PART 6 NI 51-102

AIF focuses on material info about issuer and business at the end of recent financial year, in context of past and

future developments, risks and other external factor that may impact issuer.

• Description of business: products and services, special skill and knowledge, competitive conditions, new products,

intangible properties, cycles, economic dependence on major Ks, description of capital structure/dividends, environmental protection, employees, foreign operations, inter-corporate relations, corporate structure, **exec compensation** etc.

• Includes a three year history of business, significant acquisitions in the year, dividends, legal proceedings, info on

directors and officers, conflicts of interest.

Must be filed w/in **90 days of the end of issuer’s fiscal year**. Includes similar info in prospectus, only material info need be disclosed.

So within 90 days of financial year’s end, Issuer is filing:

🡪audited fin statements
🡪MD&A
🡪AIF

##### Certification Requirements

CEO/CFO must certify annual financial statements (Form 52-109F1) and interim filings (Form 52-109F2) as *NI 52-109 CERT of Disc of Iss’s annual & interim filings.* Board or audit committee must approve the statements. CEO and CFO (or equivalent) of RI must certify that the two documents do not contain any misstatements or omissions of material facts.

CEOs and CFOs are obliged to certify, to the best of their knowledge, that the materials presented **“fairly present”** any financial information provided, must declare that adequate **disclosure controls and procedures (DC&P**) are in place, and that **internal control over financial reporting** (**ICFR**) is sufficient. In line with the overall theme of CD, investors require assurance that the protection offered by proper DC&P and ICFR are in place; any “material weakness relating to design”, any “limitation of scope of design”, and any changes regarding DC&P and ICFR must be disclosed via CD.).

🡪CEO/CFO could be held **personally liable**In contrast to certification of senior mgmt under prospectus, must state that: “constitutes full, true and plain disclosure of all material facts…”, CD inquires more closely into the more fluid and ongoing aspects of the issuer and requires upper management to be engaged and responsible for informing investors, not only about change, but about the issuer’s ability to accurately measure and report said change

#### Proxy and Information Circular Disclosure NI 51-102 PART 9

Proxy: securityholder has nominated another person to attent and act for the securityholder and on the secholder’s behalf at a meeting of the security holders 🡪 their proxy or nominee, must vote as directed.

##### Mandatory Solicitation of Proxies

These strict proxy rules ensure that there is informational symmetry between retail investors and institutional investors. So rules ensure investors have info circ whenever attempting to influence fellow investors to help address info asymm btw retail/inst investors. Retail inves do not have time/resources to thoroughly investigate/research.

**A. Proxies**

MGMT must mail a form of proxy to each security holder (registered and beneficial), either before or at the time as the notice of the meeting to which the proxy applies. **MGMT must solicit proxies for annual & special meetings, at which at least one director will be elected.**

**B. Information Circular NI** 51-102 PART 9 + 51-102F *Info Circ*RI must send out form of proxy and infor circular when giving notice of a meeting to its security holders. Info circular must contain info to enable securityholders to make informed decisions on proxy votes. Info circ must be prepared in a prescribed form (51-102F *Info Circ*). They are mandatory whenever there is a solicitation. Non-mgmt solicitation need not include info circ if soliciting proxies from 15 or fewer securityholders.

**C. Solicit and solicitation If solicit 🡪 must send info circular**
**NI 51-102 defines “solicit”,** in connection with a proxy, includes

(a) requesting a proxy whether or not the request is accompanied by or included in a form of proxy;

(b) requesting a securityholder to execute or not to execute a form of proxy or to revoke a proxy;

(c) sending a form of proxy or other communication to a securityholder under circumstances that to a reasonable person will likely result in the giving, withholding or revocation of a proxy; or

d) sending a form of proxy to a securityholder by management of a reporting issuer

**D. Form of Proxy FORM 54-101F4 (if from intermediary) or FORM 54-101F6 (if directly from RI)**Form when executed appoints a proxy: form of proxy. **PROXYHOLDER:** authorized to act as substitute for another and vote. Must state whether it is solicited by or on behalf of mgmt, alert as to possible conflict of interest. Must state that the secholder can choose any person.

Securityholders can choose from the list of directors/officers from the form of proxy to be their proxy or they can assign it to a “voting agent” (advisory firms or investment managers). Proxyholders can also be given **discretionary authority** to vote on issues arising at the shareholder meeting. Security holder must make intention known to RI at least 48 hours before meeting.

**E. Form of Info Circular Form 51-102F5**Must include sufficient info + securityholders aware of their rights eg. proposed special resolutions. Info circ must be given as of a specified date not more than 30 days before info circ first sent out. 16 requirements include:

🡪must be dated, state whether person or company giving proxy has power to revoke it
🡪persons making solicitation must be identified
🡪if taken by mgmt, and if any director intends to oppose mgmt
🡪statement on form of proxy itself that sec have right to appoint any person to be their nominee (duplicate of proxy form in info circ)
🡪statement of executive compensation
🡪if anyone, proxy solicitor, nominee for election as director have material interests in matters to be acted upon at meeting
🡪appointment of auditor
🡪must state if any directors up for election were involved in cease trade orders

NB: matters other than approval of annual fin statements (need not be included in Info Circ)
NB: should deliver materials to beneficial owners of securities and if mgmt plans to make proxy solicitation by public means (exempt from proxy solicitation) **51-102CP PART 9**

##### Executive Compensation Disclosure FORM 51-102F6

Named Exec Officers (NEO): CEO, CFO, each of 3 most highly compensated exec officers, who received more than 150K. Any compensation paid directly/indirectly by co, or a subsidiary to each director and NEO. Compensation defined broadly under form: pension value, options etc. Form includes “compensation discussion and analysis” outlining rationale behind compensation policy/strategies.

##### Costs of Proxy Solicitation

Issuer bears costs of proxy solicitation made **by or on behalf of mgmt** provided that it is made in respect of a *bona fide* issue of corporate policy. If it is only in the self interst of directors, they have to bear the cost. For non-mgmt proxy solicitations (activist shareholders): reimbursement is put to a shareholders vote, should still be *bona fide* purpose.

##### Consequences of Proxy Irregularities **Form 51-102F5**

If proxy procedures not followed properly, shareholders could legally challenge it later to undo the decision reached by the proxy votes. Eg. providing insufficient info to shareholders on how valuation reached before finalization of purchase agreement *Garvie v. Axmith*

#### Delivery of Periodic Disclosure

Secholders are entitled to have period CD docs delivered to them upon request.AIFs need not be delivered, filed on SEDAR. Often securities registered in names of intermediaries, who hold them for beneficial owners (their clients). NI 54-101 *Communication with Beneficial Owners of Securities of a Reorting Issuer* ensures that beneficial owners receive the periodic disclosure to which they are entitled.

The intermediary (Depository) keeps list of non-objecting beneficial owners (NOBOs), who do not object to have their ID revealed, and those who are objecting beneficial owners (OBOs). Issuer first requests beneficial ownership information from registered owner (intermediary), then RI can send info directly to NOBOs, issuer sends docs to intermediary who then sends it to OBOs (includes Form 54-101F7 *Request for Voting Instructions Made by Intermediary*).

All docs filed on SEDAR + those that must be sent to sec via email/paper/mail. Send NOBOs Form 51-101F6 *Request for Voting Instructions.* RI can also provide notice and access to NOBOs. File the info circ and notice on SEDAR and RI’s website.

#### Timely Disclosure

##### Material Change Reports (MCRs) FORM 51-102F3 + s. 85 (B)

If material change 🡪 triggers MCRs (see definition of material change: business, operation, capital)

MCR inform commissions, mrket participants and public about important changes in issuer’s affairs. File
it ASAP (at least 10 days within finding out of change). 🡪 issue **news release (on SEDAR) and file w/ commission AND prepare/file MCR with Com:** FORM 51-102F3.
 1st MCRs ensure sec markets perform pricing/evaluation functions in most prompt / efficient manner 2nd prevent insiders from taking advantage of their special position.

Best Practices as set by **NP 51-201**: see pg. 13 for guidance on material changes
🡪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

A RI may file MCR confidentially to commission w/ written reasons for non-disclosure under 2 circumstances: **NI 51-102 PART 7.** Must continue to notify commission **every 10 days** if it is still confidential.

1)reasonable opinion that immediate disclosure would be unduly detrimental to its interests
2)when decision made by senior mgmt amounts to a material change and is awaiting probable board approval

🡪So in both cases, the MCR release is **delayed**, **but still filed** **w/ Commission**, not released to public, but eventually disclosed to public w/ news release and public MCR.

##### Selective Disclosure NP 51-201

SD defined by CSA as “when a company discloses **material non public information** to one or more individuals or companies and NOT broadly to the investing public (**NP 51-201**). SD can be intentional or accidental and those individuals are typically analysts, institutional investors, investment dealers and other market professionals.

**Regulatory Consequences for selective disclosure**
Canada does not have direct regulatory standards. However, it is subject to general disclosure standards under NP 51-201 and potential insider trading regulations.

NP 51-201 addresses SD by reviewing existing continuous disclosure provisions that touch on SD. Those provisions discuss administrative policies, and outline potential risks from certain types of contact between issuers and analyst. The relevant provisions are:

* s. 3.4 - Tipping prohibition;
* s. 3.6 - If an issuer **unintentionally** discloses some material information it should make an **immediate public announcement**, and **request exchanges to halt trading until the announcement is disseminated**; moreover, the issuer should also **inform those who have knowledge** of the information that the information is material and is yet to be publicly disclosed;
* must promptly disclose the confidential info
* ss. 6.7-6.9 – encouraging issuers to have disclosure policy, disclosure spokesperson, issue “**quiet periods”** and avoid problematic “analyst-related activities”; have policy of only providing non material info to analysts.
* ss. 5.1-5.3 - lists the problematic analyst-related activities, for example,
1. Private briefings with analysts, institutional investors and other market professionals;
2. The way a company confirms analyst reports as to whether the selective confirmation communicates information above and beyond the initial forecast, and whether addition information is material;
3. Even having **confidentiality agreements** with analysts does not protect issuers from liability for tipping.

However, NP 51-201 is only a policy. Commissions may hold administrative enforcement proceeding for SD violations (**s. 155 offences generally, s. 161 enforcement orders).** And the various mitigating factors the Commissions will take into account include: (1) whether the issuer has implemented and followed “reasonable policies and procedures to prevent contraventions of the tipping provisions, (2) whether SD was unintentional, and whether any corrective steps were taken after the SD had occurred.

## Exempt Distributions NI 45-106 Prospec & Reg Exemptions + NI 45-102 Resale Rules

**1st Type of Exemption:** Mandatory Exemptions set out by objective criteria: NI 45-106 *Prospectus and Registration Exemptions*

**2nd Type of Exemption:** considerable discretionary by regulators to grant exemption.

Securityholder that wishes to trade an exempt market security have 3 options:

1) continue to trade sec w/in closed exempt market only, by relying on further exemtion
2)qualify sec under prospectus – transform them into freely traded securities
3)under NI 45-102 Resale Rules: secholder may hold the exempt securities until a specified ‘hold period’ expires. The hold period allows time for info about sec to build up in the marketplace. Once hold over, sec may be freely traded. Hold period won’t expire unti Issuer has been RI for certain time.

### Rationale and Exemptions under it

#### A. No Need to Know: Purchaser Already Familiar with Issuer or Securities

##### Rights Offering PART 2, DIV 1

A distribution to issuer’s existing security holders to purchase more shares of issuer on pro rata basis. Fast way to raise capital. Issuer **must** provide written notice of details of offering to regulator in advance of offering. Regulator has 10 days to raise any objections. Issuer must follow **NI 45-101** *Rights Offering*.

##### Dividend Distribution and Reinvestment Plans PART 2, DIV 1

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.
A reinvestment plan is an agreement between an issuer and its securityholders, under which the securityholder choose to reinvest their cash dividends automatically; purchase more of the issuer’s securities.

##### Conversion, Exchange or Exercise PART 2, DIV 5

Still dealing with issuer’s security on the same terms of securities previously issued. Eg. a convertible security, converted to a diff type of sec at security holder’s election. If it is of RI, must give written notice advance of the distribution to regulators and regulator has 10 days to raise objections.

##### Family, Friends, and Business Associates Exemption; Founder, Control Person and Family Exemption PART 2, DIV 1

Distribution to family, close personal friends, or close business associates of issuer’s directors, executive officers, founder, or control person is exempt in every juris except Ontario.
**Family Member:** very broad definition
**Close Personal Friend:** is one who has known the person in question (eg. director) long enough to be in a position to assess that person’s capabilities and trustworthiness. Must be direct relationship, not friend of a friend. Not simply b/c related, belong to same org, or used to work together.
**Close Business Associate:** sufficient prior business dealings with a director, exec officer, founder or control person of issuer to be in a position to assess that person’s capabilities and trustworthiness.

##### Affiliate Exemption PART 2, DIV 1

Distribution to a subsidiary of issuer.

##### Employee, Executive Officer, Director and Consultant PART 2, DIV 4

Distribution **by issuer or by a control person** in securities of issuer to an employee, executive officer, director or consultant of issuer is an exempt distribution. Employee stock options etc. must be voluntary participation.

##### Investment Fund Exemption PART 2 DIV 3

##### Private Issuer Exemption PART 2 DIV 1

A distribution by a **private issuer (not reporting issuer) to an accredited investor** or a person who has a **close relationship w/ issuer** is an exempt distribution. Close relationships include employees, officers, and directors, and their family members, close personal friends and close business associates.

##### Distributions to Existing Shareholders Exemption CSA Notice 45-313

Offering made available to all existing security holders with same type of listed security.

#### B. No Need to Know: Purchaser is Sophisticated or Otherwise Able to Protect Itself

##### Accredited Investor

Distribution to AI both as a corp entity or individual. Individuals may qualify under 3 tests (NI 45-106:

1. **Financial Assets test:** individual beneficially owns (alone or w/ spouse) financial assets with an aggregate net realizable value before taxes of more than $1 million.
2. **Net Income Test:** individual w/ pre-tax income in each of the past 2 years of more than $200K (or combined w/ a spouse of more than $300K), and who “reasonably expects” to exceed that level in the current year.
3. **Net Asset Test:** individual who (alone or w/spouse) has net assets of at least $5 million. (total liabilities subtracted from total assets (including residence).

**Individuals** registered as a rep of a registered dealer/advisor also qualify. If AI is created or used solely to purchase or hold securities as an AI cannot use this exemption eg. private equity investors.

Issuer **must** report the distribution w/in 10 days of the distribution to commission in **FORM 45-106F1**, or in BC, more extensive form **FORM 45-106F6,(Exempt Distribution Report)** must file disclosure of purchase details, a bit onerous.

##### Minimum Amount Investment

A distribution to a purchaser acting as a principal, where the securities have an acquisition cost of at least $150K and the purchaser pays in cash. Issuer must report distribution w/in 10 days to commission in FORM 45-106F1 or in BC FORM 45-106F6.

#### C. No Need to Know: Investment Very Safe

Canada Savings Bond, provincial equivalents, municipal bonds, bank bonds etc. Also includes **short term debt**, as long as not convertible, company has approved credit rating from DRO eg. commercial paper, IOU, maturing not more than one year from date of issue.

NB: Asset backed commercial paper falls under short term debt exemption. This is how very unsafe ABCP’s found placement within this exemption, there was no prosp req’d b/c of diminished need to knw.

#### D. Redundncy or Dual Regulation: Prospectus Level Information is Available from Another Source or Required by Another Regulator

##### Take Over Bid and Issuer Bid

A distribution made in accordance with a TOB or an issuer bid is exempt because bid must be accompanied by a bid circular providing investors w/ prospectus level disclosure.

##### Business Combination or Reorganization

Amalgamation, merger, reorg or arrangment must be 1) made under a statutory procedure; 2) described in an info circular pursuant to NI 51-102 + approved by shareholders 3) a dissolution or winding up.

##### Acting as Underwriter

A distribution btw a person and a purchaser acting as an underwriter or between or among persons acting as underwriters.

#### Cost/Benefit Analysis: Ensuring Smaller Issuers and Not for Profits Can Access Capital Markets

Access to capital markets outweighs the costs associated w/ a somewhat reduced level of disclosure available to public.

##### Offering Memorandum Exemption PART 2 DIV 1

Often used by junior start ups. OM as substitute for prospectus level type of disclosure. OM discloses info in writing details about its business and securities offered. OM not reviewed or receipted by commission. OM misrep do attract liability. In BC, anyone can buy pursuant to the OM, no restriction on value of tranx, need not be an eligible investor. When distribute through OM exemption, issuer must report distribution w/ 10 days to commission, **FORM 45-101F6.** Not fully harmonized across Canada.

**2 prescribed forms one for qualifying issuers and one for other issuers.**

Includes: issuer/underwriter information, reporting issuer status, issuer’s industry, insiders and promoters of non-reporting issuers, distribution date, number and type of securities, geographical information about purchasers, information about purchasers, Commissions and finder’s fees, Contact Information

Qualifying Issuers- Reporting issuer that files its CD docs on SEDAR, has never defaulted on these, and has filed Annual Information Form (AIF) for most recent financial year OR under NI 51-102 *Continuous Disclosure Obligations*

For Other Issuers (non-Reporting Issuers)- main difference between forms is that qualifying issuers can reference into their OM essentially any documents/information they have already disclosed by being qualified issuers

OM must contain risk acknowledgment in **FORM 45-106F4**, contractual right for rescission or damages available, they can cancel the agreement 2 days after signing. Must contain certificate that is signed by CEO/CFO (+2 other directors), and each promoter that there are no misrep.

##### Isolated Distribution

An isolated distribution by an issuer in its own securities is exempt if two conditions met:

1)distribution not part of similar successive tranx
2)distribution must not be by a person whose usual business is trading in securities.

Must report it w/in 10 days in Form 45-106F6.

##### 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 $150K. Must report it w/in 10 days in Form 45-106F6.

##### Not for Profit Issuers

Distributions by issuer that is organized exclusively for educational, benevolent, fraternal, charitable, religious or recreational purposes and not for profit, on 2 conditions: 1) no security holder may benefit from distribution 2) no commission or remuneration be paid associated w/ distribution

##### Crowdfunding

Raise capital via internet. There is a proposed crowdfunding prospectus exemption under review/comment, not yet in stone. It would limit crowdfunding revenue to $1.5 million in a 12 month period, w/ only certain types of issuers and securities qualifying. Each investor could invest a max of $2500 in single investment and $10K in a calendar year. Need to sign risk acknowledgement. There is another Start Up exemption, crowdfunding revenue limited to max $150K twice in calendar year and offering doc in a specified form. Each investor could invest max of $1500, no restriction yet set on how many times.

##### Discretionary Exemptions

Commission may allow exemption in certain circumstances where it is not prejudicial to the public interest **s. 76(1) BCSA.** Their decision cannot be appealed. Often granted where an issuer meets almost all the requirements of a mandatory exemption. If receive exemption, operable across Canada, except in ON as per MI 11-102 *Passport System*.

### The Resale Rules NI 45-102

Securityholder that wishes to trade an exempt market security has 3 options:

1) continue to trade sec w/in closed exempt market only, by relying on further exemption
2)qualify sec under prospectus – transform them into freely traded securities
3)under NI 45-102 Resale Rules: secholder may hold the exempt securities until a specified ‘hold period’ expires. The hold period allows time for info about sec to build up in the marketplace. Once hold over, sec may be freely traded. Hold period won’t expire unti Issuer has been RI for **four months.**

**Hold period is four months**: NI 45-102
We want to prevent **back door underwritin**g by preventing issuers from immediately reselling to public.

If relevant 45-106 exemption is listed in **Appendix D** of NI 45-102 🡪 restricted period applies to resale of these exempt securities.
**Securities will be come free trading when Restricted period satisfied:**

1) Issuer must have been **reporting issuer** in Canadian jurisdiction for minimum **4 months prior to distribution**

2) Minimum **4 months** must have passed since original distribution

3) Security Certificate must have legend denoting the original 4-month trading restriction or written notice must be given to original purchaser

4) Trade can**’** t be a control distribution

5) No unusual effort to prepare the market or create demand

6) No extraordinary commissions or consideration can have been paid

7) If seller is insider or officer, they can**’** t have reasonable grounds to believe that issuer is in default of securities legislation

Accredited investor
Family, friends and business associates
Founder, control person and family
Affiliates
**Offering memorandum**
Minimum amount investment
Asset acquisition
Isolated distribution by issuer

If relevant 45-106 exemption is listed in **Appendix E** of NI 45-102 🡪 seasonal period applies

**Securities will become free trading when Seasonal period satisfied:**

1) Issuer must have been **reporting issuer** in Canadian jurisdiction for minimum **4 months prior to distribution**

2) Trade can**’** t be a control distribution

3) No unusual effort to prepare the market or create demand

4) No extraordinary commissions or consideration can have been paid

5) If seller is insider or officer, they can**’** t have reasonable grounds to believe that issuer is in default of securities legislation

Rights offering
Reinvestment plan
Private issuer
Business combination and reorganization
Take-over bid and issuer bid
Offer to acquire to security holder outside local jurisdiction
Investment fund reinvestment
Employee, executive officer, director and consultant
Distributions among current or former employees, executive officers, directors or consultants of non-reporting issuer
Dividends and distributions
Conversion, exchange or exercise

## Registrant Regulation

We regulate intermediaries: dealers who engage in or hold themselves out as) the business of trading securities= UW, advisers, investment fund managers. We want to ensure their solvency, integrity, and proficiency. If acting as solo dealer, must register as firm and individual category

**BCSA part 5
NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*NI 33-109 *Registration Information***

#### Dealers and Advisers

##### Registration Requirement

Dealers and Adviser have to register if their activity triggers the “business trigger”, which

means “trading or advising for a business purpose” or holding yourself out as engaging in the

business of trading or advising in securities, includes indirect solicitation.

• Factors considered for the business trigger: engaging in activities similar to a registrant;

intermediating trades or acting as a market maker; directly or indirectly carry on the activity

with repetition, regularity or continuity; being, or expecting to be, remunerated or

compensated; directly or indirectly soliciting.

#### Investment Fund Managers

Have only one category under which to register. Instead of “business trigger” the determining factor on whether you have to register is “control” over (or power to direct) the business operations of an investment fund and performing the functions and activities of a fund (list of activities on p480). This category applies to both firms and individuals.

#### 3 FIRM Categories of Registration

Firms apply for registration using **Form 33-109F6 Firm Registration**

##### Dealer Categories:

Investment Dealers (any security eg. UW); Mutual Fund Dealers; Scholarship Plan Dealers;

Exempt Market Dealers; Restricted Dealers

##### **dealer"** means a person who trades in securities or exchange contracts as principal or agent: BCSA

##### Adviser Categories:

**portfolio managers (any security, class question example**), restricted portfolio managers (any security subject to restrictions imposed by ED)

##### **"portfolio manager"** means an adviser who manages the investment portfolio of clients through discretionary authority granted by one or more clientsInvestment Fund Manager Category

See investment fund manager category above. BSCA

##### 5 Individual Categories of Registration Form 33-109F4

Individuals who act on behalf of the above firm categories, may have to register for both. Generally, individual cannot act as registrant for more than one firm.

* dealing representative (for firm in dealer category)
* advising representative (for firm in advising category)
* associate advising representative (an apprentice advisor that must be supervised)
* ultimate designated person (UDP) (**every registered firm must have one**): responsible for promoting compliance at the firm and overseeing the effectiveness of the firm’s compliance
* chief compliance officer (CCO) (**every registered firm must have one**): responsible for monitoring and overseeing the compliance system at firm, which includes establishing policies and procedures.

Permitted Individual

"permitted individual" means an individual who is (a) a director, chief executive officer, chief financial officer, or chief operating officer of a firm, or who performs the functional equivalent of any of those positions, or (b) an individual who has beneficial ownership of, or direct or indirect control or

direction over, 10 percent or more of the voting securities of a firm.

Permitted individuals are reviewed by ED as part of assessing the firm’s overall fitness for registration.

All Individuals must be “fit for registration” according to criteria set out in NI 31-103 and

submit information as required by Form 33-109F4 Registration of Individuals and Review of

Permitted Individuals. 3 main criteria for determining fitness:

• **Proficiency:** requiring the education, training, and experience that a **reasonable person**

would consider necessary to perform the activity competently. Specific requirements

apply for each category of individual registrants and are set out in Part 3 of NI 31-103.

These include examination, certification, and experience requirements.

• **Integrity:** individual applicant must have an honest character. Info provided in the

application but also legal action against the applicant or conflict of interest will be taken

into consideration by ED.

• **Solvency:** Individual must be in sound financial condition. Not just current solvency but a

history of bankruptcy will be taken into consideration.

#### Individual Applications

##### Dealing Representative

Individual may be dealing rep for the above categories. If applying as dealing rep for investment dealer must be an ‘approved person’ as defined by IIROC (Investment Industry Regulatory Org of Canada): a partner, director, officer, emloyee or agent of an approved member firm. Same for dealer MFDA. These 2 SROs have their own rules.

##### Advising Rep and Associate Advising Rep

Advising rep or associate advising rep for portfolio mgmr, they are apprentices.

##### Ultimate Designated Persons and Chief Compliance Officers

For IIROC member firms UDP must be CEO or sole proprietor.

#### Registrant Obligation

The registration regime’s concern with the fair treatment of individuals by registrants appears in two places:

1. ***Securities Rules*, Reg 194-97, s 14 - Fair dealing with clients**, which states that a registrant or their representative must deal fairly, honestly and in good faith with their clients;
2. **NI 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*,Parts 13 and 14.**

NI 31-103, Parts 13 and 14 pertain to the relationship between a registered firm, dealer or adviser and its clients. They establish a number of obligations to ensure protection of the client. Of relevance are:

* **Know-Your-Client (KYC) and Suitability Requirements:** A registrant is usually required to comply with KYC requirements and with suitability requirements that are prescribed. Among other things, a registrant must ensure that it has sufficient information regarding: (i) the client’s investment needs and objectives; and (ii) the client’s risk tolerance: **NI 31-103, s 13.2(2)(c), *ibid.*, s 13.3.**
* **Conflicts:** Briefly, a registrant is required to identify and address conflicts faced in the course of its operations: ***ibid.*, s 13.4(1), (2)**. Duty triggered where a reasonable investor would expect to be informed of a conflict of interest: ***ibid.*, s 13.4(3).**

Examples of conflicts of interest

Eg. Excessive trading by a broker in a client's account largely to generate commissions. Churning is an illegal and unethical practice that violates SEC rules and securities laws = churning
eg. front running: sell to buyer and then buy from seller and broker gets the spread (57.3)

* **Loans and Margin**: A provide any client that intends to borrow money to finance the purchase of securities with a disclosure explaining the risk of doing so: ***ibid.*, s 13.13**.
* **Complaints**: A registered firm is required to document, and to deal fairly and effectively, with every complaint it receives in respect of any of its products or services: ***ibid.*, s 13.15**. Addressing complaints are addressed by ***ibid.*, s 13.16**
	+ For examples, see: **31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* [CP - Rescinded]**
* **Relationship Disclosure**: registrant must provide a client with disclosure regarding the client’s relationship with the registrant. Must give the client information such as: (1) a discussion which products or services of the registered firm will meet the client’s investment objectives and how, (2) list of investment risk factors; and (3) a description of the conflicts of interest: **NI 31-103, ss 14.2(1), (2)**

**Change of Registration info:** notify ED of any changes to info previously submitted for review.
**Transfers:** registered individual or permitted individual that leaves a registered firm to join another registered firm is able to transfer their registration automatically FORM 33-109F7

#### Registrant Exemptions PART 8 OF NI 31-103

Exemptions from Registration exist for market intermediaries and do not need to be applied for. Generally, if you comply with the conditions of the particular exemptions, then that is enough.

Exemptions apply to:

1. Dealers
2. Advisers
3. Investment Fund Managers

There are 6 main exemptions that we need to be aware of

1. **International Dealers** - allows international dealers who trade “foreign securities” with a “Canadian permitted client” to do so without registering as a dealer in Canada so long as they meet the requirements
2. The dealer’s head office or principal place of business is in a foreign jurisdiction
3. The dealer is properly registered in the foreign jurisdiction in a category which is comparable to if he was registered as a dealer in the local jurisdiction
4. The dealer has submitted to the Commission a completed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service*
5. **International Advisors** - allows international advisers who advise in “foreign securities” with a “Canadian permitted client” to do so without registering as an advisor in Canada so long as they meet the requirements
6. Adviser is located in a foreign jurisdiction
7. Adviser is properly registered in the foreign jurisdiction in a category which is comparable to if he was registered as an adviser in the local jurisdiction
8. Adviser engages in the business of an adviser in that foreign jurisdiction
9. At the end of the most recently completed financial year, the adviser’s portfolio management activities in Canada contributed to 10% or less of its aggregate consolidated gross revenue
10. Advisor has submitted to the Commission a completed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service*
11. **Client Mobility** – Firms and individuals are exempt from registration requirements when an existing client moves to a different jurisdiction.
	* + - 1. Registered as a dealer or advisor in principal jurisdiction
				2. Provides services to 10 or fewer clients (for firms) or 5 or fewer clients (for individuals) in another Canadian jurisdiction
				3. Must submit a completed Form 31-103F3 *Use of Mobility Exemption* to the local Commission after first using the exemption
12. **Northwest Exemption** - Certain registration exemptions expired in 2010 and at the same time, the Alberta, British Columbia, Manitoba, Saskatchewan, Yukon, Northwest Territories and Nunavut Commissions issued orders for this Northwest Exemption. The Northwest Exemption allows for a dealer not to be registered to distribute securities under the following exemptions :
	* + - 1. Accredited Investor
				2. Family, friends and business associates
				3. Offering memorandum
				4. Minimum Investment Amounts

However, this only applies when the following conditions are met:

1. The firm is not registered or required to be registered under provincial or territorial securities legislation or under foreign securities legislation
2. The firm does not advise or recommend to the purchaser that the security being traded is suitable for them
3. The firm obtains from the purchaser a signed Risk Acknowledgement Form
4. The firm has not provided other financial services to the purchaser
5. The firm does not hold or have access to the purchaser’s assets
6. The firm has electronically filed with the Commission a current information report
7. **Generic Advice** – An adviser is exempt from registration requirements if the advice they give is not tailored to the needs of the recipient. Examples of generic advice would be advice delivered through newspapers, magazines, the radio, the internet, or at conferences. If, however, the advice given at a conference is to solicit the audience to make specific trades in specific securities, then it may not qualify as generic advice and registration would be required.
8. **Capital Accumulation Plans** – CAPs are tax-assisted investment or savings plans where the member is able to make investment decisions only among options offered within the plan and do not require registration. Examples of CAPs are defined contribution pension plans or group registered education savings plans.

## Insider Trading

#### Persons in a Special Relationship with the Reporting Issuer

\*Even if no special relationship found, commission still has discretion to lay offence as per their public interest powers

##### Insiders, Affiliates and Associates

A person or a company is in a special relationship with a reporting issuer if: BCSA definitions

**3**  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**

**(i)   the issuer,**

**(ii)   a person that is proposing to make a take over 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,**

(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),

(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

(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 🡪 **TIPPING**

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

(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 (DEFENCE?)** referred to in subparagraph (i). **TIPPING**

**Affiliate** 🡪 subsidiary of each other
**Associates** 🡪 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, if a person has a substantial beneficial interest in or is a trustee for a trust, or if one person owns or controls more than 10 % of a second’s voting securities.
**Insider** 🡪 1) reporting issuer’s directors/officers; (2) person with direct or indirect ownership, control, or direction of over 10% of issuer’s voting securities; or (3) issuer itself (e.g., repurchase). – s. 1(1).

**Tippers/Tippees:** Tippers pass material non-public information to others w/or w/o trading on it themselves. Tippees who do NOT act on the info are NOT liable, though the tipper is liable regardless. Tippees who trade are liable for illegal IT, and tippees who tip others are liable for tipping.

**Insider trading, tipping and recommending**

**Section 57.2**  sets out prohibitions against insider trading, tipping and recommending.

##### Administrative Liability

The elements of **illegal insider trading** are following: **(57.2)(2)** prove on BoP

1) a person in a special relationship with a reporting issuer
2)**trades** in the issuer’s securities
3) with knowledge of a material fact or change
4)that has not been generally disclosed.

NB: no need to show motive to trade w/ non public info, insider can show that its actions did not involve using the info

The elements of **illegal tipping** are the following: **(57.2) (3)**
1) a person in a special relationship w/ a reporting issuer
2) with knowledge of a material fact or change
3) that has not been generally disclosed
4) informs another person of that information, **other than in the necessary course of business**.

The elements of **illegal recommending: (57.2)(5)**
 a special relationship person w/ knowledge of material non public info **recommends or encourages** another person to purchase or sell the reporting issuer’s securities or to engage in a transaction involving derivatives.

##### Materiality

Materiality is determined from reasonable investor’s perspective in IT cases. Use market impact test. Look at all the circumstances. Hindsight bias beware, can help w/ corroboration. See notes/caselaw on materiality. Timing is important!

**Material change**

(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

“**material fact”** as “a fact that would reasonably be expected to have a significant effect on the market price or value of securities

***Re Donnini*  (2002) OSC:** Donnini was director and large shareholder of a parent company which was negotiating w/ a mining company about warrants financing. OSC found that by speaking to a number of co workers at the parent company, the deal was *likely* to go through at $6.75 per share, and that counted as knowledge of a material fact, even though deal was not certain to occur. This finding was confirmed by Donnini’s trading pattern. He built up his short position by borrowing shares and selling them for $7 or more, if the deal went through at 6.75, he could buy shares to cover his short position and profit .25 cents on each share. He knew the deal would reasonably be expected to significantly effect the market price/value of the securities. His trades were consistent with him knowing that the info was material fact.

##### Disclosure and Dissemination

Info must not be public. Info becoming public involves: 1) disclosure and 2) dissemination (distributed broadly enough). Eg. posting on a website is not enough CSA suggests news releases, conference calls.

**Disclosure** (releasing the information)is incomplete without **dissemination** (ensuring the information is distributed broadly enough), which should be conducted in a manner calculated **1.** to effectively reach the marketplace, and **2.** to enable investors to have a reasonable time to analyze the information. (***NP 51-201 Disclosure Standards, s 3.5(2)***).

In determining **whether material information has effectively reached the market place**, consider:

* Company’s traditional practices for publicly disclosing information (***NP 51-201, s 3.5(3)***); and,
* How broadly investors and the investment community follow the company (***NP 51-201, s 3.5(3)***).

No modern case law on what constitutes **a reasonable time for the purposes of dissemination** (***Green v Chaterhouse Group Canada;*** *held that a shareholder who had received some disclosure that a take-over bid for his shares might be made at a price substantially higher than the market price did not constitute proper disclosure*) (***Re Harold P Connor;*** *held that an insider who traded almost immediately after a press release had been filed should have delayed by one trading day in order to allow for sufficient dissemination*), but certainly the reasonable time period is getting shorter as the pace of technological growth moves securities markets faster (***NP 51-201, s 3.5(2)***).

In determining **whether dissemination has been made within a reasonable time**, consider:

* Circumstances in which the event arises;
* Nature and complexity of the information;
* Nature of the market for the company’s securities; and,
* Manner used to release the information (***NP 51-201, s. 3.5(2)***).

##### Evidentiary Issues

*Re Suman 2012 OSC* inferences can be drawn from circumstantial evidence, evidence is clear, cogent, and convincing, cannot be speculative/tenuous. Evidence of well timed, highly uncharacteristic, risky and highly profitable trades. *Holtby* use inferences for specific instances: circumstantial evidence as to motive, certain habit or practice, after the fact conduct that could reflect guilt. Look at searches on net, phone call history

Defences to Administrative IT Liability

##### Reasonable Belief in General Disclosure

Defence is available to a special relationship person accused of IIT or tipping if they can prove on the balance of probabilities that they reasonably believed that the material information had been generally disclosed (***Securities Act,* RSBC 1996**, ***s 57.4(1)-(2)***)

* An honest but unreasonable belief is not sufficient (***Re Gorrie* (2006)**; *held not reasonable for special relationship person to have believed that tip he received from CEO regarding impending acquisition just hours after AGM had been generally disclosed*).

##### Reasonable Belief in Specific Disclosure

A special relationship person will not be found liable for trading or tipping if that person can prove a reasonable belief that the other party or the tippee, had knowledge of the material info or ought to reasonably to have known it. **S. 57.4(1)-(2)**

##### No Knowledge

Show that special relationship person actually had no knowledge of the material non public info. Show that company implemented policies/procedures around preventing m. n. p. i. from being passed around the company eg. Chinese Wall. **S. 57.4(5**)

##### Acting Without Using the Information

Eg. trade made as per an automatic plan entered into before the person had knowledge or the trade was made to meet obligations under a binding K entered into before person had knowledge.

##### Tipping in the Necessary Course of Business

Determined on the facts in each case. We do not want to unduly burden ordinary business activities and communications. Eg. *Royal Trustco* , disclosing info to a major shareholder as part of an attempt to defend against a TOB held not to be in the necessary course of business. Cannot disclose m.n.p.i. to analysts, institutional investors or other securities market professionals. Must becareful at these meetings! Eg. financial info/profit forecasts. Disclosure to credit rating agencies is typically regarded as in the necessary course of business.

When a reporting issuer discloses material non-public info in the necessary course of business, the issuer must ensure that the recipients understand they cannot buy or sell the issuer’s securities until the info is generally disclosed, and cannot pass the info along to anyone else. Eg. get confidentiality agreement

Examples of necessary course of business as per NP 51-201 Disclosure Standards

(a) vendors, suppliers, or strategic partners on issues such as research and development, sales and marketing, and supply contracts;

(b) employees, officers, and board members;

(c) lenders, legal counsel, auditors, underwriters, and financial and other professional advisors to the company;

(d) parties to negotiations;

(e) labour unions and industry associations;

(f) government agencies and non-governmental regulators; and

(g) credit rating agencies (provided that the information is disclosed for the purpose of assisting the agency to formulate a credit rating and the agency's ratings generally are or will be publicly available)

##### Tippee Unaware that Tipper was a Special Relationship Person

Tippee cannot be liable for illegal IT or for tipping another person, if original tippee did not know and could not reasonably have known that original tipper was a special relationship person.

##### Reasonable Mistake of Fact Regarding Materiality

A genuine reasonable belief that info in question was not material. **R v. Fingold** Held that the special relationship person knew of disappointing and unexpected financial results which had not been generally disclosed when he traded. He did not believe that the info would substantially affect market price, and that this belief was reasonable bc he believed the company’s ongoing projects were viable and likely to be successful. This defence is available b/c insider trading is a strict liability offence, so definition of material fact is subjective in this context of reasonable mistake of fact. Rarely successful defence.

Administrative Liability Penalties

Admin sanctions include monetary penalities, cease trade orders, denials of exemptions and prohibitions from acting as a director or officer.

If prosecuted in court, $3 million fine in BC (155(5)) and 3x profit. ‘Profit made’ applies when the special relationship person **sells** securities. It is the amount the person sold for less the securities average trading price for 20 trading days after the material non public disclosure was generally disclosed. Loss avoided when you **buy** is the average price over those 20 trading days, less the amount the person paid.

For a tipper, the profit made is any consideration the tipper received for tipping.

#### Criminal Liability

Same as securities prohibitions, only difference is that it opens it up to all issuers, not just reporting, and includes *mens rea* element.

## Take Over Bids MI 62-104 *TOB and Issuer Bids*

Aim is to conduct bids in a manner that achieves 3 purposes: 1) equal treatment of the target’s securityholders 2) provision of adequate info to the target’s security holders 3) an open and even handed bid process.

**TOB:** an offer to securityholders to acquire some or all of the target’s outstanding voting or equity securities (not debt sec), where the securities bid for, together with the securities already owned by the offeror will be **20% or more** of the outstanding securities of that class of the target’s securities.
🡪 MI 62-104 *TOB and Issuer Bids*

#### Exemptions from TOB Regulations

##### Normal Course Purchase

Offeror may acquire up to %5 of the outstanding securities in a given class over a 12 month period w/o triggering TOB regs.

##### Private Agreement

If offeror purchases sec from five persons at most and the total consideration paid by the offeror, is no more than %115 of the market price of the sec

##### Non Reporting Issuer

##### Foreign Take Over Bids

At least 90% of the offerees are resident outside of Canada.

##### De Minimis

Fewer than 50 securityholders of the class to which the bid applies, and the constitute less than %2 of outstanding securities of that class.

#### TOB PROCEDURES

#### Early Warning System MI 62-104 TOB and Issuer Bids

EWS obliges persons to disclose their holdings of a company’s securities at certain thresholds (whether or not they intended to launch a TOB). Alert security holders, prevent creeping take over. Once alerted, the directors can take defensive measures or solicit competing bids + security holders can decide whether they want to tender to a bid.

**%10 + ?**

Early warning disclosure is req’d when a person acquires beneficial ownership, direction or control of **%10** or more of a class of securities. 🡪 MI 62-104 *TOB and Issuer Bids* s. 5.2(1):
1. The person must promptly **issue and file a news release** containing info in Appendix E of NI 62-103 *The Early Warning System and Related TOB and Insider Reporting Issues*

Information req’d: person’s name/add, security holdings, consideration offered and person’s purpose in effecting the tranx that gave rise to news release (eg. intention to acquire ownership, director, or control of issuer’s sec.)
2. File formal report w/ Commission w/in 2 business days

3. Each time the person acquires an **additional %2** or more of the class of securities, it must issue another news release and file another report w/ the commission.
If there has been any material fact set out in a previous, this must be disclosed (NI 62-103).
Offeror restricted from trading in sec from event triggering disclosure to one day **after** report filed with com.

#### The Offer

##### To whom the TOB must be made and delivered

Offer must extend to ALL securityholders of that class

##### Commencing Bid

TOB can be commenced in 2 ways. **First**, TOB can be initiated by delivering the bid to offerees (target company’s securityholders). **Second**, TOB can be commenced by publishing an advertisement containing a brief summary of the bid in a major daily newspaper. If choose latter, bidder must
🡪 file TOB and deliver to target’s principal office on or before date of newspaper publication
🡪the offeror must request a list from target of its securityholders on or before date of publication AND
🡪offeror must deliver the TOB to offerees w/in 2 business days of receiving the list.
MI 62-104

##### Minimum Deposit Period

TOB must allow offerees at least **35 days** (bidder could choose longer period) to decide whether to accept the bid and deposit their securities. The bidder cannot take up or buy any securities deposited under the TOB, or buy any securities of that class 🡪 MI 62-104.

##### Consideration

Consideration for the security holders securities can be cash, other securities or a combination. Consideration for shares must be as high as that paid for by the bidder in the 90 period before launcing the TOB. 🡪 MI 62-104.

#### Supplemental Warning System

Once a TOB is launched, any addition %5 or more acquired by person, must issue news release before trading opens on next business day. Then again issue news release for ever %2 increase. MI 62-104.

##### Offeror’s TOB Circular **FORM 62-104F1**

Bidder must deliver TOB Circular to the offerees at same time at commencing the bid + file it w/ Comm, but Comm doesn’t vet it. Info req’d in form:
🡪name/description of usual activities
🡪class/number of sec subject to TOB
🡪dates on which TOB will commence & expire
🡪offeree’s withdrawl rights
🡪purpose of TOB
🡪material facts that would impact offeree’s decision
🡪signed certificate that circular contains no untrue statement of material fact/omission of material fact

Must inform offerees if any changes occur to the offer, eg. deposit period 🡪 variation notice
🡪must have at least 10 days btw notice and end of deposit period (an extension may be needed).

##### Director’s Circular

Why Directors Circulars (DC) are important and how they help advise shareholders?

Despite the inherent conflict of interest in a hostile TOB, directors are intimately connected with the target company and could be a valuable source of information to help security holders decide whether to tender their securities to the bid. The DC can expose directors to civil liability for misstatements or bad faith. At all times, directors are expected to act in **the best interests of the corporation (*BCE***). Recall **NP 62-202**, directors must protect the bona fide interest of the target’s shareholders.

What is the source of the duty to provide a DC?

🡪 **s. 99** of BC *Securities Act*
🡪 **MI 62-104** *Take-Over Bids and Issuer Bids*,(2.17 -2.22)
-prepare/send DC no later than **15 days** after the date of the bid
Directors must make:
**(1)** recommendation to security holders to reject/accept with reasons OR
**(2)** advise they cannot make recommendation with reasons OR
**(3)** advise that they are still considering, but will advise upon further communication
-DC must be in **FORM 62-104F3**
-provide any **Notice of Change** to DC
-**Individual Directors** may file their own circular, need not act unanimously.
-**Consent of Expert:** must include written consent of expert to use their work

What are some components of **FORM 62-104F3 (20 disclosure items in total)?**

🡪**Item 4**: how much of the target company’s securities is beneficially owned or over which control or direction is exercised by each director and officer, and if known after reasonable enquiry, by associates, affiliates, and insiders
🡪**Item 7:** Any relationship between the bidder and the directors and officers of the target company must be disclosed such as payments or compensation for losing their office if the TOB is successful
🡪**Item 12:** Additional information: target company can provide info to rebut any misleading/inaccurate info in the bidder’s circular
🡪must **disclose any defensive tactics** contemplated by management
🡪**Item 19:** Directors must provide certificate that they made no misrepresentations in the circular

##### Withdrawal Rights of Offerees MI 62-104.

They can revoke their acceptance of the offer by
🡪any time before bidder takes up securities
🡪any time before 10 day extension period for changes/variations expires
🡪any time 3 or more days after securities are taken up, if offeror has not paid for them.

##### Take Up and Proportional Take UP

Offeror must take up and pay for securities w/in 10 days of TOB expiring, none can be taken up until 35 TOB period is over. Offeror must pay for taken up securities asap, no later than 3 business days after they are taken up.

Proportional take up: if bidder makes offer for less than all the outstanding securities in a class and more are tendered than were bid for, offeror must take up proportionally those that were tendered. 🡪 no first come, first served basis, shareholders treated equally.

##### Sanctions

First, statutory civil liability provisions where investors can seek to recover damages for misrepresentation. Second, administrative sanctions, where violators face such penalties as cease trading orders etc. An ‘interested person’ may apply to Com regarding alleged TOB infractions, comm. May halt distribution or require amendments to offering docs. Interested person may also apply to court for compensation, rescission.

#### Defensive Tactics

Target may want to defend because 1) compensation being offered is inadequate (seek alternatives) 2) honestly abhors TOB for whatever reason, will search for alternative 3)mgmt is acting out of self preservation (not necessarily in best interests of the corporation.

Fiduciary Duty of Directors: to the corporation requires them to canvass the market for better options, to get the best price for security holders. Given inherent conflict of interst defensive tactics looked at w/caution. Recall **NP 62-202**, directors must protect the bona fide interest of the target’s shareholders.

##### 1. White Knight

WK is a different offeror, brought in by the target’s directors to make a competing TOB.

##### 2.Issuer Bid

Issuer makes a bid for its securityholders’ securities (acquire/redeem)

##### 3. Sale of Crown Jewels

Sell the target’s crown jewels, most valuable assets, make target less attractive

##### 4.Lock Up Option

Option to a party to buy a large block of securities or a substantial percentage of the target’s assets if triggering even occurs (TOB). Prevents bidder from gaining control.

##### 5. Break Fee

Pay a fee to the white knight even if their TOB attempt fails.

##### 6. Golden Parachute

Compensation packages given to directors/senior officers if their employment is terminated by TOB, this might deter bidders from making the hostile bid.

##### 7. Conflicting Out

Target gives all leading law firms some work to conflict them out, to prevent firms from acting for bidder

##### 8. Greenmail

Blackmail by bidder to make TOB unless target repurchases bidder’s securities at a premium.

##### 9. Shareholders’ Rights Plan (Poison Pill) Not if but when policy

SRP is a rights offering offered by the target company to its securityholders allowing them to buy more shares at a heavily discounted price on triggering event eg. TOB. A SRP will make the TOB considerably more expensive, since it will also need to buy these newly issued securities in order to gain control (its % ownership decreases upon exercise of SRP). **SRP could also extend time mgmt has to look at alternatives.** **If used inappropriately, could be subject to cease trade order.**

**The Bidder can make application to Sec com under s. 114 to seek a cease trade and subvert the SRP**

In ***Re Royal Host***: BCSCn decided that SRPs would be held legit ONLY IF used as **temporary measure** either to solicit alternative bids or induce the offeror to improve its bid. Cannot use this as **just say no tactic b** against the TOB, we cannot take away autonomy of shareholders in deciding to reject or accept bid. 🡪 outlined in NP 62-202

In ***Re Pulse Data***(2007): ASC declined to cease trade SRP b/c shareholders voted on whether or not to keep it while knowing that it was unlikely any other offers weould emerge. So maintaining the SRP would protect the *bona fide* interests of the target’s securityholders. But cannot keep SRP indefinitely.

In ***Re Neo Material***(2009): OSC refused to cease trade, 81% of sec holders approved to keep SRP. So long as SRP allows mgmt to fulfill their fiduciary duties the plan continues to serve a purpose. Can be maintained a bit longer as long as supported by shareholders and appropriate. But cannot keep SRP indefinitely.

In ***Lion’s Gate Entertainment*** 2010: BCSCn: still SRP is temporary and issue is not if but when. Opportunity to shareholders to vote on the SRP is not equivalent as giving them opp to respond to bid.

\*\*\*\*In ***Re Baffin Iron Mines Corp*** (2010) OSC: In response to hostile TOB, directors adopted SRP so they could look at alternative offers, they found a white knight and promised the white knight that they would not look for anymore offers. At this point, the SRP served its purpose and had to go. OSC cease traded Baffin. **OSC said that SRP has to go when it has served its purpose by facilitating an auction, encouraging competing bids or otherwise maximizing shareholder value**.

In ***Re Inmet Mining Corp*** (2012) BCSCn: is there a real and substantial possibility that leaving the SRP in place any longer would result in greater shareholder value.

NI 62-105: CSA new proposal allow target boards facing unwanted bid to deploy SRP for a longer period, subject to shareholder approval. Shareholders to approve an SRP w/in 90 days of its adoption by the board or of the launch of the TOB. SRP would have to be approved annually by the shareholders (offeror excluded from these votes), and terminated at anytime by majority vote of shrders. So it slightly changes the ‘not if but when’ policy of commissions.

##### Empty Voting and Hidden Ownership

**Empty voting**: The investor has voting rights but no net economic exposure to the shares.

Voting power should lie with those who have the most financial risk involved in a decision, since the economic exposure ensures that the voter has an interest in the economic well-being of the issuer. A voter who faces no economic risk may have an interest in the issuer making poor decisions, or in achieving a result that is detrimental to other shareholders of a target (generally, as well as in a TOB context), who do face economic risk.

Negative voting: the investor has voting rights and *negative* net economic exposure; the investor wants the share price to decrease.

**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.

**CSA’s Proposed Amendments**

|  |  |
| --- | --- |
| Prior regulatory proposals (March 13, 2013) | CSA Notice 62-307 (Oct 10, 2014)[[1]](#footnote-2) |
| MI 62-104[[2]](#footnote-3)- new definitions, incl. for “derivative”, “equity equivalent derivative” (EED), “economic interest”, “specified securities lending arrangement” (SSLA), “securities lending arrangement” (SLA)- 5.1(4): if you have an EED, you are deemed to control or direct the related security of the issuer. | The CSA decided it was “not appropriate at this time” to include EEDs in determining the threshold for early warning reporting disclosure.The CSA decided to go ahead with these: - exempt lenders from disclosure requirements if they lend shares in an SSLA- exempt borrowers from disclosure requirements if they borrow shares in an SLA- provide guidance clarifying the current application of early warning reporting requirements to certain derivatives and requiring disclosure of derivatives in the early warning report |
| NI 62-103[[3]](#footnote-4) - new early warning disclosure requirements in 62-103F1:* when transactions involve an EED, or SLA (3.3 and 3.4)
* the concept of “deemed to have control” (3.2, 3.6)
* material terms of any agreement, etc. that involves an EED , and any other related financial instrument and its impact on the acquiror’s securityholdings (3.7)
* existence and terms of any SLA (3.8) and SSLA (3.9)
* any transaction that had the effect of altering (directly or indirectly) the acquiror’s economic exposure to the issuer (3.10)
 |
| NP 62-203[[4]](#footnote-5)- explains EED (e.g. return swap)- explains SLA (borrower gets voting rights while lender retains economic exposure) |

**Assessment**

From CSA Notice 62-307, it appears that

* Empty voting and hidden ownership problems that arise from derivatives will not be addressed in the Final Amendments, since EEDs will not be included in determining early warning disclosure obligation.
* Empty voting and hidden ownership problems caused by short-selling or borrowing arrangements will not be addressed, since the notice proposes to exempt lenders and borrowers from disclosing SLAs or SSLAs.
* Until further updates come out, it is unclear how the CSA plans to “provide guidance” on applying early warning disclosure requirements to derivatives.

In short, the proposed Final Amendments, as opposed to the prior proposals, do not seem to address the problems of empty voting or hidden ownership arising from the use of derivatives, short-selling or borrowing practices in a meaningful way.

## Statutory Civil Liability & Due Diligence

5 BASES FOR SCL:

1. Prospectus Misrepresentation
2. Offering Memorandum Misrepresentation
3. Circular Misrepresentation
4. Trading & Tipping on material non public info
5. Misrepresentation in continuous disclosure documents

Misrepresentation under BCSA

(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

Reliance, negligence and causation are defences to a claim of misrepresenation under SCL provisions. Onus on Def to prove them, not on PL to prove them. PL just has to prove the misrepresentation was made.

#### Procedural Matters

##### Standing

1. **Prospectus Misrepresentation** 🡪 the document’s recipient (purchaser) S. 131
2. **Offering Memorandum Misrepresentation** 🡪 the document’s recipient (purchaser) 132.1
3. **Circular Misrepresentation** 🡪 the document’s recipient (securityholder) 132
4. **Trading & Tipping on material non public info** 🡪 (RI, person on otherside of insider trader/tippee): s. 136 *BCSA*
5. **Misrepresentation in continuous disclosure documents** (**secondary market liability)** 🡪 the document’s recipient S. 140.3

Commission may also seek standing from court for IT/tipping if RI not pursuing it w/in 60 days of being requested to by comm, enforcing the RI right of accountability.

5. **Misrepresentation in continuous disclosure documents** (**secondary market liability)** 🡪 **standing**

See notes below for SML

#### Class Actions

Every province has class action proceedings legislation that allows for securities class actions. Class is certified where identifiable class of plaintiffs raising common issues of fact or law. The requirement that plaintiff’s claim be based on common issues is difficult if plaintiff’s claim is based on common law negligent misrepresenation, which **requires proof of reliance**. Very hard to prove actual reliance on each individual person’s factual case.

In ***Bre X* :** ONCA allowed class certification for negligent misrep b/c individual circumstances of pl were not yet required, it would help move the litigation along. This followed by ***Silver****,* where Ontario Superior Court certified class action for negl misrep, @ cert stage, pl only necessary to show their claim disclosed cause of action.

***Green*** : Ont Superior ct refused to certify class action b/c dispensing w/ requirement to prove individual reliance would make the statutory secondary market liability provisions redundant (in which reliance need not be proven), but in SCL there is a limit on damages, where as under common law, no limit. 🡪 this is state of the law now. SCL seen as preferable to resolving claims.

##### Limitation Periods for SCL Actions

If seeking recission, it is 180 days from date of tranx
If seeking other actions (damages), it is earlier of: 1) 3 years from date of tranx and 2) 180 days after PL first had knowledge of facts underlying cause of action.

For Secondary market liability, LP is earlier of 1) 3 years from the date the impugned conduct occurred and 2) 6 months after issuance of news release disclosing that the PLs have obtained leave to commence SML SCL action.

#### SCL for Prospectus, Offering Memorandum and Circular Misrepresenations PART 16 BCSA

##### Liability

1. **Prospectus Misrepresentation** 🡪 the document’s recipient (purchaser) S. 131

Bought securities between final receipt date and closing of distribution. There is a misrepresentation in the prospectus or misrep resulted from a material change that was not disclosed improperly or not at all. NB, no need for material facts to be disclosed during distribution, only material changes.

**Right of Action Against:**

a) issuer or selling securityholder (rescission or damages)
b) any UW who signed prospectus (rescission or damages)
c) any director of issuer (damages only)
d) any person who consented to any part of prosts (damages only, liable only for their part) eg. expert
e) any other person who signed the prospectus (damages only) (CEO, CFO, promoter, credit supporters
\*Joint & Several Liability

2. **Offering Memorandum Misrepresentation** 🡪 the document’s recipient (purchaser). OM liability arises the same way as above. S. 132.1
\*Joint & Several Liability

**Right of Action Against:** OM investor has rescission or damages against issuer and selling securityholder

3. **Circular (TOB) Misrepresentation** 🡪 the document’s recipient (securityholder) Liability triggered when circular sent to securityholders. S. 132
\*Joint & Several Liability

**Right of Action Against:** rescission or damages against **offeror** AND
🡪 right of damages only against
1) any director of the offeror when TOB doc was signed;
2) any person who consented to any part of the TOB doc (only liable as to their part), and
3) any other person who signed the TOB doc.

#### Defences to Liability for Prospectus, OM, and Circular Misrepresentation

ONUS OF PROOF on party claiming the defence.

##### 1. Knowledge of the Misrepresentation s. 131(4)

Complete defence to prove prospectus investor, OM investor or TOB document investor knew of the misrep at time of purchase. Defence available to issuer, control person, or TOB offeror.

##### 2. Impugned Party Had No Knowledge s. 131(5)(a) (no consent at all)

An impugned party is not liable for misrep if it proves that the prospectus, OM, or TOB doc was **sent** **without** their **knowledge or consent.** Upon becoming aware of the situation, the impugned party must have given “**reasonable general notice”** of their lack of knowledge or consent.

##### 3. Withdrawal of Consent s. 131(5)(b)

If the person withdrew consent to a prospectus, OM, or TOB doc when the person became aware of a misrepresentation **after it was filed**, and they gave ‘**reasonable general notice’** of the withdrawal and the reason.

##### 4. Reliance on an Expert s. 131(5)(c)

If misrep relates to expert’s contribution to prospectus, TOB, or OM, impugned party (eg. director) did not believe there was a misrepresentation and had no reasonable grounds to believe it.

Defence if propspectus or TOB doc **misquoted or took out of context the expert’s report**. (eg. expert)

Defence of **reasonable investigation**: standard of prudent person in the circumstances (eg. UW, mgmt, other than expert): Did the person reasonably investigate the report? After investigation, did they believe on reasonable grounds that report fairly represented the expert’s report, opinion or statement?

Defence of **reasonable general notice** (eg. anyone other than expert): upon becoming aware of misrep did the impugned party ASAP advise commission, and give reasonable general notice of misrep?

##### Due Diligence Defence s. 131(6), (7), 132(6), (7), 132.1(5)

You will **NOT** be liable for misrep unless you failed to conduct such reasonable investigation as to provide reasonable grounds for believing there was no misrepresentation OR unless he or she believed there has been a misrepresentation. The investigation = due diligence.

In ***YBM Magnex:* OSC** held that directors will each be judged on a standard appropriate to their background, experience and position w/in the company (insider or outside directors). If there is no cause for worry, directors can rely on outside advisers, but if there are facts and circumstances that prudent person would not rely on the professional advice, reliance is unreasonable. Look at degree of participation, access to info and skill.

UW must avoid automatic reliance and challenge disclosure the issuer proposes on IPO. Certificate of UW “to the best of its knowledge, information and belief” (bit more wiggle room here for UW). In contrast w/ directors who must certify that prosp constitutes **full true and plain disclosure of all material facts**.

##### Damages for Misrep in Prospectus, OM, and Circular

Damages limited to amount security depreciated as a result of the misrep. Joint and several liability, any party is liable for all the damages.

##### Kerr v. Danier Leather as a defence

FOFI and financial forecasts carry implied representations that forecasts are **objectively reasonable** as snapshot of material facts at time prospectus receipted. Issuer not obliged to disclose any material facts that arise after and call into question the reasonableness of the forecasts, but they must disclose material changes.

##### SCL for Trading or Tipping w/ Material Non-public Information

Same as administrative offence, insiders or tippers are jointly and severally liable. Same defences apply to SCL as to administrative offence, see earlier notes. Damages the same as admin offence. One difference is that insider/tipper is also liable to reporting issuer itself for trades made in the issuer’s securities. Impose accountability for benefit/advatange. The only defence to this is that the material non public was generally disclosed.

#### Secondary Market SCL Legislation PART 16.1 BCSA see HANDOUT

SHAHDIN CREATE CHEAT SHEETS!!!

5. **Misrepresentation in continuous disclosure documents** (**secondary market liability)** 🡪 **standing**

🡪when release **doc containing misrepresentation**, and release made by a ‘**responsible issuer’,** an **‘influential person’**, or a ‘**person with actual, implied or apparent authority’** to act on behalf of the responsible issuer or the influential person

🡪when a ‘**public oral statement’** relating to the business or affairs of a ‘responsible issuer’ and containing a misrepresentation is made by a ‘**person with actual, implied or apparent authority to speak on behalf of the responsible issuer**

🡪 when a **‘public oral statement’** relating to a “responsible issuer” and containing a misrepresentation is made by an ‘**influential person’** or ‘**a person w/ actual, implied or apparent authority** to speak on behalf of that influential person.

🡪where a responsible issuer fails to make timely disclosure 140.3(4)

You have standing if you bought bought/sold securities from time the doc released or oral statement made until it was publicly corrected or until the change was finally disclosed.

**Definitions:** Part 16.1 BCSA

**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

 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**;

 **2. "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,

 **3. "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;

##### Burden of Proof

Misrept in ‘core documents’ (Prospectus, TOB, Circulars, items req’d by sec law) the plaintiff need prove only the misrep.

For misrep in non-core docs and public oral satements, PL must also prove that the def (except expert defendant): knew of the misrepresentation; deliberately avoided discovering that there was a misrepresentation; or was guilty of gross misconduct.

For failure to make timely disclosure, onus is on PL to prove that the def (except a responsible issuer, investment fund manager, or an officer of a responsible issuer or investment fund manager): knew of the change and that it was material; deliberately avoided discovering that there was a change or that it was material; or was guilty of gross misconduct.

##### Defences in Secondary Market Liability

1.the investor knew of the misrep or material change when making the tranx
2. The def made a reasonable investigation and no reasonable grounds to believe there was a misrepresentation
3. There was a justified confidential disclosure of a material change
4. The misrepresentation was reasonably disclosed forward-looking information, with appropriate cautionary language
5. The defendant relied on an expert with no reasonable grounds for believing there was a misrep.

##### Damages

Damages calculated per security.

If the following three events occurred sequentially:

1. Company misrepresented or delayed disclosure,

2. Investor acquired company securities,

3. Company publicly corrected misrepresentation or properly disclosed material change,

• And, if investor disposed securities within 10 trading days of correct disclosure, then:

Investor compensation = average price paid – deposition price received.3

 If those first three events occurred, and if investor disposed securities after 10 trading days, then:

Investor compensation = the smaller of these two amounts:

1. Average price paid – deposition price received

2. Average price paid – average price over first 10 post-disclosure trading days.4

If the first three events occurred, and if investor did not dispose securities by assessment date, then:

Investor compensation = average price paid – average price over first 10 post-disclosure trade

Day

If defendant proves external factors (i.e. not misrepresentation or untimely disclosure, e.g. the loss of a

major supplier) inflated calculated compensation amount, then:

Investor compensation decreased accordingly.6

If defendant knowingly authorized, permitted or acquiesced regarding misrepresentation or untimely disclosure, then:

Defendant liable for full amount of damages (i.e. no market liability cap applies).

For responsible issuer or non-individual influential person:

Liability cap = greater of $1 million or 5% market capitalization.

For any of the following people:

1. Individual influential person

2. Director or officer of the responsible issuer or influential person

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1. <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy6/PDF/62-307__CSA_Notice___October_10__2014/> [↑](#footnote-ref-2)
2. <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy6/PDF/62-104__MI_Amendment_Proposed__Annex_A__March_13_2013/> [↑](#footnote-ref-3)
3. <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy6/PDF/62-103__NI_and_F_Amendment_Proposed__Annex_C__March_13_2013/> [↑](#footnote-ref-4)
4. <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy6/PDF/62-203__NP_Amendment_Proposed__Annex_B__March_13_2013/> [↑](#footnote-ref-5)